Greensands

Greensands Holdings Limited Annual Report and Financial statements for the year ended 31 March 2018

Contents

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Introduction

Greensands Holdings Limited ('GSH' or 'the company') is the ultimate parent company of Southern Water Services Limited (Southern Water) and all other group companies disclosed in note 33, with no minority interests.

The only operating company in the Group is Southern Water and the information contained in this Strategic Report is therefore mainly based upon the activities of this company only. This information is fully supported by GSH and has been adopted from the Southern Water Annual Report which is published on the Southern Water website. Sections 1 and 2 that follow contain reviews of GSH and Southern Water for the year to 31 March 2018, respectively.

1) Greensands Holdings Limited

Strategic Report:

The Business

GSH acts as a holding company, with the only trading subsidiary being Southern Water.

This section sets out the financial performance and structure of the Group as well as the corporate governance in place at GSH. A summary of the activities, performance and key risks relating to Southern Water are described in section 2 from page 14.

Group financial performance

The accounting policies of the Group, including any changes in accounting policies in the year, are set out on pages 48 to 60.

Consolidated income statement - summary

The consolidated income statement of GSH is summarised in Table 1 below:

Table 1	Years ended 31 March		Change
	2018 £m	2017 £m	%
Revenue	**829.7**	809.7	*2.5*
Other operating income	**2.4**	1.3	*84.6*
Operating costs	**(337.6)**	(308.3)	*9.5*
Depreciation, net of amortisation	**(266.9)**	(252.6)	*5.7*
Operating profit	**227.6**	250.1	*(9.0)*
Other income	**11.2**	-	-
Profit on disposal of fixed assets	**0.8**	0.4	*100.0*
Net finance costs	**(322.0)**	(292.8)	*10.0*
Fair value gains/(losses) on derivative financial instruments	**46.3**	(416.8)	*111.1*
Loss before tax	**(36.1)**	(459.1)	*92.1*
Tax (charge)/credit	**(15.0)**	109.3	*113.7*
Loss for the financial year	**(51.1)**	(349.8)	*85.4*

Operating profit largely reflects the trading results of Southern Water for the year and additional depreciation from the revaluation of assets on acquisition.

Revenue increased to £829.7 million (2017: £809.7 million). This increase partly results from changes to our inflation-linked water and wastewater tariffs, in part offset by the loss of income following the sale of our retail non-household business to specialist retailer Business Stream on 1 April 2017.

2017–18 has been a year of change and challenge resulting in an increase in operating costs of £29.3 million to £337.6 million (2017: £308.3 million). The major reasons for this increase are described below and in Table 2.

During 2016–17 Southern Water restructured its Customer Service teams to improve performance in this area, focusing on proactive customer contact and initiatives to improve our bad debt performance. This investment in cash collection has seen us spend £3.4 million on debt recovery this year, which has resulted in a reduction of £3.5m in the bad debt provision charged to the income statement with further reductions expected in the future. Overall, these structural changes have led to efficiencies of £1.9 million across Customer Service in 2018–19.

We began 2017–18 with enforcement orders in place from the Drinking Water Inspectorate and investigations under way from the Environment Agency (EA). In response we have established a new Compliance and Asset Resilience directorate and implemented a significant programme of work to address the issues raised investing £3.9 million. These changes will improve our risk management and ensure our reporting processes have greater oversight better maintaining the integrity of our data. We have also made improvements to our IT, spending an additional £3.6 million.

Prolonged periods of dry weather during 2017–18 led us to make to a precautionary application for a drought permit in early 2018 for the River Medway as Bewl Water, our key resource in that area, was only 33% full. We moved water into Bewl increasing our pumping costs, and also increased our spend on leakage detection to further prepare ourselves for a possible drought.

In addition, during March 2018 we experienced some extremely cold weather followed by a rapid thaw. As a result we experienced an increase in the number of bursts on our own network and on customers' pipes, generating additional overtime and pipe repair costs. We also provided emergency water and compensation for customers affected. These weather related issues resulted in additional costs of £4.3 million.

In order to continue to provide a resilient water supply we invested in a variety of projects in 2017–18. In the South Hampshire area we have designed a plan to improve the environmental resilience of the Rivers Test and Itchen for periods of severe drought to help protect the river's ecology. This project has resulted in increased environmental costs of £3.1 million.

We also spent a further £3.5 million on managing our defined benefit pension scheme in 2017–18. This increase resulted from additional advisory costs relating to agreeing a new deficit reduction plan with the Trustees and The Pension Regulator, together with the impact of changing market conditions. These changes included a movement in corporate bond yields, which lowered discount rates, increasing the accounting cost charged to the income statement.

We have also been working hard to prepare our Business Plan for 2020–25 which will be submitted to Ofwat in September 2018. The preparatory work, including consultations with customers and stakeholders, needed to develop this plan resulted in additional costs of £2.9 million this year.

Table 2 **Year-on-year increase/(decrease) in operating costs**	**£m**
Inflation	11.4
Increased debt and cash collection activity	3.4
Decreased bad debt charge	(3.5)
Customer Services efficiencies	(1.9)
Costs resulting from exceptional weather conditions	4.3
Compliance function and data team	3.9
Increased pension costs	3.5
IT improvements	3.6
Additional environmental provisions	2.9
Business Plan 2020–25 (PR 19)	2.9
Other	(1.2)
Movement in operating costs	29.3

Depreciation increased to £266.9 million (2017: £252.6 million) as a result of our significant capital investment programme. New schemes commissioned during the year added £12.8 million to the depreciation charge.

Operating profit for 2017–18 decreased to £227.6 million (2017: £250.1 million), a 9.0% reduction as a result of the factors set out above.

Other income includes the profit of £11.2 million from the sale of our non-household retail business on 1 April 2017. Further details of this transaction are shown in note 5 to the financial statements.

The profit on disposal of fixed assets of £0.8 million (2017: £0.4 million) mainly relates to the sale of surplus vehicles and the release of deferred revenue from the historical sale of income rights relating to aerial masts.

Net finance costs increased to £322.0 million (2017: £292.8 million). This increase was largely driven by higher Eurobond interest of £12.4 million in Greensands Europe and higher indexation in SWS on inflation-linked bonds of £17.9 million as a result of increasing RPI in 2017–18 together with the full year effect of interest on loans issued in 2016-17 of £3.0 million. This was partially offset by an increase in interest capitalised of £7.9 million resulting from the larger capital investment programme.

The fair value gain on our derivative financial instruments amounted to £46.3 million (2017: loss £416.8 million). To calculate the fair value of our derivative instruments we discount their forecast future cash flows using UK Government bond yields. These future forecast cash flows are predictable, and match the future forecast movement in our revenues and 'Regulatory Capital Value', but government gilt yields are constantly moving, with the result that the valuation of our derivative instruments can be volatile. For example in 2016–17 in particular, there was a significant reduction in gilt yields which resulted in a large increase in the liability associated with our derivative instruments and a loss of £416.8 million charged to the income statement, despite there being little change to their future forecast cash flows. The changes in value that are recorded during the lives of derivatives do not represent cash flows.

We have recognised a total tax charge to the income statement of £15.0 million (2017: credit £109.3 million). This differs from the credit that may be expected of £6.9 million, based on the loss before tax of £36.1 million and the current period tax rate of 19%, as described in note 10. This is primarily the result of the treatment of Eurobond interest for which we have not claimed a tax deduction of £6.7 million offset by permanent differences in relation to disallowable expenses amounting to £15.3 million.

The loss after taxation for the year amounted to £51.1 million (2017: loss £349.8 million).

Consolidated statement of financial position – summary

The consolidated statement of financial position for GSH is summarised in Table 3 below:

Table 3	As at 31 March	
	2018	2017
	£m	£m
Non-current assets	**6,200.2**	6,032.1
Current assets (excluding cash)	**212.2**	190.7
Cash and cash equivalents	**287.3**	302.3
Total assets	**6,699.7**	6,525.1
Current liabilities	**(670.0)**	(300.1)
Non-current liabilities	**(6,869.2)**	(7,021.5)
Total liabilities	**(7,539.2)**	(7,321.6)
Total net liabilities	**(839.5)**	(796.5)
Shareholders' deficit	**(839.5)**	(796.5)

At 31 March 2018 the Group had non-current assets of £6,200.2 million (2017: £6,032.1 million), an increase of £168.1 million from 31 March 2017. This increase results from capital investment in tangible and intangible assets by Southern Water of £440.2 million offset by depreciation of £266.9 million. Total non-current assets as at 31 March 2018 include goodwill arising on acquisition of £85.1 million (2017: £85.1 million).

Current assets increased to £212.2 million (2017: £190.7 million). This increase mainly results from an increase in

Southern Water's unbilled income principally due to the timing of the billing of wholesale services to our new non–household retail customers of £14.4m. At March 2017 we did not have any comparable unbilled income as our non–household customers had received final bills during February and March 2017, before their transfer to Business Stream. In addition to this, a rates recovery of £3.3 million has been recognised in unbilled income at the end of the year.

Current liabilities increased to £670.0 million (2017: £300.0 million). This increase is principally caused by the transfer of a Class A £300 million loan, repayable in 2019, from long to short term. Additionally, at March 2018 amounts classed as other accruals and deferred revenue includes an interest accrual for bond interest of £141.0 million. This bond interest is normally paid in March but this year was paid in the first week of April 2018. These increases were partially offset by the inclusion in current liabilities at March 2017 of an accrual for the final dividend of £54.2 million owed to shareholders.

At 31 March 2018 non-current liabilities totalled £6,869.2 million (2017: £7,021.6 million). The decrease of £152.4 was principally the result of the transfer of a Class A loan of £300 million to current liabilities, together with the revaluation of our derivative financial instruments which fell by £46.3 million. These reductions were offset by the current year indexation charge of £38.8 million and Eurobond interest of £119.3 million which increased the value of our loans and an increase in the value of other non-current liabilities resulting from sewer and pumping stations adoptions totalling £23.5 million.

As at 31 March 2018, the Group had net liabilities of £839.5 million (2017: £796.5 million). Excluding the liability associated with the Eurobonds, which are shareholder loans and included within non-current liabilities, of £1,116.9 million (2017: £997.6 million), the underlying shareholder equity was £277.4 million (2017: £201.1 million).

Consolidated cash flow statement – summary

The consolidated cash flow statement for GSH is summarised in Table 4 below:

Table 4	Years ended 31 March	
	2018 £m	2017 £m
Net cash inflow from operating activities	**466.9**	524.0
Net cash used in investing activities	**(369.5)**	(273.6)
Net cash (used in)/from financing activities	**(112.4)**	13.8
Net (decrease)/increase in cash and cash equivalents	**(15.0)**	264.2

Net cash inflow from operating activities has reduced to £466.9 million for 2017–18 from £524.0 million in 2016–17, largely resulting from movements in working capital.

This decrease is partly due to an increase in debtors in 2017–18 of £23.5 million due to the impact of the sale of our non–household retail business to Business Stream. In the previous year, during February and March 2017, we raised our final bills to our non-household customers and this sped up our cash collection process resulting in a fall in debt of £12.3 million at March 2017. At March 2018, due to timing of the billing of our wholesale water to retailers, we have an increase in unbilled income of £14.4million.

There was an increase in the level of creditors seen in 2016–17 of £20.1 million compared to a reduction in creditors in 2017–18 of £5.4 million. This 2016–17 movement was driven by an increase in the value of deposits and deferred revenue held on the Balance Sheet associated with developer activity and also by the timing of payments to suppliers, which has partially reversed in 2017–18.

The net cash used in investing activities increased to £369.5 million (2017: £273.6 million). This increase was mainly due to the profile of our capital investment programme. There was a significant increase in the number of investment projects in construction during 2017–18 - the third year of the 5 year business plan period - resulting in an increase in capital expenditure of £111.6 million.

The net cash used in financing activities was £112.4 million (2017: inflow £13.8 million). This was primarily caused by the previous year's outflows reducing by £238.3 million as a result of the net impact of new loans offset by loan repayments. This was partially offset by lower interest paid in 2017–18 which fell by £113.6 million from the previous year. This fall occurred principally because bond interest payments normally made at the end of the year fell into April 2018.

Overall these resulted in a net decrease in cash and cash equivalents of £15.0 million (2017: net increase of £264.2 million).

Financial KPIs

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

The net debt used in the net debt to RCV ratio is calculated as consolidated secured short-term and long-term borrowings less cash and short-term deposits. The RCV of Southern Water is set by Ofwat for five-year periods at periodic reviews and reflects forecast growth in the asset base. It is adjusted at each periodic review for any out-performance, shortfalls in outputs or permitted additional investment and for certain asset disposals. The target for the current five-year regulatory period ending March 2020 is to maintain the ratio of consolidated net debt to RCV at no more than 90%; at 31 March 2018 it was 86%. Lock-up is defined as a restriction on all dividend payments.

The consolidated EBITDA to consolidated net cash interest is targeted to be maintained comfortably above the 2.0 times covenanted level.

Net debt: RCV	%
2016–17 performance:	87
2017–18 performance	86
Covenanted lock-up level	93
Covenanted default level	95

Consolidated EBITDA to cash interest cover	Times
2016–17 performance	2.9
2017–18 performance	3.1
Covenanted default level	2.0

Dividend policy

Our dividend policy takes into account the interests of all stakeholders to ensure that while shareholders are fairly rewarded for their continued investment and confidence in the group, the group can maintain its long-term capital structure and improve the services it offers to its customers.

When determining whether to make a dividend payment the following steps are followed:

1. A holistic view of Southern Water's performance in the year is considered which forms a 'gateway' to the proposal of a dividend. This gateway includes how well the company has delivered the promises and performance commitments it made as part of agreeing to the charges Ofwat allows it to make for its services, known as the company's price determination.
2. If it is agreed that a dividend will be paid, we, as a group, start with a base level of dividend appropriate to Southern Water's price determination and its actual level of gearing.
3. We then take into account Southern Water's financial performance during the year. Where the company has performed better than would be reflected in the base level of dividend, we consider whether it is appropriate to increase it while also taking into account how an equitable share of its profits can be passed on to customers and other stakeholders.
4. It is important to note that we do not automatically pay the full amount of the calculated level of dividend. We may retain dividends in the group, or defer them to a future period, to maintain financial resilience, a sustainable long-term capital structure, and give due regard to employees and other stakeholder interests relevant to the group as a whole.

Our dividend policy is intended to support the credit ratings of the group and ensure continued access to diversified sources of finance. As part of step four we carry out an assessment of:

i. headroom under debt covenants
ii. the impact on Southern Water's credit rating
iii. the liquidity position and ability of Southern Water to fulfil licence conditions
iv. key areas of business risk

In light of Ofwat's recent publications regarding governance in the water sector and its proposals for the next business plan for 2020–25 we will be reviewing our dividend policy to ensure that it strikes the right balance between the interests of customers and investors.

For the current financial year to 31 March 2018 no ordinary dividends have been declared and are instead, being retained within the group in order to support financial resilience as we make preparations for Southern Water's next price determination (the five years from 2020 to 2025).

Taxation

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

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

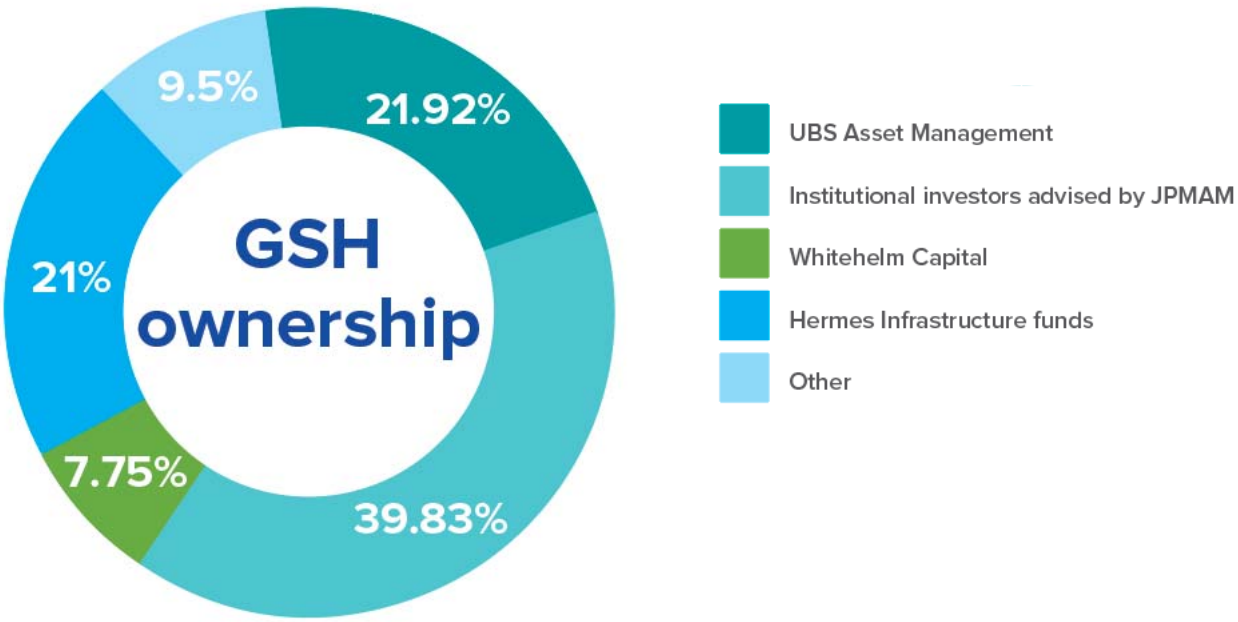
Further information regarding the Southern Water tax position can be found in the Annual Report for Southern Water which is published on its website.

Capital structure, liquidity and other financial matters

Capital structure, ownership and borrowing covenants

Ownership

GSH is owned by a consortium of long-term investors representing infrastructure investment funds, pension funds and private equity and no single shareholder has majority control.

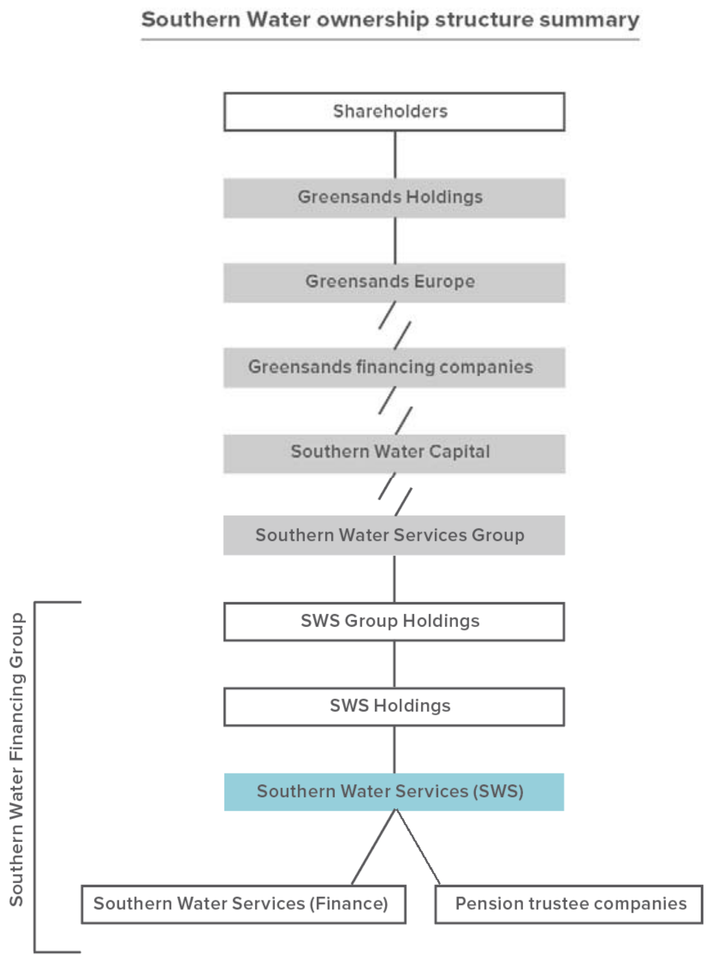


UBS Asset Management – a large-scale global asset manager, offering investment capabilities across all major traditional and alternative asset classes
JP Morgan Asset Management (JPMAM) – a large-scale global asset manager advising institutional investors
Whitehelm Capital – Shareholding managed by Whitehelm Capital on behalf of Motor Trades Association of Australia and Prime superannuation funds
Hermes Infrastructure funds – Hermes Infrastructure is part of Hermes Investment Management and is a specialist infrastructure manager operating a diversified, well-established, UK-focused shared investment platform. With £4.1bn of assets under management, Hermes Infrastructure is one of the UK's largest direct investors
Other – other minor shareholdings held by infrastructure investment companies

Group structure

In September 2007, the Greensands Group of companies was established for the purpose of the acquisition of 100% of the share capital of Southern Water Capital Limited, the then ultimate parent company of Southern Water from the Royal Bank of Scotland (investing £1.9 billion of equity and debt to finance the acquisition).

The holding company structure for SWS is shown in the diagram below and this is followed by an explanation of the principal companies in the structure.



Greensands Holdings Limited (GSH) – Established in 2007, as a single purpose entity for the acquisition of the Southern Water Capital group, GSH is the ultimate parent company of Southern Water and all other group companies, with no minority interests. GSH is a Jersey registered company, but it is UK tax resident and, as such, is liable for tax in the UK. The only operating company in the Group is Southern Water Services. Accordingly, the GSH Board shares and supports the aims of the board of Southern Water for the long-term success of that company. GSH holds 100% of the share capital of Greensands Europe and has no direct holdings in any other entities.

Greensands Europe – Was established as part of the financing for the acquisition of the Southern Water Capital group from RBS in 2007. Greensands Europe has issued debt that is held by our shareholders in proportion to their respective shareholdings.

Greensands financing companies – A number of financing companies were established as part of the acquisition in 2007 to provide additional external financing. Security granted to the lenders of this financing is limited to the share capital of Greensands Holdings Limited. There are no debt guarantees in place between the Greensands financing companies and the Southern Water Financing group, with the result that SWS is fully protected, and fully isolated, from a default at any Greensands company.

Southern Water Capital (SWC) – Was the previous holding company for the Southern Water group established as part of the sale of Southern Water by Scottish Power in 2002. SWC does not trade and holds preference shares in SWS from which it receives dividends.

Southern Water Services Group (SWSG) – The immediate parent company of the securitised group which acts as a holding company for this group following the financial restructuring on 2003.
Southern Water Financing Group – Southern Water established a financing structure, known as a Whole Business Securitisation (WBS), in 2003 following its sale by ScottishPower. The WBS sets strict rules which

demonstrate to investors that Southern Water is a safe and reliable business in which to invest. This structure helps to reduce our financing costs and improves access to long-term and secure sources of finance. Reducing financing costs ultimately benefits customers in the form of lower bills.

The WBS works by creating a ring-fence around the Southern Water business in the form of a financing group. The financing group, whose immediate parent is SWSG, provides security to finance providers in the form of a charge over the share capital of SWS Group Holdings (SWSGH). No security is provided over our individual regulated operating assets. This structure ensures that, in the unlikely event that either Southern Water or SWSF were to default on their debt obligations, Southern Water would continue to operate as usual. Debt providers are not permitted to either break up or interrupt the business and can therefore only look to a new owner of the financing group to recover their debt in the unlikely event of serious default.

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

One of the CTA arrangements is a limit on the indebtedness of Southern Water and SWSF. This includes precautionary 'early warning' limits which prevent the payment of dividends if a limit is breached. We ensure that we operate with sufficient financial headroom against these limits and have not breached a limit at any time since the implementation of the financing framework in 2003.

Southern Water Services (Finance) (SWSF) – Our financing subsidiary, SWSF, was established for the express purpose of raising debt finance on our behalf under the securitisation in 2003.

Due to administrative reasons applicable at the time of the WBS it was necessary for SWSF to be registered in the Cayman Islands in order to raise debt listed on bond markets. This requirement is no longer necessary and we are planning to close this company.

SWSF is wholly and exclusively resident for tax in the UK and files tax returns only with HMRC. This means that any profit or loss made by this company is subject only to UK tax.

Interest rate, liquidity and cash management risk

Southern Water hedges its exposure to interest rate risk on at least 85% of its outstanding debt liabilities in respect of Class A and Class B debt for the period to the next periodic review and at least 70% in the next period (on a rolling basis) into either index-linked or fixed rate obligations.

Additional funds are raised as required, to ensure that sufficient cash and/or facilities are available to fund the business for at least the next twelve months and both Southern Water (Greensands) Financing plc and Southern Water have debt covenants to this effect.

The Group sets exposure and minimum credit rating limits for deposits of cash balances.

The Group has debt both at the regulated and non-regulated levels, with some of this debt owed to shareholders. Debt service at Greensands is dependent upon distributions from Southern Water Services and is subject to the risk that funds could be locked up in the Southern Water Financing Group and not available to fund future interest payments or dividends outside of the regulated part of the Group. The Group has a series of covenants within the Greensands financing structure which include a restriction on paying shareholder dividends if available liquidity reduces to below a full year of debt service. As at 31 March 2018 liquidity at Greensands covered future interest payments for 20 months. Interest is only payable on the shareholder debt in so far as cash is available to do so.

An additional risk which occurs from time to time is the requirement to refinance debt as it matures. There are a number of debt maturities within the Group over the next twelve months and this is particularly a risk at Greensands where liquidity is insufficient to repay debt at this level. The Group is planning to refinance this debt as part of the review of the capital structure in preparation for the next regulatory period. These plans are sufficiently advanced to provide confidence that the maturing debt will be refinanced.

The regulatory framework, under which revenues and the RCV are indexed, exposes the Group to inflation risk. This risk is managed through the use of index-linked instruments within the overall debt portfolio.

An analysis of net debt is included in note 29 to the financial statements.

Credit risk

For Southern Water, 82% of the water and wastewater services revenue is received from household customers. The Water Industry Act 1999 prohibits the disconnection of domestic customers for failure to pay water and wastewater charges. An extensive range of collection and recovery methods is employed, as appropriate to the individual circumstances of the customer, to minimise the risk of non-payment.

Following the opening of the competitive market on 1st April 17 non household customers are serviced by water retail companies under licence. Southern Water transacts directly with the water retailers for the Wholesale charges. The new market operates under strict guidelines governed by Ofwat which minimises risk of debt and non-payment. Failure to pay results in the retail company losing its licence.

The level of provision against non-collection of charges is reviewed on an annual basis, based on the age profile of the debt and the likelihood of recovery. A material increase in uncollected revenue, compared with that assumed in the setting of price limits, may provide grounds for an interim price determination by Ofwat.

Financial Risk

See page 39, included within the Directors' report.

Rating

Credit ratings for both Southern Water (Greensands) Financing and Southern Water Services are as follows:

Credit rating	Southern Water (Greensands) Financing	Southern Water Services
Standard & Poor's	BB-	Class A debt: A- Class B debt: BBB
Fitch	BB-	Class A debt: A- Class B debt: BBB
Moody's	Not applicable	Class A debt: Baa1 Class B debt: Ba1 Corporate family rating: Baa2

Fitch has also rated Greensands UK Limited long-term issuer default rating at B+. On 5 July 2018 Fitch placed the Greensands Group credit ratings on negative outlook. This credit rating action is in response to the current political and regulatory climate including where Ofwat have introduced a number of proposals which could influence the ability of the regulated part of the group to distribute funds. There is no change to the stable outlook for Southern Water Services.

During the year the credit rating agencies each reviewed their assessment of the credit ratings for Southern Water. The credit ratings of Standard and Poor's and Fitch have a Stable Outlook and the credit ratings for Moody's have a Negative Outlook. We are currently engaging with financial stakeholders as part of our financing plans to improve the financial resilience of Southern Water in preparation for the next five-year business plan for the period 2020–25.The company has established a programme for the 2020-25 business plan to ensure they are able to deliver a high quality submission to Ofwat, by their deadline of 3 September 2018. Southern Water has continued to respond to all Ofwats consultations on price review methodology and will maintain close dialogue with Ofwat and other regulators on key issues.

The Group is fully in compliance with all of its covenants.

Corporate Governance

Overview

Greensands Holdings Limited (GSH) acts as a single-purpose entity as the ultimate holding company for Southern Water and provides the financing structure for the Group. As a consequence, the GSH Board complements and supports the aims of Southern Water for its long-term success. Whilst certain matters are reserved to the GSH Board and/or GSH's shareholders, these matters do not impact the day-to-day operations of Southern Water and nor do they materially affect Southern Water's ability to function as an independent company in providing an essential public service.

Details of the governance of GSH are listed below, and those of Southern Water can be found in its Annual Report which is published on the Southern Water website.

Board membership and Chairman

The GSH Board comprises five directors. Three of these directors, including, with effect from 1 May 2018, the Chair, are appointed by a shareholder represented by JP Morgan Asset Management; one director is appointed by shareholder represented by UBS Asset Management; and one is appointed by shareholders represented by Hermes. Another shareholder is entitled to appoint an observer to attend and take part, but not vote, at GSH Board meetings.

The previous Chairman of Southern Water, Robert Jennings, was a member of the GSH Board. However, following a review of Southern Water's and Greensands' governance arrangements, it was decided that the Chairman of Southern Water, Bill Tame, would not be a member of the GSH Board and so no independent members of Southern Water's Board sit on the Board of GSH.

Board operation

GSH is party to the shareholder agreement between the shareholders in the Greensands consortium. Under that agreement, the GSH Board members, apart from the Chair (if one has been appointed), also comprise the Boards of the six subsidiaries down to Greensands Investments Limited. Two of the GSH directors comprise the board of Southern Water Capital Limited. No director of GSH is also a director of Southern Water Services Limited, although one was an alternate director for a shareholder-nominated director on the Southern Water board during the year.

The GSH Board normally meets at least four times a year on its own. The business at such meetings includes agreeing formally any changes in membership, noting any relevant shareholder activity and approving formally any transfers of shareholdings as well as to review and, if thought fit, approve any matters reserved to the GSH Board. The GSH Board also receives regular operational and financial performance reports in respect of Southern Water. The financial performance of Southern Water represents the principal financial performance of the Group.

The GSH Board members are very mindful of the independence of the directors of Southern Water. Following a review of the governance of Southern Water and Greensands, the GSH Board members are no longer present when the Southern Water board meets, unless specifically invited to attend. The GSH Board members can bring additional knowledge, skills and resources of their nominating shareholders and employers, as well as their own personal skills, experience and knowledge of businesses and business sectors similar to that of Southern Water.

For compliance with Condition P of Southern Water's Licence, the shareholders who are considered to be the Joint Ultimate Controllers of Southern Water have given undertakings to provide all necessary information to that company, not to cause Southern Water to breach any of its obligations and to ensure that there are not fewer than three independent non-executive directors on the Southern Water board. Copies of those undertakings are published on Southern Water's website.

GSH does not have any executive directors nor any dedicated management employees.

The GSH directors are not remunerated by GSH for their appointments.

Role of the Company Secretary

The Company has appointed both Joanne Statton and Intertrust Corporate Services (Jersey) Limited to act as joint company secretary. Joanne Statton is also Company Secretary of Southern Water. All directors have access to the advice and services of the Company Secretariat team. The company secretary is responsible for ensuring that the Board operates in accordance with its governance framework and that there are good information flows to the Board. The appointment and removal of the company secretary is reserved to the GSH Board.

Director induction, training and development

GSH directors take advantage of the induction and training opportunities available to Southern Water directors as appropriate. On appointment to the Board, a director will discuss and agree induction coverage and then an appropriate comprehensive and individualised induction pack is provided, which will include information on Southern Water and the holding Group structure, the regulatory framework of Southern Water, customer service and the operation of assets, strategic plans, financial reports, business plans and the governance framework. This and further relevant information is summarised in a directors' handbook.

Board meetings

Due to the changes in Southern Water's governance and the GSH Board's composition, the Board only held two scheduled meetings during the year. The Board also addressed a number of other matters through written resolutions. The agenda and papers are sent to the Board members in advance of each meeting.

In addition to its scheduled Board meetings, the GSH Board members were invited to and attended a number of Southern Water board engagement days in respect of Ofwat's price review for 2020-2025 and GSH directors have been engaged in representing the interests of the shareholders as part of this process.

The Board has no standing committees.

Table of attendance at Board meetings

Attendance at scheduled Board meetings in 2017–18			
Susan Howard (appointed 19 January 2018)	-/-	Randy Daniels (resigned 19 January 2018)	1/2
Andrew Gilbert (appointed 26 September 2017)	-/-	Michael Nagle (resigned 19 January 2018	2/2
Brian Goodwin as alternate to Andrew Gilbert (with effect from 26 September 2017)[1]	-/-	Andrew Truscott (resigned 26 September 2017	1/2
Paul Hedley (appointed 19 January 2018)	-/-	Jeffrey Woodward as alternate to Bronte Somes (resigned 26 April 2017)	-/-
Bronte Somes	2/2		
Thibault Contat Desfontaines as alternate to Bronte Somes (appointed 21 September 2017)	-/-		
Robert Wall	2/2		

[1]Brian Goodwin was previously alternate to Andrew Truscott until Andrew Truscott's resignation on 26 September 2017.

Annual General Meeting

As a result of changes in Jersey Company Law, to bring it in line with Company Law in England and Wales, GSH, as a private company, is no longer required to hold an AGM. As a result the Board has decided that it will no longer hold an Annual General Meeting.

2) Southern Water Services Limited

Strategic Report summary:

Southern Water Services Limited is the only operating company of the Group. The financial statements of Southern Water, containing a full Strategic Report and Corporate Governance report, are published alongside these financial statements on the Southern Water website. An overview of the performance of the company is provided below.

A year of challenge, change and progress

During 2017–18 Southern Water has delivered significant improvements in areas such as customer experience while laying foundations for success in others, such as building more resilience into its core services.

The company knows that it still has a long way to go to provide the quality of service it aspires to deliver to its customers. However, 2017–18 was a period in which Southern Water faced its challenges and began its cultural shift towards becoming the modern, innovative and public service-focused organisation it needs to be and knows it can be. Cultural change takes time, but the company has started by working to be brilliant at the basics so its customers routinely receive the high-quality core services of a clean, safe drinking water supply, wastewater removal and customer care. The company has also started to look at what it can do now to harness technology, innovation and adopt new ways of thinking to secure a resilient water future for the South East.

Part of this will mean demonstrating to customers and stakeholders that water is not only vital for life but can enable economic growth, be used as a renewable source of energy and is crucially important to our precious natural environment. Southern Water proposes to change how it works, improve how it communicates and forge stronger partnerships to help everyone in its region understand the true value of water.

In 2017–18 the company worked hard to build trust with customers, stakeholders and regulators. As part of this, it strengthened its accountability processes and reporting procedures by setting up a Compliance and Asset Resilience directorate to bring greater scrutiny and assurance to this area. Southern Waters customers have a right to ask questions about how it operates and to receive straight answers, especially at a time when there is so much debate about the legitimacy of the privatised water sector.

In addition, the company acknowledges the need to have constructive and progressive relationships with its regulators and is therefore grateful for the time and guidance given to it in the last 12 months by, among others, Ofwat, the Drinking Water Inspectorate (DWI) and the Environment Agency.

In the following pages there is an overview of the challenges, changes and achievements that have defined Southern Water's year.

A much-improved service but still more to do

Although Southern Water remains 15th out of 18 in the industry performance tables for customer satisfaction, the results of its work to transform its customer service meant that at one point during 2017–18, it was the fastest improving company in its sector.

By increasing its focus on what customers need from them, delivering it when they want it and via channels they find most convenient, the company has seen some encouraging results. For example in the positive feedback received by its growing Home Move team, who offer tailored advice to customers moving within its area.

In 2017–18 the company also cut written complaints by 21%, adding to the 47% reduction it achieved in 2016–17. It has also become much faster at managing written complaints with 75% now resolved within three days.

To make life simpler for customers, it signed a joint billing arrangement with South East Water so those customers whose water and wastewater services are split between the two companies now only receive a single bill. This move was in direct response to customer feedback and the company is pleased to have introduced this change seamlessly, transferring around half a million customer accounts.

Helping customers in vulnerable circumstances has always been a focus for Southern Water and in 2017 it renewed this commitment, setting up a new steering group as part of its Reach and Support initiative. The group is made up of a regional network of organisations from local authorities to debt management agencies and will enable information-sharing and more tailored support for those customers who need it most.

Southern Water knows that it still has a long way to go to catch up with the best performers in its industry but the progress it has made over the past year demonstrates its commitment to providing excellent customer service.

Getting better at the basics now while setting goals to be brilliant tomorrow

Getting the basics right every time is extremely important to the company and in 2017–18, the 2.5 million customers who receive its drinking water consumed it at a standard that met 99.96% of the quality measures demanded by the DWI.

In its other core service – removing wastewater effectively – the company also made progress in 2017–18, thanks to investments in its infrastructure, with a fall in the number of sewer blockages, pollutions and internal and external flooding incidents caused by failures of its networks.

However, Southern Water does not underestimate the scale of the task the company faces in ensuring that it provides consistently excellent core services for every customer, every day. This is always its intention and yet in 2018, some customers were left without their water supply following an exceptional weather event of freeze and rapid thaw of pipes across its network. Although the company worked around the clock to get water supplies restored as quickly as possible, with the vast majority back in supply within 12 hours, it took a few days to return some customers to normal service. It sincerely apologised to, and compensated, all those affected. It is also determined to take every lesson it can from this incident to improve both the way it responds to emergency situations and how it prepares its network to be more resistant to extreme weather.

This event crystallised a theme that features strongly in the drafts of its next business plan – that to fulfil its ambition to be brilliant at the basics, the company needs to focus on building long-term resilience into its networks. Therefore, although before the thaw the company had planned for typical winter weather and its Board had approved an additional £80 million to upgrade its water and wastewater operations by 2020, its next business plan will focus on a range of programmes to work systematically and comprehensively towards strengthening its infrastructure. One of these is its Networks 2030 project, which will take a holistic view of network management. You can read more about this in the sections on Delivering reliable services and Protecting its natural resources in the Southern Water strategic report.

Planning for a resilient water future for the South East and championing the value of water

In 25 years Southern Water estimates that it will have lost a third of its water sources through climate change and yet its population will have grown by 20%, with 500,000 additional households. So as well as providing a good level of service today, the company has a duty to plan ahead in a region where water sources are already under pressure.

The drought permit Southern Water applied for early in 2018 for the River Medway is an example of this. Although the permit was precautionary to mitigate the low levels at Bewl Water reservoir in Kent – which was only 33% full in November 2017 – it was an illustration of the immediate need for its ongoing work to have a responsive Drought Plan and Water Resource Management Plan in place to secure water supplies.

Southern Water must also continue to invest in its supply network now, which is why the company recently announced an additional £2 million on top of its existing annual spend of more than £14 million a year to find and fix leaks in its network.

However, the company cannot tackle water scarcity alone. Following its industry-leading universal metering programme, its customers are now among the most water-efficient in the UK and use around 16% less water than they did in 2010. The UK average, according to Water UK, is 141 litres per person per day whereas in its region, the average is 129. Southern Water is proposing to lead again with an ambitious project called Target 100, which aims to help customers manage their water consumption more efficiently and cut their water use to 100 litres per person, per day by 2040.

So, Target 100 will not just be about building on its existing water efficiency programme; it will also be about raising awareness about the value of water. Southern Water will work with energy and food producers, farmers and landowners, local government, regulatory bodies, environmental groups, parish councils, charities and business groups to help drive innovation and behaviours that more effectively manage water resources.

Target 100 is part of a holistic approach to managing what the company think of as the utility of water. This means understanding that the work of water utilities is at the heart of communities because efficient water and wastewater services are fundamental to the success of other sectors such as health, business, tourism and leisure, and for the sustainable growth of its economy across the country. For instance, tourists attracted into its region may not be Southern Water customers, but they enjoy the utility of water as they visit its beaches and, as a result, spend time and money in its area, contributing around £12 billion a year to the local economy.

Southern Water is investing in research and development into technology, science and processes that can improve all aspects of the water supply and wastewater removal process so it can make the most of the utility of water. In 2017–18 alone, the company spent £3.9 million on research and development projects. These included supporting a PhD project to manage microplastics in wastewater, trialling a smart water quality monitoring network, and developing a new digital tool, provisionally called a Waterbit, which allows customers to monitor their real-time water use and help them reduce consumption.

However, innovation is about much more than technology, it is also about radical thinking. Southern Water works with some of the brightest minds at the region's universities to help it devise predictive modelling programmes and new technologies but the company also plans to set up its own in-house skills academy of problem-solvers.

Meanwhile, its desire to bring innovative ideas together was behind its commissioning of an independent report last year. Called Water Futures, it recognised that the water industry is at a turning point and facing unprecedented change. It also highlighted the extent to which stakeholders across its region need to work together to maximise the outcomes of proposals to protect its water supplies. Southern Water has responded in a follow-up document, Southern Water Futures that outlines five initiatives to transform its service and bring stakeholders with them on this journey.

The first of these is Target 100 (mentioned above), while others involve the expansion of its catchment plans, the creation of resource hubs at its larger treatment works, and initiatives under Networks 2030, that will update and automate its network so the company can track and fix issues and build capacity sustainably. The full report is available at **southernwater.co.uk/waterfutures**.

Building better relationships to protect the environment and support the local economy

To maximise the potential of the utility of water in its region, collaborating with customers and stakeholders on projects is crucial. Examples the company are working on include catchment plans, which bring together a range of organisations to identify and implement cost-effective solutions to tackling pollution that can affect water quality in specific water source (catchment) areas. One example of this is the Brighton ChaMP (Chalk Management Partnership) which unites Southern Water, Brighton and Hove City Council, the Environment Agency, Natural England, the South Downs National Park Authority, the University of Brighton and Brighton and Lewes Downs Biosphere to protect and improve the quality of groundwater (water that fills pores and cracks in rocks below ground) so it remains a sustainable water resource for public water supply.

Protecting one of the region's greatest assets, its bathing waters, is vital from a number of perspectives including public health and wellbeing, environmental welfare and economic prosperity in the South East. As one of the most highlighted environmental issues of the past year, Southern Water is on a mission to reduce the amount of plastic in the environment, in its business and on its beaches. Southern Water has launched a company-wide plastics policy to reduce the amount of single-use plastics, like coffee cups, at its own sites. Southern Water is also proud to have piloted a scheme in Brighton working alongside the city council and other stakeholders groups in Brighton and Hove to provide refill sites across the city so people can re-use a single bottle. The pilot was run in partnership with the national Refill campaign.

Meanwhile, in 2017, local communities from the Isle of Wight to the Isle of Sheppey came together with Southern Water to address issues that might be affecting the quality of their bathing waters and ensure their long-term sustainability. These bathing water steering groups are not only helping preserve the beaches for residents of the region to enjoy but they are also putting plans in place to attract money into the region from tourists.
Southern Water have also continued to expand its Bathing Water Enhancement Programme, which is a £31.5 million industry-leading initiative to improve the quality of its beaches. It aims to bring a further seven bathing waters across the region to 'excellent' standard by 2020. In 2017–18 the company was proud to see that of the 83 designated bathing waters in the region, every one achieved the minimum standards required for the first time in several years. A vast improvement when you consider in 1989, 31% failed to meet the basic standards that were required at the time.

The chief executive of Southern Water, Ian McAulay, has also been keen to learn from and work with different industries and share his expertise by joining bodies that support its local economy such as the Greater Brighton Economic Board and CBI, which speaks on behalf of 190,000 businesses of all sizes and sectors.

Improving accountability and responding to challenges

In 2017–18 Southern Water worked with its regulators to address issues that will help it improve its business. For instance, its regulator, Ofwat, told the company back in 2016 that the standard of some of the information it makes publicly available fails to meet its expectations. In addition, the company received feedback from its customers and stakeholders that sometimes its communications are confusing, too technical, or that its website is awkward to use. Southern Water accepted these criticisms and set about doing more to meet the expectations of its regulators and customers. In 2017, the company was pleased that Ofwat acknowledged a significant improvement in the quality of information the company presents. However, the company also fully accepts its findings that the company still has shortcomings to address.

Meanwhile, Southern water began the 2017–18 period with Enforcement Orders in place from the DWI in relation to the submission of information and data and delays to some improvement works.

The company is also assisting the Environment Agency (EA) and Ofwat with ongoing investigations in relation to the operation of some of its wastewater treatment works and reporting processes. Southern Water is working proactively with the EA and Ofwat to resolve their investigations which are still evolving.

As part of this process, the company has carried out additional assurance on 2016 and 2017 data which has identified a need to correct previously reported performance for Wastewater Treatment Works – population equivalent, and Wastewater Treatment Works – number of failed works. The company is currently reviewing the 2015 data and it appears that Ofwat Outcome Delivery Incentive penalties may have been applicable in respect of the 2015 calendar year. The additional technical assurance that we have carried out on wastewater treatment performance data is now being rolled out for the years 2014 to 2010.

Southern Water is implementing significant programmes of work which will improve its public health and environmental compliance culture. The assurance process conducted this year has identified a number of areas where the company needs to strengthen its non-financial reporting processes and these will be incorporated into its improvement programme over the forthcoming year.

As previously mentioned, Southern Water has embarked on a programme of improvements to transform its business in all areas from operational to cultural. One of the key areas of improvement is in the way the company manages its reporting mechanisms. Southern Water knows that to protect public health it is vital that its standards comply with those set down by its regulators who need to be able to judge its performance based on the achievement metrics applied to its industry. To that end, its new Compliance and Asset Resilience directorate will improve the company's risk management, give greater oversight to its reporting procedures and assure the integrity of its data.

As part of this, in September 2017 Southern Water commenced a data transformation programme to centralise its data management and improve the quality of its collection, analysis and deployment of statistical intelligence. Led by the newly-created Data Team, this transformation has enabled the company to make more use of advanced analytics and data science and the organisation can now look forward to maximising its use of revolutionary artificial intelligence and machine-learning.

Southern Water is particularly proud that in November 2017, the company's Data Team began a cross-sector initiative to create a shared portal for common regulatory data and to release open data sets. The Data Team collaborated with technology partners and delivered the platform. The portal, called DataWell, now has seven water companies, a group of universities, Ofwat, the EA and Open Data Institute involved in the project.

Prior to a Public Inquiry in March this year, Southern Water reached an agreement with the EA about changes to its licence to take water from the Rivers Itchen and Test. Southern Water accepted the licence changes, which reduce the volume of water it can take, and believe the agreement enables a new, positive way forward for both parties, for public water supplies and for the habitats and ecology of the River Itchen and River Test. The EA has given Southern Water reassurances around maintaining public water supplies until new reliable water supplies can be found to replace those lost by the licence changes. In turn, the company have committed to a multi-million pound package of monitoring procedures and measures to lessen the environmental impact of potential drought permits and drought orders that may be needed until the replacement supplies (which Southern Water are urgently pursuing) can be implemented.

Southern Water is changing. The ambitious plans the company is making mean that it cannot have an internal culture and behaviours that fail to deliver on the outcomes the company has committed to for customers, regulators, the environment and other stakeholders. In order to deliver improved services and a resilient future for water in the South East, Southern Water are undertaking a number of transformational programmes, which rely on it operating within a modern, transparent and ethical compliance framework. Quite simply, the standards and behaviour that had led to some of the legacy issues the company is now facing will not be tolerated. Southern Water are drawing a line under the past and look forward to continuing the more collaborative relationships it is establishing with its regulators and stakeholders to benefit customers.

This year, along with other essential service providers, the company has responded to the requirements of the European Union's directive on the security of Networks and Information Systems to improve their defences against malicious cyber attacks which could damage the UK's infrastructure, economy or public health. Southern Water is strengthening its security systems in line with this to improve its resilience against attempts to disrupt its services. Meanwhile, the company is making a significant investment to upgrade its IT systems as part of overall plans to improve the efficiency of its business.

Network security also means protecting its customers, employees, stakeholders and suppliers against the possible misuse of their personal data. In May, the General Data Protection Regulations (GDPR) came into effect to introduce stricter rules on managing the use and storage of personal data. All employees across the business have been made aware of the importance of the secure handling of personal information.

Over the past year, as an industry, the company has also faced challenges from politicians and the media to defend its performance record and fitness to serve the public. The question about nationalisation is a fair debate to have but the company need to consider whether customers and the environment would truly benefit from a re-nationalised water sector. As its chairman noted in his introduction in the Southern Water annual report, Water UK estimates that £150 billion has been invested in the industry since privatisation. It is vital that any future structure of the sector has access to similar funding that keeps pace with a growing population and the impact of climate change while continuing to deliver a high standard of drinking water and the protection of its environment.

Southern Water also recognises that while there has been some innovative work taking place in its industry over the years, collectively the company have not always shared its achievements, adding to negative public perceptions of its sector.

In fact, Southern Water has a long-established record in many areas such as driving down leakage and water consumption. Southern Water also provides excellent value for money given the huge investments the company make to improve its service. Its daily combined bill for water supply and sewerage services was just £1.15 in 2017–18, and is predicted to rise to £1.19 in 2018–19.

Providing a stable financial base

As described above, 2017–18 has been a year of significant change and challenge for Southern Water. This is reflected in its operating profit for the year which fell by £22.3 million to £236.6 million, largely driven by an increase in its operating costs this year.

In particular, the company has spent an additional £3.9 million setting up the Compliance and Asset Resilience directorate and Data Team. These teams, as described earlier, have been established to improve the processes and assurance of its non-financial reporting so that customers and stakeholders can have trust in its integrity. In addition, the company has spent £3.6 million to improve the operation of its IT systems.

As mentioned earlier, 2017–18 saw some challenging weather conditions. Overall the company incurred an additional £4.3 million to mitigate the potential drought, for example pumping to refill its Bewl Water reservoir, and restoring water supplies to customers affected by the bursts following the thaw in March.

Southern Water has also been busy this year preparing to submit its business plan for 2020–25 to Ofwat in September 2018. This work, which included consultations with customers and stakeholders, increased its operating costs in the year by £2.9 million. Its focus over the next two years is to transform its business in readiness for the delivery of the next business plan objectives.

In 2017–18, the company also saw a significant increase in its capital investment programme as it completed the third year of its current business plan. In total Southern Water spent over £440 million investing in its assets during the year. This included the completion of a scheme to replace 30 kilometres of water mains in Kent, the ongoing redevelopment of its Woolston wastewater treatment works and an upgrade to its wastewater treatment works at Eastbourne.

As its Chairman stated in the Southern Water annual report, the water industry has been the focus of considerable scrutiny during the year, not least in relation to how the industry is financed. Southern Water are responding to this in reviewing its current financial structure and have announced that the company intend to close its Cayman Islands registered subsidiary.

Any changes the company makes to its financial structure, along with the continued capital investment in its assets and transformation activities, will be focused on ensuring that the company has a stable financial base to deliver on the commitments made in its current and future business plans.

Southern Waters people – proudly supporting its communities

The company’s employees’ families play on the beaches, drink the water and use the wastewater services provided by Southern Water. It is therefore important for Southern Water to provide as great a service to all its customers as they would like to receive themselves.

Last year, where the company felt new approaches were necessary to improve its effectiveness, for example in Customer Service, it has been lucky to have been supported in implementing these changes by highly accomplished employees. While the company has said goodbye to some colleagues who had served the company with dedication and skill, the company also promoted many experienced employees from within the business and recruited new people from other sectors to broaden its knowledge and skills-base.

While the changes have been necessary, the company does not underestimate how unsettling it can be during periods of transition to new working arrangements. So it is grateful for the professionalism shown by colleagues during this time.

As well as being committed to providing the best services the company can as employees and, for the most part, customers of Southern Water, their employees are also commonly members of the communities the company serve. Consequently, it is often a labour of love for them to support community initiatives.

Southern Water employees spent the equivalent of 623 days volunteering at organisations across the region and raised just under £147,700.

Last year, its Learn to Swim programme – which has taught 750,000 children over the last 25 years to be safe around water – was shortlisted for two awards (Utility Week and the Better Society Awards).The company was also pleased to be invited to meet the Department for Digital, Culture, Media and Sport to discuss how it could share its model with other water companies.

Southern Water is pleased to have been shortlisted for the Utility Week Stars Awards for its collaborative project to help customers reduce water consumption in its River Itchen Challenge.

Protecting the health and safety of its employees and contractors as they go about their work for the company is extremely important. Southern Water is therefore pleased that in 2017–18 the company received the Order of Distinction from the Royal Society for the Prevention of Accidents in recognition of its excellent record in maintaining staff health and safety over the past 19 years. Last year the company recorded two periods of more than 100 days free of any reportable injuries and will be maintaining its vigilance to protect those who work for them from injury and harm.

Of course, caring about health and safety extends to emotional wellbeing and at the company’s sixth Health, Safety and Wellbeing conference in 2017, this was a central theme. Southern Water is committed to the Time to Change programme to tackle the stigma surrounding mental health and the company was pleased to reflect this at the conference.

In April 2017, competition entered the non-household water market. Southern Water sold its non-household business portfolio to the company, Business Stream, and while the company no longer provide retail services to non-household customers, it remains a wholesaler. Its Wholesale Services team has since been recognised in an independent survey by Water.Retail for its hard work in developing relationships with retailers to ensure the efficient, compliant and fair delivery of water and wastewater wholesale services. Southern Water was ranked the second-best wholesaler of England’s nine water and wastewater companies, narrowly behind first-placed United Utilities. This is great feedback for its team, and has emphasised what the company needs to do to continue delivering, and improving, its service for retailers.

Focusing on the future

In a number of areas, Southern Water is ahead of its industry colleagues. Southern Water has led the way with metering and 100% of the waste from its works and offices has been recycled. This makes them one of only a handful of utilities to achieve a zero waste policy. Southern Water were among the first to raise awareness of wet wipes, which clog its sewers, pressed for government action to address the issue, and in 2017 won a CIPR Gold award for its campaign The Unflushables. Southern Water wants to develop its role as innovators and thought-leaders, not only to provide excellent services for its own customers but to influence the water industry as a whole in the way the company value and protect the world’s most precious commodity.

Change is coming for the whole of its sector and the company are busy making sure they are prepared for it. Southern Water know the company need to improve in some areas, however, its performance figures from the past year contain some results to be proud of and the company are pleased to have set wheels in motion in 2017–18 to achieve its ambitious agenda for the years ahead.

Southern Water Risks

Risk management is a core component of Southern Water's wider governance and internal control framework, which provides the overarching structure through which the company is managed to achieve its objectives.
The most significant risks facing the company are referred to as 'principal risks'. Its Executive Leadership Team and Board consider these to have the greatest potential to stop Southern Water achieving its strategic objectives, based on outputs from 'top down' and 'bottom up' risk assessments and the review and monitoring process.

Changes to principal risks

Throughout the year, Southern Water makes an assessment of how the regulatory and physical environment has changed, and what impact it has had on its principal risks. This year no new principal risks have been recognised, although the scope of two risks has been expanded as set out in the table below.

Principal risk 2016–17	Principal risk 2017–18	Rationale for change
Cyber security	Information security and Governance	New Data Protection standards (GDPR) came into effect in May 2018. Southern Water has therefore recognised the increased scope of its responsibilities for handling personal data in a compliant manner.
Regulatory reform	Future price limits and regulatory reform	In September 2018 Southern Water must submit a five-year business plan to Ofwat covering the period 2020–25. Much of the preparatory work for the business plan occurred during 2017–18. If Ofwat does not believe that its business plan is high quality this may materially affect the revenue the company can earn in the period 2020–25. During the past year there has also been heightened political focus on the sector. The policy of the official opposition is renationalisation of the sector. Fundamental changes to the regulation of and structure of the sector could materially affect its business.

The Southern Water Board is responsible for determining the nature and extent of the principal risks it is willing to take in order to achieve the strategic objectives of the company.

The company's strategy for risk management is that all principal risks are identified, assessed and managed to within acceptable levels. To achieve this, the Board and senior management promote a culture that encourages a routine consideration of principal risks in decision making and supports the integration of risk management within its critical processes and ways of working. Risk management and internal control systems are monitored by the Audit and Risk Review Committee on behalf of its Board. This covers all material controls including financial, operational and compliance controls.

The purpose of its approach to risk management is to support better decisions through an improved understanding of risk.

Figure 1: Southern Water Risk management process

The objectives of its risk management strategy are to:

- identify and understand all the principal risks that the company face
- select and proactively adopt those risks that deliver the right returns, and understand their potential impact on the company
- take action to manage the risks the company does not want to be exposed to, ensuring its resources are effectively and efficiently prioritised and used
- monitor and report the risks the company is taking against its desired strategic objectives.

Every employee is responsible for helping Southern Water to effectively manage its exposure to these risks and for making Southern Water a more resilient organisation, able to successfully respond to its changing environment.

Southern Water ensures controls are in place so the company can take action to minimise the impact of risks. To do this, risks are managed through a central database where they are ranked and assigned to senior managers who are responsible for implementing mitigation plans. Risks are reviewed each month and those considered most critical are escalated to its Executive Leadership Team, the Board and the Audit and Risk Review Committee. Any new risks added to the database with a high score are passed to a director and Chief Executive Officer for immediate review.

Risk appetite

The amount of risk its Board are willing to take to achieve its strategic objectives is referred to as the risk appetite. Southern Water is in the process of identifying a risk appetite for each of its principal risks. It will then form a key element of its governance and reporting framework and will be reviewed annually by its Board.

Southern Water operates a complex infrastructure of water and wastewater assets, from pipelines to processing sites, over a broad geographical area and the company recognises that extreme weather conditions and failure of its assets can have a negative impact on its customers. As a result the company has clearly defined operating processes, procedures and control frameworks, including incident management, to mitigate its compliance and operating risks. In doing so the company acknowledges that it also has to prepare for the unexpected and where some risk emerges that was not anticipated, the company deals with it accordingly.

Southern Water employs sound enterprise risk management principles, transparent decision-making, and effective communication to prioritise risk. The company aims to minimise its exposure to compliance, operational and regulatory risk, while accepting and encouraging more risk in pursuit of its mission and objectives. The company's acceptance of risks is subject to ensuring that potential benefits and risks are fully understood before developments are authorised, and that sensible measures to mitigate risk are established.

This means the company will not seek to intervene in all situations; rather its approach is based on judgement and the circumstances of each potential intervention and an assessment of its impact. Southern Water prioritises its actions in terms of risk, cost and perceived benefits in a consistent and transparent way, choosing the most appropriate course of action.

Unchanged in the year	Risk reduced in the year	Risk increased in the year

Customer

Customer service	*(Industry risk)*
	Commentary: Increasing customer expectations and rising standards of customer service across the sector mean that the company may incur financial penalties if the company does not continuously improve its customer service performance. The Service Incentive Mechanism (SIM) was developed by Ofwat to incentivise improvements in customer service and compares performance across the water sector. Rewards and penalties will be assessed by Ofwat for each company based on relative performance across the four year period from 2015 to 2019. Southern Water has set itself challenging targets, including, for example, identifying then reducing its unwanted call volumes and its improvement programmes are working to deliver these for its customers
	Mitigation: This year the company implemented an organisational restructure to help deliver its improved strategy for customer service. Southern Water plan to use more insight into customer trends to design a broader range of tailored services and training for its staff. Improvements to customer service are being made continually. Its next step in improving its service is to change the way the company works with outsourced partners. Southern Water has identified how working with a number of different companies, has caused customer issues. Consequently the company is in the process of appointing a new, single outsourced partner. Southern Water continues to actively engage with its customers and stakeholders to strengthen its links with local organisations such as councils and community groups. Southern Water will continue to improve its customers' experience by providing enhanced online facilities for them to manage their accounts. Where customers do need to speak to Southern Water directly, the company has ensured the opening hours of its contact centre are convenient. Southern Water are also re-designing its bills to make them easier to understand. Additionally, the company are using software to identify customers who are still dissatisfied after they have spoken to Southern Water and taking recovery actions to turnaround their experience.
Movement in risk exposure since 2017	**Performance in 2017–18:** *Southern Water has seen an improvement in its customer service risk since 2017. In the last year there was a 21% reduction in the number of written complaints. Southern Water is also dealing with 85% of all complaints received within three days, with the majority being responded to within 24 hours.* *During the year the company implemented an organisational restructure in its Customer Services department. During this period of transition the company delivered an enhanced service for its customers that resulted in an improvement in its qualitative SIM ranking from 16th to 15th in the industry. While its performance is improving, the company recognise that the company remain behind many of its peers and, based on its relative performance over the last three years, the company expect that Ofwat will impose a financial penalty in 2020. Our relative performance in 2018–19, the final year of assessment, will increase or decrease the level of penalty that the company face.*

Bad Debt *(Industry risk)*

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

Although the company only operate in the south east of England the company note that the ongoing Brexit process may have an adverse economic effect on its customers and their ability to pay for its services. While there are no signs that this has affected its bad debt position to date it is a risk that the company continues to monitor and review.

Mitigation: Southern Water understands that some customers may experience financial difficulties, particularly in difficult economic times. Southern Water encourages customers who are struggling to make payments to contact its Affordability Team as early as possible. To help those in difficulty the company offer a range of flexible instalment plans and tariffs, including a social tariff that was introduced in April 2015.

In addition the company have partnered with Orbit, a company that provides specialist doorstep Debt Advice to customers in financial difficulty, (to date over 95,000 customers have been referred).

Southern Water are proactive in collecting payment from its customers and in helping households pay any outstanding bills. Where necessary, should internal contact strategies fail, the company may refer customer accounts to a panel of debt collection agencies. This helps Southern Water to control its bad debt position and the associated cost to serve its customers. As a final course of action, litigation may be considered where the company believe customers have the financial means to pay any outstanding arrears.

Southern Water will shortly be enhancing its customer data to enable it to tailor the experience that its customers receive from the company. This will enable the company to more quickly identify and support customers who may be in financial hardship. Southern Water are overhauling its debt recovery strategies to be more responsive to individual customers' circumstances and are committed to ensuring that its service partners use systems and behaviours that accord with its values.

Movement in risk exposure since 2017

Performance in 2017–18:

This year, through using different engagement methods, the company has been able to reduce its bad debt provision charge to £21.8 million (2017: £25.3 million).

Southern Water are aiming to improve on this performance further in the financial year for 2018–19.

Climate

Resilience to drought *(Industry risk)*

Commentary: Some areas of the South East are classified as areas of 'severe water stress'. Climate change and more variable weather patterns are predicted to pose an increasing challenge for all water companies in the region in future years in terms of the volume of water available.

Given that the company supply drinking water to more than one million households across Kent, Sussex, Hampshire and the Isle of Wight it is critical that the company are able to ensure access to adequate water resources so it can supply customers and support the economy.

Mitigation: Through its investment planning process, the company identify and then develop those schemes which are necessary to ensure the company can meet anticipated demands for water over the next 25 years.

Its long-term investment plan sets out the additional measures that the company will take across its region to ensure it has a secure supply of water. These measures include schemes such as: leakage reduction, strategic transfers and the development of new resources. As a result of its Universal Metering Programme, nearly 90% of customers now have a meter.

Should a drought occur the company has a Drought Plan which the company would follow to introduce measures to conserve water and secure additional resources through drought permits and drought orders and by changing the way in which the company operates its sources. Southern Water also maintains its Water Resources Management Plan, using an industry-leading approach which allows it to plan to operate under a wider range of droughts than the company have seen in the past.

During 2017–18 the company applied for and were granted a drought permit to help resupply Bewl Reservoir. Southern Water also began a campaign to increase customer awareness about the current state of water availability and the actions the company has been taking to protect water supplies.

Movement in risk exposure since 2017

Performance in 2017–18:

Last year the company reported how the lack of rainfall the company received in 2016–17 had increased this risk. Lower than average rainfall continued through much of 2017 and as a result, groundwater levels and the level of its Bewl Water reservoir were very low at the end of 2017. As a result, the EA declared Kent (among other areas of the country) to be in a drought position.

In December 2017 and the early months of 2018 higher than average rainfall was received. This resulted in an improvement in the level of water in its boreholes which are now either at, or slightly above, the position this time last year. In addition, the company continues to improve supply resilience and drive water efficiency measures in its vulnerable areas. Such areas of concern include the Kent Thanet region where the company witnessed extremely low groundwater levels at the end of 2017.

This improvement in groundwater levels, together with pumping to re-fill Bewl Water, now means that restrictions will not be needed in 2018–19.

Resilience to flooding *(Industry risk)*

Commentary: Changing rainfall patterns, more frequent and intense storms and rising sea levels, could all lead to an increased risk of flooding if volumes overwhelm its assets. Excessive rainfall can result in high groundwater levels which are not possible to control. This leads to flooding to private land and property, possible contamination of water supply, and infiltration/inundation of sewers. The serious floods seen in recent years have also highlighted the need to protect its water and wastewater treatment works and pumping stations from being affected during a flood.

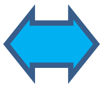
Mitigation: To help combat this risk, the company has prioritised schemes for investment in 2015–20. Southern Water are investing over £400 million during this period to provide a reliable and effective wastewater service, part of which will be used to keep over 39,500 kilometres of sewers and 3,321 wastewater pumping stations well maintained. It will also fund its replacement or refurbishment of about 100 kilometres of sewers, with the parts of its network in most need of repair and of most structural use targeted first.

Southern Water are also focusing on reducing the risk of blockages, which are a major cause of flooding from sewers. This will include carrying out targeted surveys of its sewers using cameras, performing regular sewer cleaning work, and putting more resources into keeping its drainage plans up to date to fully understand how much capacity the company will need for the years ahead. The company will also provide its customers with better information about the causes of blockages and how they can prevent them. Through investment of £268 million, the company intend to ensure there is no increase in the number of blockages in its sewer network.

Southern Water are working collectively with other Water and Sewerage Companies in collating information for the national picture of headroom capacity and flood risk, as part of the 21st Century Drainage project for which UKWIR (UK Water Industry Research) are project managing the delivery.

In addition the company are running its hydraulic models to determine properties and areas at risk of flooding in severe weather that national sewer design standards cannot cope with, to assist in building its five-year Business Plan from a resilience perspective.

Movement in risk exposure since 2017



Performance in 2017–18:
Southern Water has met all of its business targets this year for sewer blockages, sewer collapses, external flooding, and internal flooding incidents. While this risk has remained the same as last year, the company continue to focus on reducing this further and improving the resilience of its network.

Operational

Resilient Supply of good quality water *(Industry risk)*

Commentary: Southern Water must ensure the company can supply enough drinking water to cater for a growing population of more than 2.5 million people. Should operational treatment processes fail, the water supply becomes contaminated, or its water distribution network fails:

- there is a risk that water could be supplied to customers that is unfit for consumption, and would require a widespread notice in order to protect public health
- large numbers of customers could find their water supply becomes cut off
- harmful chemicals could be released to the environment.

This could cause damage to its reputation, and lead to prosecution and fines by the Environment Agency or the Drinking Water Inspectorate (DWI).

DWI enforcement actions are referred to in the Risk and Compliance section of Southern Water's Annual Performance Report 17–18 which is available on its website **southernwater.co.uk/our-reports**.

Mitigation: To avoid such incidents the company prioritise investments in the maintenance of critical assets and technology. Southern Water also ensures all its employees are trained appropriately to perform their roles well.

In the event of interruption to supply, emergency plans have been developed to ensure continued supply of water to customers, either through use of alternative supply pipes, tankering or provision of bottled water.

Our business plan 2015–20 includes schemes to add carbon filters and other more advanced filters at its water treatment works in high risk areas such as Hastings, to help improve the taste and smell of water. Our activities to improve water quality include upgrades to wells and boreholes, service reservoirs and water supply works, as well as flushing mains and cleaning service reservoirs, which store water underground before it is pumped to customers' taps.

To avoid problems associated with nitrates and pollutants being washed into rivers from high surface run off after heavy rain, the company have processes to stop water abstraction during and after heavy storms. Drinking Water Safety Plans have been completed which identify where and how problems can arise with drinking water quality and cover the entire supply system, from catchment to customers' taps.

Movement in risk exposure since 2017

Performance in 2017–18:

During the year the company experienced some challenging circumstances, in particular the extreme freeze and thaw in February and March 2018, which resulted in an increase in the number of bursts in its own network and customer pipes.

While the company achieved drinking water quality compliance of 99.96%, the company missed its annual targets for minutes without supply for customers and leakage. However, leakage remains in line with its target for the five-year regulatory period.

As a result the company have increased the risk in this area this year.

Southern Water have done much to improve its future position, including strengthening its resilience in high risk areas such as Thanet and the Isle of Wight. Delivery of nitrate removal and UV capital schemes also contribute to this. Following the severe weather event this winter the company have also enhanced its contingency and incident management plans.

Information Security and Governance *(Southern Water specific risk)*

Outcomes affected

Commentary: Southern Water provides water and wastewater services to customers across its regional infrastructure, which is considered critical national infrastructure.

As a result, the company recognises it's operational and enterprise IT systems may be a potential target for information security threats which could have a significant impact on its business reputation, ability to operate, and the resilience of its operational assets.

Additionally, because of the nature of its activities, the company hold and process large quantities of personal and payment data about its customers and employees. It is important that the company treat this information with respect and in accordance with the requirements of information governance. Information governance brings together Data Protection (GDPR) and Information/Cyber Security (NIS) directives under one umbrella as part of an overall information governance framework. The main objective of this is to be able to manage risks and issues holistically across the organisation. Information governance also incorporates physical security as part of its scope.

Mitigation: Southern Water manage this risk through IT security standards, and ongoing monitoring of its IT infrastructure to identify risks and threats. Where needed the company use incident management processes and business continuity plans.

Southern Water continues to invest in cyber threat mitigation strategies in response to the ever-changing risk landscape and the company work with the National Cyber Security Centre. Over the past 12 months the company have used industry experts to review its cyber security and help develop improvement plans.

Southern Water undertakes regular testing to assure its security measures during the year or whenever the company make improvements to its IT systems.

The company has policies in place identifying the need to have in place safeguards surrounding the collection, handling, use, storage and destruction of personal data, and ensuring its compliance with GDPR. This policy is supported by data protection training which is mandatory for all staff. Southern Water has established an Information Governance Council and a GDPR programme in preparation for the new GDPR legislation. NIS-related risks are also being assessed. Its information security, information governance and data protection training, policies and processes are currently being updated to ensure the company comply with its obligations under the new legislation.

Movement in risk exposure since 2017

Performance in 2017–18:

During 2017–18 the company continued to develop its Information Security resilience to protect its infrastructure and the information the company holds, as well as ensuring the company was prepared for GDPR and NIS regulations which came into effect from May 2018.

In addition the company has created a new Data Team to help ensure that the integrity of, and controls around, the data it holds are in place and are investing in significantly upgrading the backbone of its IT infrastructure to ensure that it meets the needs of the organisation.

Wastewater treatment works failures and pollution incidents *(Industry risk)*

Commentary: Our region benefits from a high quality environment, both inland and coastal. Southern Water is fortunate to have some extremely rare habitats, as well as some of the best quality river fishing and coastline in the UK.

Reliable wastewater services are essential to maintain public health and protect the environment. Ensuring its assets operate effectively is critical in minimising the risks to public health and/or the environment from pollution and/or sewer flooding.

As well as the potential to cause damage to the environment or distress to customers, incidents like these can also lead to prosecution and fines by the Environment Agency (EA) and cause damage to its reputation.

Southern Water are continuing to assist Ofwat and the EA with some ongoing investigations in relation to the operation of some of its wastewater treatment works and reporting processes. The investigations are still evolving and no clarity of their findings or further action and associated financial impact, if any, can be quantified at this time.

Southern Water has significantly improved the level of internal assurance which has enabled the independent external assurance of 2017 data. Southern Water have also carried out this improved assurance on 2016 data which has identified a need to correct previously reported performance for Wastewater Treatment Works – population equivalent, and Wastewater Treatment Works – number of failed works. Southern Water is currently reviewing the 2015 data and it appears that Ofwat Outcome Delivery Incentive penalties may have been applicable in respect of the 2015 calendar year. The additional technical assurance that the company has carried out on wastewater treatment performance data is now being rolled out the years 2014 to 2011.

It is likely that the company will be required to make future revenue adjustments and/or pay penalties and fines in relation to any restated figures. The Ofwat investigation could result in Ofwat taking enforcement action which may include the imposition of a financial penalty, which could be material in nature as Ofwat can impose a financial penalty of up to 10% of turnover for each breach. Any penalty or fine will be dependent on a consideration of the severity of the findings of the investigations. These will be subject to ongoing discussion and agreement reflecting, amongst other matters, the mitigating actions being taken by the company to respond to these matters after review.

Mitigation: Southern Water continues to operate and maintain its assets effectively.

The company monitors the function and performance of its assets on a continuous basis through a central control room and the company have formed a data analytics and reporting team to review pollution-related data. Southern Water also monitors any instances when its Combined Sewer Overflow (CSO - back-up over-flow pipes) are used, to proactively identify infrastructure under stress. This, together with its new works management system has significantly improved the way the company dispatch work. Southern Water can respond quicker to asset-related events and deliver the required planned preventative maintenance more efficiently.

The majority of its £1.8 billion capital investment programme for 2015–20 is targeted to maintain, enhance and extend its wastewater and water sites and its networks to reduce the risk of asset failures and asset-related incidents. This investment allows Southern Water to ensure a resilient wastewater service while accommodating increases in demand as a result of population growth, new environmental standards and climate change.

In the financial year 2017–18 the company invested £144.7 million at its wastewater treatment works and pumping stations to reduce risks at critical sites. Southern Water also invested £46.3 million in its sewer networks.

In addition, its customer-orientated fats, oils and grease educational programme is targeted at those catchments with blockage hotspots. Southern Water are also increasing customer awareness about how to avoid blocked drains.

Movement in risk exposure since 2017	**Performance in 2017–18:**
	*As a result of the ongoing investigations by Ofwat and the EA in relation to the operation of some of its treatment works the company have increased this risk this year.*

Health and Safety *(Southern Water specific risk)*

Commentary: The health and safety of its employees and the public while the company are providing its services is of the highest priority. The nature of its work requires that its employees and contractors undertake activities or use equipment which, if uncontrolled, has the potential to cause significant harm. Southern Water and its contractors have comprehensive processes and procedures to prevent injury and occupational ill-health. Failure to comply with its Health & Safety Management System and associated procedures could result in death, serious injury or adverse health effects. Southern Water could be liable for prosecution under the Health and Safety at Work and Corporate Manslaughter Acts, civil claims and employers' liability and professional liability. In addition, there would be a significant reputational risk arising from the adverse publicity.

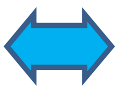
Emotional wellbeing is an important part of caring about health and safety and the company recognises that wellbeing has a major impact on all aspects of its work.

Mitigation: Southern Water has taken all necessary steps to ensure the potential health and safety risk is suitably mitigated and controlled. Southern Water has a clearly defined strategy, safety protocols and standards that are set. Health and safety performance and compliance is monitored and reported to the Board on a monthly basis and to the tri-annual Board Health and Safety Committee. The Executive Leadership Team monitors health and safety performance via detailed reports at the monthly Health and Safety Management Review meeting. This group ensures there is an adequate system for meeting its responsibilities to its staff, customers and members of the public. These services have been developed and are continuously reviewed to ensure they meet the needs of the business and its employees at work.

All staff receive suitable health and safety training, and the company have a campaign to encourage staff to report 'near misses' or hazards at work to help further reduce the risk of injuries or ill-health. Additionally, every employee has ready access to a copy of the corporate policy statement and health and safety processes and procedures.

Wellbeing was a central part of its 2017 Health and Safety conference and Southern Water is committed to the 'Time to Change' programme to raise awareness and understanding of mental health issues.

Movement in risk exposure since 2017



Performance in 2017–18:

Southern Water have maintained a consistent high standard for health and safety throughout the 2017–18 year, recording two periods of more than 100 days without a reportable injury to a member of its own staff or those of its supply chain. Its health and safety record has been recognised again by RoSPA which awarded Southern Water an Order of Distinction in April 2018.

Financial

Financing its business *(Southern Water specific risk)*

Commentary: A significant change in interest rates, a reduction in the availability of credit to the water industry, or a decrease in its credit rating, could put its ability to finance its capital investment programme or refinance its existing debt maturities at risk in the future. Maintenance of specified credit ratings is required as a condition of its regulatory licence and its borrowing covenants. A failure to maintain certain credit ratings could lead to a restriction in dividend payments.

As a minimum, the company intends to maintain its current risk profile. Southern Water only enters into treasury transactions to manage inherent risk and support prudent funding, not to speculate.

Our current credit ratings are:

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

During the year, Moody's updated the outlook on the credit ratings of Southern Water from Stable to Negative. The change to outlook reflected Moody's view of how well Southern Water is currently positioned to withstand a material reduction to the regulatory return on Regulatory Capital Value (RCV) after 2020. Southern Water is considering this as part of its five-year business plan for 2020–25.

Mitigation: Southern Water ensures that the company maintain sufficient cash reserves and liquidity facilities to finance its operations for at least 18 months.

Southern Water also ensures the aggregate nominal value of debt maturities does not exceed 40% of RCV in any single regulatory period (and 20% of RCV in any 24 months). Exposure to interest rate rises on its current borrowings is also hedged by a subsidiary company, Southern Water Services (Finance) Limited, and current borrowings are at either fixed rates or index-linked. Southern Water ensure that sufficient funds are available for its operational and capital investment programme through ongoing monitoring and forecasting of its cash flow and the company take steps to manage this when necessary.

Credit ratings comprise regulatory framework, financial risk and operational risk. Regulatory risk is improving as the company gain clarity of the planning process for 2020–25, albeit the key value for the weighted average cost of capital (WACC) is uncertain. Financial risk is stable for the current regulatory period 2015–20, in part supported by its stated gearing targets. Operational risk is supported by its annual improvement since 2011.

Movement in risk exposure since 2017

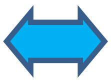
Performance in 2017–18:
Southern Water is expecting a material reduction in the funding for interest and returns (i.e. the 'WACC') for the next price review commencing 2020. Our plans for 2020–25 (the next price review period) are being finalised and the company will submit them to Ofwat in September 2018. An important part of this plan will be to reduce leverage and improve interest cover ratios at Southern Water in order to maintain a robust long-term capital structure.

Defined benefit pension scheme *(Southern Water specific risk)*

Commentary: Southern Water operates a defined benefit pension scheme which has been closed to new entrants from 1 April 2005. Southern Water remains liable for rights earned by past and present members of the scheme. Changes in demographics and fluctuations in investment markets may affect the cost of funding pension promises. Increased scrutiny of deficit recovery proposals by The Pensions Regulator could result in a higher funding requirement for the final salary pension scheme in the future. The company has been in discussions with the Trustees and The Pensions Regulator on the details of an appropriate long-term funding solution for the scheme.

Mitigation: Southern Water agreed a long-term funding and risk management strategy with the Trustees in relation to the 2013 valuation. This is monitored regularly by Southern Water and the Trustees, and mitigating actions are reviewed and implemented as appropriate. The process of agreeing the 2016 valuation and funding plan has consequently been delayed by The Pensions Regulator since querying the pace of funding adopted to address the deficit.

Movement in risk exposure since 2017



Performance in 2017–18:
Southern Water has been monitoring the deficit in its defined benefit pension scheme carefully. Southern Water is confident the deficit will be reduced over the next five years, and has the financial agility to adjust its financing strategy accordingly.

Strategy and Regulation

Compliance with regulations and legislation *(Industry risk)*

Commentary: Southern Water are a highly regulated business with three main regulators: Ofwat, the Drinking Water Inspectorate (DWI) and the Environment Agency (EA). If the company do not meet the standards set by these bodies, the company could face fines, legal action and, in the worst case, the loss of its appointment as a water and wastewater company. As with all companies the company are also required to comply with legislation for example Competition Law and the Bribery Act.

As reported last year, this risk remains high as a result of certain regulatory compliance issues, described below, which have been raised by its regulators.

Southern Water are continuing to assist Ofwat and the EA with some ongoing investigations in relation to the operation of some of its wastewater treatment works and reporting processes.

The DWI has maintained an enforcement action against Southern Water regarding its monitoring and reporting processes, and its compliance with Water Quality regulations regarding the collection of the required number of samples.

Southern Water provide a significant amount of data to the EA about the performance of its assets and any wastewater or sewage discharges the company make into what is known as the 'water environment', such as rivers, streams and coastal waters.

Southern Water faces investigations from the Environment Agency regarding the performance of certain wastewater sites and an investigation by Ofwat into the performance of its wastewater treatment sites and the reporting of relevant compliance information. The investigations are still evolving and no clarity of their findings or further action and associated financial impact, if any, can be quantified at this time.

Southern Water has significantly improved the level of internal assurance which has enabled the independent external assurance of 2017 data. Southern Water have also carried out this improved assurance on 2016 data which has identified a need to correct previously reported performance for Wastewater Treatment Works – population equivalent, and Wastewater Treatment Works – number of failed works. Southern Water is currently reviewing the 2015 data and it appears that Ofwat Outcome Delivery Incentive penalties may have been applicable in respect of the 2015 calendar year. The additional technical assurance that the company have carried out on wastewater treatment performance data is now being rolled out the years 2014 to 2011.

It is likely that the company will be required to make future revenue adjustments and/or pay penalties and fines in relation to any restated figures. The Ofwat investigation could result in Ofwat taking enforcement action which may include the imposition of a financial penalty, which could be material in nature as Ofwat can impose a financial penalty of up to 10% of turnover for each breach. Any penalty or fine will be dependent on a consideration of the severity of the findings of the investigations. These will be subject to ongoing discussion and agreement reflecting, amongst other matters, the mitigating actions being taken by the company to respond to these matters after review.

From 2016–17, Ofwat has also made an annual assessment of its assurance as part of its company monitoring framework (CMF), publishing a report on its website.

Note – further details are included in its updated statement of Risks, Strengths and Weaknesses, March 2018, available on its website at southernwater.co.uk/its-reports.

Mitigation: Southern Water has continued with its work to improve its internal assurance capabilities, focusing on those processes that result in reporting to its regulators. This has included setting up a separate compliance directorate, detailed mapping of its processes, stabilisation and improvement of its systems and the development of a robust compliance framework. Additionally the company are developing a culture transformation programme to embed a compliance culture into the organisation.

Southern Water have developed a transformation programme for its water business that the company are calling 'Water First' and have made significant progress on rectifying any issues found following a series of compliance related field audits at its waste water treatment sites. Southern Water is continuing to improve the traceability and auditability of the sampling programme and as part of this the company are rolling out a handheld GPS system to all samplers. Southern Water has rolled out technical training on critical compliance issues for water operatives and wastewater operatives.

Southern Water have responded to the comments raised by Ofwat in its Company Monitoring Framework assessment and have met Ofwat to discuss its concerns about its wastewater reporting. Internal monitoring and assurance is undertaken during the year and annual reporting is supported by external verification through its financial and technical auditors to provide assurance on compliance with its obligations.

Awareness training is provided throughout the company for non-technical compliance issues, such as the Bribery Act and Competition Law, to ensure everyone understands its legal obligations. All sections of the business review compliance with company procedures through self-assessment every six months, and implement improvement plans, if necessary.

Movement in risk exposure since 2017

Performance in 2017–18:

During 2017–18 the company have continued to work hard to respond to areas where its regulators had expressed concerns. Although the company have made progress, the company recognise that there is still further work to do in order to deliver the regulatory compliance expected of Southern Water.

In November 2017 Ofwat published its latest CMF report. Overall, *Ofwat said that it had seen some areas of significant improvement from Southern Water in 2017 as compared to the previous year.*

However, overall Ofwat found a number of minor concerns in its reporting and with its data assurance. This included reporting of its outcomes and the fact that the company were unable to provide assurance over three of its wastewater metrics, a few minor errors in its financial information and the quality of its casework responses. As a result, Ofwat concluded that the company had not yet made enough of an improvement to lift Southern Water out of the 'prescribed' category

Delivery of its capital investment programme *(Southern Water specific risk)*

Commentary: Southern Water has a capital investment programme of £1.8 billion between 2015 and 2020. Southern Water has plans in place to ensure the company will deliver this and the company are working hard to ensure its focus is maintained to complete all works on time.

If the company are unable to deliver significant parts of the programme on schedule, its ability to provide an excellent service to its customers could be compromised. Any failure to deliver would also prevent Southern Water from fulfilling the promises that the company have made in its business plan and lead to possible action by the Environment Agency, Drinking Water Inspectorate or Ofwat.

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

Movement in risk exposure since 2017

Performance in 2017–18:
Capital expenditure in the first two years of the programme was behind that set out in the business plan, increasing the risk in this area. Southern Water have accelerated the programme in 2017–18 in order to recover this position and remain on track to deliver its required outcomes by the end of the investment programme in 2020.

PR19 price review and regulatory reform *(Industry risk)*

Commentary: During recent years, there has been a significant focus on reform within the water industry, concentrating on the introduction of competition and a greater use of market mechanisms to promote innovation and efficiency. From April 2017, the retail market for non-household customers opened, which required structural changes within the company to allow Southern Water to continue to comply with regulatory requirements and to manage the anticipated shift in customer base.

The regulatory framework continues to evolve as it is reviewed to ensure that it is fit for the challenges of the future. This includes assessing the costs and benefits of extending retail competition to all residential customers.

Our current business plan and approved pricing structure runs until 2020. The next period runs from 2020–25 and the company have begun work on its new business plan. This must be submitted to Ofwat by 3 September 2018. If Ofwat do not believe that its business plan is of high quality, this many affect materially the revenue the company can earn in the period 2020–25.

Southern Water must also ensure the company continue to monitor and adapt to any changes in the assessment criteria the company are measured against by the Drinking Water Inspectorate and the Environment Agency.

Mitigation: Southern Water has established a programme for the 2020–25 business plan to ensure that the company are able to deliver a high quality submission to Ofwat, by their deadline. Development of the plan includes significant engagement with its customers and stakeholders, as well as detailed costing of options to deliver service improvements and improve the resilience of the services the company provide.

Southern Water has continued to respond to all Ofwat's consultations on price review methodology and will maintain close dialogue with Ofwat and other regulators on key issues. Southern Water closely monitors developments in the requirements from its regulators Ofwat, The Drinking Water Inspectorate and the Environment Agency. To anticipate changes the company have proactively initiated programmes of investment in its infrastructure that will help Southern Water to be prepared and resilient to their changes.

Movement in risk exposure since 2017

Performance in 2017–18:

This risk has increased during the year as a result of the further detail provided by Ofwat on the approach to its five-year business plan for 2020–25, including the level of detail and quality of evidence they expect to see in its business plan. Its programme to deliver its business plan to Ofwat by September remains on track.

The level of risk has also increased as a result of the level of political focus on the sector. There is a risk that this focus results in either significant changes to the structure of the sector or new regulatory requirements placed on water companies.

The Strategic Report was approved by the Board of Directors and signed on its behalf by the Company Secretary.

J Statton
Company Secretary
5 July 2018

Directors' report for the year ended 31 March 2018

The directors of Greensands Holdings Limited (Registered Number: Jersey 98700) present their report and the audited financial statements for the year to 31 March 2018.

Group

Greensands Holdings Limited (the company) was incorporated on 28 September 2007 as the parent company of Greensands Europe Limited, whose subsidiaries include Greensands Investments Limited.

On 15 October 2007, the company became the ultimate parent company of the Southern Water group of companies, via the acquisition of Southern Water Capital by Greensands Investments Limited.

Principal activities of the company

The company's principal activity is that of a holding company for Greensands Europe Limited and its subsidiaries. The directors expect the company to continue to carry out these activities in the future.

Principal activities of the Group

The principal activities of the Group are the provision of water supply and wastewater services in the south-east of England.

The trading results reflect the performance of the major trading subsidiary Southern Water Services Limited (Southern Water).

Strategic report

The information that fulfils the requirement of the Strategic Report can be found in the Strategic Report sections on pages 2 to11 and pages 14 to 36.

Future developments

The information regarding future developments of the company can be found in the Strategic Report sections on pages 2 to 11 and pages 14 to 36.

Results and dividends

The consolidated statement of other comprehensive income on page 43 shows the Group's results and loss for the year. Further details are also available in the Strategic Report section on page 2.

No ordinary dividends were declared during the year ended 31 March 2018 (2017: £108.2 million).

Directors and their interests

The directors who held office during the year ended 31 March 2018 and up to the date of signing the financial statements, unless otherwise stated, were as follows:

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

M Nagle	Resigned as director 19 January 2018
A Truscott	Resigned as director 26 September 2017
B Goodwin	Alternate director to A Gilbert (appointed 26 September 2017)
B Somes	
J Woodard	Resigned as director and appointed as alternate director to B Somes 20 July 2016 and resigned as alternate director 26 April 2017
R Daniels	Resigned as director 19 January 2018
R Wall	
A Gilbert	Appointed as director 26 September 2017
P Hedley	Appointed as director 19 January 2018
S Howard	Appointed as director 19 January 2018
T Desfontaines	Alternate to Bronte Somes (appointed 21 September 2017)

Research and development

The improvement of existing services and processes, together with the identification and development of new technology and solutions, are important aspects of the Group's strategy to enhance the quality of service to customers and improve methods of working. Research and development charged to the income statement amounted to £1.1 million (2017: £1.0 million).

Employees

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

The Group has established Business Involvement Groups to facilitate meaningful consultation between management and employees through elected employee representatives. The groups meet regularly at both a functional and company-wide level.

In 2017, the group introduced the Gallup employee survey to reset its approach to employee engagement and to help develop management action plans.

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

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

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

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

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

The group holds an annual Health and Safety Conference, which this year focused on wellbeing. It attracted 214 people from across the group and its partners. Southern Water is committed to the 'Time for change' programme to raise awareness and understanding of mental health issues.

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

Disabled employees: Applications for employment by disabled persons are always fully considered, bearing in mind the abilities of the applicant concerned. In the event of members of staff becoming disabled every effort is made to ensure that their employment with the Group continues and that appropriate training is arranged. It is the policy of the Group that the training, career development and promotion of disabled persons should, as far as possible, be identical to that of other employees.

Speak Up: Employees are actively encouraged to Speak Up if they see things that are not quite right. This helps us work better as a company and fosters a culture where we ensure that we are always doing the right thing for each other, our customers, the environment and other stakeholders.

Environmental issues

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

The Group recognises its responsibility to operate within a framework that supports sustainable development and has established, where possible, indicator targets which are measurable. Performance against these targets is monitored and reported regularly.

Political donations

No political donations were made in either year.

Land and buildings

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

Financial risk management objectives and policies

The Group intends to at least maintain its present risk profile, as measured by its Southern Water investment grade credit rating. The Group does not enter into treasury transactions for the purpose of speculation, but only to manage risk inherent in the business or funding on a prudent basis.

Interest Rate Risk - The Group hedges Southern Water's exposure to interest rate risk on at least 85% of its total outstanding debt liabilities in respect of Class A Debt and Class B Debt for the current year to the next Periodic Review and at least 70% in the next period to the subsequent Periodic Review (on a rolling basis) into either index-linked obligations or fixed rate obligations.

Inflation Risk - The regulatory framework, under which revenues and the RCV are indexed, exposes the Group to inflation risk. The Group manages this risk through the use of index-linked instruments within its overall debt portfolio.

Liquidity risk – The Group raises additional funds, as required, to ensure that it has sufficient cash and/or facilities to fund the business for at least the next twelve months.

The Group has debt both at the regulated and non-regulated levels, with some of this debt owed to shareholders. Debt service at Greensands is dependent upon distributions from Southern Water Services and is subject to the risk that funds could be locked up in the Southern Water Financing Group and not available to fund future interest payments or dividends outside of the regulated part of the Group. The Group has a series of covenants within the Greensands financing structure which include a restriction on paying shareholder dividends if available liquidity reduces to below a full year of debt service. As at 31 March 2018 liquidity at Greensands covered future interest payments for 20 months. Interest is only payable on the shareholder debt in so far as cash is available to do so.

An additional risk which occurs from time to time is the requirement to refinance debt as it matures. There are a number of debt maturities within the Group over the next twelve months and this is particularly a risk at Greensands where liquidity is insufficient to repay debt at this level. The Group is planning to refinance this debt as part of the review of the capital structure in preparation for the next regulatory period. These plans are sufficiently advanced to provide confidence that the maturing debt will be refinanced.

Cash management risk – The Group sets exposure limits for, and deposits cash balances with, organisations whose credit ratings are rated a minimum of Moody's P1, Standard & Poor's A1 or Fitch F1.

Going concern

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

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

- The Group's business activities, together with the factors likely to affect its future development, performance and position, which are set out in the Strategic Report on pages 2 to 11 and 14 to 36.

- The financial position of the Group, its cash flows, liquidity position and borrowing facilities, which are described in the Financial Performance reviews on pages 2 to 7. Further details of the Group's net debt position can be found in note 29 of the financial statements.

- The Group has available a combination of cash and committed undrawn bank facilities totalling £864.3 million at 31 March 2018 (2017: £880.0 million). These funds are sufficient to fund the operating and capital investment activities of the Group for the 12 months from the date of signing the financial statements.

- The Group operates in an industry that is currently subject to economic regulation rather than market competition. Ofwat, the economic regulator, has a statutory obligation to set price limits that it believes will enable the water companies to finance their activities. These limits have been set for the period April 2015 to March 2020.

- As at 31 March 2018 liquidity at Greensands covered future interest payments for 20 months. There are, however, a number of debt maturities within the Group over the next twelve months and this is particularly a risk at Greensands where liquidity is insufficient to repay debt at this level. The Group is planning to refinance this debt as part of the review of the capital structure in preparation for the next regulatory period. These plans are sufficiently advanced to provide confidence that the maturing debt will be refinanced.

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

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

Qualifying third party indemnity

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

Directors' responsibilities statement

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

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as issued by the International Accounting Standards Board and as adopted by the European Union. The financial statements are required by law to 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.

International Accounting Standard 1 requires that financial statements present fairly for each financial year the company's financial position, financial performance and cash flows. This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the International Accounting Standards Board's 'Framework for the preparation and presentation of financial statements'. In virtually all circumstances, a fair presentation will be achieved by compliance with all applicable IFRSs. However, directors are also required to:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
- make an assessment of the company's ability to continue as a going concern.

The directors are responsible for keeping proper accounting records that 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 (Jersey) Law 1991. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Responsibility statement

We confirm that to the best of our knowledge:

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

Statement of disclosure of information to auditor

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

(1) so far as the director is aware, there is no relevant audit information of which the Group's auditor is unaware; and

(2) he/she has taken all the steps that he/she ought to have taken as a director in order to make himself/herself aware of any relevant audit information and to establish that the Group's auditor is aware of that information.

Auditor

Deloitte LLP has indicated its willingness to continue in office.

Approved by the Board of Directors and signed on its behalf by:

J Statton
Company Secretary
23 July 2018

Financial statements

Consolidated income statement

For the year ended 31 March 2018

	Note	**2018 £m**	2017 £m
Continuing operations			
Revenue	4	**829.7**	809.7
Other operating income	4	**2.4**	1.3
Operating costs			
- before depreciation and amortisation		**(337.6)**	(308.3)
- depreciation and amortisation		**(266.9)**	(252.6)
Total operating costs		**(604.5)**	(560.9)
Operating profit	5	**227.6**	250.1
Other income		**11.2**	-
Profit on disposal of fixed assets		**0.8**	0.4
Finance income	9	**1.1**	1.3
Finance costs	9	**(323.1)**	(294.1)
Fair value gains/(losses) on derivative financial instruments	9	**46.3**	(416.8)
Net finance costs	9	**(275.7)**	(709.6)
Loss before taxation		**(36.1)**	(459.1)
Taxation	10	**(15.0)**	109.3
Loss for the financial year		**(51.1)**	(349.8)

The notes on pages 48 to 90 form part of these financial statements.

Consolidated statement of other comprehensive income

For the year ended 31 March 2018

	Note	**2018 £m**	2017 £m
Loss for the financial year		**(51.1)**	(349.8)
Other comprehensive income/(loss):			
Items that cannot be reclassified to profit or loss:			
Actuarial gain/(loss) on pension scheme	24	**9.8**	(71.4)
Movement on deferred tax relating to retirement benefit obligations	23	**(1.7)**	12.8
Deferred tax movement due to rate change	23	**-**	(1.7)
Total other comprehensive income/(loss) for the year, net of tax		**8.1**	(60.3)
Total comprehensive loss for the year attributable to the owners of the company		**(43.0)**	(410.1)

Consolidated statement of financial position
as at 31 March 2018

	Note	Group 2018 £m	Group 2017 £m
Non-current assets			
Goodwill	12	**85.1**	85.1
Intangible assets	13	**61.1**	61.1
Property, plant and equipment	14	**6,049.7**	5,876.4
Investments	16	**0.1**	0.1
Derivative financial instruments	22	**4.2**	9.4
		6,200.2	6,032.1
Current assets			
Inventories	17	**2.9**	2.7
Trade and other receivables	18	**209.3**	188.0
Cash and cash equivalents	29	**287.3**	302.3
		499.5	493.0
Total assets		**6,699.7**	6,525.1
Current liabilities			
Trade and other payables	19	**(370.4)**	(300.7)
Borrowings	20	**(299.6)**	0.6
		(670.0)	(300.1)
Non-current liabilities			
Borrowings	21	**(4,994.9)**	(5,133.6)
Derivative financial instruments	22	**(1,292.2)**	(1,347.4)
Deferred tax liabilities	23	**(317.5)**	(300.9)
Retirement benefit obligations	24	**(171.7)**	(176.9)
Provisions for liabilities	25	**(3.4)**	(0.5)
Other non-current liabilities	26	**(89.5)**	(62.2)
		(6,869.2)	(7,021.5)
Total liabilities		**(7,539.2)**	(7,321.6)
Net liabilities		**(839.5)**	(796.5)
Equity			
Called up share capital	27	**921.9**	921.9
Share premium account	28	**4.5**	4.5
Retained earnings	28	**(1,765.9)**	(1,722.9)
Total deficit		**(839.5)**	(796.5)

The financial statements of Greensands Holdings Limited (Registered Number: Jersey 98700) on pages 42 to 90 were approved by the Greensands Holdings Limited Board and authorised for issue on 23 July 2018. They were signed on its behalf by

B Somes
Director

Company statement of financial position
as at 31 March 2018

	Note	**Company 2018 £m**	Company 2017 £m
Non-current assets			
Investments	16	**1.0**	1.0
Other non-current assets	15	**1,016.6**	1,016.6
		1,017.6	1,017.6
Current assets			
Trade and other receivables	18	**-**	54.2
		-	54.2
Total assets		**1,017.6**	1,071.8
Current liabilities			
Trade and other payables	19	**(32.0)**	(86.2)
Non-current liabilities			
Borrowings	21	**(59.2)**	(59.2)
Total liabilities		**(91.2)**	(145.4)
Net assets		**926.4**	926.4
Equity			
Called up share capital	27	**921.9**	921.9
Share premium account	28	**4.5**	4.5
Retained earnings	28	**-**	-
Total equity		**926.4**	926.4

The company reported a profit for the financial year ended 31 March 2018 of £nil (2017: £108.2 million).

The financial statements of Greensands Holdings Limited (Registered Number: Jersey 98700) on pages 42 to 90 were approved by the Greensands Holdings Limited Board and authorised for issue on 23 July 2018. They were signed on its behalf by

B Somes
Director

Consolidated statement of changes in equity

For the year ended 31 March 2018

	Called up share capital (Note 27) £m	Share premium account (Note 28) £m	Retained Earnings (Note 28) £m	Total £m
Balance at 1 April 2016	**921.9**	**4.5**	**(1,204.6)**	**(278.2)**
Loss for the financial year	-	-	(349.8)	(349.8)
Other comprehensive loss for the year			(60.3)	(60.3)
Total comprehensive loss for the year	-	-	(410.1)	(410.1)
Equity dividends paid (note 11)	-	-	(108.2)	(108.2)
Balance at 31 March 2017	**921.9**	**4.5**	**(1,722.9)**	**(796.5)**
Loss for the financial year	-	-	(51.1)	(51.1)
Other comprehensive income for the year			8.1	8.1
Total comprehensive loss for the year	-	-	(43.0)	(43.0)
Equity dividends paid (note 11)	-	-	-	-
Balance at 31 March 2018	**921.9**	**4.5**	**(1,765.9)**	**(839.5)**

Company statement of changes in equity

For the year ended 31 March 2018

	Called up share capital (Note 27) £m	Share premium account (Note 28) £m	Retained earnings £m	Total £m
Balance at 1 April 2016	**921.9**	**4.5**	**-**	**926.4**
Profit for the financial year	-	-	108.2	108.2
Other comprehensive income for the year	-	-	-	-
Total comprehensive income for the year	-	-	108.2	108.2
Equity dividends paid (note 11)	-	-	(108.2)	(108.2)
Balance at 31 March 2017	**921.9**	**4.5**	**-**	**926.4**
Profit for the financial year	-	-	-	-
Other comprehensive income for the year	-	-	-	-
Total comprehensive income for the year	-	-	-	-
Equity dividends paid (note 11)	-	-	-	-
Balance at 31 March 2018	**921.9**	**4.5**	**-**	**926.4**

Consolidated statement of cash flows

For the year ended 31 March 2018

	Note	**2018 £m**	2017 £m
Cash from operating activities		**467.0**	524.1
Tax paid		**(0.1)**	(0.1)
Net cash from operating activities	29	**466.9**	524.0
Investing activities			
Interest received		**1.2**	1.1
Purchase of property, plant and equipment		**(373.5)**	(246.7)
Purchase of intangible assets		**(15.9)**	(31.1)
Receipt of grants and contributions		**6.5**	3.1
Sale of property, plant and equipment		**0.4**	-
Other income		**11.8**	-
Net cash used in investing activities		**(369.5)**	(273.6)
Financing activities			
Equity dividends paid		**(54.2)**	(54.0)
Interest paid		**(54.1)**	(167.7)
Payment of derivative accretion		**(3.7)**	(2.5)
Repayment of borrowings		**(150.0)**	(80.0)
Repayments of obligations under finance leases		**(0.4)**	(0.3)
Issue costs of new loans		**-**	-
Proceeds of new loans		**150.0**	318.3
Net cash (used in)/from financing activities		**(112.4)**	13.8
Net (decrease)/increase in cash and cash equivalents		**(15.0)**	264.2
Cash and cash equivalents at beginning of the year		**302.3**	38.1
Cash and cash equivalents at end of the year		**287.3**	302.3

Company statement of cash flows

For the year ended 31 March 2018

No statement of cash flows is prepared for the company due to it not holding any cash balances in the current or prior year.

Notes to the consolidated financial statements

For the year ended 31 March 2018

1 Accounting policies

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

Basis of preparation

Greensands Holdings Limited is a company incorporated in Jersey (JE98700) under the Companies Act. The address of the registered office is given on page 1. The principal activities of the company and its subsidiaries (the Group) and the nature of the Group's operations are set out in the Strategic Report on pages 2 to 11.

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs). The financial statements have also been prepared in accordance with IFRSs adopted by the European Union and therefore the Group financial statements comply with Article 4 of the EU IAS Regulation.

The financial statements have been prepared on the going concern basis under the historical cost convention, except for the revaluation of financial instruments, which occurs at the end of each reporting period as explained in the accounting policies below.

Historical cost is generally based on the fair value of the consideration given in exchange for the goods and services.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or estimated using another valuation technique. In estimating the fair value of an asset or a liability, the Group takes into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Fair value for measurement purposes in these consolidated financial statements is determined on such a basis, except for leasing transactions that are within the scope of IAS 17 ‘Leases’, and measurements that have some similarities to fair value but are not fair value, such as net realisable value in IAS 2 ‘Inventories’ or value in use in IAS 36 ‘Impairment of Assets’.

In addition, for financial reporting purposes, fair value measurements are categorised into Level 1, 2 or 3 based on the degree to which the inputs to the fair value measurements are observable and the significance of the inputs to the fair value measurement in its entirety, which are described as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date;
- Level 2 inputs are inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly; and
- Level 3 inputs are unobservable inputs for the asset or liability.

Basis of consolidation

The Group financial statements include the financial statements of the company and all entities controlled by the company (its subsidiaries) made up to 31 March each year.

Control is achieved when the company: has the power over the investee, is exposed, or has rights, to variable return from its involvement with the investee; and has the ability to use its power to affects its returns. The company reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of these three elements of control.

The company considers that it has power over the investee when the voting rights are sufficient to give it the practical ability to direct the relevant activities of the investee unilaterally.

Consolidation of a subsidiary begins when the company obtains control over the subsidiary and ceases when the company loses control of the subsidiary. Specifically, the results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the date the company gains control until the date when the company ceases to control the subsidiary.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used into line with the Group’s accounting policies. All intragroup assets and liabilities, equity, income, expenses and cash flows relating to transactions between the members of the Group are eliminated on consolidation.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2018

1 Accounting policies (continued)

Adoption of new and revised accounting and financial reporting standards

There were no new or revised significant accounting standards adopted in the current year.

At the balance sheet date, the following Standards and Interpretations were in issue but not yet effective:

IFRS 9 ‘Financial Instruments’ affects the measurement and disclosure of financial instruments with effect from 1 April 2018. The group does not anticipate that the classification of its financial assets and liabilities will change significantly as a result of the adoption of IFRS 9.

IFRS 9 requires entities to use an expected credit loss model for impairment of financial assets instead of an incurred credit loss model. This will impact the calculation of the provision for bad and doubtful debts where future credit losses will now need to be recognised. During the year the group have addressed this, and have already taken future credit losses into account when building the model which calculates the bad and doubtful debt provision, thus this change will have no effect on the company.

IFRS 15 Revenue from Contracts with Customers The standard is effective for periods commencing on or after 1 January 2018. This standard introduces a new revenue recognition model and replaces IAS 18 ‘Revenue’, IAS 11 ‘Construction Contracts’, IFRIC 13 ‘Customer Loyalty Programmes’, IFRIC 15 Agreements for the Construction of Real Estate’, IFRIC 18 ‘Transfer of Assets from Customers’ and SIC-31 ‘Revenue – Barter Transactions Involving Advertising Services’. The standard requires revenue to be recognised in line with the satisfaction of performance obligations identified within contracts between an entity and its customers, at an amount that reflects the transaction price allocated to each performance obligation. Particular challenges exist within the water industry as formal written contracts do not exist for most transactions with customers. Contracts are instead implied through statute and regulation. Judgement is therefore required in identifying the services contained within the contract and the customer with whom the contract is entered into, which in turn impacts on how the performance obligations are considered and therefore revenue recognised.

There are two main areas of the group’s activities that will be impacted by the adoption of IFRS 15:

- Core water and wastewater services, accounting for 94.3% of the group’s revenue under current accounting standards; and
- Capital income streams accounting for 2.4% of the group’s income in the income statement under current accounting standards, but where £75.7 million of balances are currently included within deferred grants and contributions on the statement of financial position.

Other ancillary revenue streams are not expected to be significantly impacted, and no significant judgements are required in relation to these.

Core water and wastewater services:

These services relate to: (i) the supply of clean water; and (ii) the removal and treatment of wastewater, with provision of each of these services deemed to be a distinct performance obligation under the contract with customers, though following the same pattern of transfer to the customer who simultaneously receives and consumes both of these services over time. No significant judgements are required in identifying customers of these services. In accordance with IFRS 15, revenue relating to these activities will be recognised over time as these performance obligations are satisfied. The adoption of the new standard is not expected to have any impact on the timing and amount of revenue recognised in these services.

Since the group is under a statutory obligation to provide water and wastewater services to its domestic properties, these services could be provided to customers who are unlikely to pay. Under IFRS 15, such revenue is not recognised. Currently, we consider that at the point of billing customers there is no one identifiable group of customers who are unlikely to pay, and so all revenue is deemed to be collectable.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2018

1 Accounting policies (continued)

Capital income:

Capital income refers to the group's income streams relating to transactions, typically with property developers, which impact the group's capital network assets. It should be noted that this area remains under active consideration within the industry and the accounting profession more broadly, and that the accounting treatment ultimately adopted by the group in this area could therefore be impacted by the outcome of these on-going discussions. However, the directors anticipate that the adoption of IFRS 15 in relation to this area will not materially impact reported revenue. Certain amounts held in deferred grants and contributions may be treated as realised through reserves as part of the finalisation of this review.

IFRS 16 'Leases' sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, i.e. the customer ('lessee') and the supplier ('lessor') and will be effective for the group from 1 April 2019. The impact on the results or net assets of the group or company of the changes to the standard has not yet been quantified in detail but this is not expected to be significant because the group does not hold a significant value of operating leases.

There are no other standards and interpretations in issue but not yet adopted that the directors anticipate will have a material effect on the reported income or net assets of the group.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2018

1 Accounting policies (continued)

Going concern

The Group's and company's business activities, together with the factors likely to affect the future development and position, are set out in the Strategic Report on pages 2 to 36.

The directors have undertaken a detailed review of the group's and company's liquidity requirements compared with the cash and facilities available, the financial covenant position including projections based on future forecasts, the current ratings and financial risk. As part of their review the directors have considered the need to refinance the Class A £300 million bond due for repayment in March 2019 and £177.2 million of inflation-linked swaps with a legal maturity of March 2037 which include a mandatory break at March 2019. The bond is in the process of being refinanced and the inflation-linked swaps are in the process of being extended to 2025 and are not expected to be a draw on our liquidity.

On the basis of their assessment of the group and company's financial position the directors have a reasonable expectation that the group and company have adequate resources to continue in operational existence for the foreseeable future, being a period of at least 12 months from the approval of these financial statements. For this reason they continue to adopt the going concern basis of accounting in preparing the annual financial statements; further details can be found in the Directors' Report on pages 39-40.

Business combinations

On acquisition, the assets and liabilities and contingent liabilities of a subsidiary are measured at their fair values at the date of acquisition. The consideration transferred in a business combination is measured at fair value, which is calculated as the sum of the acquisition-date fair values of assets transferred by the Group, liabilities incurred by the Group to the former owners of the acquiree and the equity interest issued by the Group in exchange for control of the acquiree. Acquisition-related costs are recognised in profit or loss as incurred.

At the acquisition date, the identifiable assets acquired and the liabilities assumed are recognised at their fair value at the acquisition date, except that:

- deferred tax assets or liabilities and assets or liabilities related to employee benefit arrangements are recognised and measured in accordance with IAS 12 'Income Taxes' and IAS 19 'Employee Benefits' respectively; and
- assets (or disposal groups) that are classified as held for sale in accordance with IFRS-5 'Non-current Assets Held for Sale and Discontinued Operations' are measured in accordance with that Standard.

Goodwill arising in a business combination is recognised as an asset at the date that control is acquired (the acquisition date). Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any non-controlling interest in the acquiree and the fair value of the acquirer's previously held equity interest (if any) in the entity over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed. If, after reassessment, the Group's interest in the fair value of the acquiree's identifiable net assets exceeds the sum of the consideration transferred, the amount of any non-controlling interest in the acquiree and the fair value of the acquirer's previously held equity interest in the acquiree (if any), the excess is recognised immediately in profit or loss as a bargain purchase gain.

Goodwill is not amortised but is reviewed for impairment at least annually.

For the purpose of impairment testing, goodwill is allocated to each of the Group's cash-generating units expected to benefit from the synergies of the combination. Cash-generating units to which goodwill has been allocated are tested for impairment annually, or more frequently when there is an indication that the unit may be impaired. If the recoverable amount of the cash-generating unit is less than the carrying amount of the unit, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets of the unit pro rata on the basis of the carrying amount of each asset in the unit. An impairment loss recognised for goodwill is not reversed in a subsequent period. On disposal of a cash-generating unit, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2018

1 Accounting policies (continued)

Segmental reporting

The Group's revenue arises from the provision of services within the United Kingdom. It has a large and diverse customer base and is not reliant on any single customer.

The Southern Water board and management team review all internal management information on a single segment basis and accordingly no segmental information is provided in this report.

Revenue recognition

Revenue represents the income receivable (net of value added tax) in the ordinary course of business for goods and services provided. In respect of unbilled charges, revenue includes an estimate of the consumption between the date of the last meter reading and the period-end. The revenue accrual is estimated using a defined methodology based upon historical billing, consumption information and the applicable tariff.

Revenue from the supply of services represents the value of services provided under contracts to the extent that there is a right to consideration and is recorded at the fair value of the consideration due. Revenue is recognised when the amount of revenue can be measured reliably and it is probable that the economic benefits associated with the transaction will flow to the Group. Revenue is not recognised when it is considered probable that economic benefits will not be received. In these circumstances revenue is only recognised when collectability is reasonably certain. Payments received in advance of revenue recognition are recorded as deferred income.

For provisioning purposes, revenues and outstanding arrears are segmented based on customer characteristics. Should a group of customers attract a provision rate of 100%, i.e. assessed as not generating economic benefit, revenue would not be recognised. In 2017–18 no segment of customers met this criterion and so revenue has been recognised in full.

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

Interest income is recognised on a time proportionate basis using the effective interest method.

Dividend income from investments is recognised when the shareholders' rights to receive payment have been established (provided that it is probable that the economic benefits will flow to the company and the amount of revenue can be measured reliably).

Provision for impairment of trade receivables

The bad debt provision is calculated by applying estimated recovery rates to various categories of debt, reflecting past collections experience and expectations of future recovery of outstanding receivables at the date of the statement of financial position.

Taxation

The taxation charge in the income statement represents the sum of the tax currently payable and deferred tax.

Current taxation is based on the result for the year as adjusted for disallowable and non-taxable items and items of income or expense which are taxable or deductible in other years. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the statement of financial position date.

Deferred taxation is tax expected to be payable on temporary differences between the treatment of certain items for taxation and accounting purposes. Deferred taxation is provided on all temporary differences that have originated but not reversed by the end of the reporting period. It is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised based on tax laws and rates that have been enacted or substantively enacted at the reporting date.

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

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2018

1 Accounting policies (continued)

Goodwill

Goodwill represents a single cash generating unit, being the excess of cash paid by Greensands Investments Limited for the fair value of assets acquired from Southern Water Capital, the then ultimate parent company of the Southern Water group of companies, less amortisation charged up to the date of transition to IFRS from UKGAAP on 1 April 2014.

Goodwill is initially recognised and measured as set out above and on page 65 with the carrying value being reviewed for any indicators of impairment on an annual basis.

Intangible assets

Intangible assets are measured at cost less subsequent amortisation and any impairment. Amortisation of intangible assets is calculated on a straight-line basis over the estimated useful lives, which are primarily three to ten years. The estimated useful life and amortisation method are reviewed at the end of each reporting period, with the effect of any changes in estimate being accounted for on a prospective basis.

Expenditure on research activities is recognised as an expense in the period in which it is incurred.

Property, plant and equipment

Property, plant and equipment comprises:

i. Freehold land and buildings – comprising land and non-operational buildings.
ii. Plant and machinery – comprising structures at sites used for water and wastewater treatment; pumping or storage, where not classed as infrastructure, along with associated fixed plant.
iii. Infrastructure assets – comprising a network of systems consisting of mains and sewers, impounding and pumped raw water storage reservoirs, sludge pipelines and sea outfalls.
iv. Assets under construction.
v. Other assets – comprising vehicles, computers, mobile plant and meters.

All property, plant and equipment is stated in the statement of financial position at cost or at deemed cost on transition to IFRS, less any subsequent accumulated depreciation and subsequent accumulated impairment losses.

The difference between depreciation based on the fair valued carrying amounts of assets and depreciation based on the asset's original cost is transferred annually from the revaluation reserve to retained earnings through equity. The costs of repairs to the infrastructure network are recognised in the income statement as they arise.

Expenditure which results in replacement or renewal of infrastructure or enhancements to the operating capability of the infrastructure network is capitalised.

Items of property, plant and equipment that are transferred to the Group from customers or developers are initially recognised at fair value in accordance with IFRIC 18 'Transfers of Assets from Customers'. The corresponding credit is recorded as deferred income and released to other income over the expected useful lives of the related assets.

Borrowing costs directly attributable to the construction of qualifying assets, that necessarily take a substantial period of time to get ready for their intended use, are capitalised during the period of time that is required to complete and prepare the asset for its intended use. The commencement of capitalisation begins when both finance costs and expenditures for the asset are being incurred and activities that are necessary to get the asset ready for use are in progress. Capitalisation ceases when substantially all the activities that are necessary to get the asset ready for use are complete. Other borrowing costs are expensed.

Subsequent costs are included in the asset's carrying amount or recognised as separate assets, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance costs are charged to the income statement as incurred. Assets are depreciated on a straight-line basis over their estimated operating lives, which are principally as follows:

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2018

1 Accounting policies (continued)

Property, plant and equipment (continued)

		Years
Land and buildings:	- Land[1]	Not depreciated
	- Buildings	10-60
Plant and machinery:	- Operational structures[2]	15–80
	- Fixed plant	10–40
Infrastructure assets:	- Water mains	100–120
	- Sewers	80–200
	- Reservoirs	200
	- Ancillary structures	10–70
Assets under construction:		Not depreciated
Other:	- Vehicles, computers and mobile plant	3–10

The estimated useful lives and depreciation method are reviewed at the end of each reporting period, with the effect of any changes in estimate accounted for on a prospective basis.

[1] Freehold land is not depreciated, nor are assets in the course of construction until they are commissioned. Commissioning is deemed to occur when a new works is officially taken over from the contractor, following completion of performance and take-over tests.

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

Impairment of tangible and intangible assets

At the end of each reporting period, the Group reviews the carrying amounts of its tangible and intangible assets, to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Recoverable amount is the higher of fair value less costs to sell and value in use.

If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognised immediately in the income statement, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is recognised immediately in the consolidated income statement, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

Grants and contributions

Grant and contributions received are treated as either revenue or deferred income in line with IFRIC 18 as defined by the nature of the receipt.

Infrastructure receipts, contributions received following new connections towards enhancing the network, are recognised as revenue when they are receivable.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2018

1 Accounting policies (continued)

Grants and contributions receivable in respect of non-current assets are treated as deferred income and released to other income over the useful economic life of those fixed assets.

Grants and contributions received in respect of new connections to the water and sewerage networks are treated as deferred income and released to revenue in line with the expected expenditure they are intended to compensate.

Grants and contributions which are given in compensation for expenses incurred with no future related costs are recognised in revenue in the period that they become receivable.

Leased assets

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

(i) The Group as lessee

Where the Group enters into a lease which entails taking substantially all the risks and rewards of ownership of an asset, the lease is treated as a 'finance lease'. Assets held under finance leases are recognised as assets of the company at their fair value or, if lower, the present value of the minimum lease payments, each determined at the inception of the lease. The asset is recorded in the statement of financial position as a non-current asset and is depreciated over its estimated useful life or the term of the lease, whichever is shorter. Future liabilities to the lessor under such leases, net of finance charges, are included within creditors. Rentals payable are apportioned between the finance element, which is charged to the income statement, and the capital element, which reduces the outstanding obligation for future instalments.

Leases where the lessor retains substantially all the risks and rewards of ownership are classified as operating leases. Rentals payable under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

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

(ii) The Group as lessor

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

Non-current asset investments

Investments held as non-current assets, including investments in subsidiaries, are stated at cost, less, where appropriate, provision for any impairment in value. The carrying values of non-current asset investments are reviewed for impairment in periods if events or changes in circumstances indicate the carrying value may not be recoverable.

Inventories

Inventory is held for use in the production of water supply and treatment of wastewater. Raw materials and work in progress are valued at the lower of cost and net realisable value. Net realisable value is the estimated selling price, less further costs expected to be incurred to completion and costs to be incurred in marketing, selling and distribution.

Cash and cash equivalents

Cash and cash equivalents comprise cash and short-term bank deposits with an original maturity of three months or less, net of outstanding bank overdrafts. The carrying amount of these assets is equal to their fair value.

Deferred revenue

Deferred revenue includes monies received from customers where the related service has not yet been provided.

Amounts are deferred to the statement of financial position and released to the consolidated income statement in line with the period of the service provided.

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2018

1 Accounting policies (continued)

Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that the Group will be required to settle that obligation and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, a receivable is recognised as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

An environmental provision is made for the costs relating to decommissioned or dormant assets which have been identified as having an environmental impact.

Retirement benefits

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

The liability recognised in the statement of financial position in respect of the defined benefit pension scheme is the present value of the defined benefit obligation at the end of the period less the fair value of plan assets. The current service cost, which is the increase in the present value of the liabilities of the Group's defined benefit pension scheme expected to arise from employee service in the period, is charged to operating costs. The net interest on the scheme's net assets/(liabilities) is included in other finance charges. Actuarial gains and losses are recognised in the consolidated statement of other comprehensive income.

The pension cost under IAS 19 'Employee Benefits' is assessed in accordance with the advice of a firm of actuaries based on the latest actuarial valuation and assumptions determined by the actuary. The assumptions are based on information supplied to the actuary by the Group, supplemented by discussions between the actuary and management. The assumptions are disclosed in note 24.

Loss before taxation and net liabilities are affected by the actuarial assumptions used. The key assumptions include: discount rates, pay growth, mortality and increases to pensions in payment and deferred pensions, and may differ from actual results due to changing market and economic conditions and longer or shorter lives of participants.

The Group also operates a defined contribution pension scheme. The assets of the scheme are held separately from those of the Group in an independently administered fund. Group contributions to the scheme are charged to the income statement in the period to which they relate. Differences between contributions actually paid are shown as either accruals or prepayments in the statement of financial position.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2018

1 Accounting policies (continued)

Financial instruments

Financial assets and financial liabilities are recognised in the Group's statement of financial position when the Group becomes a party to the contractual provisions of the instrument.

Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss (FVTPL)) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at FVTPL are recognised immediately in the consolidated income statement.

Financial assets

(i) Loans and receivables

Trade receivables, loans, and other receivables that have fixed or determinable payments that are not quoted in an active market are classified as 'loans and receivables'. Loans and receivables are measured at amortised cost using the effective interest method, less any impairment. Interest income is recognised by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial.

(ii) Impairment of financial assets

Financial assets, other than those at FVTPL, are assessed for indicators of impairment at each statement of financial position date. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

For financial assets carried at amortised cost, the amount of the impairment is the differences between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate. The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account.

(iii) Derecognition of financial assets

The Group derecognises a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. On derecognition of a financial asset the difference between the asset's carrying amount and the sum of the consideration received and receivable and the cumulative gain or loss that had been recognised in other comprehensive income and accumulated in equity is recognised in profit or loss.

Financial liabilities

Fixed rate interest-bearing borrowings are initially measured at fair value, net of transaction costs, and are subsequently measured at amortised cost using the effective interest method, with interest expense recognised on an effective yield basis.

The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or, where appropriate, a shorter period, to the net carrying amount on initial recognition.

Issue costs in relation to index-linked and variable rate bonds are separately disclosed within creditors.

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

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

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2018

1 Accounting policies (continued)

Derecognition of financial liabilities

The Group derecognises financial liabilities when, and only when, the Group's obligations are discharged, cancelled or they expire.

Derivative financial instruments

The Group enters into a variety of derivative financial instruments to manage its exposure to inflation risk in line with the Group's risk management policy and no speculative trading in financial instruments is undertaken. Further details of derivative financial instruments are disclosed in note 22.

Derivatives are initially recognised at fair value at the date a derivative contract is entered into and are subsequently re-measured to their fair value at the end of each reporting period. The resulting gain or loss is recognised in the income statement immediately.

Certain derivative instruments, principally index-linked swaps, do not qualify for hedge accounting, and as such, the Group does not currently apply hedge accounting.

Derivatives with a positive fair value and derivatives with a negative fair value are set-off against each other with the net position being presented as either a financial liability or financial asset. A derivative is presented as a non-current asset or a non-current liability if the remaining maturity of the instrument is more than 12 months and it is not expected to be realised or settled within 12 months. Other derivatives are presented as current assets or current liabilities.

Embedded derivatives

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contracts and the host contracts are not measured at fair value through profit and loss.

An embedded derivative is presented as a non-current asset or a non-current liability if the remaining maturity of the hybrid instrument to which the embedded derivative relates is more than 12 months and is not expected to be realised or settled within 12 months. Other derivatives are presented as current assets or current liabilities.

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2018

2 Critical accounting judgements and key sources of estimation uncertainty

In the application of the Group's accounting policies, which are described in note 1 above, the directors are required to make judgements, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

Judgements
Critical judgements, apart from those involving estimations, that are applied in the preparation of the financial statements are discussed below:

(i) Revenue recognition
The Group recognises revenue generally at the time of delivery and when collection of the resulting receivable is reasonably assured. When the Group considers that the criteria for revenue recognition are not met for a transaction, revenue recognition is delayed until such time as collectability is reasonably assured. Payments received in advance of revenue recognition are recorded as deferred income.

(ii) Property, plant and equipment
The Group recognises property, plant and equipment (PPE) on its water and wastewater infrastructure assets where such expenditure enhances a significant length of the network or increases the capacity of the network, whereas any expenditure classed as maintenance is expensed in the period it is incurred. Determining enhancement from maintenance expenditure is a subjective area, particularly when assessing whether the length of network replaced enhances the network. In addition, management capitalise time and resources incurred by the Group's support functions on capital programmes based on judgments made in respect of the proportion of capital work performed by these functions.

The assessment of useful economic lives is also a key judgment in determining the carrying value of property, plant and equipment.

(iii) Provisions and contingent liabilities
The group exercises judgment in recognising provisions and the exposures to contingent liabilities related to pending litigation or other outstanding claims subject to negotiated settlement, mediation, arbitration or government regulation, as well as other contingent liabilities (see note 30). Judgment is necessary in assessing the likelihood that a pending claim will succeed, or a liability will arise, and the point of recognition for the associated

Sources of estimation uncertainty
The key assumptions about the future and other key sources of estimation uncertainty at the reporting period end that may have a risk of causing a material adjustment to the carrying amount of assets and liabilities within the next financial year are discussed below:

(i) Measured income accrual
The measured income accrual is an estimation of the amount of water and wastewater unbilled at the period end. The accrual is estimated using a defined methodology based upon historical billing and consumption information and the applicable tariff. The calculation is sensitive to estimated consumption for measured customers. The value of household billings raised in the year ended 31 March 2018 for consumption in prior years was £130.7 million, £1.7 million (1.3%) more than the accrual made at 31 March 2017. This difference is well within our view of acceptable tolerances for accounting estimates.

(ii) Allowance for doubtful receivables
The bad debt provision at each reporting date is calculated by segmenting customer debt based on historic debt collection and payment performance, demographic information and the age of debt outstanding. For each segment, forecast cash collection rates are determined which result in a corresponding provision percentage. The value of the provision for doubtful debts as at 31 March 2018 was £180.0 million (2017: £158.0 million).The actual level of receivables collected may differ from the estimated levels of recovery, which could impact future operating results positively or negatively.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2018

2 Critical accounting judgements and key sources of estimation uncertainty (continued)

Our sensitivity analysis suggests that the bad debt provision would vary between £1.8m and £5.3m if cash collections estimates were between 1% and 3% above or below those predicted.

Bad debt provision sensitivity analysis	31 March 2018	Sensitivity			
		1%	3%	-1%	-3%
Bad debt provision estimate (£m)	180.0	1.8	5.3	-1.8	-5.3

(iii) Retirement benefit obligations

The Group operates a defined benefit scheme as well as a defined contribution scheme. Under IAS 19 'Employee Benefits' the Group has recognised an actuarial gain of £9.8 million for the year to 31 March 2018 (2017: loss of £71.4 million).

The pension cost and liabilities under IAS 19 are assessed in accordance with directors' best estimates using the advice of an independent qualified actuary and assumptions in the latest actuarial valuation. The assumptions are based on member data supplied to the actuary and market observations for interest rates and inflation, supplemented by discussions between the actuary and management. The mortality assumption uses a scheme-specific calculation based on CMI 2016 actuarial tables with an allowance for future longevity improvement.

The principal assumptions used to measure schemes' liabilities, sensitivities to changes in those assumptions and future funding obligations are set out in note 24 of the financial statements.

(iv) Provisions and contingent liabilities

The Group evaluates its exposures to contingent liabilities relating to pending litigation or other outstanding claims and recognises provisions using estimates to quantify the possible range of the financial settlement. Because of the inherent uncertainty in this evaluation process, actual losses may be different from the originally estimated provision.

(v) Goodwill

An impairment review on goodwill is conducted at least annually. The net asset value of the subsidiaries is used in the impairment review. Therefore any estimations or judgements used in respect to the value of the assets or liabilities of the subsidiaries may affect the outcome of the impairment review.

3 Segmental analysis

The directors believe that the whole of the Group's activities constitute a single class of business. The Group's revenue is generated wholly from within the United Kingdom. The Greensands Holdings Limited Board and management team review all internal management information on a single segment basis and accordingly no segmental information is provided in this report.

4 Revenue

An analysis of the Group's income is as follows:

Continuing operations	**2018 £m**	2017 £m
Water and sewerage services	**782.8**	764.8
Other services	**46.9**	44.9
Total revenue	**829.7**	809.7
Other operating income	**2.4**	1.3
Other income (note 5)	**11.2**	-
Profit on disposal of fixed assets	**0.8**	0.4
Interest receivable (note 9)	**1.1**	1.3
Total income	**845.2**	812.7

Other operating income includes rents receivable.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2018

5 Group operating loss for the year

Group loss for the year has been arrived at after charging/(crediting):	**2018 £m**	2017 £m
Depreciation on		
- owned assets	**250.9**	237.0
- assets held under finance leases	**1.0**	0.7
	251.9	237.7
Amortisation of intangible assets	**15.0**	14.9
Other income (see note below)	**11.2**	-
Profit on disposal of property, plant and equipment	**0.8**	0.4
Research and development expenditure	**1.1**	1.0
Rentals under operating leases		
- Properties	**1.9**	1.7
- Vehicles	**2.6**	2.2
Employee costs (note 7a)	**63.9**	56.5
Amortisation of grants and contributions (see note 26)	**(2.3)**	(1.2)
Fees payable to the company's auditor in respect of:		
- statutory audit of the company's financial statements	**0.2**	0.3
- other services pursuant to legislation	**0.1**	0.1
- all other services	**-**	0.2
Total audit and non-audit fess	**0.3**	0.6

Audit related and non-audit services primarily relate to regulatory assurance fees, and other taxation and professional fees.

Note On 1 April 2017 the group completed the disposal of SWS Ltd.'s non-household water and wastewater retail business, principally comprising billing and customer service activities, to Business Stream. This resulted in a £11.2 million profit after costs, which included a provision for unrecoverable debts of £2.1 million. Cash proceeds of £11.8 million are disclosed under other income in the cash flow statement on page 47.

6 Profit of the parent company

The profit for the financial year dealt with in the financial statements of the parent company is £nil (2017: £108.2 million). The prior year's profit was paid to the shareholders of the company as ordinary dividends (see note 11).

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2018

7 Employee information

	2018 £m	2017 £m
(a) Group employee costs		
Wages and salaries	**89.9**	81.9
Social security costs	**9.2**	8.3
Pension costs - Defined contribution	**3.0**	2.6
- Defined benefit	**6.7**	5.1
Total employee costs	**108.8**	97.9
Less: charged as capital expenditure	**(44.9)**	(41.4)
Charged to the income statement	**63.9**	56.5

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

(b) Average number of persons employed by activity

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

	2018 Number	2017 Number
Operations	**1,160**	1,298
Customer services	**258**	317
Corporate centre	**871**	505
	2,289	2,120

8 Directors' emoluments

During the year there were no payments made to directors by the Group in return for services as a director of Greensands Holdings Limited. However, two other directors received £8,300 each (2017: one director £15,000) paid by one of the ultimate shareholders.

9 Net finance costs

	2018 £m	2017 £m
Finance income		
Interest receivable	**1.1**	1.3
	1.1	1.3
Finance costs		
Interest payable on loans	**(337.1)**	(320.2)
Interest rate swap receipts	**42.0**	43.3
Indexation	**(38.8)**	(20.9)
Amortisation of issue costs	**(1.6)**	(2.0)
Amortisation of gilt lock proceeds	**0.1**	0.1
Amortisation of bond premium	**0.7**	0.7
Other finance expense (note 24)	**(4.9)**	(3.7)
	(339.6)	(302.7)
Amounts capitalised on qualifying assets	**16.5**	8.6
	(323.1)	(294.1)
Fair value gains/(losses) on derivative financial instruments		
Derivative financial instruments not designated as hedges	**46.3**	(416.8)
Net finance costs	**(275.7)**	(709.6)

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2018

9 Net finance costs (continued)

A large proportion of the payment of interest payable on loans falls due on 31 March. Where this date is not a business day, the interest is paid on the next following business day.

Borrowing costs included in the cost of qualifying assets during the year arose on the general borrowing pool and are calculated by applying a capitalisation rate of 4.10% to expenditure on such assets (2017: 4.23%).

10 Taxation

	2018 £m	2017 £m
Current tax:		
Current year	**0.1**	0.1
Total current tax charge	**0.1**	0.1
Deferred tax:		
Origination and reversal of temporary differences	**14.2**	(89.5)
Adjustment in respect of prior years	**0.7**	-
Effect of corporation tax rate change	**-**	(19.9)
Total deferred tax	**14.9**	(109.4)
Total tax charge/(credit) on loss	**15.0**	(109.3)

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

	2018 £m	2017 £m
Loss before tax	**(36.1)**	(459.1)
Current tax:		
Tax at the UK corporation tax rate of 19% (2017: 20%)	**(6.9)**	(91.8)
Permanent differences	**15.3**	8.9
Deferred tax assets not recognised	**6.7**	(14.8)
Differences between current and deferred tax rates	**(0.8)**	8.3
Impact of tax rate changes	**-**	(19.9)
Adjustment in respect of prior years – deferred tax	**0.7**	-
Tax charge/(credit) for year	**15.0**	(109.3)

Factors that may affect future tax charges:

A reduction in the main rate of corporation tax to 17% from the 1 April 2020 was enacted in the Finance Bill 2016, and deferred tax balances at the Balance Sheet date have been calculated using this rate.

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

Note 23: Deferred tax liability shows that the balance is made up of a deferred tax liability arising on accelerated capital allowances and other short-term timing differences, and deferred tax assets arising on the fair value revaluation of financial instruments and the pension deficit.

At the reporting date the group has unused tax losses of £5.6m (2017: £5.6m) with a deferred tax asset of £0.9m (2017: £0.9m). A deferred tax asset has not been recognised in respect of these group losses due to the uncertainty of suitable taxable profits in the foreseeable future on which to utilise the losses.

In 2017, a deferred tax asset had been recognised in respect of £39.6m of group losses which were available for offset against future profits.

Future tax relief of £171.0m (2017: £131.7m) is expected to be available for accrued interest that will be deductible for tax purposes on a paid basis. No deferred tax benefit has been recognised in respect of these interest deductions, as it is probable that they will not reverse in the foreseeable future and there is uncertainty over the availability of suitable taxable profits against which these may be offset.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2018

10 Taxation (continued)

The total amount of deferred tax asset un-provided is £30.0m (2017: £23.3m). At present it is not envisaged that the unwinding of the underlying temporary differences will give rise to a tax benefit in the foreseeable future.

There is no expiry date in relation to un-provided amounts.

Deferred tax liabilities have not been discounted.

In addition to the amount charged to the consolidated income statement, the following amounts relating to tax have been recognised in the consolidated statement of other comprehensive income:

	2018	2017
	£m	£m
Deferred tax		
Arising on income and expenses recognised in other comprehensive income:		
Tax credit on actuarial losses on defined benefit pension scheme	**1.7**	(12.8)
Deferred tax movement due to rate change	**-**	1.7
Total income tax recognised in other comprehensive income	**1.7**	(11.1)

11 Dividends

	2018	2017
	£m	£m
Amounts recognised as distributions to equity holders in the year:		
Current year interim dividend of £nil (2017: £0.0586) per share	**-**	54.0
Current year final dividend of £nil (2017: £0.0588) per share	**-**	54.2
	-	108.2

The 2017 final dividend of £54.2 million was paid in April 2017.

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2018

12 Goodwill

Group	£m
Carrying amount at 1 April 2017	85.1
Impairment at 31 March 2018	-
Net book value at 31 March 2018	**85.1**

Goodwill represents a single cash generating unit, being the excess of cash paid by Greensands for the fair value of assets acquired from Southern Water Capital, the then ultimate parent company of the Southern Water group of Companies, less amortisation charged up to the date of transition to IFRS from UKGAAP on 1 April 2014.

Goodwill is reviewed annually for impairment by comparing the underlying statement of financial position value of the Group, having adjusted for net debt, with the Regulatory Capital Value (RCV) of Southern Water Services. The excess of value over the RCV is then compared to recent transactions in the water industry to assess whether the book value of the Group is supportable.

Other indicators considered are, the financial performance, operating performance and future changes to the operating environment of our only operating company Southern Water Services.

To date no indicators of impairment have been identified.

13 Intangible assets

	Externally generated		
	Assets under construction £m	**Other £m**	**Total £m**
Cost			
At 1 April 2017	20.1	90.1	**110.2**
Additions	15.0	-	**15.0**
Transfers	(6.2)	6.2	**-**
Disposals	-	(1.6)	**(1.6)**
At 31 March 2018	28.9	94.7	**123.6**
Amortisation			
At 1 April 2017	-	49.1	**49.1**
Charge for the year	-	15.0	**15.0**
Disposals	-	(1.6)	**(1.6)**
At 31 March 2018	-	62.5	**62.5**
Net book amount			
At 31 March 2018	**28.9**	**32.2**	**61.1**
At 31 March 2017	20.1	41.0	61.1

The Group currently does not have any internally generated intangible assets.

Included within additions above is £0.3 million (2017: £1.3 million) of interest that has been capitalised on qualifying assets in accordance with IAS 23 ‘Borrowing costs’ offset by corrections to previous years additions of - £0.5 million. The cumulative net book value of the borrowing costs capitalised amount to £1.4 million (2017: £1.8 million). The Group has elected to apply IAS 23 from 1 April 2003, as permitted by the standard.

Other intangible assets include software, studies and research and development trials.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2018

14 Property, plant and equipment

The Group tangible assets are shown below. The company has no tangible assets.

	Land & buildings £m	Plant & machinery £m	Infra-structure assets £m	Assets under construction £m	Other £m	Total £m
Cost						
At 1 April 2017	1,572.9	3,102.4	2,597.9	313.8	628.8	**8,215.8**
Additions	-	-	-	425.2	-	**425.2**
Transfers	3.1	112.6	84.0	(239.7)	40.0	**-**
Disposals	(0.5)	(2.0)	(0.8)	-	(31.5)	**(34.8)**
At 31 March 2018	1,575.5	3,213.0	2,681.1	499.3	637.3	**8,606.2**
Depreciation						
At 1 April 2017	684.4	1,168.9	88.5	-	397.6	**2,339.4**
Charge for the year	41.3	123.2	31.2	-	56.2	**251.9**
Disposals	(0.5)	(2.0)	(0.8)	-	(31.5)	**(34.8)**
At 31 March 2018	725.2	1,290.1	118.9	-	422.3	**2,556.5**
Net book amount						
At 31 March 2018	**850.3**	**1,922.9**	**2,562.2**	**499.3**	**215.0**	**6,049.7**
At 31 March 2017	888.5	1,933.5	2,509.4	313.8	231.2	5,876.4

Freehold land is stated at a cost of £51.7 million at 31 March 2018 and 31 March 2017 and is not depreciated.

The Group's interest in land and buildings are almost entirely freehold.

Included within additions above is £16.7 million (2017: £7.3 million) of interest that has been capitalised on qualifying assets in accordance with IAS 23 'Borrowing Costs'. The cumulative net book value of the borrowing costs capitalised amount to £177.3 million (2017: £167.4 million). The Group has elected to apply IAS 23 from 1 April 2003, as permitted by the standard.

Assets held under finance leases

Included in the amounts shown above are the following amounts in relation to property, plant and equipment held under finance leases:

	2018 £m	2017 £m
Net book amount at 31 March	**4.5**	5.3

All assets held under finance leases relate to vehicles and are included in the asset class of 'Other' disclosed in the above table.

In accordance with IFRS 1 'First-time Adoption of International Financial Reporting Standards', the Group has elected to measure its infrastructure and operational assets at 1 April 2014, being the date of transition to IFRS, at their fair value and to use that fair value as their deemed cost at that date.

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2018

15 Other non-current assets

	Company 2018 £m	Company 2017 £m
Amounts owed by group undertakings	**1,016.6**	1,016.6

All amounts due from group undertakings are unsecured, interest free and repayable on demand.

16 Investments

	Group 2018 £m	Group 2017 £m
Other external investments		
At 1 April	**0.1**	0.1
Additions	**-**	-
Total investments as at 31 March	**0.1**	0.1

The investment above represents a non-controlling interest of 7.17% in a private limited company called, Landlord TAP Limited. The company owns a national web portal set up as part of a Water UK initiative to improve data on tenants and thereby increase collections with the aim of reducing customer bad debt.

	Company 2018 £m	Company 2017 £m
Greensands Europe Limited		
At 1 April and 31 March	**1.0**	1.0
Total subsidiary investments	**1.0**	1.0

A full list of subsidiaries is disclosed in note 33.

17 Inventories

	Group 2018 £m	Group 2017 £m
Raw materials	**2.5**	2.0
Work in progress	**0.4**	0.7
	2.9	2.7

The company does not hold any inventory.

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2018

18 Trade and other receivables

	Group 2018 £m	Group 2017 £m
Trade receivables	**273.6**	224.6
Provision for impairment	**(180.0)**	(123.3)
Net trade receivables	**93.6**	101.3
Accrued income	**74.2**	53.1
Prepayments	**20.2**	19.7
Other receivables	**21.3**	13.9
	209.3	188.0

Accrued income as at 31 March 2018 includes water and sewerage income not yet billed of £53.3 million (2017: £50.2 million).

The directors consider that the carrying values of trade and other receivables are reasonable approximations of their fair values.

	Company 2018 £m	Company 2017 £m
Greensands Investments Limited		
Other receivables	**-**	54.2
	-	54.2

Provision for impairment

Movements on the doubtful debts provision were as follows:

	Group 2018 £m	Group 2017 £m
At 1 April	**(123.3)**	(111.9)
Amounts reinstated (see note below)	**(34.6)**	
Charge for bad and doubtful debts	**(21.8)**	(25.3)
Charge for non-household bad debt	**(2.1)**	-
Amounts written off during the year	**1.8**	13.9
At 31 March	**(180.0)**	(123.3)

At each reporting date, the Group evaluates the recoverability of trade receivables and records allowances for doubtful receivables based on experience.

The Group does not include in revenue and trade debtors those accounts that are deemed irrecoverable. During 2017–18 the Group completed a project to review the collectability of its debts. This has resulted in a restatement of debtors and the bad debt provision, with no impact on the net position.

The following table provides information regarding the ageing of receivables that are specifically provided for:

	Group 2018 £m	Group 2017 £m
Current	**0.2**	0.7
1-2 years	**0.3**	2.4
2-3 years	**0.5**	11.8
3-4 years	**0.5**	14.1
more than 4 years	**0.7**	39.8
	2.2	68.8

A collective provision is recorded against assets which are past due but for which no specific provision has been made. This is calculated based on historical experience of levels of recovery.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2018

18 Trade and other receivables (continued)

The aged analysis of receivables that were overdue at the reporting date but not individually provided for is as follows:

	Group 2018 £m	Group 2017 £m
Current	**72.0**	59.7
1-2 years	**47.3**	32.1
2-3 years	**37.0**	13.7
3-4 years	**28.5**	8.6
more than 4 years	**58.4**	6.4
	243.2	120.5

The amounts above are reconciled to gross and net debtors in the tables below:

At 31 March 2018	**Gross £m**	**Provision £m**	**Group Net £m**
Not due	**28.2**	**-**	**28.2**
Overdue not specifically provided	**243.2**	**(177.8)**	**65.4**
Overdue and specifically provided	**2.2**	**(2.2)**	**-**
	273.6	**(180.0)**	**93.6**

At 31 March 2017	Gross £m	Provision £m	Group Net £m
Not due	35.3	-	35.3
Overdue not specifically provided	120.5	(54.5)	66.0
Overdue and specifically provided	68.8	(68.8)	-
	224.6	(123.3)	101.3

Credit risk

Trade receivables neither past due nor impaired relate to domestic and retail customers whose history of payments supports no impairment being made.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2018

19 Trade and other payables

	Group 2018 £m	Group 2017 £m
Trade payables	**21.0**	18.9
Capital creditors and capital accruals	**107.1**	96.8
Corporation tax	**0.1**	0.1
Other taxation and social security	**2.8**	3.0
Other payables	**-**	54.2
Other accruals and deferred revenue	**239.4**	127.7
	370.4	300.7

Amounts included in other payables in the previous year included the final dividend declared of £54.2 million which was paid in April 2017. The directors consider that the carrying values of trade and other payables are not materially different from their fair values.

	Company 2018 £m	Company 2017 £m
Other payables	**-**	54.2
Amounts owed to group undertakings	**32.0**	32.0
	32.0	86.2

The directors consider that the carrying values of trade and other payables are not materially different from their fair values.

20 Current borrowings

	Group 2018 £m	Group 2017 £m
Current		
Obligations under finance leases	**0.7**	0.5
Loans and other borrowings - Class A £300m – 6.135% fixed rate 2019	**299.6**	-
Premium deferred on issue	**0.7**	0.7
Deferred gilt lock proceeds (note 21 (ix))	**0.1**	0.1
Debt issue costs (note 21 (vii))	**(1.5)**	(1.9)
	299.6	(0.6)

Further descriptions about the above items are given in note 21 ‘Non-current borrowings’.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2018

21 Non- current borrowings

An analysis of the external loans is shown below:

Loans and other borrowings:	Notes	Group 2018 £m	Group 2017 £m
Class A £350m 6.192% fixed rate 2029	21(i),(ii),(iii)	**376.9**	378.7
Class A £150m 3.706% index linked 2034	21(iii),(iv)	**267.7**	259.2
Class A £35m 3.706% index linked 2034	21(iii),(iv)	**62.6**	60.4
Class A £350m 6.640% fixed rate 2026	21(i),(ii)	**373.0**	375.3
Class A £150m 3.816% index linked 2023	21(iii),(iv)	**241.9**	235.2
Class A £350m 5.000% fixed rate 2021	21(i),(ii)	**348.6**	348.2
Class A £150m 5.000% fixed rate 2041	21(i),(ii)	**145.8**	145.7
Class A £200m 4.500% fixed rate 2052	21(i),(ii)	**197.2**	197.1
Class A £300m 5.125% fixed rate 2056	21(i),(ii)	**292.7**	292.7
Class A £300m 6.125% fixed rate 2019	20,21(i),(ii)	**299.6**	299.2
Class A £175m 2.780% fixed rate 2031	21(ii)	**173.9**	173.9
Class A £75m 2.960% fixed rate 2036	21(ii)	**74.5**	74.5
Class A £60m – 0.000% index linked 2025	21(iv),(x)	**64.6**	62.1
Class A £40m - 0.000% index linked 2026	21(iv),(xi)	**42.5**	41.0
Artesian £165m 4.076% index linked 2033	21(iii),(iv)	**299.6**	290.5
Artesian £156.5m 3.635% index linked 2032	21(iv)	**233.9**	225.8
Total Class A debt		**3,495.0**	3,459.5
Class B £250m 4.500% fixed rate 2038	21(ii),(v)	**248.9**	248.3
£250m 8.500% Guaranteed Secured Fixed Rate Notes 2019	21(ii)	**249.4**	248.9
£125m Facility Agreement 2016 – Libor plus 3.250% 2022	21(vi)	**121.8**	122.0
£75m Facility Agreement 2016 – Libor plus 4.000% 2025	21(vi)	**73.1**	73.2
Eurobonds 12.000% 2038 (note 32)		**1,116.9**	997.6
Term Facility Agreement 2014 £150m - 6-month Libor plus 1.950% 2021		**-**	150.0
Term Facility Agreement 2017 £150m – 6-month Libor plus 1.550% 2022		**150.0**	-
Debt issue costs	21(vii)	**(176.6)**	(183.1)
Premium deferred on issue	21(viii)	**9.5**	10.2
Deferred gilt lock proceeds	21(ix)	**4.9**	4.9
Obligations under finance leases		**1.6**	1.5
Total borrowings		**5,294.5**	5,133.0
Current borrowings	20	**299.6**	(0.6)
Non-current borrowings		**4,994.9**	5,133.6

	Company 2018 £m	Company 2017 £m
Loans from group undertakings	**59.2**	59.2

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2018

21 Non-current borrowings (continued)

Class A and Class B loans are guaranteed and secured pursuant to a guarantee and security agreement (the Security Agreement). The agreement is over the entire property, assets, rights and undertaking of each of Southern Water Services Limited, Southern Water Services (Finance) Limited (SWSF), SWS Holdings Limited, and SWS Group Holdings Limited. In the case of Southern Water Services Limited, this is to the extent permitted by the Water Industry Act 1991 and the Licence to own and operate water assets.

Notes:

(i) The Group has entered into swap agreements that convert Class A fixed rate debt into either floating or index-linked debt in accordance with the Group's financial risk management policy.

(ii) Fixed rate bonds are recognised net of issue costs, discounts and inclusive of premiums (where applicable) on issue and are carried at amortised cost using the effective interest rate method.

(iii) The bond premiums referred to in note (ii) above also apply to various index-linked bonds. The premiums date back to 2003 when the related bonds were issued and arose when a number of the Group's swap instruments were effectively closed out and the resulting loss was rolled forward into the pricing of these bonds. The premiums are carried at amortised cost using the effective interest rate method.

(iv) The value of the capital and interest elements of the index-linked loans is linked to movements in the Retail Price Index. The increase in the capital value of index-linked loans during the year of £38.6 million (2017: £20.9 million) has been taken to the income statement as part of finance costs.

(v) The interest rate on the Class B £250 million is fixed at 4.50% until March 2022 when it reverts to Libor plus a margin to be determined.

(vi) The £200 million funds have been recognised net of associated issue costs amounting to £3.5 million combined. Both loans are being carried at amortised cost using the effective interest rate method.

(vii) Debt issue costs represent issue fees paid by SWSF and SWC that are not otherwise accounted for within the amortised cost of specific loans. Where these costs are attributable to a specific instrument they are being amortised over the life of that instrument. The remaining costs are being amortised over the weighted average life of the loans advanced at the time the costs were incurred. As at 31 March 2018 debt issue costs amounted to £176.6 million (2017: £183.2 million) of which £1.5 million (2017: £1.9 million) represents the short-term amount which is disclosed separately in note 20.

In addition to the above, swap break costs are included within this balance. These costs originated prior to securitisation when a swap was entered into, to act as a hedge for the future issue of bonds under securitisation. The swap was closed out and break costs were incurred when the bonds were issued in July 2003. The accounting treatment of these costs mirror the amortised cost value of opposing related bonds referred to in note (iii) above. These bonds are inclusive of premiums that compensate the swap break costs suffered.

(viii) The deferred bond premium represents the additional book value of the Class A Artesian £156.5 million loan issued in 2004. The premium is being amortised over the life of the bond.

(ix) Prior to the issue of the Class A £300 million bond in the year to 31 March 2008, SWSF entered into a gilt lock agreement, resulting in the receipt of £6.3 million, which was advanced to SWS along with the proceeds of the bond issue. The proceeds have been deferred and are being released to the income statement over the life of the loan.

(x) The Class A £60 million loan is index-linked with an interest rate of 0.00% until 2025.

(xi) The Class A £40 million loan is index-linked with an interest rate of 0.00% until 2026.

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2018

21 Non-current borrowings (continued)

Repayments fall due as follows:	**2018 £m**	2017 £m
Borrowings excluding finance leases:		
Between one and two years not by instalments	**248.6**	548.1
Between two and five years not by instalments	**1,096.8**	620.2
After five years not by instalments	**3,648.5**	3,964.3
	4,994.0	5,132.6
On demand or within one year not by instalments	**298.9**	(1.1)
	5,292.9	5,131.5
Finance leases:		
Between one and two years not by instalments	**0.1**	0.6
Between two and five years not by instalments	**0.8**	0.4
After five years not by instalments	**-**	-
	0.9	1.0
On demand or within one year not by instalments	**0.7**	0.5
	1.6	1.5
Borrowings including finance leases:		
Between one and two years not by instalments	**248.7**	548.7
Between two and five years not by instalments	**1,097.6**	620.6
After five years not by instalments	**3,648.5**	3,964.3
	4,994.9	5,133.6
On demand or within one year not by instalments	**299.6**	(0.6)
	5,294.5	5,133.0

It is the group's policy to lease its commercial vehicles under finance leases. Obligations under finance leases comprise optional residual value balloon payments due on vehicle leases at the end of the lease period, where the minimum lease payments (including finance charges) have been prepaid at the start of the lease. If the group opts not to pay the balloon payment, it must return the vehicle to the lessor.

The average lease term is five years.

For the year ended 31 March 2018, the average effective borrowing rate was 4.61% (2017: 5.31%). Interest rates are fixed at the contract date. All leases are on a fixed repayment basis and no arrangements have been entered into for contingent rental payments.

All lease obligations are denominated in sterling.

The fair value of the group's lease obligations is approximately equal to their carrying amount.

The group's obligations under finance leases are secured by the lessors' rights over the leased assets disclosed in note 14.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2018

22 Financial instruments

The following table provides a comparison by category of the carrying amounts of the Group's financial assets and financial liabilities at 31 March 2018 and 31 March 2017.

Financial assets and liabilities by category	Group 2018 £m	Company 2018 £m	Group 2017 £m	Company 2017 £m
Financial assets				
Derivative financial instruments designed as FVTPL*				
- Non-current	**4.2**	**-**	9.4	-
Held to maturity investments				
- Non-current	**0.1**	**1.0**	0.1	1.0
Trade and other receivables				
- Current (excluding prepayments)	**189.1**	**-**	168.3	-
Cash and cash equivalents				
- Current	**287.3**	**-**	302.3	-
Total financial asset	**480.7**	**1.0**	480.1	1.0
Financial liabilities				
Derivative financial instruments designed as FVTPL*				
- Non-current	**1,292.2**	**-**	1,347.4	-
Borrowings				
- Current	**299.6**	**-**	(0.6)	-
- Non-current	**4,994.9**	**59.2**	5,133.6	59.2
Trade and other payables				
- Current	**370.4**	**32.0**	297.6	86.2
Total financial liabilities	**6,957.1**	**91.2**	6,778.0	145.4

*Fair value through profit and loss.

The below table analyses derivative financial instruments held on the statement of financial position.

Derivative financial instruments	Group 2018 Assets £m	Group 2018 Liabilities £m	Group 2017 Assets £m	Group 2017 Liabilities £m
Derivative financial instruments not designated as hedges:				
Interest rate swaps	**4.2**	**(10.8)**	9.4	(15.0)
RPI swaps	**-**	**(1,281.4)**	-	(1,332.4)
Total derivative financial instruments	**4.2**	**(1,292.2)**	9.4	(1,347.4)
Derivative financial instruments can be analysed as follows:				
Current	**-**	**-**	-	-
Non-current	**4.2**	**(1,292.2)**	9.4	(1,347.4)
	4.2	**(1,292.2)**	9.4	(1,347.4)

The notional principal amount of the outstanding interest swap contracts at 31 March 2018 was £1,775.7 million (2017: £1,775.7 million).

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2018

22 Financial instruments (continued)

In accordance with IAS 39 the Group has reviewed all contracts for embedded derivatives that are required to be separately accounted for if they do not meet certain requirements set out in the standard. None were identified during the year or previous year.

i) Financial risk management objectives and policies

The principal financial risks to which the Group is exposed are interest rate, liquidity and RPI risks. The Board has approved policies for the management of these risks.

Interest rate risk

The Group's interest rate risk is primarily in relation to its fixed rate borrowings (fair value risk) and floating rate borrowings (cash flow risk). Interest rate derivatives are used to manage the overall interest rate profile within the Group policy, which is to maintain a higher proportion of net debt at fixed rates of interest having regard to the prevailing interest rate outlook.

The weighted average effective interest rates at the statement of financial position dates by class of debt were as follows:

	Group 2018 %	Group 2017 %
By class of debt (all classed as financial liabilities)		
Class A	**4.73**	4.68
Class B	**4.74**	4.74
Artesian	**1.96**	2.13
Greensands £250m bond	**8.75**	8.75
Greensands £125m facility	**3.96**	3.95
Greensands £75m facility	**4.51**	4.46

The weighted average interest costs at the statement of financial position dates were as follows:

	Group 2018 %	Group 2017 %
Fixed	**8.40**	8.23
Floating	**3.51**	3.52
Indexed	**3.40**	3.26

Liquidity risk

The Group raises funds, as required, to ensure that it has sufficient cash and/or facilities to fund the business of Southern Water Services Limited for the next twelve months.

Credit risk

Trade receivables neither past due nor impaired relate to domestic and retail customers whose history of payments supports no impairment being made.

RPI risk and sensitivity analysis

The principal market risks are interest rates and movements in RPI. Interest rates on the Group's loans are currently either fixed or fully effective swap instruments are in place to swap floating rates for fixed. RPI impacts indexation charged on index-linked loans and swaps. These instruments form an economic hedge with the Group's revenues and regulatory assets, which are also linked to RPI inflation.

The Group also notes that on-going Brexit negotiations will increase uncertainty around these risk areas in the short term.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2018

22 Financial instruments (continued)

Interest sensitivity analysis

The following table details the sensitivity of the group's profit before tax and equity to changes in interest rates. The sensitivity analysis has been based on the amount of net debt in place at the reporting date and, as such, is not indicative of the years then ended.

Increase/(decrease) in profit before tax and equity	Group 2018	Group 2017
1% increase in interest rate	**(49.4)**	(48.4)
1% decrease in interest rate	**49.4**	48.4

Inflation sensitivity analysis

The following table details the sensitivity of profit before tax to changes in the RPI on the group's index-linked borrowings. The sensitivity analysis has been based on the amount of index-linked debt held at the reporting date and, as such, is not indicative of the years then ended.

Increase/(decrease) in profit before tax and equity	Group 2018	Group 2017
1% increase in RPI	**(21.4)**	(20.6)
1% decrease in RPI	**21.4**	20.6

For further details about Group financing matters please refer to the 'Capital structure, liquidity and other financial matters' section of the Strategic Report contained within these financial statements on page 8.

ii) Maturity of financial liabilities and financial instruments

The maturity profile of the Group's financial liabilities at 31 March 2018 and 31 March 2017 is disclosed within note 21.

The table below analyses the Group's derivative financial instruments into relevant maturity profiles based on the remaining period at the reporting date.

	Within one year £m	Within two to five years £m	Within five to 25 years £m	After 25 years £m	Total £m
At 31 March 2018					
Derivative financial instruments – asset	**-**	**4.2**	**-**	**-**	**4.2**
Derivative financial instruments – liability	**-**	**(169.7)**	**(503.0)**	**(619.5)**	**(1,292.2)**
	-	**(165.5)**	**(503.0)**	**(619.5)**	**(1,288.0)**

	Within one year £m	Within two to five years £m	Within five to 25 years £m	After 25 years £m	Total £m
At 31 March 2017					
Derivative financial instruments – asset	-	9.4	-	-	9.4
Derivative financial instruments – liability	-	(178.7)	(516.1)	(652.6)	(1,347.4)
	-	(169.3)	(516.1)	(652.6)	(1,338.0)

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2018

22 Financial instruments (continued)

iii) Fair values of financial assets and financial liabilities

The following table provides a comparison by category of the carrying amounts and the fair values of the Group's financial assets and financial liabilities at 31 March 2018 and 2017.

	Group 2018 Book value £m	**Group 2018 Fair value £m**	Group 2017 Book value £m	Group 2017 Fair value £m
Cash and cash equivalents	**287.3**	**287.3**	302.3	302.3
Non-current asset investments	**0.1**	**0.1**	0.1	0.1
Non-current derivative financial instruments	**4.2**	**4.2**	9.4	9.4
	291.6	**291.6**	311.8	311.8
Current borrowings	**(299.6)**	**(319.4)**	0.6	0.6
Non-current borrowings	**(4,994.9)**	**(5,989.8)**	(5,133.6)	(6,166.7)
Non-current derivative financial instruments	**(10.8)**	**(10.8)**	(15.0)	(15.0)
Non-current RPI swaps	**(1,281.4)**	**(1,281.4)**	(1,332.4)	(1,332.4)
	(6,586.7)	**(7,601.4)**	(6,480.4)	(7,513.5)

Derivative activity is undertaken by subsidiaries in the Group, Greensands Senior Finance Limited, Southern Water (Greensands) Financing Plc and Southern Water Services (Finance) Limited (SWSF), as determined by the Board, which considers the overall risk profile of the Group and enters into derivatives to mitigate or hedge any risks identified, as appropriate. No derivatives are undertaken for trading purposes, or to benefit from price fluctuations.

No derivative activity is undertaken by the company.

The SWSF business consists of lending to other group companies and raising external finance.

All fair values are based on arm's length transactions in normal market conditions. Where available, market values have been used to determine fair values.

The fair value of the Group's long-term borrowings has been estimated based on quoted market prices for the same or similar debt where possible. Where prices did not exist, the fair value has been estimated based on the calculations of the present value of future cash flows using the appropriate discount rates in effect at the statement of financial position dates.

For interest rate swap agreements the fair value has been estimated based on market valuations at the statement of financial position dates.

The Group has no material un-hedged monetary assets and liabilities denominated in a currency different from the local currency of the particular operation.

Fair values of other non-current liabilities, current trade and other payables, provisions and current trade and other receivables have been estimated as not materially different from book value and have been excluded from the table above. The same can be said for non-current asset investments; however, this balance has been displayed in the table above.

In accordance with IFRS 13 'Fair Value Measurement', the financial instruments carried at fair value on the statement of financial position have been classified as level 2 for fair valuation purposes, being valued by reference to valuation techniques using observable inputs other than quoted prices in active markets for identical assets and liabilities. The future cash flows have been discounted at a rate that reflects credit risk.

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2018

23 Deferred tax liabilities

Deferred tax is provided as follows:

	Accelerated tax depreciation £m	Revaluation of financial instruments £m	Retirement benefit obligations £m	Losses and other timing differences £m	Total £m
At 1 April 2016	587.8	(165.4)	(19.8)	18.9	421.5
(Credit)/charge to income statement	(12.4)	(67.6)	0.1	(9.7)	(89.6)
Credit to other comprehensive income	-	-	(12.8)	-	(12.8)
Effect of change in tax rate					
–income statement	(32.0)	12.9	0.1	(0.9)	(19.9)
-other comprehensive income	-	-	1.7	-	1.7
At 1 April 2017	543.4	(220.1)	(30.7)	8.3	300.9
(Credit)/charge to income statement	(2.7)	19.5	(0.1)	(2.5)	14.2
Prior year adjustment					
(Credit)/charge to income statement	(6.4)	-	-	7.1	0.7
Charge to other comprehensive income	-	-	1.7	-	1.7
At 31 March 2018	**534.3**	**(200.6)**	**(29.1)**	**12.9**	**317.5**

Deferred tax assets and liabilities are offset where the Group has a legally enforceable right to do so. The following is the analysis of the deferred tax balances (after offset) for financial reporting purposes:

	2018 £	2017 £
Deferred tax liabilities	**534.2**	543.4
Deferred tax assets	**(216.7)**	(242.5)
	317.5	300.9

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2018

24 Retirement benefit obligations

The deficit associated with retirement benefit obligations has decreased to £171.7 million (2017: £176.9 million). This has primarily resulted from a lower value of year end liabilities due to a change in the future mortality improvements from the 2015 projections to the 2016 projections, a reduction in the RPI inflation assumption, partially offset by a decrease in the discount rate used to calculate the value of the scheme liabilities.

Pension schemes operated

The Group principally operates one defined benefit pension scheme (final salary) and one defined contribution scheme, details of which are shown below:

1. Southern Water Pension Scheme (SWPS), a funded defined benefit scheme, was closed to new members on 31 December 1998, re-opened in July 2003 and closed once more to new entrants on 1 April 2005. This scheme has nine trustee directors. The Southern Water Services Executive Pension Scheme (SWEPS) was also closed to new entrants and merged with the SWPS on 1 April 2005.

   The Trustees are responsible for administrating the Fund which is held separately from the company. Legal and General and Blackrock are unit registrars for Southern Water Pension Scheme unit holdings, and appoint custodians at individual pooled fund level (not client holding level). The directors of SWS are responsible for setting the accounting assumptions for the fund for inclusion in these financial statements.

   As part of the Group's interactions with both the Trustees and when required the Pensions Regulator, we look to agree a long-term funding and risk management strategy for the pension liability and this is viewed as a key risk as set out on page 32 above. We are currently in regular dialogue with the Trustees and also in ongoing discussions and correspondence with the Pension Regulator regarding the current deficit and the Board are keen to agree a reasonable resolution of a long-term funding solution for the scheme.

   The main risks of the scheme are as follows:

   a) Asset volatility
   For the purpose of setting the contribution requirements, the calculation uses a discount rate set with reference to government bond yields, with allowance for additional return to be generated from the investment portfolio – whereas under FRS 101, the defined benefit obligation is calculated using a discount rate set with reference to corporate bond yields.

   The schemes hold a significant proportion of their assets in growth assets. The returns on these assets may be volatile and are not correlated to the value placed on the liabilities. This means that the deficit may be volatile in the shorter term, which may result in an increase in the contribution requirements and an increase in the net defined benefit liability recorded on the statement of financial position.

   However, the Group believes that return-seeking assets offer an appropriate level of return over the long term for the level of risk that is taken. Furthermore, the scheme's other assets are well-diversified by investing in a range of asset classes, including liability-driven investments, government bonds and corporate bonds.

   b) Changes in bond yields
   A fall in bond yields increases the value placed on the liabilities for reporting purposes and for setting the Group's contribution requirements. However, in this scenario the scheme's investment in corporate and government bonds is expected to increase and therefore offset some of the increase in the value placed on the liabilities.

   c) Life expectancy
   The majority of the scheme's obligations are to provide benefits for the life of the member, so increases in life expectancy will result in an increase in the scheme's liabilities. This is particularly significant where the longer duration and inflation-linked nature of the payments result in higher sensitivity to changes in life expectancy. The scheme does not contain a hedge against increases in future life expectancy.

   d) Inflation risk
   The majority of the scheme's benefit obligations are linked to inflation and higher out-turn inflation will lead to a higher benefit obligation (although in most cases caps on the level of inflationary increases are in place to protect the plan against extreme inflation). The majority of the schemes' assets do not provide a direct hedge against changes in inflation as they are either fixed-interest in nature, e.g. corporate bonds and government bonds, or have an indirect link to inflation, e.g. equities.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2018

24 Retirement benefit obligations (continued)

2. A second company stakeholder scheme, which is a defined contribution scheme, is also available to all employees.

   Contributions made to the defined contribution scheme for the year ended 31 March 2018 amounted to £3.0 million (2017: £2.6 million). No contributions were outstanding at either year-end.

Members of all schemes receive an annual statement of their accrued benefits.

The latest actuarial valuation of the SWPS was carried out as at 31 March 2013 using the projected unit method. For closed schemes under this method the current service cost will increase as the members of the schemes approach retirement. The assumptions that have the most significant effect on the results of the valuation are those relating to the rate of return on investments, and the level of inflation, which drives pension increases in the SWPS.

The principal assumptions in the valuation were as follows:

	2013 **SWPS** % per annum (pa)
Return on investments: pre-retirement Return on investments: post-retirement (pensioner/non-pensioner)	FI Gilt curve + 65 bps
Salary growth	2.50%
Pension increases on the excess over guaranteed minimum pensions (where capped at 5% pa)	2.75%

The term ‘FI Gilt curve’ refers to the generally available fixed interest gilt yield curve agreed by the Trustees and the Group for the purposes of the 2013 actuarial valuation.

The assets of the scheme had a market value of £574.5 million at 31 March 2013. This was sufficient to cover 77% of the scheme’s benefits. The duration of the scheme liabilities is 21 years.

Expected employer and employee contributions to the defined benefit scheme for 2018-19 are £6.4 million (2017-18 £5.6 million) and £0.2 million (2017-18 £0.2 million) respectively under the current Schedule of Contributions.

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2018

24 Retirement benefit obligations (continued)

IAS 19 – assumptions, asset, liability and reserves disclosures

The formal actuarial funding valuation was carried out as at 31 March 2013 and updated to 31 March 2018 by a qualified independent actuary. The major assumptions used by the actuary are set out in the table below.

	2018	2017
	% pa	% pa
Price inflation (RPI)	**3.2**	3.3
Price inflation (CPI)	**2.2**	2.3
Rate of increase in salaries (plus an age-related promotional scale)	**2.4**	2.4
Rate of increase of pensions in payment (MIS* members only)***	**2.2**	2.3
Rate of increase of pensions in payment (Old section** members only)***	**3.2**	3.3
Rate of increase of pensions in payment (all other members)***	**3.1**	3.2
Rate of increase for deferred pensions (MIS* members only)***	**2.2**	2.3
Rate of increase for deferred pensions (all other members)***	**3.1**	3.2
Discount rate	**2.7**	2.8

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

** For this section the Trustee will endeavour to meet any indexation of excess pension above the 5% per annum cap on increases that apply to other sections of the Scheme.

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

Assumptions regarding future mortality experience are set based on advice, published statistics and experience. For 2017–18, the company has used the post-retirement mortality assumptions based on the standard SAPS mortality tables together with future improvements in line with CMI 2016 improvements with a long-term improvement rate of 1.25% per annum.

	2018	2017
	Years	Years
Longevity at age 65 for current pensioners		
Male	**22.4**	22.7
Female	**24.1**	24.8
Longevity at age 65 for future pensioners		
Male	**23.7**	24.4
Female	**25.5**	26.7

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2018

24 Retirement benefit obligations (continued)

The assets and liabilities in the schemes and the expected rates of return at 31 March 2018 and 31 March 2017 were:

	Value at 2018 £m	Value at 2017 £m
Equities	**207.9**	186.1
Government bonds	**176.8**	190.3
Non-government bonds	**339.4**	355.5
Cash	**12.6**	11.0
Total market value of plan assets	**736.7**	742.9
Total value of plan liabilities	**(908.4)**	(919.8)
Accrued deficit in the plan	**(171.7)**	(176.9)
Related deferred tax asset	**29.2**	30.7
Net retirement benefit obligations	**(142.5)**	(146.2)

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

Reconciliation of the present value of the scheme liabilities	**2018 £m**	2017 £m
At 1 April	**919.8**	776.4
Current service cost	**6.7**	5.1
Interest expense	**25.3**	27.5
Member contributions	**0.2**	0.2
Experience gain on liabilities	**5.3**	(12.0)
Actuarial (gain)/loss on liabilities:		
- due to changes in demographic assumptions	**2.7**	(11.0)
- due to changes in financial assumptions	**(13.9)**	165.6
Benefits paid	**(37.7)**	(32.0)
Scheme liabilities at 31 March	**908.4**	919.8

Sensitivity analysis of the scheme liabilities

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

	Change in assumption	**Impact on scheme liabilities (%)**	**Impact on scheme liabilities (£m)**
Discount rate	+/- 1%	-/+ 18	-/+ 164
Rate of inflation*	+/- 1%	+/- 15	+/- 135
Rate of increase in pensions in payment	+/- 1%	+/- 12	+/- 113
Mortality	+/- 1yr	+/- 4	+/- 37

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

The above sensitivity analysis is based on a change in an assumption while holding all other assumptions constant. In practice, this is unlikely to occur, and changes in some of the assumptions may be correlated. The methods and types of assumptions used in preparing the sensitivity analysis did not change compared to the previous period.

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2018

24 Retirement benefit obligations (continued)

Reconciliation of the value of the scheme assets	**2018 £m**	2017 £m
At 1 April	**742.9**	674.1
Interest income	**20.4**	23.8
Gain on assets above interest	**3.9**	71.2
Employer contributions	**7.0**	5.6
Member contributions	**0.2**	0.2
Benefits paid	**(37.7)**	(32.0)
Administrative expenses	**-**	-
Bid value of scheme assets at 31 March	**736.7**	742.9

The total return on scheme assets was £24.3 million (2017: return of £95.0 million).

Total cost recognised as an expense	**2018 £m**	2017 £m
Current service cost	**6.7**	5.1
Net interest cost	**4.9**	3.7
Administration expenses	**-**	-
Total income statement expense before deduction for tax	**11.6**	8.8

Analysis of the amounts recognised in other comprehensive income	**2018 £m**	2017 £m
Actual return less expected return on pension scheme assets	**3.9**	71.2
Experience (loss)/gain arising on scheme liabilities	**(5.3)**	12.0
(Loss)/gain due to changes in demographic assumptions	**(2.7)**	11.0
Gain/(loss) due to changes in financial assumptions	**13.9**	(165.6)
Total gain/(loss) recognised in OCI before adjustment for tax	**9.8**	(71.4)

The cumulative amount of actuarial losses recognised in other comprehensive income is £255.1 million (2017: £264.9 million).

Analysis of the movement in the scheme's deficit during the year	**2018 £m**	2017 £m
Deficit in the scheme at 1 April	**(176.9)**	(102.3)
Employer's contributions	**7.0**	5.6
Employer's current service cost	**(6.7)**	(5.1)
Financing charge	**(4.9)**	(3.7)
Administration expenses	**-**	-
Actuarial gain/(loss)	**9.8**	(71.4)
Deficit in the scheme at end of year	**(171.7)**	(176.9)

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2018

25 Provisions for liabilities

	Group 2018 £m	Group 2017 £m
Environmental obligations		
Provision as at 1 April	**0.5**	0.5
Utilised in year	**-**	-
Increase in year	**2.9**	-
Provision at 31 March	**3.4**	0.5

The environmental provision relates to costs for the decommissioning of abandoned sites and environmental commitments made for ecology work following the South Hampshire abstraction inquiry. No reimbursement is expected. The period over which the provision will be utilised cannot be determined thus the provision is not discounted. Discounting the provision would not materially affect its value.

26 Other non-current liabilities

	Deferred revenue £m	Grants & contributions £m	Group Total £m
At 1 April 2017	14.2	48.0	62.2
Receivable in year	-	30.0	30.0
Released to income statement	(0.4)	(2.3)	(2.7)
At 31 March 2018	**13.8**	**75.7**	**89.5**

These grants and contributions relate to property, plant and equipment.

Deferred revenue of £13.8 million (2017: £14.2 million) relates to the proceeds from the sale of income rights relating to aerial masts and sites owned by the Group. The income will be credited to the income statement evenly over the life of the lease.

27 Called up share capital

	Group and Company 2018 £m	Group and Company 2017 £m
Authorised, allotted, called up and fully paid		
921,874,025 Ordinary shares of £1 each	**921.9**	921.9

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

28 Other reserves

	Group 2018 £m	Group 2017 £m
Share premium account	**4.5**	4.5
Retained earnings	**(1,765.9)**	(1,722.9)
	(1,761.4)	(1,718.4)

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2018

28 Other reserves (continued)

	Company 2018 £m	Company 2017 £m
Share premium account	**4.5**	4.5
Retained earnings	**-**	-
	4.5	4.5

29 Notes to the cash flow statement

Cash generated by operations	**2018 £m**	2017 £m
Continuing operations		
Operating profit	**227.6**	250.1
Adjustments for:		
Depreciation of property, plant and equipment	**251.9**	237.7
Amortisation of intangible assets	**15.0**	14.9
Difference between pension charge and cash contributions	**(0.3)**	(0.4)
Amortisation of grants and contributions	**(2.3)**	(1.2)
Operating cash flows before movements in working capital	**491.9**	501.1
Increase in inventories	**(0.2)**	(0.4)
(Increase)/decrease in receivables	**(22.2)**	3.3
(Decrease)/increase in payables	**(5.4)**	20.1
Increase in environmental provisions	**2.9**	-
Cash from operating activities	**467.0**	524.1
Tax paid	**(0.1)**	(0.1)
Net cash generated from operating activities	**466.9**	524.0

Cash and cash equivalents	**2018 £m**	2017 £m
Cash and bank balances	**287.3**	302.3

Cash and cash equivalents comprise cash and short-term bank deposits with an original maturity of three months or less, net of outstanding bank overdrafts. The carrying amount of these assets is equal to their fair value.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2018

29 Notes to the cash flow statement (continued)

The table below details changes in liabilities arising from financing activities, including both cash and non-cash changes. Liabilities arising from financing activities are those for which cash flows were, or future cash flows will be, classified in the cash flow statement as cash flows from financing activities.

Analysis of net debt (including changes in liabilities from financing activities)	**At 1 April 2017 £m**	**Cash flow £m**	**Fair value adjust-ments £m**	**New finance leases £m**	**Other non-cash changes £m**	**At 31 March 2018 £m**
Cash and cash equivalents	302.3	(15.0)	-	-	-	**287.3**
Liabilities from financing activities:						
Term facilities/index linked loans (note 21)	(5,131.5)	-	(41.2)	-	(120.2)	**(5,292.9)**
Finance lease liabilities (note 21)	(1.5)	0.4	-	(0.5)	-	**(1.6)**
Interest rate swaps (note 22)	(1,338.0)	3.7	46.3	-	-	**(1,288.0)**
Total liabilities from financing activities	(6,471.0)	4.1	5.1	(0.5)	(120.2)	**(6,582.5)**
Net debt	(6,168.7)	(10.9)	5.1	(0.5)	(120.2)	**(6,295.2)**

Other non-cash changes of £120.2 million relate to Eurobond interest, amortisation of loan issue costs, gilt lock proceeds and deferred proceeds. Bank loan fair value movements include indexation and effective interest. These movements are partially offset by a fair value gain on derivative financial instruments.

Balances at 31 March 2018 comprise:	**Current assets £m**	**Current liabilities £m**	**Non-current liabilities £m**	**Total £m**
Cash and cash equivalents	287.3	-	-	**287.3**
Derivative financial instruments	4.2	-	(1,292.2)	**(1,288.0)**
Debt issue costs	-	1.5	175.1	**176.6**
Gilt lock proceeds	-	(0.1)	(4.8)	**(4.9)**
Borrowings due within one year	-	(300.3)	-	**(300.3)**
Borrowings due after one year	-	-	(5,164.3)	**(5,164.3)**
Finance leases	-	(0.7)	(0.9)	**(1.6)**
Net debt	291.5	(299.6)	(6,287.1)	**(6,295.2)**

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2018

30 Contingent liabilities

Southern Water faces investigations from the Environment Agency regarding the performance of certain wastewater sites and an investigation by Ofwat into the performance of its wastewater treatment sites and the reporting of relevant compliance information. The company is working proactively with the Environment Agency and Ofwat to resolve their investigations which are still evolving. At this time, no clarity of the findings of these investigations or further action and associated financial impact, if any, can be quantified.

The company has also revisited the reporting of the Wastewater Treatment Works number of failed works and population equivalent performance measures provided in previous years. The company is currently revisiting the 2015 data and it appears that Ofwat Outcome Delivery Incentive penalties may have been applicable in respect of the 2015 calendar year. The additional technical assurance that Southern Water has carried out on wastewater treatment performance data is now being rolled out for the years 2014 to 2011.

It is likely that Southern Water will be required to make future revenue adjustments and/or pay penalties and fines in relation to any restated figures. The Ofwat investigation could result in Ofwat taking enforcement action which may include the imposition of a financial penalty, which could be material in nature as Ofwat can impose a financial penalty of up to 10% of turnover for each breach. Any penalty or fine will be dependent on a consideration of the severity of the findings of the investigations. These will be subject to on-going discussion and agreement reflecting, amongst other matters, the mitigating actions being taken by the company to respond to these matters after review. As a result, it is not possible to recognise an accounting provision at this time.

Southern Water's new Compliance and Asset Resilience directorate is leading improvements in data integrity and the planning, scheduling, monitoring and performance reporting to the Environment Agency and Ofwat. Further information on this programme can be found in our Final Assurance Plan 2018, which is available on our website **southernwater.co.uk/our-reports**.

Other contingent liabilities

Companies of the size and scale of Southern Water Services Limited are sometimes subject to a number of claims disputes and potential litigation. The significant ones currently include on-going investigations by regulatory bodies (the EA, DWI and Ofwat) as well as a potential claim in respect of property search income. The directors consider that, where it is possible to be estimated reasonably an appropriate position has been taken in reflecting such items in these financial statements.

It is not currently possible to estimate the financial effect and likely timing of any associated outflow of some of these given the early stage of the investigations and claims and the potential range of outcomes.

Following the South Hampshire abstraction inquiry Southern Water Services Limited has committed to undertake certain environmental work should a drought order be required on the rivers Itchen, Test or Candover Stream between 2018 and 2030. Details of the agreement are still being finalised, as a result it is not possible to provide an estimate of the potential financial effect of the agreement.

Contractors submit claims to Southern Water Services Limited for the estimated final cost of their works. These claims are reviewed to assess where the liability for the costs rests and the amount that will actually be settled. The expected amount is included within capital creditors and a further sum is identified as a contingent liability, representing a proportion of the difference between the contractor's claim and Southern Water Service Limited's valuation.

Neither the company nor the Group had any contingent liabilities for capital claims at the year-end (2017: £nil).

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2018

31 Financial commitments

(a) Capital commitments are as follows:

	2018 £m	2017 £m
Contracted for but not provided for in respect of contracts placed in respect of property, plant and equipment	**516.5**	354.8
Contracted for but not provided for in respect of contracts placed in respect of intangible assets	**9.7**	9.7

(b) The group as lessee

	2018 £m	2017 £m
Lease payments under operating leases recognised as an expense in the year	**4.5**	3.9

As at 31 March 2018 and 2017, the group had outstanding commitments for future minimum lease payments under non-cancellable operating leases in respect of vehicles and land and buildings for which the payments fall due as follows:

	Land and buildings		Other	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Within one year	**1.7**	1.7	**0.1**	0.2
In the second to fifth years inclusive	**7.0**	6.2	**-**	0.3
After five years	**13.2**	13.0	**-**	0.1
	21.9	20.9	**0.1**	0.6

Operating leases are charged to the income statement over the lease term.

Operating lease payments represent rentals payable by the group for certain of its office properties and group vehicles.

Commercial vehicle leases are negotiated for an average term of five years, and rentals are fixed for an average of five years, with an option to extend on an ad hoc basis at the then prevailing market rate.

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2018

32 Related party transactions

Balances and transactions between the company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note. Transactions between the Group and its associates are disclosed below.

Greensands Holdings Limited is owned and controlled by a consortium of investors. At 31 March 2018, the largest shareholder in Greensands Holdings Limited is an institutional investment company advised by JP Morgan Asset Management.

The transactions and balances with the Group's related parties (i.e. the shareholders) are summarised below.

	2018 £m	2017 £m
Eurobond interest		
IIF Int'l SW UK Investment Ltd	**37.3**	33.4
Phildrew Nominees Ltd	**24.3**	21.8
National Nominees Ltd	**9.2**	8.3
Sky Brace Investments Ltd	**5.7**	5.1
Sumaya Investments Ltd	**5.7**	5.1
Falkirk Council - Falkirk Council Pension Fund	**0.5**	0.4
The City of Edinburgh Council – Lothian Pension Fund and Lothian Buses Pension Fund	**1.4**	1.2
Hermes Infrastructure Fund LP	**25.0**	22.4
SW Holdings LP	**2.3**	2.1
Simcoe Yeoman Water Ltd	**7.9**	7.1
Total Eurobond interest payable to related parties	**119.3**	106.9
Loans and other borrowings greater than one year:		
Eurobonds – Shareholder loans		
IIF Int'l SW UK Investment Ltd	**112.4**	112.4
Phildrew Nominees Ltd (UBS IIF)	**20.1**	20.1
Phildrew Nominees Ltd (UBS IINF)	**2.8**	2.8
Phildrew Nominees Ltd (UBS II4F)	**22.2**	22.2
Phildrew Nominees Ltd (UBS IIUSTEF)	**11.1**	11.1
Phildrew Nominees Ltd (UBS IIF (A) LP)	**5.2**	5.2
Phildrew Nominees Ltd (UBS IIF (B) LP)	**6.9**	6.9
Phildrew Nominees Ltd (UBS IIF (C) LP)	**5.0**	5.0
National Nominees Ltd - Motor Trades Association of Australia Super Fund	**21.4**	21.4
National Nominees Ltd – Prime Super	**6.5**	6.5
The Northern Trust Company (as custodian for Future Fund Investment Company No.2 Pty Ltd)	**-**	-
Sky Brace Investments Ltd	**17.1**	17.1
Sumaya Investments Ltd	**17.1**	17.1
Falkirk Council - Falkirk Council Pension Fund	**1.4**	1.4
The City of Edinburgh Council – Lothian Pension Fund and Lothian Buses Pension Fund	**4.1**	4.1
Hermes Infrastructure Fund LP	**14.0**	14.0
Hermes Infrastructure Fund Spring I LP	**7.8**	7.8
Hermes Infrastructure Fund Spring II LP	**46.0**	46.0
Hermes Infrastructure Fund Spring III LP	**7.8**	7.8
SW Holdings LP	**7.0**	7.0
Simcoe Yeoman Water Ltd	**23.9**	23.9
Accrued interest	**757.1**	637.8
Total Eurobonds – Shareholder loans	**1,116.9**	997.6

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2018

33 Subsidiaries

As at 31 March 2018 the company held 100% of the ordinary share capital of Greensands Europe Limited. Greensands Europe Limited's principal subsidiaries are listed below and are included within these consolidated financial statements.

Company	Registered address	Activity
Greensands UK Limited	Southern House, Yeoman Road, Worthing	Non-trading activities
Southern Water (Greensands) Financing plc	Southern House, Yeoman Road, Worthing	To raise debt finance
Greensands Junior Finance Limited	Southern House, Yeoman Road, Worthing	To raise debt finance
Greensands Senior Finance Limited	Southern House, Yeoman Road, Worthing	To raise debt finance
Greensands Investments Limited	Southern House, Yeoman Road, Worthing	Non-trading activities
Southern Water Capital Limited	Southern House, Yeoman Road, Worthing	Non-trading activities
Southern Water Investments Limited	Southern House, Yeoman Road, Worthing	Non-trading activities
Southern Water (NR) Holdings Limited	Southern House, Yeoman Road, Worthing	Non-trading activities
Southern Water (NR) Limited	1 Exchange Crescent, Conference Square, Edinburgh	Non-trading activities
SWS Group Holdings Limited	Southern House, Yeoman Road, Worthing	Non-trading activities
SWS Holdings Limited	Southern House, Yeoman Road, Worthing	Non-trading activities
Southern Water Limited	Southern House, Yeoman Road, Worthing	Intermediate parent company for Southern Water(NR) Group
Southern Water Services Limited	Southern House, Yeoman Road, Worthing	Supply of Water and Wastewater Services
Southern Water Services Finance Limited*	Ugland House, PO Box 309, George Town, Grand Cayman	To raise debt finance
Southern Water Services Group Limited	Southern House, Yeoman Road, Worthing	Non-trading activities
Southern Water Industries Limited	Southern House, Yeoman Road, Worthing	Dormant
Bowsprit Holdings Limited	Southern House, Yeoman Road, Worthing	Dormant
Monk Rawling Limited	Southern House, Yeoman Road, Worthing	Dormant
Bowsprit Property Development Limited	Southern House, Yeoman Road, Worthing	Property development
EcoClear Limited	Southern House, Yeoman Road, Worthing	Dormant
Southern Water Executive Pension Scheme Trustees Limited	Southern House, Yeoman Road, Worthing	Dormant
Southern Water Pension Trustees Limited	Southern House, Yeoman Road, Worthing	Dormant
Southern Water Retail Services Limited	Southern House, Yeoman Road, Worthing	Dormant

*The country of incorporation for this company is the Cayman Island.

All of the above subsidiary companies are wholly-owned by ordinary shares and incorporated within the United Kingdom unless stated otherwise.

Independent auditor's report to the members of Greensands Holdings Limited

Report on the audit of the financial statements

Opinion
In our opinion:

- the financial statements of Greensands Holdings Limited (the ‘parent company’) and its subsidiaries (the ‘group’) give a true and fair view of the state of the group’s and of the parent company’s affairs as at 31 March 2018 and of the group’s loss for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union; and
- have been properly prepared in accordance the Companies (Jersey) Law 1991.

We have audited the financial statements of Greensands Holdings Limited (the ‘parent company’) and its subsidiaries (the ‘Group’) which comprise:

- the consolidated income statement
- the consolidated statement of other comprehensive income;
- the consolidated and parent company statement of financial position;
- the consolidated and parent company statement of changes in equity;
- the consolidated cash flow statement; and
- the related notes 1 to 33.

The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the European Union.

Basis for opinion
We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs(UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the group and Greensands Holdings Limited in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC’s Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of matter – contingent liability in respect of regulatory investigations
We draw attention to note 30 in the financial statements concerning the uncertain outcome of certain regulatory investigations regarding the performance of certain wastewater plants. Southern Water faces investigations from the Environment Agency regarding the performance of certain wastewater sites and an investigation by Ofwat into the performance of wastewater treatment sites and the reporting of relevant compliance information. At this time, no clarity of the findings of these investigations or further action and associated financial impact, if any, can be quantified. As the ultimate outcome of the matter cannot presently be determined no provision for any liability that may result has been made in the financial statements. Our opinion is not modified in respect of this matter.

Conclusions relating to going concern
We are required by ISAs (UK) to report in respect of the following matters where:

- the directors’ use of the going concern basis of accounting in preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the group’s or the parent company’s ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

We have nothing to report in respect of these matters

Other information
The directors are responsible for the other information. The other information comprises the information included in the annual report, other than the financial statements and our auditor’s report thereon. Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

Independent auditor's report to the members of Greensands Holdings Limited (continued)

We have nothing to report in respect of these matters.

Responsibilities of directors
As explained more fully in the statement of directors' responsibilities, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the group's and Greensands Holdings Limited's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the group or Greensands Holdings Limited or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements
Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

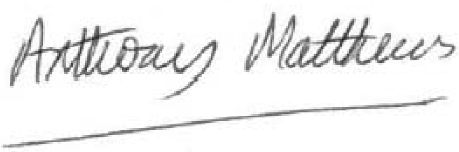
Report on other legal and regulatory requirements

Matters on which we are required to report by exception
Under the Companies (Jersey) Law 1991 we are required to report in respect of the following matters if, in our opinion:

- proper accounting records have not been kept by the parent company, or proper 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
- we have not received all the information and explanations we require for our audit.

We have nothing to report in respect of these matters.

Use of our report
This report is made solely to the company's members, as a body, in accordance with Article 113A of the Companies (Jersey) Law 1991. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.



Anthony Matthews FCA
for and on behalf of Deloitte LLP
London, United Kingdom
31 July 2018