Greensands Holdings Limited Annual Report and Financial statements for the year ended 31 March 20

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 37, 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 2020, 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 is described in section 2 from page 18.

Group financial performance

Accounting policies

The accounting policies of the Group, including any changes in accounting policies in the year, are set out on pages 53 to 72 and include details of the impact of a new standard, IFRS 16 'Leases' which became effective for the group from 1 April 2019.

Income statement

The group's income statement is summarised in Table 1 below.

Table 1	Years ended 31 March	
	2020	2019
	£m	£m
Revenue before regulatory settlement	**878.0**	876.3
Other operating income	**1.4**	1.2
Operating costs before regulatory settlement	**(376.9)**	(340.5)
Trade receivables impairment charge	**(29.6)**	(10.7)
Depreciation, net of amortisation	**(271.3)**	(279.3)
Operating profit before regulatory settlement	**201.6**	247.0
Regulatory settlement	**-**	(138.5)
Operating profit after regulatory settlement	**201.6**	108.5
Other income	**-**	0.2
Profit on disposal of fixed assets	**0.9**	0.7
Profit before interest and tax	**202.5**	109.4
Net finance costs	**(342.0)**	(374.0)
Fair value gains/(losses) on derivative financial instruments	**349.4**	(217.4)
Profit/(Loss) before tax	**209.9**	(482.0)
Tax (charge)/credit	**(106.5)**	31.7
Profit/(Loss) for the financial year	**103.4**	(450.3)

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

Revenue before the regulatory settlement increased to £878.0 million (2019: £876.3 million). This increase largely results from changes to Southern Water's inflation-linked water and wastewater tariffs. The increase in revenue resulting from the annual change to tariffs was substantially offset by a reduction in consumption, resulting in a small increase to revenues overall. The impact of COVID-19 included within revenues has been estimated as a net reduction in consumption of £0.7 million for the year following the application of the lockdown by the Government in March 2020. An analysis of revenue is provided in note 5 to the financial statements.

2019–20 has been a challenging year for Southern Water which has been preparing for the delivery of its plan for the next regulatory period 2020–25, while addressing historic performance and managing an increased number of operational issues that arose during the year. As a result, operating costs of the group, before the charge for bad and doubtful debts and the regulatory settlement, increased by £36.4 million to £376.9 million (2019: £340.5 million).

The major movements in operating costs are described below and presented in Table 2.

In order to prepare for the challenge of the next five-year period, improve its services and, ultimately, reduce its costs, Southern Water has undertaken a number of restructuring activities during the year. These have included transferring the majority of its customer services activities to Capita, closing the final salary pension scheme and reshaping a number of teams across the business. As a result, it has incurred a number of one-off restructuring costs, totalling £7.7 million.

Table 2 Year-on-year increase/(decrease) in operating costs	£m
Inflation	11.6
Restructuring	7.7
Sewer repairs	4.8
Wastewater compliance	4.6
Wastewater weather related	4.5
Increase in leakage activity	3.2
Provisions	4.0
Environmental provision	(3.3)
Debt collection costs	(1.6)
IFRS 16 operating leases	(2.0)
Pensions	(0.8)
Other	3.7
Movement in operating costs	**36.4**

Southern Water's wastewater operational teams have responded to a number of challenges during the year including:

- A number of significant sewer bursts on its network which resulted in £4.8 million of additional costs, principally tankering and repairs to minimise disruption to its service
- Interventions at a number of sites to mitigate compliance risk, totalling £4.6 million, including the repair of equipment at treatment works, the hire of additional back-up equipment and the provision of additional tankering to reduce the risk of spills to the environment
- Additional tankering and wastewater treatment costs of £4.5 million to deal with high groundwater levels following the storms and wet weather experienced this winter.

On the water supply and distribution network, Southern Water has continued additional activity to reduce leakage. Southern Water started this last year by increasing the size of its teams and collaborating with its partners, following the impact of the Freeze/Thaw on its network. This high temperature variance had negative impacts on its physical plant and resulted in additional costs of £3.2 million in its activity to find and fix leaks during the year.

As reported in Southern Water's Annual Performance Report last year, it has been improving the processes for making and recording customer appointments for some functions that undertake tasks at customers' premises. During the course of making these improvements, Southern Water identified that a number of historic guaranteed standards of service (GSS) payments for missed appointments may have been due and, therefore, it has made a provision of £3.0 million this year for these historic payments.

In addition, as disclosed on page 22, Southern Water has recognised a provision of £1.0 million in relation to the charges presented by the Environment Agency to the court regarding historic wastewater performance. This provision represents a minimum amount as indicated by the Sentencing Guidelines and an allowance for legal costs. The court has a very broad discretion to assess the level of the fine and the provision is not intended to indicate or predict any particular level. The Southern Water Board will continue to review the level of provision made as more information becomes available.

Over the past two years, Southern Water has made environmental provisions for work to improve the environmental resilience of the Rivers Test and Itchen in Hampshire for periods of severe drought to help protect the rivers' ecology. No significant additions to this provision were required during the year, resulting in a reduction in operating costs of £3.3 million. Other, changes to operating costs in the year arose from:

- debt management, which fell due to lower litigation costs of £1.6 million
- the removal of operating lease costs, amounting to £2.0 million, from the income statement following the implementation of IFRS 16 'Leases' effective from 1 April 2019
- the net change to pension costs from increasing employer stakeholder pension contributions of £1.0 million, which were offset by the one-off cost incurred in the prior year for Guaranteed Minimum Pension Equalisation costs of

£1.8 million.

As a result of the impact of the COVID-19 pandemic on Southern Water's view of the future collectability of debt outstanding at 31 March 2020, it has recorded a significant additional bad debt charge during the year. Overall, its charge for bad and doubtful debts increased by £18.9 million to £29.6 million (2019: £10.7 million). Of this increase, £16.0 million represents its estimate of the impact of COVID-19 on the collectability of these debts.

Meanwhile, depreciation and amortisation decreased to £271.3 million (2019: £279.3 million) as a result of a number of large, but short-life, assets becoming fully depreciated over the past two years.

As a result of the factors set out above, operating profit (before regulatory settlement made in 2018–19) decreased to £201.6 million (2019: £247.0 million) – an 18% reduction, one third of which relates to the COVID-19 bad debt charge.

As reported in the Annual Report last year and disclosed on page 22, following its investigation into Southern Water's historical wastewater treatment works compliance reporting, Ofwat confirmed its intention to impose a penalty under Section 22A of the Water Industry Act. This penalty comprises a fine of £3.0 million together with a reduction to future revenues of £122.9 million at 2017–18 prices, which will be made by way of a rebate to wastewater customers over the period 2020–25. Southern Water provided for these in full in the financial statements for 2018–19, resulting in a reduction to operating profit of £138.5 million (at forecast outturn prices) for that year.

The profit on disposal of fixed assets of £0.9 million (2019: £0.7 million) mainly relates to minor property and vehicle disposals and the release of deferred revenue from the historical sale of income rights relating to aerial masts.

Net finance costs (excluding fair value gains or losses on derivative financial instruments) decreased by £32.0 million to £342.0 million (2019: £374.0 million). This reduction is driven by the refinancing activities undertaken at the end of the prior year which have resulted in a reduction in net interest payable of £35.0 million offset by an increase in Eurobond interest in Greensands Europe of £16.5 million. In addition, there was lower indexation on our index linked debt of £5.4 million and an increase in the amount of interest capitalised of £9.8 million.

The fair value gain on the Group's derivative financial instruments amounted to £349.4 million (2019: loss £217.4 million). There have been some changes to derivatives in the year, described on page 11, but the primary driver for changes in the valuation is the fluctuation in UK Government bond yields which are used to discount the future cash flows. As Government gilt yields are constantly moving the valuation of our derivative instruments can be volatile. These changes do not represent cash flows.

The Group has recognised a total tax charge to the income statement of £106.5 million (2019: £31.7 million tax credit). This differs from the charge that may be expected of £39.9 million, based on the profit before tax of £209.9 million and the current period tax rate of 19%, as described in note 11. The difference is primarily due to not having reduced the Group's taxable profits for the treatment of Eurobond interest for which Greensands Europe Limited have not claimed a tax deduction. Also the announcement made in the Governments Budget Statement in March 2020 that the rate of Corporation Tax would not be reducing to 17% as announced and would remain at 19%. As a result a charge of £45.3 million has been recognised in the income statement for the impact of this change on the Group's deferred tax balance.

The profit after taxation for the year amounted to £103.4 million (2019: £450.3 million loss).

Cash flow statement – summary

Overall, cash and cash equivalents decreased in 2019–20 by £232.3 million (2019 £227.5 million increase). This general year-on-year movement of £459.8 million principally results from the refinancing activities that the Group undertook during the prior year, described on page 11. Further details of the significant year-on-year movements are provided in Table 3 below.

	Years ended 31 March			
Table 3	**2020 £m**	**2019 £m**	**Movement**	**Explanation**
Net interest	**(293.8)**	(220.9)	(72.9)	The increase in net interest payable was largely the result of the timing of annual bond interest payments and the refinancing exercise. The annual bond interest payments are made on the 31 March or nearest working day after that date. Payments made in 2019-20 relating to the prior year amounted to £107.2 million. In FY19 Southern Water incurred additional costs of £27.9 million relating to early repayment of our Class B loan together with the payment of interest accrued on the loan of £10.0 million. Additionally in the prior year the Group incurred one-off charges relating to the refinancing exercise and the closing of the Caymans subsidiary of £8.4 million.
Net movement on borrowings	**(82.3)**	478.0	(560.3)	During the year loan and credit facility repayments were made totalling £644.3 million (2019: £404.1 million); these were offset by new loans and an increase in credit facilities of £562.0 million (2019 £882.1 million).
Payments on restructure of derivative instruments	**140.0**	(122.5)	262.5	During the current year Southern Water has restructured the cash flows associated with an existing financial instrument, which brought forward a cash receipt of £140.0 million at present value. In the prior year costs of £113.6 million were incurred from extending the mandatory breaks on Southern Water's swap agreements, together with the net cost for the early termination of swaps of £8.9 million.
Other	**3.8**	92.9	(89.1)	The net cash movement from operating activities and Southern Water's capital investment programme. The inflow of cash was lower in FY20 due to an increase in the level of capital expenditure.
	(232.3)	227.5	(459.8)	

Statement of financial position – summary

The Group's statement of financial position is summarised in Table 4 below:

Table 4	Years ended 31 March	
	2020	2019
	£m	£m
Non-current assets	**6,825.7**	6,405.1
Current assets (excluding cash)	**217.6**	232.4
Cash and cash equivalents	**282.5**	514.8
Total assets	**7,325.8**	7,152.3
Current liabilities	**(1,084.4)**	(1,118.7)
Non-current liabilities	**(7,290.9)**	(7,280.7)
Total liabilities	**(8,375.3)**	(8,399.4)
Total net liabilities	**(1,049.5)**	(1,247.1)
Total deficit	**(1,049.5)**	(1,247.1)

At the end of the year to 31 March 2020, the Group had non-current assets of £6,825.7 million (2019: £6,405.1 million), an increase of £420.6 million from March 2019. This increase results from the ongoing capital investment programme which increased the value of property plant and equipment and intangible assets by £263.8 million and an increase in the value of group non-current financial derivative assets of £156.8 million.

Current assets decreased to £217.6 million (2019: £232.4 million) principally as a result of the increased provision for bad debt relating to COVID-19 of £16.0 million.

Current liabilities decreased to £1,084.4 million (2019: £1,118.7 million). This decrease mainly results from a reduction in the accrual for interest on bonds by £107.4 million, which were paid on 31 March in the current year offset by a transfer from non-current liabilities of the regulatory settlement liability of £35.6 million and an increase in current borrowings of £33.1 million primarily due to the timing of loan repayments.

At 31 March 2020 non-current liabilities totalled £7,290.9 million (2019: £7,280.7 million). This increase of £10.2 million was principally the result of the following:

- An increase in borrowings of £66.6 million, following an increase in the Eurobond debt of £150.5 million and a reduction in long term borrowings of £83.9 million.
- An increase in lease liabilities of £27.4 million following the implementation of IFRS 16 'Leases'.
- A decrease in the derivative financial instruments liability of £52.6 million following their valuation at 31 March 2020.
- An increase in the deferred tax liability of £124.0 million in part driven by the announcement that the corporation tax rate would not decrease to 17% from 1 April 2020 together with current year results.
- A reduction in retirement benefit obligations of £124.2 million, following the closure of the scheme to future accrual, a lump sum deficit payment of £17.3 million and the movement in market conditions at 31 March 2020.
- A transfer to current liabilities of the regulatory settlement liability £35.6m.

As at 31 March 2020, the Group had net liabilities of £1,049.5 million (2019: £1,247.1 million). Excluding the liability associated with the Eurobonds, which are shareholder loans and included within non-current liabilities, of £1,401.4 million (2019: £1,250.9 million), the underlying shareholder equity was £351.9 million (2019: £3.8 million).

Dividend policy

The detail of the dividend policy for the group is determined by the dividend policy of Southern Water.

Any dividend paid by Southern Water is firstly used to pay interest on borrowings outside of Southern Water and surplus cash is then used to pay interest on the Eurobonds and/or a shareholder dividend.

<u>Dividend policy of Southern Water:</u>

Southern Water's dividend policy is formulated to ensure a fair balance of reward between investors and customers. To deliver on its vision for the successful delivery of Southern Water's Business Plan for 2020–25, all stakeholders must share in success: customers benefitting through enhanced service and lower bills, and shareholders earning a fair return on the near £2 billion of equity invested.

When proposing payment of a dividend, the directors of Southern Water, acting independently in accordance with their directors' duties and in accordance with Southern Water's licence, will apply the following principles:

1. Determination of a base level of dividend, based on an equity return consistent with Southern Water's most recent Final Determination and its actual level of gearing. This recognises its management of economic risks and capital employed.

2. In assessing any adjustment to the base level of dividend, Southern Water will take into account all of its own performance. This would reflect Southern Water's overall financial performance as compared to the final Business Plan for 2020–25 as agreed by Ofwat and would explicitly consider a qualitative assessment of customer service levels and how customers share in our successes.

3. The group will consider Southern Water's financial resilience ahead of any dividend decision, and whether any financial outperformance should be re-invested to benefit customers. This consideration will also include taking into account the interests of employees, other stakeholders, and pension schemes.

   Southern Water's dividend policy is intended to support the financial resilience and investment grade credit ratings of the business and ensure continued access to diversified sources of finance. As part of step three, it carries out an assessment of:

   a) headroom under debt covenants
   b) the impact on Southern Water's credit rating
   c) the liquidity position and ability to fulfil Southern Water's licence conditions
   d) key areas of business risk.

4. Southern Water will be transparent in the payment of dividends and will clearly justify the payment in relation to the factors outlined above.

5. Southern Water publishes its Dividend Policy annually (as part of the Annual Report), and highlights any changes.

Having undertaken its assessment for 2019–20 the Southern Water Board has decided not to declare an ordinary share dividend for 2019–20 (2019: £nil). The potential level of base dividend was calculated as £70.4 million. In addition the Southern Water Board approved preference share dividend payments of £9.0 million in 2019–20 (2019: £5.9 million) and a further £5.0 million related to an accrual at 31 March 2019. A further £2.4 million has been accrued at 31 March 2020.

No dividend has been proposed or paid by GSH in the period or subsequently.

Group Tax Policy

The Group's Tax Policy is consistent with the overall values and corporate strategy of the group and considers financial risk, reputational risk, and social responsibilities. The group's approach to tax planning is to align to business decisions made in the best interests of customers and stakeholders, rather than use tax planning to drive or determine business decisions. Group focus is therefore on compliance and tax planning is always aligned with commercial and economic activity.

The Group's approach to tax management is to be fully compliant with tax laws, rules, regulations and reporting requirements in all operations. This extends to following both the letter of the law as well as the spirit of the law. A culture of doing the right thing is embedded in the Group's core values and the Group's approach to tax embodies this by ensuring it pays the right amount of tax, in the right place, at the right time. The Group also uses the expertise of professional tax advisers to ensure it maintains best practice in its approach to compliance and in circumstances when additional advice is deemed appropriate.

The Group is open and transparent and does not use tax avoidance schemes or take an aggressive stance on the Group's interpretation of tax legislation when tax planning.

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

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

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 at each five-year periodic review and reflects its initial market value plus subsequent capital investment and inflation. The RCV is adjusted at each periodic review for relevant changes to the level of expenditure or performance during the five-year period.

Net debt: RCV	Hold co %	Mid co %	SWS %
2016–17 performance	87	-	77
2017–18 performance	86	-	77
2018–19 performance	90	76	66
2019–20 performance	90	76	67
Covenanted lock-up level	93	85	75 (85 pre 2017-18)
Covenanted default level	95	95	95

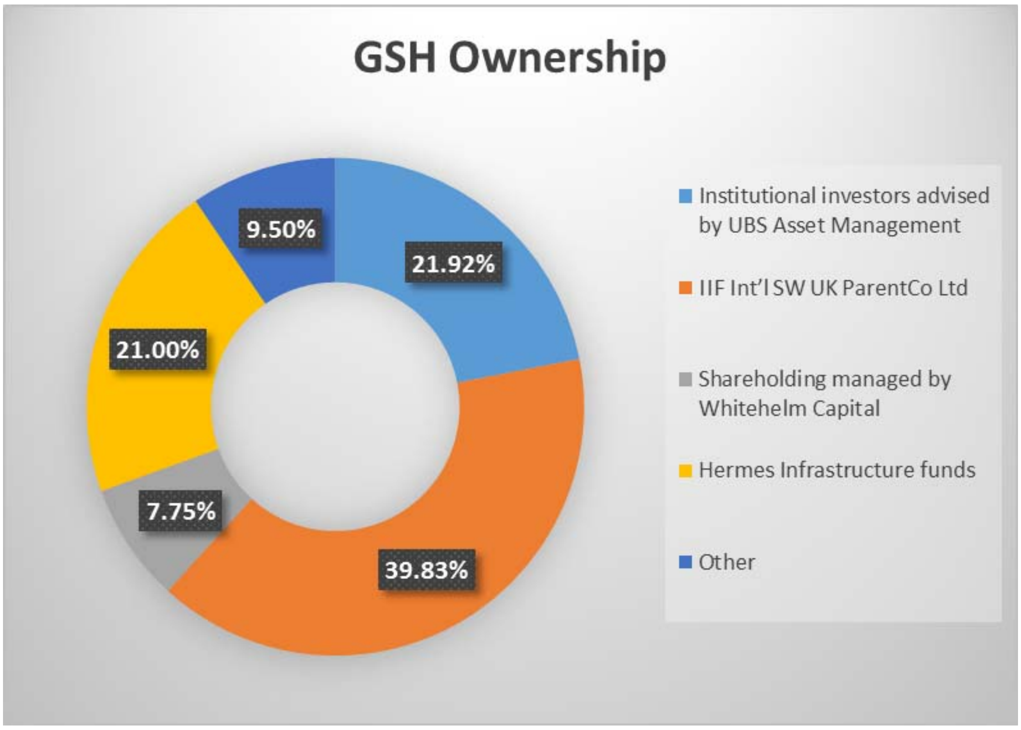
Consolidated EBITDA to cash interest cover	Hold co Times
2016–17 performance	2.9
2017–18 performance	3.1
2018–19 performance	2.9
2019–20 performance	2.8
Covenanted default level	2.0

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 – shareholding advised by UBS Asset Management, a large-scale global asset manager, offering investment capabilities across all major traditional and alternative asset classes
IIF Int'l SW UK ParentCo Ltd - a constituent entity of the Infrastructure Investments Fund (IIF), a fund advised by J.P. Morgan Asset Management, 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 Federated Hermes International, formerly 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).

During 2018–19 additional Greensands financing companies were added to the group structure as part of a financing plan to improve the financial resilience of Southern Water ahead of the PR19 price review period starting April 2020. These new companies form the 'Midco' financing companies in the holding company structure diagram on page 12.

Southern Water is the only operating company in the group. As a result, all companies above Southern Water in the group structure are reliant on dividends being passed up from Southern Water to allow them to make interest payments due on external loans.

Going concern

Reflecting on the expectations of volatile distributions arising from Southern Water due to the implementation of the new business plan as a result of the recently agreed Final Determination and possible scenario based covenant stress due to COVID 19 in the foreseeable future, the Board has engaged external specialist advisors to identify and assess the mitigation options and activities available, to the Board and shareholders, in order to financially restructure the Greensands Group above the regulated company Southern Water. The financial restructuring plans under consideration by the Board, and shareholders, amongst a range of options include proposed covenant amendments, liquidity being made available and/or debt restructuring to provide liquidity to meet the requirements of the Group's borrowing facilities. Whilst initial dialogue has begun, final agreement on these plans has yet to be reached with debt holders. Further detail of this material uncertainty associated with going concern is set out on page 44 below.

Financing in 2019–20

A Sustainable Financing Framework was put in place at Southern Water during 2019–20 which aligns its long-term strategy with its social and environmental commitments. An independent Second Party Opinion is also provided by DNV-GL to ensure alignment with the relevant bond/loan principles and guidelines.

The Framework also sets out a robust process for project evaluation, project selection, the management of proceeds and reporting.

The majority of Southern Water's assets and expenditure on projects, and programmes of work, fall within the eligible green categories and the eligible social categories taken from the Green Bond Principles and the Social Bond Principles.

Southern Water issued its inaugural financing under the Sustainable Financing Framework in May 2020 with a dual tranche public bond amounting to £825 million.

During 2019-20 Southern Water also restructured the cash flows associated with an existing financial instrument, which brought forward a cash receipt of £140.0 million at present value.

Financing in 2018–19

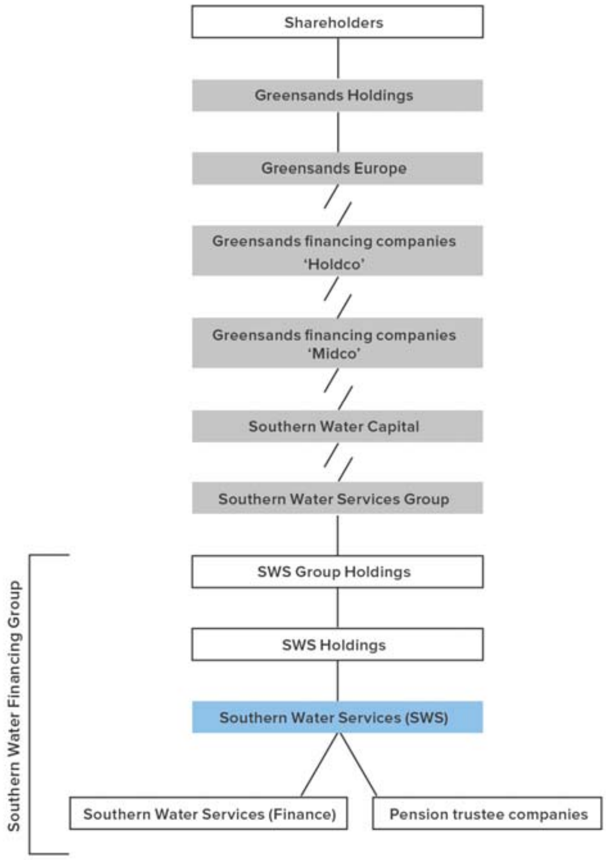
The financing during 2018–19, which included the incorporation of additional Greensands financing companies, is summarised below:

- £450 million new borrowings raised by new Greensands financing companies formed as a 'Midco' financing structure
- £250 million new borrowing raised by existing Greensands financing companies ('Holdco' financing structure)
- £700 million of new finance was invested into Southern Water, net of £12 million costs, by a repayment of inter-company liabilities totalling £687.3 million
- These proceeds were used by Southern Water to repay £400 million of outstanding Class B debt, provide £150 million towards repayment of the £300 million Class A bond repaid 1 April 2019, £113.6 million was used toward reducing the interest cost of our inflation linked derivatives for the period 2021 to 2031, and the remaining £37 million was used to pay costs associated with repaying the Class B debt and terminating a derivative associated with the Class B debt.

In addition to the dividends paid up to the Greensands entities from Southern Water, the Greensands financing companies also maintain liquidity facilities which can provide a short term source of finance.

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

Southern Water ownership structure summary



Greensands Holdings (GSH) – The ultimate parent company within the group. GSH was established in 2007 for the acquisition of the Southern Water Capital group, from RBS, by the shareholders. The company is Jersey registered, but it is UK tax resident and, as such, is liable for tax in the UK. The company was incorporated in Jersey because Jersey law allows greater choice than the UK as to the way distributions can be made to shareholders. GSH holds 100% of the share capital of Greensands Europe and has no direct holdings in any other entities.

Greensands Europe (GSE) – A subsidiary of GSH incorporated in England and Wales and resident for tax in the UK. GSE was established to issue bonds as part of the financing for the acquisition of the Southern Water Capital group in 2007. GSE has issued debt, Eurobonds, which are held by our shareholders in proportion to their respective shareholdings. This bond debt meets the eligibility requirements of the 'quoted Eurobond exemption' for tax purposes. The Eurobonds are listed on the International Stock Exchange in the Channel Islands which is a recognised stock exchange for the purposes of the quoted Eurobond exemption by HMRC. The bonds were issued on this stock exchange for ease of administration, as they are issued to the shareholders of the group and are not traded.

Greensands financing companies 'Holdco'– A number of companies, all incorporated in England and Wales and resident for tax in the UK, were established to provide additional external financing for the acquisition of the Southern Water Capital group in 2007. Security granted to the lenders of this financing is limited to the share capital of Greensands Holdings Ltd. There are no debt guarantees in place between the Greensands financing companies and the Southern Water Financing Group, with the result that SWS is fully protected, and fully isolated, from a default at any Greensands company.

Greensands financing companies 'Midco'– The Greensands Midco group of financing companies was incorporated in 2018 as part of a financial restructuring exercise to improve the financial resilience of Southern Water. The objective of the restructure was to reduce the total leverage within the Southern Water Financing Group and to reduce interest payments at Southern Water to help manage financial covenants. The debt issued by Midco companies is senior to that issued by the Greensands Holdco group of financing companies.

Southern Water Capital (SWC) – The previous holding company for the Southern Water group established as part of the sale of Southern Water by ScottishPower in 2002. SWC is incorporated in England and Wales and resident in the UK for tax. It does not trade and holds preference shares in SWS from which it receives dividends.

Southern Water Services Group (SWSG) – The immediate parent company of the securitised group which acts as a holding company for this group following the financial restructuring in 2003. SWSG is incorporated in England and Wales and resident in the UK for tax.

Southern Water 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 its 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 Southern Water's 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 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.

SWS Group Holdings – An intermediate holding company forming part of the securitised group. The company is incorporated in England and Wales and resident for tax in the UK.

SWS Holdings – The immediate holding company for Southern Water, forming part of the securitised group. The company is incorporated in England and Wales and resident for tax in the UK.

Southern Water Services (SWS) – This is the only operating company within the group, providing water and wastewater services to customers across Kent, Sussex, Hampshire and the Isle of Wight. Southern Water is incorporated in England and Wales and resident for tax in the UK.

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

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

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

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	Not applicable	Class A debt: BBB+
Fitch	Not applicable	Class A debt: BBB+
Moody's	Not applicable	Class A debt: Baa3

*There is no longer a credit rating performed on this company.

Following the announcement by Ofwat of the outcome of its investigation into Southern Water's wastewater performance in September 2019, and its acceptance of the PR19 Final Determination in February 2020, the credit rating agencies each reviewed their assessment of the credit ratings for Southern Water. The credit ratings are shown in the table above and the outlooks of Standard and Poor's and Fitch is Negative Outlook, Moody's is Stable.

The Group is fully in compliance with all its debt 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. While 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 are appointed by an infrastructure fund managed by JP Morgan Asset Management; one director is appointed by infrastructure funds managed by UBS Asset Management; and one is appointed by pension funds and infrastructure funds managed by Hermes. Another shareholder is entitled to appoint an observer to attend and take part, but not vote, at GSH Board meetings.

The Chairman of Southern Water is not a member of the GSH Board and so no 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. Three of the GSH directors comprise the board of Southern Water Capital Limited and three of the directors of GSH are also directors of the MidCo entities – Greensands Finance Holdings Limited, Greensands Finance Limited and Greensands Financing plc. In February 2020, Mike Nagle was appointed to the board of Greensands Finance Holdings Limited. No director of GSH is also a director of Southern Water Services Limited.

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. Areas of particular focus during the year have included:

- Southern Water's 2020–25 Business Plan and the decision to accept the final determination from Ofwat
- Southern Water's execution plan to enable it to deliver the 2020–25 Business Plan
- Southern Water's transformation and efficiency programmes
- Changes on the Board of Southern Water
- The refinancing exercises undertaken in 2019 and update of the Prospectus in 2020
- The settlement reached with Ofwat in respect of wastewater compliance in Southern Water and the prosecution by the Environment Agency, including the impact on the wider group's financeability

The GSH Board also receives regular operational and financial performance reports in respect of Southern Water with the Chairman, Chief Executive Officer and Chief Financial Officer as regular attendees at GSH Board meetings. 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. GSH Board members are not 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.

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

Richard Manning, together with Intertrust Corporate Services (Jersey) Limited, act as joint company secretary. Richard Manning is also General Counsel & 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

The Board held four scheduled meetings during the year. In addition to the scheduled Board meetings, the Board met a number of times to discuss and receive reports on Southern Water's transformation and efficiency programmes and its plans to deliver the 2020–25 Business Plan. The Board also met once in August 2019 in order to appoint John Lynch as a replacement for Andrew Gilbert as the director representing the infrastructure fund managed by JP Morgan Asset Management. From March 2020 onwards, the Board also met to discuss and receive updates in respect of the COVID-19 pandemic and its impact on Southern Water. 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 shareholders and Board members were invited to attend an investor day arranged by Southern Water to provide shareholders an opportunity to question senior executives and receive an update in respect of Southern Water.

The Board has no standing committees. In July 2019, the Board formed a sub-committee in order to give final approval to the 2018-19 financial statements with authority to make non-material amendments, to approve the final version of the accounts and to authorise their signature.

Table of attendance at Board meetings

Attendance at scheduled Board meetings in 2019-20	
Susan Howard	4/4
Andrew Gilbert (resigned 5 August 2019)	2/2
Brian Goodwin as alternate to Andrew Gilbert (to 5 August 2019) and to John Lynch (5 August to 28 November 2019) (resigned 28 November 2019)	-/-
Paul Hedley	4/4
John Lynch (appointed 5 August 2019)	2/2
Bronte Somes	4/4
Thibault Contat Desfontaines as alternate to Bronte Somes (resigned 29 November 2019)	-/-
Robert Wall	4/4

Note: attendance includes attendance in person and by telephone, noting that a majority, including the Chair must be physically located in the United Kingdom pursuant to the Company's Articles of Association.

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.

Due to the impact that COVID-19 has had on normal working practices, regular meetings are continuing to be held but via approved telecommunication means.

2) Southern Water Services Limited

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 Southern Water is provided below.

In its region Southern Water has some of the rarest chalk streams in the world, some of the best bathing water quality, two National Parks, four Areas of Outstanding Natural Beauty, a world-heritage biosphere and more than 200 Sites of Specific Scientific Interest. Southern Water has a responsibility to look after all of this, and to improve it where they can. This is in addition to its statutory licence obligations to supply water and wastewater services to its customers.

Its vision is to deliver a resilient water future for the region. To do that Southern Water needs to face up to many challenges, including the effects of climate change and the need to be continuously reducing its own environmental impact and footprint. Southern Water is pushing forward with a number of strategic programmes under its Water for Life brand, which genuinely resonate with its customers, employees and other stakeholders.

Southern Water's performance and key challenges 2019–20

Any report on a financial year end of March 2020 will obviously need to address the extraordinary events of the final few weeks of the year, in which the whole country went into government-mandated lockdown in response to the COVID-19 virus. Southern Water has adapted remarkably well and continues to deal with the developing situation. Southern Water is a provider of an essential public service, and many of its employees are key workers whose tasks are critical to keeping water and wastewater services flowing for its customers. Southern Water moved in just one week from business as usual to a well-rehearsed Business Continuity Plan running against four simple priorities:

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

Southern Water are deeply proud of the way that its people, and the business as a whole, has performed against all four of these priorities. That is particularly so for its frontline workers, who have taken on a higher degree of risk for themselves and their families, to ensure that water has flowed and wastewater been treated continuously. It is unimaginable to think about facing the challenges of COVID-19 without a reliable water supply.

Customer service

Over the past five years, Southern Water has helped almost 300,000 customers who may have found it difficult to pay their water bills, exceeding its target of 194,700 by more than 100,000.

Southern Water is fully aware that some of its customers' circumstances have changed drastically and unexpectedly as a result of COVID-19. Therefore, they have made its processes easier for people who need to discuss or apply for help with their bills. Southern Water also made it possible for third parties to apply for priority services on behalf of vulnerable friends and family.

Its performance in other customer service areas this year has been mixed. Southern Water has celebrated helping its customers reduce their water consumption, with the per-person consumption of 126.5 litres a day – well below its target and the average for the rest of the UK. This establishes an excellent foundation for Target 100 – its long-term commitment to take average consumption below 100 litres per person, per day, by 2040.

However, it is clear they need to make more progress in other areas. Throughout the year, Ofwat has been testing its new customer satisfaction measures – C-MeX and D-MeX. Southern Water support this move towards a more comprehensive measure of customer satisfaction, where they are judged across the full breadth of their customer base. Its early C-MeX score is behind most of its peers, but it has initiated a number of projects and plans to improve, e.g. offering a much wider mix of channels for customers to communicate with them, simplifying its bills to make them easier to understand, and providing important messages.

Southern Water has had incidents in the year that resulted in them paying for service failures under the Guaranteed Standards Scheme provisions. It has made nearly 5,000 individual payments, significantly exceeding its target of 2,291. These were mostly due to large-scale supply interruptions, but also partly due to failures in its process for referring debt to collection agencies. In its drive to be as transparent as possible, and ensure historic performance has been properly stated, Southern Water has also been auditing and investigating how they have made and kept appointments since 2015 and found some process flaws. As a result, Southern Water is making backdated payments to a number of customers under the same provisions.

As Southern Water continues to improve and manage its customer service, they have entered into a significant partnership contract with Capita. This meant a difficult transition period of restructuring teams and losing a number of people, and relocating some services to Rotherham. However, they believe its work with Capita will continue to assist them with the transformation of its customer experience.

Operations

On the operational side of the Southern Water's business, performance has also been a mixture with some very significant challenges being addressed.

Most scientific climate-change predictions suggest Southern Water will experience wetter winters and drier summers in future, with an increased likelihood of more intense rainfall leading to flooding. During the year, Southern Water saw some of the most concentrated periods of rainfall on record, and demonstrated its improved ability to deal with them; we thank their employees for their dedication and energy in achieving this. Through storms Ciara and Dennis Southern Water maintained supply for all customers; something not all utilities could manage. However, as a result of some large-scale incidents in autumn 2019, Southern Water missed its target for supply interruptions.

Southern Water has improved its overall water resilience by reducing the volume of asset outage, but it did not achieve its five-year leakage target despite additional investment. This was due to how Southern Water were impacted by the effects of the extraordinary 2018 winter and droughts of 2018 and 2019. The impacts of these events caused an increase of around 13 Ml/d in reported base leakage. Southern Water is delighted that they have reduced that in the two years since, by close to 15% in the most stressed part of its region, which is its committed reduction percentage for the next five-year period.

Its bathing water performance stands out as a highlight, with 62 bathing waters categorised as excellent. In addition, it's Fat, Oils and Grease (FOG) team picked up several awards for making a real difference in its work with restaurants close to bathing waters.

Southern Water is still an outlier on the Drinking Water Inspectorate's new ERI and CRI water-quality measures, but are delivering a number of plans, including investing in its higher-risk assets, to bring its numbers down. Provisional figures for 2019 to December Southern were: CRI 7.656; ERI 1,433.477; against an industry average of CRI 2.868; ERI 688.694.

The Group is also very pleased to report that Southern Water kept its commitment to avoiding water-use restrictions throughout the five-year regulatory period.

Disappointingly though, the number of pollution incidents related to its assets was significantly higher than its targets, with seven serious (category 1 and 2) and 427 category 3 incidents*. This is not acceptable to them and Southern Water continues to invest in its systems and assets, £54 million in 2019–20, to improve this performance. The Pollution Reduction Plan Southern Water has put in place has been built with eight Critical Success Factors and has improved root cause analysis, risk understanding, site resilience, cultural awareness and self-reporting, now at 86.5% (2018: 83%). The plan is now published on its website and progress is regularly reviewed with the Enviroment Agency and the Southern Water Board.

*As reported previously, Southern Water has identified a number of issues with spill data. The details of the steps taken and that continue to be taken, to improve the robustness of the spill data collection, the data processing systems and the assurance of that data, have been shared with the EA and Ofwat. As those steps have not yet reached completion, the data supplied would continue to have an error band of up to 10%.

Ofwat investigation

Following a lengthy investigation into how Southern Water's wastewater business was run between 2010 and 2017, with which they co-operated throughout, Ofwat published its final decision in October 2019. In addition to a fine of £3 million, the report set out a number of agreed actions, supported by undertakings given by Southern Water, including the making of rebates to current customers and payments to former customers, and a commitment to greater transparency on environmental performance.

Southern Water has been taking significant steps to improve its wastewater business and they are working hard to regain their customers' trust. Southern Water conducted workshops to explain what had happened, how they would be making reparation and how they were putting the right checks and balances in place. In addition, their customers have been receiving explanations with their bills since April 2020.

Environment Agency investigations

Like other wastewater operators, in the normal course of operations Southern Water occasionally faces Environment Agency investigations following wastewater incidents. In addition to those, Southern Water has been subject to a detailed investigation regarding permit breaches at some of its wastewater treatment works in two locations during the period 2010–15. A case was opened in Maidstone earlier this year in relation to these events and Southern Water agreed it should be elevated to the Crown Court. Southern Water have already entered guilty pleas to the charges presented to the court and are focused on transparency and doing the right thing for its customers and other stakeholders. Southern Water are limited in what it can write about the case at this stage, but they will be letting the court have details of all of the plans they have put in place to address the issues raised, and all of their environmental improvement plans. Southern Water is also committed to assisting the Environment Agency with its additional investigation into sampling compliance and reporting issues. Read more on page 22.

Financial performance

2019–20 has been a year in which Southern Water has continued its transformation journey and responded to a number of significant operational events. The costs associated with these are reflected in its operating profit for the year (excluding regulatory settlement), which fell by £44.1 million to £212.3 million.

The operational challenges of dealing with the impact of the wet and stormy weather over the winter, improving its wastewater asset maintenance to improve compliance, and reacting to a number of large sewer repairs, increased its wastewater operating costs by £13.9 million.

Southern Water spent an additional £3.2 million this year increasing the size of its leakage team and its collaboration with partners to help reduce leakage levels. Whilst it is pleasing that it has seen a very large reduction in overall levels compared to the previous year, they still have further to go to meet the challenging targets they have set for the period to 2025.

Southern Water also incurred one-off costs of £7.7 million due to organisational restructuring and its cost base as part of preparations for the delivery of its business plan for 2020–25. This included setting up the partnership with Capita to help transform its customer experience, as well as making changes to pension arrangements for its employees.

As a result of the COVID-19 virus Southern Water has also reviewed its provision for impairment of trade receivables. The impact of the pandemic on the economy and the financial position of individuals has been dramatic and is anticipated to last for many months to come. Therefore, Southern Water has made an additional provision of £16 million in the year to reflect the potential impact this may have on the collectability of its outstanding customer debt at 31 March 2020.

In 2019–20, its capital investment programme continued at pace as Southern Water completed the final year of its current business plan. In total Southern Water spent over £500 million investing in its assets during the year. This included the finalisation of the redevelopment of its Woolston wastewater treatment works, improvements to its sewer network in Thanet, a number of improvements to wastewater assets across its area, to improve compliance and performance, and the creation of a new IT data centre.

Southern Water also successfully secured £825 million in sustainable bonds in one of the biggest public market financing issues for the water sector in May 2020, establishing an environmental, social and governance (ESG) sustainable financing framework. It demonstrated a set of standards for a company's operations that socially conscious investors use to screen potential investments.

Its business plan for the next regulatory period sets out a number of targets with a significant level of investment. In order to ensure that Southern Water maintains its financial stability it is reviewing this as they deal with the current situation.

Its priorities to 2025

In the course of preparing its 2020–25 business plan, Southern Water consulted extensively with its customers to ascertain their priorities. They were very clear on four things they wanted to deliver which were:

- investing in the environment;
- investing in future resilience;
- providing support for those who cannot afford their bills; and
- being fair and transparent on dividends and executive pay.

Eighty-four per cent of customers also told Southern Water that they thought their bills were affordable.

Its plan proposes 47 performance commitments for the five-year period 2020–25, directly aligned to a number of key outcomes co-created with its customers and stakeholders, to use water wisely, protect and improve the environment, deliver great service and be fit for the future.

Ofwat's detailed scrutiny and challenge of Southern Water's plan culminated with the publication of its Final Determination in December 2019. It largely accepted the ambitious improvement targets that Southern Water set in its plan, but significantly reduced the level of funding available to deliver them and in some cases required improvements to be made more quickly.

While Southern Water were disappointed by the outcome of Ofwat's review, it chose not to appeal the decision to the Competition and Markets Authority. Southern Water are now focused on making the important changes that will enable it to meet the challenges that Ofwat has set it, to deliver a step change in performance at the same time as reducing bills.

Southern Water puts resilience at the heart of its strategy, focusing on becoming brilliant at the basics while transforming key areas of its business. Its Water for Life business plan 2020–25 outlined the actions Southern Water will take to deliver on its commitments to customers in an integrated, collaborative way, using systems thinking to deliver joint solutions to some of its bigger challenges, namely climate change and population growth.

Examples of this in action would be the work already started on a regional water grid through Water Resources in the South East, or the energy and water strategies created through its work with the Greater Brighton Infrastructure Panel. Southern Water will be focusing on reducing carbon emissions to get closer to net zero, in line with the Water UK Public Interest Commitments. This will mean being more innovative in the way it thinks about its infrastructure. Southern Water were also the first water company in the UK to have a plastics policy, looking at how they use plastic in its supply chain and the water cycle. Southern Water is also discussing some exciting projects with the rivers and wildlife trusts, and looks forward to seeing them develop.

For vulnerable customers, Southern Water will be increasing the number on its Priority Services Register so it can offer specific assistance, and Southern Water will continue to support customers who struggle to pay their bills.

Engagement and values

In putting together its business plan, Southern Water learnt a lot about how best to engage with its stakeholders, setting up the right channels and relationships to make two-way conversation easier. Southern Water now spends far more time with their customers than previously. Their teams spend a significant proportion of their time with stakeholders, as do teams across Southern Water, and they are receiving positive feedback.

When Southern Water started to review its purpose, vision and values last year, the guiding rule for outcomes was to keep it simple and understandable. The creation of the brand message of 'Water For Life' captures what Southern Water do, but it also brings home to people the fact that the work undertaken by Southern Water is essential for everyday life.

Its values are, simple and everybody can live up to them. Southern Water employees all know what they can do to succeed together, to always improve and, in particular, to do the right thing. It allows people to just take a step back and assess their actions.

These values are now being embedded in the business and Southern Water continue to look at ways to ensure they become part of everyday life. Southern Water believes its Water for Life message brings them consistency. It is something everyone at Southern Water can identify with and explain to its customers.

Relationships

Southern Water has expressed its thanks to all of its colleagues and wider supply chain for the commitment they have shown to the transformation journey it is on. Its customers have been patient, and Southern Water have been pleased with the feedback it has received from them.

Southern Water's relationships with its regulators have improved immeasurably. Whilst it still has a number of issues to solve, the need to continue to show evidence of real performance improvement is still vitally important.

Southern Water has also been and remains engaged in purposeful conversations with the Government and the National Infrastructure Committee that, again, are moving items along a path of improvement.

Rebuilding trust and looking forward

Southern Water's transformation programme touches almost every part of its business, and serves as acknowledgement that it needed to make big improvements. Southern Water has made key investments in people, processes and systems. It has appointed people with different perspectives – from the retail, energy and telecoms sectors – as well from the water sector, to draw on varied experience and to better serve its customers.

Keith Lough, who Southern Water welcomed as its new Chairman in August 2019, came from a strong regulatory background. In Keith's statement in the Southern Water Annual Report, he explains how Southern Water also have people on the Board who understand the many different parts of its business, including particularly its customer focus.

The ethos of the Southern Water Board is one of continuous improvement and striving for excellence, as they believe this is key to building trust with all who Southern Water engage with. This belief is at the core of its 'brilliant at the basics' ambition in its Water for Life plan, which is hugely important to Southern Water. Southern Water has instilled a culture of reinforcing its core values to drive its actions, which in turn it hopes will build trust and a resilient water future.

Southern Water believes that this is the decade of resilience. The challenge is enormous, but Southern Water is convinced that it has the skills, plans, relationships and desire in its business to succeed in its ambition to create a resilient water company for the South East.

Ofwat and Environment Agency investigations

Ofwat investigations

As previously announced, Southern Water's wastewater treatment compliance was under investigation by Ofwat since June 2017, due to breaches of statutory obligations from 2010–17.

Southern Water began investigating issues at its wastewater treatment sites in July 2016 before alerting Ofwat to deeper issues in March 2017.

A key finding from Ofwat was that, between 2010 and 2017, some of Southern Water's wastewater treatment sites were manipulated by employees to pass sampling tests they otherwise might have failed.

A Final Notice, clearly setting out the plans for Southern Water to make rebates to current customers and payments to former customers, and a commitment to greater transparency on environmental performance, was published by Ofwat in October 2019.

The notice confirmed that the payments to former customers, and the reduction in wastewater charges for current customers, will total £123 million (in 2017–18 prices) together with a £3 million fine*.

The rebates to current customers began with the April 2020 bills. For former customers, advice on how to claim has been published at **southernwater.co.uk/our-performance/making-amends-to-our customers**.

The notice also contained details of its plans for greater transparency on environmental performance, including information on pollution incidents, flow and spill reporting, wastewater treatment works compliance, regional bathing water compliance results, emissions and river levels; this is published at southernwater.co.uk/our-performance/environmental-performance **.

The third commitment from the notice was to ensure that employees did not receive bonuses or incentive payments for personal objectives linked to wastewater compliance when Southern Water fails to meet its relevant performance commitments.

* Customers will not bear any of the costs.
** This is subject to constraints on reporting environmental information or data that is provided by the Environment Agency

Environment Agency investigations

Like other wastewater operators, in the normal course of operations Southern Water occasionally faces Environment Agency investigations following wastewater incidents. In addition to those, Southern water has been subject to a detailed investigation regarding permit breaches at some of its wastewater treatment works in two locations during the period 2010–15. In February 2020 the agency presented 51 charges before the court and Southern Water has entered guilty pleas to these charges. The exact nature and scale of the permit breaches over the period are still under investigation. Southern Water will be as open and transparent as possible and are committed to working with the agency to ensure a swift conclusion to resolve the case. Since Chief Executive Ian McAulay joined in 2017, he has been driving thorough internal reviews of its wastewater business and is leading a major transformation programme.

For the reasons also set out in note 27 to the financial statements, supported by legal advice, the Southern Water Board has concluded that it is not yet possible to make a reliable overall estimate of the financial obligation that will arise from this prosecution, notwithstanding the guilty pleas and the Sentencing Council's Guidelines for Environmental Offences. However, the Southern Water Board does recognise that there will be a minimum liability associated with these charges and has therefore recognised a provision of £1 million reflecting a minimum amount as indicated by the Sentencing Guidelines and an allowance for legal costs. The court has a very broad discretion to assess the level of the fine and the provision is not intended to indicate or predict any particular level.

When considering the above it is noted there is no clarity as to how these charges may evolve and how the disputed levels of culpability and environmental harm may be determined. The sentencing guidelines are very wide and there is a requirement for the court to examine the financial circumstances of the organisation in the round. The Southern Water Board will continue to review the level of provision made as more information becomes available.

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

Risks

The group has one operating company, Southern Water. The risks relating to this company are covered in detail on the following pages. The Group faces additional financial risks which are detailed below:

Liquidity and refinancing risk

As the Group raises finance and therefore has debt service requirements in addition to those of Southern Water it faces liquidity and refinancing risk in addition to those described in the principal risks and uncertainties section of the Southern Water financial statements.

The Group comprises four separate debt financing structures of Southern Water, Greensands Financing (Midco), Southern Water (Greensands) Financing (Holdco) and Greensands Eurobonds. These financing structures contain various debt covenants which if breached will result in a lock-up of distributions from the lower structures which will increase the liquidity and refinancing risk higher up the financing chain. As at 31st March 2020 and the date of these financial statements there were no debt covenant breaches and each of the financing structures had sufficient liquidity for at least the next twelve months.

Refinancing risk may also be impacted by rating agencies view of the credit quality of the water industry and the Southern Water, Midco and Holdco financing structures. The current ratings of Southern Water (Greensands) Financing and Southern Water is set out on page 15. As at the date of these financial statements there are no material debt maturities which require refinancing in the Group within the next twelve months.

As explained in detail in the Director's report, the Group has sufficient liquidity available to meet the requirements of its borrowing facilities for a period of at least 12 months from the date of signing the financial statements and up to October 2021 at which point the Group may face a liquidity shortage absent the execution of any mitigation options and activities.

Mitigation plans progressing include, the engagement, by the Board, of external specialist advisors to identify and assess the mitigation options and activities available, to the Board and shareholders, in order to financially restructure the Group. The financial restructuring plans under consideration by the Board, and shareholders, may include liquidity being made available and/or debt restructuring to provide liquidity to meet the requirements of the Group's borrowing facilities for the period beyond October 2021. A final agreement on these plans has yet to be reached.

Southern Water risks

The most significant risks facing Southern Water are referred to as 'principal risks'. The principal risks are the greatest risks to the Southern Water's business objectives, both those inherent to the nature of its operations and company-specific circumstances. Southern Water therefore consider principal risks to be those with the capacity to have the greatest impact on its business.

As part of delivering better outcomes for its customers and regulators, and becoming a more resilient organisation, Southern Water continues its transformation programme. Through the programme, Southern Water is working to materially improve processes and systems to ensure that it continually develops the way it carries out its business. In the past, Southern Water has fallen short of meeting standards required by its regulators and ourselves. Its transformation programme helps to ensure that the mistakes of the past are not repeated.

Through the comprehensive and ongoing transformation process, Southern Water is committed to delivering the level of service its customers – and all of its stakeholders – expect and deserve. The degree of transformation in itself brings with it both some risk and significant opportunity, which will be closely monitored and reflected in the relevant principal risks reported in this and future reports.

The Southern Water Board is deeply committed to its role of embedding risk management at every level of the organisation. As part of its transformation, Southern Water has recognised the need to improve its approach to risk and resilience management.

Last year, the Southern Water Board created a specific Risk Committee, formed a new Risk and Compliance Directorate and implemented a risk and resilience enhancement programme. Its risk management methodologies are still evolving and its next stage of improvements in risk and resilience management is in progress. In 2019–20, Southern Water submitted its plans to Ofwat to improve its resilience. The plan involved a comprehensive review of the key areas in its organisation responsible for its resilience, alongside subsequent recommendations for improvement. The plan was initiated in September 2019 and will continue until the end of 2021. The improvement plan spans the key resilience areas of enterprise risk management, incident management and asset investment strategy. The aim is to embed an approach to enterprise risk management that allows them to deliver a more resilient service for its customers and stakeholders.

The Southern Water Board continues to review the organisation's principal risks from a strategic perspective, while itself – and through the Risk Committee – supporting the embedding of the risk framework.

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, Southern Water has made the following changes to the principal risks from 2018–19. The 2019–20 principal risks are set out on pages 116 to 134 of Southern Water's annual report:

Principal risk 2018–19	Principal risk 2019–20	Rationale for change
Political and regulatory reform, and Price Review (PR19)	Regulatory and corporate affairs	The nature of this risk remains significant, encapsulating a similar scope, with the descriptor being updated to better reflect the risk area. The risks associated with PR19 have translated into plan delivery following completion of Ofwat's price review process.
Resilience to drought Resilience to flooding	Climate change	The new structure has replaced 'resilience to flooding' and 'resilience to drought' with a principal risk for climate change (covering its mitigation and adaptation efforts). This includes the work Southern Water is performing in both these areas. Southern Water is also defining an associated climate change risk register to consolidate its approach to climate change.
Not applicable – new risk in 2019–20	Resources COVID-19	Having reviewed its principal risks, Southern Water identified a gap relating to HR, power, supply chain and chemicals. Southern Water has therefore introduced a new principal risk to cover these key areas and the associated risks that align to them. The COVID -19 pandemic has had a major impact on the way Southern Water conduct its business and has presented significant challenges to its ability to provide its essential services to customers, its ability to meet regulatory targets and expectations and the financial viability of the business. Risks affected the whole organisation and, therefore, a new principal risk has been created with new business continuity, risk management and governance systems now in place.
Bad debt	(Declassified as 'principal risk'.) Moved within customer services	As part of the review of its risk structure, Southern Water realigned bad debt within the scope of the customer services principal risk, rather than as a standalone principal risk. It could equally have been classified as a financial risk.

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 its strategic objectives. Its strategy for risk management is that all principal risks are identified, assessed and managed within acceptable levels. To achieve this, the Southern Water Board and senior management seek to 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. Corporate risk management is monitored by a dedicated Risk Committee on behalf of the Southern Water Board, although the Southern Water Board retains ultimate responsibility for risk management.

The duties of the Risk Committee include reviewing its current risk exposure against the overall corporate risk appetite, tolerance and strategy, along with advising the Southern Water Board on the current risk exposures of Southern Water and its future risk strategy. As previously noted, these duties were transferred from the Audit and Risk Review Committee to the new Risk Committee in February 2019. Throughout the last year, the new Risk Committee has worked to further improve its corporate risk management and enable more in depth risk oversight and challenge. See the Southern Water Annual Report for more detail.

The objectives of its risk management strategy relating to principal risks are to:

- identify and understand all the principal risks that Southern Water face
- select and proactively adopt strategies and plans to address, including seeking opportunities from,

those risks that deliver the right returns, and understand their potential impact on Southern Water

- take action to mitigate its exposure to the principal risks, ensuring its resources are effectively and efficiently prioritised and used
- use the analysis of its principal risks to inform its strategy and to monitor and report the risks Southern Water are 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 it a more resilient organisation that is able to successfully respond to its constantly changing environment. Southern Water seeks to ensure controls are in place so that it can reduce the likelihood of risks occurring or take action to minimise their impact. 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 Risk Committee. Any new risks added to the database with a high score are passed to an Executive Leadership Team member and the Chief Executive Officer for immediate review. Southern Water is actively strengthening its control framework to ensure failures of the past are not repeated. Its resilience transformation project is strengthening its risk management control framework, how it impacts its risks and how Southern Water respond to new risks.

Risk appetite

The amount of risk the Southern Water Board is willing to take to achieve its strategic objectives is referred to as the risk appetite. Southern Water has developed a risk appetite for each of its principal risks, which forms a key element of its governance and reporting framework and is reviewed annually by the Southern Water Board. Southern Water has recognised that some of the challenges arising from COVID-19 and a challenging PR19 Final Determination have added additional risks. Nor do Southern Water think that the determination reflected the preferences of its customers for long-term environmental and system resilience.

Like most organisations, Southern Water is tolerating a level of risk which is outside its current preferred risk appetite. The Board and the Risk Committee are actively engaged in looking at longer-term strategic risks, as well as its risk appetites. Southern Water operates a complex infrastructure of water and wastewater assets – from pipelines to processing sites – over a broad geographical area and it recognises that extreme weather conditions and failure of its assets can have a negative impact on its customers. As a result, Southern Water has clearly-defined operating processes, procedures and control frameworks, including incident management, to mitigate its compliance and operating risks. In doing so, Southern Water acknowledges that it also has to prepare for the unexpected and when an unanticipated risk emerges, Southern Water must deal with it accordingly. Its approach to risk management is also aligned to its approach to compliance, where Southern Water has been implementing a 'three lines of defence' model of compliance.

Its aim is to employ risk management principles, transparent decision-making and effective communication to prioritise risk. Southern Water aims to minimise its exposure to compliance, operational and regulatory risk, while accepting and encouraging more risk in pursuit of its mission and objectives. Its 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 Southern Water will not seek to intervene in all situations. Instead, its approach is based on judgment 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 appropriate course of action.

Principal risks and uncertainties

Operational
Industry risk
Water

Outcomes affected

Looking after the environment
A constant supply of high-quality drinking water

Risk change in year

Risk high due to anticipated challenges in supplying water resources in its western region, in accordance with new regulatory limits. In addition Southern Water has been set increasingly challenging targets in the next business plan period, with respect to leakage, interruptions to Supply and Compliance Risk Index (CRI) and Event Risk Index (ERI).

Description

Southern Water must ensure it can supply enough good quality drinking water to cater for a growing population of more than 2.6 million people across Kent, Sussex, Hampshire and the Isle of Wight.

Risk: Should operational water treatment processes fail, the Water supply become contaminated, or its water distribution network fail:

- 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 into the environment.

Risk: Southern Water may fail to supply enough water to its Growing population of customers if resources are not sufficient. This can be from available resources becoming scarcer, e.g. Through climate change, or through protecting local environmental needs which can result in a reduction in the amount of water that can be abstracted for water supply.

This could lead to a risk to its customers, and consumer confidence, and lead to prosecution and fines by the Environment Agency or the Drinking Water Inspectorate (DWI).

Mitigating activities

(Controls in place/work Southern Water has done)

- Drinking Water Safety Plans to evaluate risks with its drinking water quality across the entire supply system
- A Catchment Risk Management team formed to understand and manage catchment risks to drinking water quality
- Trained its employees to the industry and EU skills standard to allow them to perform their roles well
- Emergency plans to continue water supply during an interruption. Southern Water has invested over £150 million on its production works during 2015–20, including:
- Improvement schemes at Testwood, Burham and Otterbourne
- General resilience improvement schemes, such as: the ability to run to waste, UV disinfection replacement and borehole headworks upgrades
- Nitrate management improvement
- Advanced filters at water treatment works in high risk areas (e.g. Hastings), to improve the taste and smell of water
- Upgrading wells, service reservoirs, flushing mains, and cleaning service reservoirs
- Leakage reduction plan
- Updated its 50-year Water Resources Management plan.

(Work Southern Water intend to do in this business plan period 2020-25)

Additionally:

- A transformation programme – Water First to embed change in processes and performance
- A culture transformation programme to develop a behavioural competency framework for its employees
- Prioritised maintenance of critical assets and technology
- Ambitious plans to drive a 15% reduction in leakage by 2025 and 50% reduction by 2050 helping its customers reduce consumption to 100 litres per person, per day
- Plans to develop new water resources in its western area to ensure sufficient supplies.

Operational
Industry risk
Customer

Outcomes affected

Responsive customer service
Better information and advice

Risk change in year

Description

Providing an excellent customer experience is a key objective. Southern Water recognises the importance of prioritising its customers, and that accomplishing its strategic goals is contingent on providing the level of service expected by its customers and its regulators.

Risk: Southern Water may not be able to provide the desired standard of service to its customers if there is inadequate capability in its people, process or systems. Its targets all aim to make the experience of dealing with Southern Water simple and easy. Southern Water is also focused on improving its performance relative to its peers within the Ofwat mechanism which has performance based rewards and penalties, for which Southern Water may incur financial penalties if it does not continuously improve its customer service performance, relative to its peers and its own targets.

The scale of the challenge is significant if the business plan period 2020–25 execution plan is to be delivered;

- Southern Water's spend on Customer Service in 2015–20 was £95m more than the allocation in its Final Determination (FD) for 2020–25, the scale of improvement required to deliver the FD is therefore significant.
- In 2015–20 the customer experience metric was SIM, for the final year Southern Water finished 16th of 17 companies in the comparative table.

Mitigating activities

(Controls in place/work Southern Water has done)

- New single outsourced partner appointed to improve the customer journey
- Active engagement with our customers and stakeholders to strengthen our links with local organisations such as councils and community groups
- Baselined our end-to-end customer journeys to identify areas where we can improve the customer experience
- Southern Water have agreed investment to support the transformation of the process and technology that underpin our customer service
- Year one: Programme is looking at strengthening customer self-service options
- Year one: Limitations with Southern Water's SAP billing solution will not be overcome with a replacement moved to 2025–30. The main investment in billing will be in changes to the bill presentation
- Year one: Development of a tailored debt strategy with supporting investment in the debt management tool Tallyman.

(Work Southern Water intend to do in this business plan period 2020-25)

Additionally:

- Delivery of the customer rebates that have been agreed with Ofwat and the GSS compliance projects.
- Seek to deliver the consolidation of the operational and billing CRMs and the new platform data migration enabling a single view of the customer, full contact history management, improved automation, and an integrated self-service portal and significantly enhanced communication capability through an integrated campaign management tool.
- It is highly likely that constraints on investment in 2020–25 will result in CRM consolidation being moved to the next business plan period 2025–30.

Operational
Industry risk:
Wastewater

Outcomes affected

Looking after the environment · Removing wastewater effectively

Risk change in year

Due to increasingly challenging targets in the next business plan period, a number of which were not funded in the price review.

Description

Southern Water's region benefits from a high quality environment, both inland and coastal. It 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.

Risk: Should operational wastewater treatment processes fail, or its sewers and pumping stations become blocked or fail, its assets may discharge sewage, which is not of the required standard, to the environment. This may cause risks to the environment or public health from pollution and/or sewer flooding. There is also the potential to cause damage to the environment or distress to customers. This could lead to prosecution and fines by the Environment Agency and a reduction in stakeholder and customer confidence.

Mitigating activities

(Controls in place/work Southern Water has done)

- Southern Water monitors function and performance of its assets on a continuous basis through a central control room
- Data analytics and reporting team proactively monitor asset Performance
- Southern Water also monitors when its combined sewer overflows are used, to proactively identify infrastructure under stress
- Monitor long-term asset risk and deterioration to target Investment
- Complete planned and proactive maintenance to drive reliability
- Have tested deployable contingency plans when incidents occur. In 2019–20 Southern Water invested at its wastewater treatment works and pumping stations to reduce risks at critical sites as well as in its sewer networks
- Southern Water has implemented an upgrade to its Asset Life Cycle Process to ensure risk and value are considered at each step of the investment cycle to provide best value for money to its customers.

(Work Southern Water intend to do in this business plan period 2020-25)

Additionally:

- A transformation programme – Environment + to embed change in standards, processes and training to drive a compliance and improve environmental performance
- Pollution reduction programme
- Customer awareness/education programmes on avoiding blocked drains, targeted at catchments with blockage hotspots
- A culture transformation programme to develop a behavioural framework for its employees.

Financial
Southern Water specific risk:
Financial

Outcomes affected

Having a firm financial footing
Looking after our assets

Risk change in year

Operational and delivery risk has increased in the next business plan period.

Description

Risk: A reduction in its credit rating or a significant increase in interest rates, 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.

Risk: A failure to maintain certain credit ratings could lead to an increase in interest cost and reduced availability of finance. Southern Water only enters into treasury transactions to manage inherent risk and support prudent funding, not to speculate.

During the year each of the rating agencies downgraded the credit ratings of Southern Water as a result of concern regarding perceived challenges it faces in its delivery of its business plan 2020–25, its relatively weak operational and financial performance and the announcement by Ofwat of the outcome of its investigation into its wastewater performance.

Its current credit ratings are provided on page 108 of the Southern Water Annual Report.

Mitigating activities

(Controls in place/work Southern Water has done)

- Southern Water maintains sufficient cash reserves and liquidity facilities to finance its operations for at least 12 months
- Southern Water takes each of the main credit agency ratios, relevant for its ratings, into account when setting the plan (1-yr, 5-yr)
- Southern Water 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)
- Successful completion of a capital restructure resulted in Southern Water leverage reducing to less than 70% and a reduction in interest costs for the period 2020 to 2030
- Current borrowings are 'fixed rates' or 'index-linked' and Southern Water has no exposure to interest rate rises on its current borrowings
- Southern Water ensures sufficient funds are available for its operational and capital investment programme.

(Work Southern Water intend to do in this business plan period 2020-25)

Additionally:

- Southern Water established a Sustainable ESG Framework during the year and in May 2020 issued its first dual tranche sustainable bond.

Corporate
Southern Water specific risk:
Compliance

Outcomes affected

Having a firm financial footing · Responsive customer service · Looking after the environment · Removing wastewater effectively · A constant supply of high-quality drinking water

Risk change in year

The Risk remains stable as a result of closure of some high profile compliance issues with both Ofwat and DWI, but with some continuing issues still to be resolved with the EA.

Description

Southern Water is a highly regulated business with three main regulators: Ofwat, the Drinking Water Inspectorate (DWI) and the Environment Agency (EA) and high standards of compliance are expected.

Risk: Inadequate culture, structure, capability, governance and assurance could result in failure to meet these high standards consistently. The consequences can be regulatory enforcement, fines, legal action and, in the worst case, the loss of its appointment as a water and wastewater company. As with all companies Southern Water is also required to comply with corporate 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, which have been raised by its regulators. Southern Water continues to be the subject of intense regulatory scrutiny, and this was reflected in the recent Ofwat investigations into its reporting and operation of its wastewater treatment works, and the associated Section 19 Undertakings that Southern Water has committed to carry out over the coming five years. Southern Water has recognised that Southern Water need to improve its culture, capability and performance in this area and improvement programmes are in place. Southern Water has one DWI enforcement order in place, which is referred to in the Risk and Compliance section of its Annual Performance Report 2019–20, which is available on its website: southernwater.co.uk/our-reports.

Southern Water is being prosecuted by the EA for wastewater permit breaches, it has pleaded guilty to charges in court and is assisting the EA with its investigations into legacy issues relating to wastewater sampling compliance. Further detail on these and the recent Ofwat investigation can be found on page 22 and in its Annual Performance Report.

Mitigating activities

(Controls in place/work Southern Water has done)

- A compliance framework, and internal monitoring and assurance is undertaken
- Dedicated Risk and Compliance function
- Subject matter experts and compliance related training
- Annual reporting is externally verified by financial and technical auditors to provide assurance on its compliance with its obligations
- Internal assurance capabilities and process improvements for reporting to its regulators, in particular: Ofwat, the Environment Agency and the Drinking Water Inspectorate
- Reinforced the ‘three lines of defence’ framework for its reporting governance and assurance activity
- Internal controls and processes to mitigate the risk of supplying incorrect or inaccurate regulatory information
- Awareness training is provided throughout its company for non-technical compliance issues, (such as the Bribery Act and Competition Law)
- Compliance with company procedures is reviewed through Self assessment every six months
- Completed a DWI enforcement order relating to improving the reliability and accuracy of its reporting
- Southern Water has agreed an extensive package of Section 19 undertakings with Ofwat as part of its response to the conclusion of the Ofwat investigations into misreporting of its wastewater treatment compliance performance. The undertakings encompass a wide range of activity including payments to customers, technical reviews of its Wastewater Treatment Works, compliance process improvements, improvements to its culture, new work to provide more transparency on its environmental performance and improvements to its board governance processes
- Code of ethics has been refreshed and all staff have been provided training

(Work Southern Water intend to do in this business plan period 2020-25)

Additionally:

- A programme to support the embedment of its Values and Code of Ethics. Southern Water is developing a behavioural Competency framework for its employees over three years (started in 2018–19)
- Continue improvements in training, investment, internal business processes and controls via its transformation programmes to improve compliance and performance
- Embed and mature its regulatory and ethical business framework

Corporate

Industry and Southern Water specific risk:

Climate change

Outcomes affected

Looking after the environment

A constant supply of high-quality drinking water

Risk change in year

Risk increased due to more stringent revised abstraction licences in Hampshire which limits its ability to access water in Hampshire and makes them more vulnerable to weather events.

Description

The impacts of Climate Change will continue to increase its related risks of water resources, drought, flooding, and extreme weather events. Southern Water supplies drinking water to a growing population of more than 2.6 million in areas already classified as under 'severe water stress' in the South East. Therefore it is critical Southern Water is able to continue to ensure access to adequate water resources for its customers. Additionally, 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.

Risk: If Southern Water is unable to improve its resilience to the extreme weather events predicted by the onset of climate change:

- Southern Water will find it increasingly difficult to supply sufficient water to meet the growing demands of its customers though scarcity of water resources, or contamination by saline intrusion of existing water reserves;
- the assets on its sites, or its sewer system network, could more easily be overwhelmed by storm events, leading to flooding or pollution in its region; and
- its coastal sites may become inundated from rising sea levels or at risk of coastal erosion.

Combatting climate change is also about mitigating the causes of climate change. In terms of Southern Water's efforts to join in with the global response to climate change, Southern Water has made a Public Interest Commitment (PIC) to becoming a Carbon neutral (Net Zero) company by 2030 (as part of the English water companies).

Risk: A failure to deliver this promise could lead to problems meeting our net zero carbon obligations and could lead to significant reputational damage and increased scrutiny or financial penalties from Southern Water's regulators, who have signalled a greater emphasis on climate change in their future strategy.

Mitigating activities

(Controls in place/work Southern Water has done)

- Drought Plan containing measures to conserve water, operate its sources and secure additional resources (via drought permits/orders)
- A 50 year Water Resources Management Plan, to provide resilience under different drought severities and a range of climate change scenarios
- Investment in new infrastructure including the Havant Thicket Reservoir
- The RAPID process will lead to new investment in the Western Area
- Part of national research via UKWIR (UK Water Industry Research) on the drainage project on the national headroom capacity and flood risk

Southern Water has invested over £40 million on its water network During 2015–20 including:

- Replacing over 70km of water mains
- Installation of the Hardham winter transfer
- National Environment Programme (NEP) water resources schemes, working to ensure its sources of supply are environmentally sustainable

Southern Water has also invested over £400 million on its

Wastewater service during 2015–20 including:

- Maintenance on 39,500km of sewers and 3,321 wastewater pumping stations
- Replacing/refurbishing 100km of sewers
- Investing £268 million to reduce the number of blockages in its sewer network
- Assessed Southern Water's current Carbon performance position and options to achieve carbon zero by 2030.

Corporate Industry and Southern Water specific risk: Climate change *continued*	
(Work Southern Water intend to do in this business plan period 2020-25) **Additionally:** • Develop long-term asset strategies taking into account latest climate forecasts • Campaigns to increase customer awareness about water availability including its industry leading Target 100 water efficiency programme • Plans to reduce its leakage rates by 15% by 2025 and 50% by 2050 • Our outage reduction plan • An investment planning process to identify and develop schemes to meet demands for water over the next 25 years • Schemes to enhance its natural catchments to improve the water quality and ecology which will increase resilience to a changing climate • Planned schemes to maintain secure supplies which will increase resilience to more extreme climatic events, for example water recycling plants and new pipelines between supply areas • Regional and National initiatives to identify potential strategic water resources for the South East, including desalination, water recycling and new pipelines from neighbouring water companies • Developing drainage and wastewater management plans • Building an extensive onwards customer behavioural programme to reduce blockages further • Southern Water is procuring solar PPAs to help achieve its target of 24% of its energy consumption from renewables generated on ours sites • Southern Water is planning CHP engine replacement on circa half of its CHP portfolio, to improve efficiency and reliability • Plans to improve its energy efficiency via asset replacement (spend to save) and plans to increase its sub-metering • Plans to start its Electric Vehicle (EV) journey in AMP7 • Our net zero carbon commitment.	

Corporate
Southern Water specific risk:
Delivery

Outcomes affected

Looking after the environment · A constant supply of high-quality drinking water · Responsive customer service · Having a firm financial footing · Removing wastewater effectively

Risk change in year

The scale of the requirements of the capital investment delivery programme combined with a tight financial settlement in the period 2020 to 2025 has increased risk in this area.

Description

Southern Water has implemented a capital investment programme of £1.8 billion between 2015 and 2020, and Southern Water has a planned investment programme of £2.1 billion between 2020 and 2025. Southern Water has plans in place to ensure Southern Water will deliver this and Southern Water is working hard to ensure its focus is maintained to complete all works on time.

Risk: If Southern Water is 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 them from fulfilling the promises that Southern Water has made in its business plan with regard to performance measured by its outcome delivery incentive measures, along with commitments to its regulators.

Mitigating activities

(Controls in place/work Southern Water has done)

Southern Water has brought significant investment capability in house (over the course of the current capital investment programme) including:

- An embedded in-house engineering and capital delivery function
- An established long-term delivery partner supply chain
- Improved investment and governance process
- Enhanced management information procedures ensure the delivery of the business plan is given the greatest level of focus within Southern Water
- Enhanced management information procedures ensure the delivery of the business plan is given the greatest level of focus within Southern Water
- Working closely with its regulators and other interested parties to resolve issues as they arise.
- Southern Water has introduced a process to ensure risk and value are considered at each step of the investment cycle to provide best value for money to its customers.

(Work Southern Water intend to do in this business plan period 2020-25)

Additionally:

- Southern Water is enhancing and continuously developing its asset planning systems, processes and capabilities; and
- Maturing its integrated technical decision-making processes.

Corporate
Southern Water specific risk:
Information technology

Outcomes affected

Responsive customer service | Better information and advice | Looking after our assets | Removing wastewater effectively | A constant supply of high-quality drinking water | Having a firm financial footing

Risk change in year

The risk in this area has reduced as we continue to make improvements to our IT infrastructure.

Description

Southern Water provide water and wastewater services to customers across its regional infrastructure, considered to be critical national infrastructure.

Risk: If Southern Water do not maintain the resilience of its operational and enterprise IT systems, their failure could have a significant impact on its business reputation, ability to operate, and the resilience of its operational assets.

Additionally, Southern Water hold and process personal and payment data about its customers and employees so it is important that Southern Water treat this information with respect and in accordance with the requirements of information governance.

Risk: Failure to properly protect the data Southern Water hold could lead to reputational damage and loss of confidence from its customers, as well as significant fines under Data Protection (GDPR) and the Network and Information Systems (NIS) Directive. Its main objective is to be able to manage these risks and issues holistically across the organisation (information governance incorporates physical security as part of its scope).

Southern Water has been rebuilding its IT capability. This transformation has been ongoing for the past three years and has featured in-sourcing of its IT capability, and has seen an improvement in its IT estate.

During the year Southern Water completed transitioning its outsour in house. This has improved its control of its IT services, and correspondingly, an improved IT environment.

Mitigating activities

(Controls in place/work Southern Water has done)

- Refresh and update of IT security and Information
- Governance (IG) policies, standards
- Improvements in the ongoing monitoring and incident management of its IT infrastructure to identify risks and threats
- Continued investment in cyber threat mitigation strategies in response to the ever-changing risk landscape
- Regular testing to re-assess its security measures during the Year
- Security and data protection training (mandatory for all its staff) and associated ‘Red Team’ exercises
- IT has Insourced its IT and security management during 2019 which has significantly improved its knowledge of the IT estate, and its ability to respond to incidents
- Commissioning of new data centre and disaster recovery environments to improve its business continuity and security posture
- Put in place an Information Governance Council with responsibilities for the oversight and governance of its GDPR and NIS compliance
- Undertaken the NIS Directive Compliance response and associated roadmap to deliver changes in SWS
- Undertaken the GDPR Phase 2 Programme to mitigate outstanding IG activities identified in GDPR Phase 1.

(Work Southern Water intend to do in this business plan period 2020-25)

Additionally:

- Continued investment and improvement activities in IT/OT Security in AMP7
- Redesign of its networks incorporating security measures
- Improving application resilience by transitioning to the new Data Centre / Disaster Recovery
- Re-assess IT risks as part of continuing focus on tightened resources in order to highlight emerging corporate risks, impacts and costs.

Corporate

Southern Water specific risk:

Resources

Outcomes affected

Responsive customer service | Better information and advice | Looking after our assets | Removing wastewater effectively | A constant supply of high-quality drinking water | Having a firm financial footing

Risk change in year

Risk remains stable in this area.

Description

The nature of its business model includes the use of long-term contracts for the provision of critical goods, services and works, as well as some outsourced activities. Some of its most critical resources include the supply of chemicals, fuel and spare parts to ensure continuity of service, as well as the energy required to power its operational equipment on a continuous basis, at a commercially viable price.

Risk: There is a risk that a failure to have the required external market capability and capacity, would lead to Southern Water being unable to deliver its committed obligations, required efficiencies in its business plan, and a return for its shareholders. In particular, if Southern Water is unable to source the requisite quantity of chemicals, its treatment processes will be inadequate, leading to poor quality drinking water, pollution of its environment or interruption of its services to its customers.

Risk: There is a risk that a failure to have an effective resilient energy model in place will lead power interruption at its sites and subsequent operational interruption, and cost inefficiencies.

Its employees are one of its most valuable assets.

Risk: Should Southern Water be unable to attract, develop or retain the best employees, Southern Water will be unable to deliver its strategic or investment objectives and the performance of the organisation will suffer.

All the above resources are intrinsic to its ongoing ability to provide its customers with resilient services, while also meeting the expectations of its regulators

Mitigating activities

(Controls in place/work Southern Water has done)

- Its contracts are awarded following rigorous qualifying selection and evaluation criteria as part of its tendering activities. These ensure the successful supplier has the sufficient capabilities and capacity to ethically and efficiently provide the required deliverables, according to the desired level of quality and in a timely fashion

- Southern Water has category managers and sourcing specialists to: help facilitate interactions between the business and the supply market, establish the selection and evaluation criteria to award contracts and help facilitate effective commercial arrangements with supply chain partners. Contract Managers are appointed within Business Functions to monitor performance, supported by dedicated Contract and Supplier Managers to protect value

- Each business function has developed continuity plans in the event that the provision of critical resources from its suppliers becomes interrupted, either through identification of alternative suppliers or stockpiling of necessary resources (e.g. chemicals) supported by its dedicated Contract and Supplier Managers

- Southern Water has developed a Supplier Relationship Management framework covering governance, 'metrics that matter', 'voice of the supplier' and 'customer of choice' principles to drive the right collaborative behaviours with its key supply chain partners, including plans for continuous improvement efficiencies

- Southern Water has regularly tested back-up generators at its sites to ensure power to them does not become interrupted and affect its services to customers

- Southern Water closely monitor its internal employment trends, and benchmark against the wider industry to detect unusual movements and react accordingly

- Southern Water routinely assess its employees' satisfaction through annual engagement surveys, and develop action plans to help identify and improve its company in key areas that may cause dissatisfaction.

Corporate Southern Water specific risk: Resources *continued*	
(Work Southern Water intend to do in this business plan period 2020-25) **Additionally:** • Define and implement Value Management Units (VMUs) to drive business value, demand management, spend control and cost category leadership • Drive a strategic approach to sourcing & category management activity focusing on value management business • Develop and implement cost category strategies aligned with business objectives • In partnership with the business and supply chain partners, embed new commercial model and ways of working to ensure supply chain efficiencies are realised • Create a new centralised Contract and Supplier Management Capability • Develop detailed procedures, processes, tools and templates and roll-out of Contract Management Centre of Excellence ready for use by Contract Managers in the business • Embed AMP7 Supplier Relationship Management framework to provide an enabler for the underpinning behaviours to deliver AMP7 required outcomes • Create a means to better harvest and deliver supplier Continuous Improvement • Where viable, Southern Water is developing its own on-site generation capabilities to reduce the dependency on national grid. This is linked to Southern Waters renewable energy ODI target to achieve 24% self-generation by 2022–23	

Corporate

Southern Water specific risk:
Health, Safety and Wellbeing

Outcomes affected

Having great people
Working in partnership

Risk change in year

Southern Water has seen an increase in reported instances this year, however, this reflects improvements in its reporting of incidents which is giving them a much more accurate view of its level of risk.

Description

The health, safety and wellbeing of its employees and the public while Southern Water provides 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, have the potential to cause significant harm.

Risk: Failure to comply with its Health and 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, its own employees have liability in this area. Finally, emotional and physical wellbeing is an important part of caring about its employees and the company recognises that wellbeing has a major impact on all aspects of its work.

Mitigating activities

(Controls in place/work Southern Water has done)

- A clearly defined strategy, safety protocols and standards are set
- Health safety and wellbeing performance and compliance is monitored and reported monthly to the Board and to the triannual Risk Committee
- The Executive Leadership Team and Operational Leadership Team monitors health and safety performance monthly
- Its processes and procedures are continuously reviewed and changed in line with legislation and industry best practice
- Employees receive suitable health safety and wellbeing training, including mental health awareness training
- Southern Water monitors the performance of its suppliers and delivery partners to ensure they meet its standards and expectations for health safety and wellbeing
- Near misses are reported, investigated and tracked
- Access to a copy of the corporate policy statement and health safety and wellbeing processes and procedures for all employees
- Comprehensive health safety and wellbeing processes and procedures help prevent injury and occupational ill health to its employees and contractors.

(Work Southern Water intend to do in this business plan period 2020-25)

Additionally:

- Committed to the 'Time to Change' programme to raise awareness and understanding of mental health issues, and established a wellbeing and mental health road map.

Corporate

Industry risk:

Regulatory and corporate affairs

Outcomes affected

Responsive customer service | Better information and advice | Having a firm financial footing | Looking after the environment | Having great people | Working in partnership

Risk change in year

Risk maintained following Ofwat's Final Determination and potential changes in future regulatory environment and future price reviews.

Description

During recent years, there has been a significant focus on the water industry at a political and regulatory level. This has included a greater use of market mechanisms to promote innovation and efficiency, and the introduction of competition (with the potential to extend retail competition to all residential customers), as well as recent debates in Government over ownership. The recent PR19 Final Determination highlighted the challenges of meeting customer expectations.

Risk: Failure to effectively monitor and adapt to any changes in Southern Water's regulatory frameworks (Ofwat, Environment Agency or Drinking Water Inspectorate) may lead to potential un-forecasted increases in administrative costs, reduced revenue, and ultimately non-compliance. The resilience of the entire sector is growing as an issue and is reflected in the latest policy from the National Infrastructure Commission.

Risk: Changes in the political landscape (e.g. Brexit, or change in Government) may cause costly consequential impacts on the water sector to which we will have to adapt.

Risk: Our current business plan and approved pricing structure runs until 2025. The Final Determination imposes stringent financial constraints, ODI and costs targets, making longer- term resilience more challenging.

Mitigating activities

(Controls in place/work Southern Water has done)

- Integrated Business Planning process has developed our AMP7 execution plan to implement delivery of our objectives in the period 2020–25
- Southern Water will respond to all Ofwat's consultations that will impact upon its business
- Southern Water also provide information to the Government, regulators, customers and the public as appropriate to help them to make informed decisions
- Southern Water is well advanced with its Brexit planning and have worked with the wider industry and Government to ensure an Integrated approach
- Southern Water closely monitor developments in the requirements from all of our regulators, inter alia, Ofwat, The Drinking Water Inspectorate and the Environment Agency
- Southern Water maintain close dialogue with Government, Ofwat and other regulators on key issues.

(Work Southern Water intend to do in this business plan period 2020-25)

Additionally:

- Work with its customers to understand their perception of its AMP7 delivery, and future ambitions
- Continue to engage constructively with all of its regulators in regards to the water scarcity challenges Southern Water face in the South East of England (including the joint development of Havant Thicket Winter Storage Reservoir with Portsmouth Water)
- Monitor carefully the appeals to the Competition and Markets Authority by four companies in the sector against their final Determinations
- Work with our regulators on how Southern Water better understand and address our customers' needs to enable successful outcomes on resilience in the next price review period 2025-30.

Corporate

Southern Water specific risk:

Transformation

Outcomes affected

Responsive customer service · Better information and advice · Having a firm financial footing · Looking after the environment · Removing wastewater effectively · Looking after our assets · A constant supply of high-quality drinking water · Affordable bills

Risk change in year

Risk increasing due to scale of changes required for the 2020–25 period, year one financial constraints and COVID-19 pandemic.

Description

Through a comprehensive and ongoing transformation programme, the business is completely committed to delivering the level of service its customers, and all of its stakeholders, expect and deserve. The degree of transformation in itself brings with it both risks and significant opportunities, which Southern Water will closely monitor.

Risk: The business has delivered the significant volume of change required to transform the business over the 2020–25 period while maintaining focus on delivery of performance objectives and deliver shareholder value in the final year of this regulatory period. There is a risk that these business changes will not lead to delivery of efficiencies, improve Southern Water's general performance, and support its incentive performance.

However, due to year one financial constraints, and the impacts caused by the COVID 19 pandemic, its ability to conclude and sustain the volume of change could be impacted due to further restraints in capacity or capability to effectively coordinate the required changes, which might result in the possible failure to deliver some customer promises, including financial targets and incentives.

Mitigating activities

(Controls in place/work Southern Water has done)

- Programme to improve its approach to risk and resilience Management
- Extensive review of its current processes in 2019–20 to identify key improvement areas and develop enterprise risk management
- Programme to address both the organisational capability needs and to improve its resilience baseline understanding of financial, corporate and operational activities
- All initiatives are developed using standard processes and business cases, ranked in order of priority, resources and wider business impact
- Transformation portfolio, office, and governance forums Established
- Scope includes initiatives in the transformation portfolio and portfolio dashboard, risk registers, benefit monitoring framework, resources, capacity and capability to mitigate the risk
- External partner support to provide capacity and capability where Required
- Southern Water has a prioritised and comprehensive change Training programme in place to support sustainability of major change activities. Prioritisation managed through business-wide impact assessments
- Execution plan developed for 2020 to 2025 and endorsed by the Board in April 2020.

(Work Southern Water intend to do in this business plan period 2020-25)

Additionally:

- Review its major transformational activities in line with year one financial constraints and the developing COVID-19 continuity plans
- Continue to prioritise programmes to reduce its underlying internal costs and the costs of delivering service improvements
- Continue to develop programmes to improve its water and waste treatment operational processes and performance (Water First and Environment+).

Corporate

Southern Water specific risk:

COVID-19

Outcomes affected

Having great people · Responsive customer service · Looking after our assets · Working in partnership · A constant supply of high-quality drinking water · Better information and advice · Removing wastewater effectively · Having a firm financial footing · Looking after the environment

Risk change in year

Coming on top of a very tight Final Determination, the COVID-19 pandemic has impacted the way Southern Water carries out its business and has presented significant challenges to the Financial viability of the business, its ability to provide its essential services to customers and its ability to meet regulatory targets and expectations. In addition, the risk has led to them transforming the way Southern Water does its business with increased remote working and additional processes to enable safe working for field team working.

Description

The COVID-19 event has put unprecedented pressure on the overall operation of the organisation. This has impacted all areas. However Southern Water has moved quickly to ensure Southern Water maintain service levels to its customers and are ensuring that its employees and contractors are able to carry out their work safely. Southern Water has provided payment breaks to support customers during challenging financial circumstances. The move to home working for a large section of its staff has impacted the way Southern Water work. If uncontrolled, COVID-19 would have potential to cause significant harm to ability to carry out its essential services and put its colleagues at risk of COVID-19.

Risk: Failure to manage this risk could lead to the realisation of a number of issues including:

- Colleagues could be at risk of COVID-19, anxiety or other health and wellbeing issues
- Its supply chain could not meet its needs, with the consequential impact upon its services
- Operational failures due to resource gaps, chemical supplies/ parts restrictions and customer demand increases /behaviour change could impact its essential services to customers of water supply, wastewater collection and customer contact
- Managing concurrent events (e.g. asset failure, heat wave, property flooding) during COVID-19 will be more challenging due to additional social distancing and/or the increased number of vulnerable customers that will need additional support
- Operational performance or regulatory duty issues linked to COVID-19 could result in challenges associated with PR19 regulatory penalties (ODIs) or other regulatory action such as enforcement or prosecution
- Adverse financial impact due to revenue loss, increased bad debt and additional COVID-19 costs.

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Mitigating activities

(Controls in place/work Southern Water has done)

- Pandemic readiness commenced in January 2020, with a dedicated COVID-19 management team in place
- Structured governance is in place to manage with Board and Executive leadership team engagement and oversight
- A structured Business Continuity approach applied prioritised on essential services. Southern Water engage with colleagues and colleague representatives, providing regular COVID-19 updates, additional guidance, and new ways of working
- Southern Water has risk assessed new ways of working and published its Company risk assessment
- Southern Water has provided additional IT infrastructure, hardware and other equipment to support remote working
- Additional finance has been raised to stabilise the financial viability of the business in response to falling income
- Supporting customers with payment breaks
- Working with retailers and Ofwat as to support falling income challenges in the non household retail market
- Its investment plans have been reviewed to understand phasing due to COVID-19 delay and/or to mitigate the financial risks
- Engaged its supply chain to monitor and mitigate risk
- Southern Water is in regular dialogue with regulators to update on its response
- Southern Water is also engaged with Water UK and other industry fora to ensure appropriate messages are communicated to regulator and government and sector support is utilised where appropriate.

(Work Southern Water intend to do in this business plan period 2020-25)

Additionally:

- Southern Water will transition to medium risk management of the consequences of COVID-19, while retaining readiness for local outbreaks or a second wave
- Southern Water is reviewing how Southern Water operate and look to benefit from opportunities that arise as Southern Water adopt new ways of working.

Directors' report for the year ended 31 March 2020

The directors of Greensands Holdings Limited (Registered Number: Jersey 98700) present their report and the audited financial statements for the year to 31 March 2020.

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.

In carrying out these activities the company is reliant on distributions from companies lower down in the group structure as its sole source of capital.

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 to15 and pages 18 to 40.

Future developments

The information regarding future developments of the company can be found in the Strategic Report sections on pages 2 to 15 and pages 18 to 40.

Results and dividends

The consolidated statement of other comprehensive income on page 47 shows the Group's results and profit 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 2020 (2019: £nil).

The company generated a loss after tax for the financial year of £236.8 million (2019: loss £780.7 million). The loss this year has been caused by recognising an impairment loss of £236.8 million in relation to the company's investment in its subsidiary, Greensands Europe Ltd (GSE) and the amounts owed by group undertakings. Please see note 7 for further details.

Directors and their interests

The directors who held office during the year ended 31 March 2020 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.

B Goodwin	Alternate director to A Gilbert to 5 August 2019 and to John Lynch 5 August to 28 November 2019. Resigned 28 November 2019
B Somes	
R Wall	
A Gilbert	Resigned 5 August 2019
P Hedley	
S Howard	
T C Desfontaines	Alternate to Bronte Somes resigned 29 November 2019
J Lynch	Appointed 5 August 2019

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 £0.5 million (2019: £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. The Group via 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 Group'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 people from across the Group and its partners to share the latest developments within the health and safety industry. The Group 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 Group and fosters a culture to ensure that the Group is 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

Details of the financial risk management are covered in the risk section on page 23 of the Strategic Report and note 23 to the consolidated financial statements.

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 credit ratings of entities within the Group and financial risk.

During this process it was identified that due to the implementation of the 2019 Final Determination for SWS and due to COVID-19 there are possible scenarios where covenants applicable to the debt held in the group structure above Southern Water Services Limited may be stressed over the next 12 months. In addition the liquidity available to pay interest on this debt is scheduled to be exhausted by October 2021 and the associated financing may be subject to certain credit rating covenants outside of the Greensands Group Directors' control.

The Directors have initiated a strategic review and consider that there are a range of options available to them in order to manage these matters. They are in early dialogue with the lenders involved and are confident that these can be resolved. These discussions, however, are at an early stage and have not been finalised at the time of issuing these financial statements. Reflecting that these have not been agreed this represents a material uncertainty associated with the going concern assumption. Overall the directors have a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future, being a period of at least 12 months from the approval of these financial statements.

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 15 and 18 to 40.
- The statements of going concern by the Board of the operating company, Southern Water Services (SWS) and representations made by management of the underlying operating company.
- The potential impact of COVID-19 on the group's operations and financial performance.
- 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 32 of the financial statements and further details of the company's liquidity position are set out on pages 10 to 15. This sets out that SWS is fully protected, and fully isolated, from a default at any Greensands company.
- The Group had cash and committed undrawn bank facilities totalling £1,170.0 million at 31 March 2020 (2019: £934.3 million) which are available at various levels of the financing structure. These funds are sufficient to fund the operating and capital investment activities of the principal operating company within the group, SWS 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 2020 to March 2025.
- Additional financing of £825.0 million (net £814.9 million) was raised in May 2020, for SWS, under a sustainability framework which ensures proceeds are used for environmental, green, and social purposes, including the repayment of debt issued for the same purpose. The use of proceeds will include investment in the PR19 business plan and the repayment of a £350.0 million bond maturing 31 March 2021. This replaces a short-term revolving credit facility of £700.0 million that was in place from 31 March 2020.

- The fact that companies above SWS in the Group structure rely on dividends from the operating company to enable them to make interest payments on their borrowings. The dividend policy of SWS is set out on page 8 above.

- The five-year business plan projections for SWS which indicate that in the absence of outperformance, it is unlikely that there will be dividend payments to the Group for the period to March 2025.

- The Group has sufficient liquidity available to meet the requirements of its borrowing facilities for a period of at least 12 months from the date of signing the financial statements and up to October 2021 at which point the Group may face a liquidity shortage absent the execution of any mitigation options and activities.

- The engagement, by the Board, of external specialist advisors to identify and assess the mitigation options and activities available, to the Board and shareholders, in order to financially restructure the Group. The financial restructuring plans under consideration by the Board, and shareholders, amongst a range of options in this strategic review include proposed covenant amendments, liquidity being made available and/or debt restructuring to provide liquidity to meet the requirements of the Group's borrowing facilities. Whilst initial dialogue has begun final agreement on these plans has yet to be reached with debt holders.

- The Eurobonds issued by Greensands Europe Limited continue to accrue interest but hold no requirement for payment in the foreseeable future and are held by the shareholders.

As a result of the factors listed above, the directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the next 12 months and they continue to adopt the going concern basis of accounting in preparing the annual financial statements. However, there is a material uncertainty related to a financial restructuring which has not been completed at the time of issuing the financial statements as identified above, which raise significant doubt about the ability of the Group and the Company to continue as a going concern and therefore the Group and Company may be unable to realise their assets and discharge their liabilities in the normal course of business.

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

Southern Water 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 Group; 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 Group, 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:

R Manning
Company Secretary
27 July 2020

Financial statements

Consolidated income statement

For the year ended 31 March 2020

	Note	**2020**	2019
		£m	£m
Continuing operations			
Revenue	5	**878.0**	876.3
Regulatory settlement	5	**-**	(135.5)
Total revenue		**878.0**	740.8
Other operating income	5	**1.4**	1.2
Operating costs before trade receivables impairment charge, depreciation, amortisation and regulatory settlement		**(376.9)**	(340.5)
Trade receivables impairment charge		**(29.6)**	(10.7)
Operating costs before depreciation, amortisation and regulatory settlement		**(406.5)**	(351.2)
Depreciation and amortisation		**(271.3)**	(279.3)
Regulatory settlement		**-**	(3.0)
Total operating costs		**(677.8)**	(633.5)
Operating profit	6	**201.6**	108.5
Operating profit before regulatory settlement		**201.6**	247.0
Regulatory settlement		**-**	(138.5)
Operating profit		**201.6**	108.5
Other income	6	**-**	0.2
Profit on disposal of property, plant and equipment	6	**0.9**	0.7
Finance income	10	**32.9**	10.5
Finance costs	10	**(374.9)**	(384.5)
Fair value gains/(losses) on derivative financial instruments	10	**349.4**	(217.4)
Net finance costs	10	**7.4**	(591.4)
Profit/(loss) before taxation		**209.9**	(482.0)
Taxation (charge)/credit	11	**(106.5)**	31.7
Profit/(loss) for the financial year		**103.4**	(450.3)

The notes on pages 53 to 111 form part of these financial statements.

Consolidated statement of other comprehensive income

For the year ended 31 March 2020

	Note	**2020**	2019
		£m	£m
Profit/(loss) for the financial year		**103.4**	(450.3)
Other comprehensive income/(loss):			
Items that cannot be reclassified to profit or loss:			
Actuarial gain/(loss) on pension scheme	25	**111.7**	(24.2)
Movement on deferred tax relating to retirement benefit obligations	24	**(17.5)**	4.1
Total other comprehensive income/(loss) for the year, net of tax		**94.2**	(20.1)
Total comprehensive income/(loss) for the year attributable to the owners of the company		**197.6**	(470.4)

Consolidated statement of financial position

as at 31 March 2020

	Note	**Group 2020 £m**	Group 2019 £m
Non-current assets			
Goodwill	12	**85.1**	85.1
Intangible assets	13	**42.1**	45.6
Property, plant and equipment	14	**6,495.4**	6,228.1
Investments	16	**0.1**	0.1
Derivative financial instruments	23	**203.0**	46.2
		6,825.7	6,405.1
Current assets			
Inventories	17	**5.1**	4.7
Trade and other receivables	18	**212.5**	227.7
Cash and cash equivalents	33	**282.5**	514.8
		500.1	747.2
Total assets		**7,325.8**	7,152.3
Current liabilities			
Trade and other payables	19	**(263.1)**	(367.0)
Borrowings	20	**(778.4)**	(747.3)
Lease liabilities	22	**(2.2)**	(0.2)
Regulatory settlement liability	26	**(35.6)**	(3.0)
Provisions for liabilities	27	**(5.1)**	(1.2)
		(1,084.4)	(1,118.7)
Non-current liabilities			
Borrowings	21	**(5,270.2)**	(5,203.6)
Lease liabilities	22	**(28.2)**	(0.8)
Derivative financial instruments	23	**(1,376.4)**	(1,429.0)
Deferred tax liabilities	24	**(416.3)**	(292.3)
Retirement benefit obligations	25	**(62.5)**	(186.7)
Regulatory settlement liability	26	**(99.9)**	(135.5)
Provisions for liabilities	27	**(4.7)**	(5.4)
Other non-current liabilities	28	**(32.7)**	(27.4)
		(7,290.9)	(7,280.7)
Total liabilities		**(8,375.3)**	(8,399.4)
Net liabilities		**(1,049.5)**	(1,247.1)
Equity			
Called up share capital	29	**921.9**	921.9
Share premium account	30	**4.5**	4.5
Non-distributable reserve	31	**60.2**	53.8
Retained losses	32	**(2,036.1)**	(2,227.3)
Total deficit		**(1,049.5)**	(1,247.1)

The financial statements of Greensands Holdings Limited (Registered Number: Jersey 98700) on pages 46 to 111 were approved by the Greensands Holdings Limited Board and authorised for issue on 27 July 2020. They were signed on its behalf by

S Howard
Director

Company statement of financial position
as at 31 March 2020

	Note	Company 2020 £m	Company 2019 £m
Non-current assets			
Investments	16	**-**	-
Other non-current assets	15	**-**	236.9
		-	236.9
Current assets			
Trade and other receivables	18	**0.2**	-
		0.2	-
Total assets		**0.2**	236.9
Current liabilities			
Trade and other payables	19	**(32.1)**	(32.0)
Non-current liabilities			
Borrowings	21	**(59.2)**	(59.2)
Total liabilities		**(91.3)**	(91.2)
Net (liabilities)/assets		**(91.1)**	145.7
Equity			
Called up share capital	29	**921.9**	921.9
Share premium account	30	**4.5**	4.5
Retained losses	32	**(1,017.5)**	(780.7)
Total (deficit)/equity		**(91.1)**	145.7

The company reported a loss for the financial year ended 31 March 2020 of £236.8 million (2019: £780.7 million). Further details can be found in note 7.

The financial statements of Greensands Holdings Limited (Registered Number: Jersey 98700) on pages 46 to 111 were approved by the Greensands Holdings Limited Board and authorised for issue on 27 July 2020. They were signed on its behalf by

S Howard
Director

Consolidated statement of changes in equity

For the year ended 31 March 2020

	Called up share capital (Note 29) £m	Share premium account (Note 30) £m	Non-distributable reserve (Note 31)	Retained Earnings Restated* (Note 32) £m	Total £m
At 1 April 2018	**921.9**	**4.5**	**46.7**	**(1,749.8)**	**(776.7)**
Profit/(loss) for the financial year	-	-	8.5	(458.8)	(450.3)
Other comprehensive loss for the year	-	-	-	(20.1)	(20.1)
Total comprehensive loss for the year	-	-	8.5	(478.9)	(470.4)
Reserves transfer*	-	-	(1.4)	1.4	-
Balance at 31 March 2019	**921.9**	**4.5**	**53.8**	**(2,227.3)**	**(1,247.1)**
Profit for the financial year	-	-	7.8	95.6	103.4
Other comprehensive income/(loss) for the year:					
Actuarial gain on pension scheme	-	-	-	111.7	111.7
Movement on deferred tax relating to retirement benefit obligations	-	-	-	(17.5)	(17.5)
Total comprehensive income for the year	-	-	7.8	189.8	197.6
Reserves transfer*	-	-	(1.4)	1.4	-
Balance at 31 March 2020	**921.9**	**4.5**	**60.2**	**(2,036.1)**	**(1,049.5)**

* The non-distributable reserve arose upon adoption of IFRS 15 and relates to deemed revenue on adoption of assets from customers and is being amortised to reserves in line with the depreciation of the related assets.

Company statement of changes in equity
For the year ended 31 March 2020

	Called up share capital (Note 29) £m	Share premium account (Note 30) £m	Retained earnings (Note 32) £m	Total £m
Balance at 31 March 2018	**921.9**	**4.5**	**-**	**926.4**
Loss and total comprehensive loss for the financial year	-	-	**(780.7)**	**(780.7)**
Balance at 31 March 2019	**921.9**	**4.5**	**(780.7)**	**145.7**
Loss and total comprehensive loss for the financial year	-	-	**(236.8)**	**(236.8)**
Balance at 31 March 2020	**921.9**	**4.5**	**(1,017.5)**	**(91.1)**

Consolidated statement of cash flows

For the year ended 31 March 2020

	Note	**2020** **£m**	2019 £m
Cash from operations		**476.8**	492.3
Tax paid		**(0.1)**	(0.1)
Net cash from operating activities	33	**476.7**	492.2
Investing activities			
Interest received		**29.8**	8.9
Purchase of property, plant and equipment		**(461.6)**	(396.5)
Purchase of intangible assets		**(11.8)**	(7.2)
Receipt of grants and contributions*		**-**	2.3
Proceeds on disposal of property, plant and equipment		**0.5**	0.3
Proceeds from disposal of business		**-**	1.8
Net cash used in investing activities		**(443.1)**	(390.4)
Financing activities			
Interest paid		**(323.6)**	(229.8)
Payment of derivative accretion		**(12.8)**	(4.7)
Repayment of borrowings		**(630.0)**	(397.7)
Repayments of obligations under finance leases		**(1.5)**	(0.6)
Advances/(payments) on restructure of derivative instruments		**140.0**	(122.5)
Issue costs of new loans		**-**	(1.1)
Proceeds of new loans		**562.0**	882.1
Net cash (used in)/from financing activities		**(265.9)**	125.7
Net (decrease)/increase in cash and cash equivalents		**(232.3)**	227.5
Cash and cash equivalents at beginning of the year		**514.8**	287.3
Cash and cash equivalents at end of the year		**282.5**	514.8

* Contributions and grants received of £6.8 million have been presented as operating cash flows in 2019–20 (investing cash flows in 2018–19) as these credits are released to operating costs over the useful economic life of the non-current asset to which they relate. These were not material in 2018–19 therefore no change to prior period cash flow presentation was made.

Company statement of cash flows

For the year ended 31 March 2020

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 2020

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 15.

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 IFRS 16 ‘Leases’, and measurements that have some similarities to fair value but are not fair value, such as net realisable value in IAS 2 ‘Inventories’ or value in use in IAS 36 ‘Impairment of Assets’.

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

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date;
- Level 2 inputs are inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly; 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 2020

1 Accounting policies (continued)

Adoption of new and revised accounting and financial reporting standards

This is the first set of the group's annual financial statements where IFRS 16 'Leases' has been applied.

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 is effective for the group from 1 April 2019. The changes effected by the new lease accounting model resulted in all leases (including those currently classified as operating leases) of more than 12 months (with some limited exceptions such as low value leases of £5,000 or less) being recognised on the company's statement of financial position.

Changes to significant accounting policies including the impact on the results or net assets of the group are set out in note 3.

The Group has not applied the following new and revised accounting standards that have been issued but are not yet effective.

In January 2020, the EU endorsed the IASB-published amendments to IFRS 9 'Financial Instruments', IAS 39 'Financial Instruments: Recognition and Measurement' and IFRS 7 'Financial Instruments: Disclosures' in respect of interest rate benchmark reform, effective for annual periods beginning on or after 1 January 2020 with early adoption permitted. These amendments provide temporary exceptions from applying specific hedge accounting requirements where a hedging relationship is directly or indirectly affected by the market-wide interest rate benchmark reform, where certain financial market benchmark reference rates (such as LIBOR) will be required to be changed to nearly risk-free alternative rates.

The directors do not expect that the adoption of the standards listed above will have a material impact on the financial statements of the Group in future periods as the Group does not currently engage in hedge accounting.

Going concern

The Group 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 40.

The directors have undertaken a detailed review of the company's liquidity requirements compared with the cash and facilities available, the financial covenant position including projections based on future forecasts, the current credit ratings of entities within the Group and financial risk.

During this process it was identified that due to the implementation of the 2019 Final Determination for SWS and due to COVID-19 there are possible scenarios where covenants applicable to the debt held in the group structure above Southern Water Services Limited may be stressed over the next 12 months. In addition the liquidity available to pay interest on this debt is scheduled to be exhausted by October 2021 and the associated financing may be subject to certain credit rating covenants outside of the Greensands Group Directors' control.

The Directors have initiated a strategic review and consider that there are a range of options available to them in order to manage these matters. They are in early dialogue with the lenders involved and are confident that these can be resolved. These discussions, however, are at an early stage and have not been finalised at the time of issuing these financial statements. Reflecting that these have not been agreed this represents a material uncertainty associated with the going concern assumption. Overall the directors have a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future, being a period of at least 12 months from the approval of these financial statements.

In forming this assessment the directors have considered the information set out in the Directors Report on page 44 above.

As a result of the factors listed above, the directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the next 12 months and they continue to adopt the going concern basis of accounting in preparing the annual financial statements. However, there is a material uncertainty related to a financial restructuring which has not been completed at the time of issuing the financial statements as identified above, which raise significant doubt about the ability of the Group and the Company to continue as a going concern and therefore the Group and Company may be unable to realise their assets and discharge their liabilities in the normal course of business.

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2020

1 Accounting policies (continued)

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.

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.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2020

1 Accounting policies (continued)

Revenue recognition

The group has adopted IFRS 15 'Revenue from Contracts with Customers' from 1 April 2018.

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

Revenue from the supply of services represents the value of services provided under contracts to the extent that there is a right to consideration and is recorded at the fair value of the consideration due.

The group recognises revenue when it transfers control over a product or service to a customer.

Revenue is recognised when the amount of revenue can be measured reliably 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.

<u>Water and wastewater services</u>
The company supplies water and wastewater services to customers in Sussex, Kent, Hampshire and the Isle of Wight. The performance obligation is the supply of services over the contractual term and is considered to be satisfied as the customer consumes based on the volume of water supplied. This is the point at which revenue is recognised.

For provisioning purposes, revenues and outstanding arrears are segmented based on customer characteristics. Since the group's only operating company, Southern Water Services Limited is under a statutory obligation to provide water and wastewater services to its domestic properties these services could be provided to customers who are unlikely to pay. Should a group of customers attract a provision rate of 100%, i.e. assessed as not generating economic benefit, revenue would not be recognised. In 2019–20 no segment of customers met this 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. Customer rebates are shown as a reduction in revenue.

<u>New connections and infrastructure charges</u>
Under IFRS 15 the performance obligation is satisfied at the point of provision of the new connection to the network, so fees received in respect of the connection are recognised at this point.

<u>Requisitions</u>
For requisitions of water mains and public sewers, the group has determined that the performance obligation is satisfied at the point of completion of the requisition works and connection of the water main or lateral drain, and the total consideration receivable is recognised in full as revenue at that point.

<u>Diversions</u>
Contributions received in respect of diversions of water mains and sewers are recognised upon completion of the diversion of the water main or sewer.

<u>Adoptions</u>
Adoptions of assets are recognised at fair value of the asset upon adoption i.e. the point at which control of the asset is obtained, within revenue as an increase to non-distributable reserves.

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 group and the amount of revenue can be measured reliably).

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2020

1 Accounting policies (continued)

Provision for impairment of trade receivables

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

This assessment generates an expectation for the level of recovery of the outstanding receivables balance and therefore the lifetime expected credit loss.

The model considers current and forward looking macro-economic events to the extent that the past response of customers to changes in the economy is built into the expected future cash collection performance for each customer segment.

Taxation

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 2020

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 in note 12 with the carrying value being reviewed for any indicators of impairment on an annual basis.

Intangible assets

Intangible assets comprises:

i. Assets under development.
ii. Other assets – comprising software, studies and development projects.

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.

Capitalised development costs are for plant installed on some of our sites to test new processes for performance data and scalability. The data is used to identify innovative and efficient future assets and processes to meet new higher environmental or quality standards. Development costs capitalised are depreciated over three to five years.

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

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 costs of repairs to the infrastructure network are recognised in the income statement as they arise.

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

Items of property, plant and equipment that are transferred to the company from customers or developers are initially recognised at fair value in accordance with IFRS 15 ‘Revenue from Contracts with Customers’.

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2020

1 Accounting policies (continued)

Property, plant and equipment (continued)

The corresponding credit is recorded as revenue through non-distributable reserves and released to retained earnings over the expected useful lives of the related assets.

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

Subsequent costs are included in the asset's carrying amount or recognised as separate assets, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the 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

		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.

Right-of-use assets are depreciated over the shorter period of the lease term and the useful life of the underlying asset. If a lease transfers ownership of the underlying asset or the cost of the right-of-use asset reflects that the group expects to exercise a purchase option, the related right-of-use asset is depreciated over the useful life of the underlying asset.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2020

1 Accounting policies (continued)

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 IFRS 15 as defined by the nature of the receipt.

Infrastructure receipts associated with new connections are recognised as revenue when they are receivable.

Deemed contributions from the transfer of non-current assets from customers are recognised as revenue through non-distributable reserves and released to retained earnings over the life of the asset.

Grants and contributions receivable in respect of 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 received in respect of diversions of water mains and sewers are treated as deferred income and recognised as revenue upon completion of the diversion.

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

Leases

The group has adopted IFRS 16 ‘Leases’ with effect from 1 April 2019.

(i) The Group as lessee

The group assesses whether a contract is or contains a lease, at inception of the contract. The group recognises a right-of-use asset and a corresponding lease liability with respect to all lease arrangements in which it is the lessee, except for short-term leases (defined as leases with a lease term of 12 months or less) and leases of low value assets (£5,000 or less). For these leases, the group recognises the lease payments as an operating expense on a straight-line basis over the term of the lease unless another systematic basis is more representative of the time pattern in which economic benefits from the leased assets are consumed.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2020

1 Accounting policies (continued)

Lease payments included in the measurement of the lease liability comprise:

- fixed lease payments;
- variable lease payments that depend on an index or rate, initially measured using the index or rate at the commencement date;
- the amount expected to be payable by the lessee under residual value guarantees;
- the exercise price of purchase options, if the lessee is reasonably certain to exercise the options; and
- payments of penalties for terminating the lease, if the lease term reflects the exercise of an option to terminate the lease.
- The lease liability is presented as a separate line in the statement of financial position.

The lease liability is subsequently measured by increasing the carrying amount to reflect interest on the lease liability (using the effective interest method) and by reducing the carrying amount to reflect the lease payments made.

The group remeasures the lease liability (and makes a corresponding adjustment to the related right-of-use asset) whenever:

- The lease term has changed or there is a significant event or change in circumstances resulting in a change in the assessment of exercise of a purchase option, in which case the lease liability is remeasured by discounting the revised lease payments using a revised discount rate.
- The lease payments change due to changes in an index or rate or a change in expected payment under a guaranteed residual value, in which cases the lease liability is remeasured by discounting the revised lease payments using an unchanged discount rate (unless the lease payments change is due to a change in a floating interest rate, in which case a revised discount rate is used).
- A lease contract is modified and the lease modification is not accounted for as a separate lease, in which case the lease liability is remeasured based on the lease term of the modified lease by discounting the revised lease payments using a revised discount rate at the effective date of the modification.

The group did not make any such adjustments during the year.

The right-of-use assets comprise the initial measurement of the corresponding lease, lease payments made at or before the commencement day and any direct initial costs. They are subsequently measured at cost less accumulated depreciation and impairment losses.

Right-of-use assets are depreciated over the shorter period of lease term and useful life of the underlying asset. The depreciation starts at the commencement date of the lease.

The right-of-use assets are presented separately from other assets in the notes to the financial statements.

The group applies IAS 36 to determine whether a right-of-use asset is impaired and accounts for any identified impairment loss as described in the ‘Property, Plant and Equipment’ policy.

As a practical expedient, IFRS 16 permits a lessee not to separate non-lease components, and instead account for any lease and associated non-lease components as a single arrangement. The group has used this practice with respect to the maintenance element associated with vehicle leases.

(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.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2020

1 Accounting policies (continued)

Non-current asset investments

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

Cash and cash equivalents

Cash and cash equivalents comprise cash and short-term bank deposits 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.

Inventories

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

Deferred revenue

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

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

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 operated a defined benefit pension scheme which closed on 31 March 2020, 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 25.

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2020

1 Accounting policies (continued)

Retirement benefits (continued)

Profit 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.

Financial instruments

The group has adopted IFRS 9 ‘Financial Instruments’ from 1 April 2018.

IFRS 9 introduces new requirements for 1) the classification and measurement of financial assets and financial liabilities, 2) impairment for financial assets and 3) general hedge accounting. There was no material impact resulting from the application of this standard.

In relation to the impairment of financial assets, IFRS 9 requires an expected credit loss model as opposed to an incurred credit loss model under IAS 39. The expected credit loss model requires entities to account for expected credit losses and changes in those expected credit losses at each reporting date to reflect changes in credit risk since initial recognition of the financial assets. In other words, it is no longer necessary for a credit event to have occurred before credit losses are recognised.

Financial assets and financial liabilities are recognised in the 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 receivable
Loans receivable that have fixed or determinable payments that are not quoted in an active market are classified as ‘held to collect’. Loans receivable are measured at fair value on initial recognition and subsequently measured at amortised cost using the effective interest method, less any impairment. Interest income is recognised by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial.

(ii) Trade receivables and accrued income
Trade receivables and accrued income are classified as ‘held to collect’ and measured at fair value on initial recognition. If there is objective evidence that the amount receivable is impaired it is written down to its recoverable amount, with the irrecoverable amount being recognised as an expense in operating costs.

The group applies an approach permitted by IFRS 9 for estimating expected credit losses on trade receivables. For trade receivables that are assessed not to be impaired individually, expected credit losses are estimated based on the group’s historical experience of trade receivable write-offs, and forward-looking macro-economic events to the extent that the past response of customers to changes in the economy is built into the expected future cash collection performance for each customer segment.

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

This assessment generates an expectation for the level of recovery of the outstanding receivables balance and therefore the lifetime expected credit loss.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2020

1 Accounting policies (continued)

Impairment of financial assets

All debt type financial assets which are not measured at FVTPL are assessed for indicators of impairment at each reporting date using a forward looking approach by identifying expected credit losses (‘ECL’s). ECLs are defined as the difference between the contractual cash flows that are due in accordance with the contract and the cash flows that the group expected to receive, discounted at the original effective interest rate.

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

Based on that analysis at the end of the reporting period, the impairment on the Group’s assets, other than trade receivables, are considered to be immaterial and no allowance has been recognised in these financial statements.

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

Derecognition of financial liabilities

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

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2020

1 Accounting policies (continued)

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 23.

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.

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

Embedded derivatives

In accordance with IFRS 9 the 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.

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 2020

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. Under IFRS 15, revenue is recognised when a customer obtains control of the goods or services and the performance obligation is complete.

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. Judgment 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.

(ii) Regulatory settlement
The treatment of the regulatory settlement was considered in the light of the specific circumstances of the approach agreed with Ofwat as noted on page 22 Reflecting that this relates to past performance and matters outside the normal regulatory framework for agreeing amounts for future billing to customers it was considered appropriate to accrue for this settlement in the 2019 financial statements when it became possible to quantify the financial impact.

There is no clear accounting standard guidance for the income statement treatment of this regulatory settlement. It was considered whether the settlement should be recognised as an expense; however, given that this is an agreed reduction in customer bills in the future, with a requirement to show this separately on invoicing as required by Ofwat, the most appropriate treatment was concluded to be to treat the invoice reductions as a reduction in revenue in 2018-19. This will be separately identified and unwound on the face of the income statement in future periods. The £3 million penalty payable to Ofwat was treated as an operating expense.

(iii) 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.

(iv) Going concern
Note 1 above sets out the key judgements arising in respect of going concern.

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2020

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

(v) Impairment
An assessment of the recoverable amount of goodwill (£85.1 million) allocated to 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, has been undertaken. The directors consider the recoverable amount to be most sensitive to the achievement of the 2021 budget and business plan of the next AMP period (2020 to 2025) of Southern Water, the group's only operating company. Budgets comprise forecasts of revenue, staff costs, overheads and interest based on current and anticipated market conditions that have been considered and approved by the Board. Whilst the group is able to manage most of the revenues generated by Southern Water, the cost projections are open to uncertainty due to factors such as unexpected weather events, inherent credit risk associated with its customer base, availability of finance at acceptable rates and regulatory pressures.

The group has faced various financial performance challenges during the year, namely from the imposed penalty sanctioned by Ofwat in response to Southern Water's wastewater treatment works compliance reporting. The year has also seen some one off additional costs in relation to Southern Water's current transformation programme, which in the long-term is expected to yield savings and efficiencies operationally.

However, the directors having assessed the outlook of the future performance and cash flows of the group are satisfied that the book value of the group is supportable in comparison to the Regulatory Capital Value (RCV) of Southern Water. Therefore, no provision for impairment has been made (2019: £nil).

Consideration of impairment associated with Company investments and intercompany receivables is given in note 7.

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. Actual consumption may differ from the estimate made which could impact future operating results positively or negatively.

The value of household billings raised in the year ended 31 March 2020 for consumption in prior years was £129.2 million. The value of these billings was lower than the accrual made at 31 March 2019. The estimation difference was £5.8 million and this has been recognised in the current year's revenue. This difference is well within our view of acceptable tolerances for accounting estimates.

(ii) Impairment of trade receivables
The trade receivables impairment 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. This assessment generates an expectation for the level of recovery of the outstanding receivables balance and therefore the lifetime expected credit loss.

The model considers current and forward looking macro-economic events to the extent that the past response of customers to changes in the economy is built into the expected future cash collection performance for each customer segment. Our underlying charge to the income statement on this basis was £13.6 million.

To reflect the significant impact that the COVID-19 pandemic is having on the macro-economic environment Southern Water has recognised an additional charge of £16.0 million, for the impairment of trade receivables, to the income statement in 2019–20. This is a significant judgment as the overall impact that the pandemic will have on the economy is continuing to evolve.

The value of the provision for impairment as at 31 March 2020 was £216.4 million (2019: £188.7 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 2020

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

(ii) Impairment of trade receivables (continued)

Our sensitivity analysis suggests that the impairment provision would vary between £1.9 million and £5.7 million if cash collections estimates were between 1% and 3% above or below those predicted.

Impairment provision sensitivity analysis	31 March 2020	Sensitivity			
		1%	3%	-1%	-3%
Impairment provision estimate (£m)	216.4	1.9	5.7	-1.9	-5.7

(ii) 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 £111.7 million for the year to 31 March 2020 (2019: loss of £24.2 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 2018 actuarial tables with a smoothing factor of 7.5 and a 1.25% pa allowance for future longevity improvement.

The major assumptions used to measure schemes’ liabilities, along with sensitivities to changes in those assumptions and future funding obligations are set out in note 25 of the financial statements.

(iii) Provisions and contingent liabilities

The group evaluates its exposures to contingent liabilities relating to pending litigation or other outstanding claims subject to negotiated settlement, mediation, arbitration or government regulation. A provision is recognised when it is probable that an obligation exists for which a reliable estimate can be made after careful analysis of the individual matter. Analysis includes assessing the likelihood that a pending claim will succeed, or a liability will arise, and the point of recognition for the associated liability.

Matters that either are possible obligations or do not meet the recognition criteria for a provision are disclosed as contingent liabilities in note 34, unless the possibility of transferring economic benefits is remote. In particular there is a contingent liability associated with an Environment Agency investigation set out in note 34 which it has not been possible to estimate. Accordingly an associated sensitivity analysis cannot be disclosed.

Provisions determined may change in the future due to new developments and as additional information becomes available. Reflecting the inherent uncertainty in this evaluation process actual cost may be different from the estimated provision. Details of provisions are disclosed in note 27 and the value provided at 31 March 2020 was £9.8 million (2019: £6.6 million). Accordingly if the amount provided was 50% under or overestimated then the provision would change by £4.9 million (2019: £3.3 million).

(iv) 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. Whilst high levels of headroom were identified at 31 March 2020 significant reductions to the calculated recoverable value in future years could lead to a material impairment given the large values held.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2020

3 Changes in significant accounting policies

A number of new standards are effective for periods beginning from 1 January 2019, including IFRS 16 'Leases'. The effect of these new standards on the group's financial statements is described below.

Other changes to accounting standards in the current year had no material impact and are as follows:

- IFRIC 23 'Uncertainty over Income Tax Treatments'
- Annual improvements to IFRS Standards 2015-2017 Cycle
- Amendments to IAS 19 'Employee Benefits'
- Amendments to IFRS 9 'Financial Instruments'.

IFRS 16 introduces new or amended requirements with respect to lease accounting. It introduces significant changes to lessee accounting by removing the distinction between operating and finance leases, requiring the recognition of a right-to-use asset and a lease liability at commencement for all leases, except for short-term leases and leases of low value assets.

In contrast to lessee accounting, the requirements for lessor accounting have remained largely unchanged. The group acts as a lessor in respect of the sale of income rights relating to aerial masts and sites owned by Southern Water Services Limited to third parties. Income received from such sales is received entirely in advance and is taken to deferred revenue and credited to the income statement over the life of the lease. This accounting treatment remains unchanged from previous periods.

Other than the aerial mast agreement detailed above, the group is not party to any material leases where it acts as a lessor, but does have a number of material property and vehicle leases.

Details of the group's accounting policies under IFRS 16 are set out in note 1, and a description of the impact of adoption is shown below.

Transition approach

The group has applied IFRS 16 using the modified retrospective approach, without restatement of comparative information. In respect of those leases previously treated as operating leases, the group has elected to measure its right-of-use assets using the approach set out in IFRS 16.C8(b)(ii). Under IFRS 16 C8(b)(ii) right-of-use assets are calculated as an amount equal to the lease liability (being the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate at the date of initial application), adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the statement of financial position immediately before the date of application.

The group's weighted average incremental borrowing rate applied to lease liabilities as at 1 April 2019 is 3.509%.

As a practical expedient, IFRS 16 permits a lessee not to separate non-lease components, and instead account for any lease and associated non-lease components as a single arrangement. The group has used this practical expedient with respect to the maintenance element associated with vehicle leases.

As part of the modified retrospective approach to transition to IFRS 16 for leases previously classified as operating leases applying IAS 17, the group has also elected to use the practical expedient permitted to apply a single discount rate to portfolios of leases with reasonably similar characteristics.

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2020

3 Changes in significant accounting policies (continued)

Impact on lessee accounting

Former operating leases

IFRS 16 changes how the group accounts for leases previously classified as operating leases under IAS 17, which were off-balance sheet.

Applying IFRS 16, for all leases, the group now recognises right-of-use assets and lease liabilities in the statement of financial position, initially measured at the present value of the future lease payments as described above.

Under IFRS 16, right-of-use assets will be tested for impairment in accordance with IAS 36 Impairment of Assets.

Under IFRS 16 the group recognises depreciation of right-of-use assets and interest on leases liabilities in the income statement, whereas under IAS 17 operating leases previously gave rise to a straight-line expense in operating expenditure.

Under IFRS 16 the group separates the total amount of cash paid for leases that are on balance sheet into a principal portion (presented within financing activities as repayments of obligations under finance leases) and interest (presented within financing activities as interest paid) in the cashflow statement. Under IAS 17 operating lease payments were presented as operating cash flows.

Former finance leases

The main differences between IFRS 16 and IAS 17 with respect to assets formerly held under a finance lease is the measurement of the residual guarantees provided by the lessee to the lessor. IFRS 16 requires that the company recognises as part of its lease liability only the amount expected to be payable under a residual value guarantee, rather than the maximum amount guaranteed as required by IAS 17. This change did not have a material effect on the company’s financial statements.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2020

3 Changes in significant accounting policies (continued)

Financial impact

The application of IFRS 16 to leases previously classified as operating leases under IAS 17 resulted in the recognition of right-of-use assets and lease liabilities. Prepayments of rentals as at the transition date have been derecognised and adjusted through the value of the related assets. The adjustments as at the date of initial application are shown in the table below.

Statement of financial position

	Impact of changes in accounting policies		
1 April 2019	**As previously reported £m**	**Impact of IFRS 16 £m**	**As restated £m**
Non-current assets			
Property, plant and equipment	6,228.1	33.2	6,261.3
Current assets			
Prepayments	23.6	(2.7)	20.9
Total impact on assets		**30.5**	
Current liabilities			
Lease liabilities	(0.2)	(2.1)	(2.3)
Non-current liabilities			
Lease liabilities	(0.8)	(28.4)	(29.2)
Total impact on liabilities		**(30.5)**	
Retained earnings		-	

Of the total right-of-use assets of £33.2 million recognised at 1 April 2019, £30.9 million related to leases of property and £2.3 million to leases of vehicles.

The table below presents a reconciliation from operating lease commitments disclosed at 31 March 2019 to lease liabilities recognised at 1 April 2019.

	£m
Operating lease commitments disclosed under IAS 17 at 31 March 2019	20.1
Effect of discounting	(0.9)
Contracts reassessed under IFRS 16 to contain a lease	11.7
Prepayments on reassessed contracts as at 31 March 2019	(0.4)
Right-of-use assets recognised at 1 April 2019	30.5
Finance lease liabilities recognised under IAS 17 at 31 March 2019	1.0
Total lease liabilities recognised at 1 April 2019	31.5

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2020

3 Changes in significant accounting policies (continued)

In terms of the income statement impact, the application of IFRS 16 resulted in a decrease in other operating expenses and an increase in depreciation and interest expense compared to IAS 17. During the year ended 31 March 2020, in relation to leases under IFRS 16, the company recognised the following amounts in the income statement:

	£m
Depreciation	3.0
Interest expense	1.2

4 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.

5 Income

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

Continuing operations	**2020**	2019
	£m	£m
Water and sewerage services:		
Household - measured	**544.3**	537.3
Household - unmeasured	**130.7**	133.2
Non-household - measured	**140.4**	141.6
Non-household - unmeasured	**5.1**	5.0
Total water and sewerage services	**820.5**	817.1
Bulk supplies	**3.9**	3.8
Infrastructure charge receipts	**9.7**	12.2
Requisitioned mains and sewers (see note (a) below)	**(0.6)**	0.1
Diversions	**0.6**	2.9
Adoptions (see note (b) below)	**7.8**	8.5
Other services	**36.1**	31.7
Total revenue before regulatory settlement	**878.0**	876.3
Regulatory settlement (see note (c) below)	**-**	(135.5)
Total revenue	**878.0**	740.8
Other operating income (see note (d) below)	**1.4**	1.2
Other income (see note 6)	**-**	0.2
Profit on disposal of property, plant and equipment	**0.9**	0.7
Interest receivable (note 10)	**32.9**	10.5
Total income	**913.2**	753.4

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2020

5 Income (continued)

a) Income from requisitions of mains and sewers is offset by refunds to developers in the year made against income recognised in previous periods.

b) Revenue associated with the adoption of assets from customers is treated as non-distributable upon recognition, and amortised to retained earnings in line with the depreciation of the related assets.

c) As reported in note 26 the group has been co-operating with Ofwat in relation to its investigation into the management, operation and performance of our wastewater treatment works.

To ensure that our customers are not disadvantaged as a result of these matters, the group has agreed to make direct customer rebates totalling £135.5 million in forecast outturn prices (£122.9 million in 2017–18 prices) over the period 2020–25. This reflects the seriousness of the breaches identified in the investigation. A provision for these rebates was made in the financial statements for 2018–19.

d) Other operating income includes the release of deferred grants and contributions relating to non-current assets from the balance sheet, as amortised in line with the useful economic life of the related assets, and rents receivable.

6 Group profit for the year

Group loss for the year has been arrived at after charging/(crediting):	**2020 £m**	2019 £m
Depreciation and amortisation on		
- Owned assets	**254.5**	**256.0**
- Assets held under finance leases	**3.7**	**1.0**
	258.2	**257.0**
Included within *Operating costs: Depreciation and amortisation* in the income statement:		
Amortisation of intangible assets	**13.1**	**22.3**
Other income (see note (a) below)	**-**	**0.2**
Profit on disposal of property, plant and equipment	**0.9**	**0.7**
Research and development expenditure	**0.5**	**1.0**
Rentals under operating leases (see note (b) below):		
- Properties	**0.2**	**1.9**
- Vehicles	**1.1**	**2.5**
Employee costs (note 8a)	**78.6**	**67.4**
Amortisation of grants and contributions (see note 27) (restated*)	**(1.2)**	**(1.1)**
Regulatory settlement (see note (c) below)	**-**	**138.5**
Fees payable to the company's auditor in respect of:		
- statutory audit of the company's financial statements	**0.5**	**0.3**
- other services pursuant to legislation (see note (d) below)	**0.1**	**0.1**
- all other services	**0.1**	**0.1**
Total audit and non-audit fess	**0.5**	**0.5**

Other services pursuant to legislation and other non-audit services primarily relate to regulatory assurance fees.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2020

6 Group operating profit for the year (continued)

(a) On 1 April 2017 the group completed the disposal of its non-household water and wastewater retail business, principally comprising billing and customer service activities, to Business Stream. Final reconciling transactions from the contract of sale resulted in a £0.2 million profit after costs in the prior period. Cash proceeds in the prior year of £1.8 million are disclosed under proceeds from disposal of business in the cash flow statement on page 52.

(b) The group has adopted IFRS 16 'Leases' with effect from 1 April 2019. Rentals under operating leases comprise payments on leases that have been assessed as short-term (12 months or less) agreements and leases of low value assets (£5,000 or less) (see Note 1 Accounting Policies for more information on the company's approach to IFRS 16 Leases).

(c) As reported in note 26 the group co-operated with Ofwat in relation to its investigation into the management, operation and performance of Southern Water's wastewater treatment works.

In addition to the provision for direct customer rebates of £135.5 million disclosed in note 5, a provision of a further £3.0 million was made within operating costs in 2018–19 for the fine imposed by Ofwat in relation to these matters.

(d) Other services pursuant to legislation and other non-audit services primarily relate to regulatory assurance fees.

7 Loss of the parent company

The loss for the financial year dealt with in the financial statements of the parent company is £236.8 million (2019: £780.7 million).

At the reporting date the company has conducted an impairment review based on the consideration of the overall value of the Greensands Holdings group. A comparison has been made between the Regulatory Capital Value (RCV) of Southern Water Services, as the operating company, to the value of investments held in the group at various consolidation levels moving all the way up to the ultimate controlling parent, Greensands Holdings Limited.

In order to undertake the impairment assessment, judgement has been made regarding the level of premium to RCV that is appropriate to consider. Typically this reflects historic transactions within the water industry and reviewing the market capitalisation of listed water companies. Additionally, with continued economic uncertainty and the performance of Southern Water relative to its peers, a reduced level of premium has been used in assessing the impairment.

Having taken into account the above and a negative reserves position held in the Greensands Europe Ltd group, the directors believe that the company's investment in Greensands Europe Ltd (GSE) of £1.0 million is fully impaired, along with £1,016.5 million in relation to the amounts owed by group undertakings. Therefore, a total impairment loss of £236.8 million (2019: £780.7 million) has been recognised in the income statement for the year.

The recoverable amount of the GSE group is a negative amount of £1,130.3 million (2019: £780.7million), which is considered to be its fair value measurement under level 2 as described in the accounting policies. No provision for costs to sell has been made as this cannot be easily and readily quantified. The full cumulative impairment write down made by the company is £1,017.5 million as this is the total available value of group assets held.

The value of impairment will continue to be reviewed annually to see whether the impairments remain or whether there are indications of an improvement in the position, for example an increase in the likely premium to RCV achievable at Southern Water. Should there be an improvement; values for the reduction in impairment would be written back.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2020

8 Employee information

		2020 £m	2019 £m
(a) Group employee costs			
Wages and salaries		**105.2**	95.7
Social security costs		**11.3**	10.7
Pension costs	- Defined contribution	**4.9**	3.9
	- Defined benefit	**7.7**	8.0
Total employee costs		**129.1**	118.3
Less: charged as capital expenditure		**(50.5)**	(50.9)
Charged to the income statement		**78.6**	67.4

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:

	2020 Number	2019 Number (restated)
Operations	**1,169**	1,111
Customer services	**98**	235
Corporate centre	**937**	939
	2,204	2,285

The prior year figures have been restated to reflect the average numbers rather than the March year end numbers.

9 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, payments of £95,800 and £70,535 were made by one of the ultimate shareholders to two of the directors (2019: two directors £50,000 each).

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2020

10 Net finance costs

	2020 £m	2019 £m
Finance income		
Interest receivable on swap instruments	**31.9**	8.7
Deposit income on short-term bank deposits	**1.0**	1.8
	32.9	10.5
Finance costs		
Interest payable on loans	**(372.6)**	(399.2)
Interest rate swap receipts	**0.5**	31.8
Indexation	**(29.3)**	(34.7)
Amortisation of issue costs	**(2.9)**	(1.8)
Amortisation of gilt lock proceeds	**0.1**	0.1
Amortisation of bond premium	**0.7**	0.7
Other finance expense (note 25)	**(4.2)**	(4.4)
	(407.7)	(407.5)
Amounts capitalised on qualifying assets	**32.8**	23.0
	(374.9)	(384.5)
Fair value gains/(losses) on derivative financial instruments		
Derivative financial instruments not designated as hedges (note 23)	**349.4**	(217.4)
Net finance costs	**7.4**	(591.4)

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 3.96% to expenditure on such assets (2019: 4.12%).

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2020

11 Taxation

	2020 £m	2019 £m
Current tax:		
Current year	-	0.1
Total current tax charge	-	0.1
Deferred tax:		
Origination and reversal of temporary differences	61.9	(33.7)
Adjustment in respect of prior years	(0.7)	1.9
Effect of corporation tax rate change	45.3	-
Total deferred charge/(credit) tax	106.5	(31.8)
Total tax charge/(credit) on loss	106.5	(31.7)

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

	2020 £m	2019 £m
Profit/(loss) before tax	209.9	(482.0)
Current tax:		
Tax at the UK corporation tax rate of 19% (2019: 19%)	39.9	(91.6)
Permanent differences	20.9	54.0
Deferred tax assets not recognised	7.5	-
Differences between current and deferred tax rates	(6.4)	4.0
Impact of tax rate changes	45.3	-
Adjustment in respect of prior years – deferred tax	(0.7)	1.9
Tax charge/(credit) for year	106.5	(31.7)

Factors that may affect future tax charges:

Reductions in the main rate of corporation tax to 17% from the 1 April 2020 were enacted in the Finance Bill 2016, and deferred tax balances at 31 March 2019 were calculated based on these reduced rates. It was subsequently announced in March 2020 that the corporation tax rate would instead maintain at to 19% from 1 April 2020. This change has been substantively enacted in Finance Bill 2020 at the Balance sheet date, and deferred tax balances at 31 March 2020 have been calculated using the 19% rate. A £40.3 million charge has been recognised in the income statement in the period to reflect the increase in the deferred tax liability as a result of the rate change. In addition, a credit of £1.5 million has been recognised in the statement of other comprehensive income to reflect the increase in the deferred tax asset relating to the pension deficit.

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.

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

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:

	2020 £m	2019 £m
Deferred tax		
Arising on income and expenses recognised in other comprehensive income:		
Tax charge/(credit)relating to retirement benefit obligations	19.0	(4.1)
Deferred tax movement due to rate change	(1.5)	-
Total deferred tax charge/(credit) recognised in other comprehensive loss	17.5	(4.1)

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2020

11 Taxation (continued)

Company
The tax charge for the year can be reconciled to the income statement as follows:

	Company 2020 £m	Company 2019 £m
Loss before taxation	**(236.8)**	(780.7)
UK corporation tax rate at 19% on loss for the year (2019: 19%)	**(45.0)**	(148.3)
Permanent differences arising on impairment loss	**45.0**	148.3
Total tax charge for year	**-**	-

12 Goodwill

Group	**£m**
Carrying amount at 1 April 2019	85.1
Impairment at 31 March 2020	-
Net book value at 31 March 2020	**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, being the basis of the recoverable amount. An assumed premium to the RCV utilising recent transactions in the water industry and other data 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 in respect of goodwill or property, plant and equipment.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2020

13 Intangible assets

	Externally generated		
	Assets in development £m	**Other £m**	**Total £m**
Cost			
At 1 April 2019	11.8	116.3	**128.1**
Additions	9.6	-	**9.6**
Transfers	(3.0)	3.0	**-**
Disposals	-	-	**-**
At 31 March 2020	18.4	119.3	**137.7**
Amortisation			
At 1 April 2019	-	82.5	**82.5**
Charge for the year	-	13.1	**13.1**
Disposals	-	-	**-**
At 31 March 2020	-	95.6	**95.6**
Net book amount			
At 31 March 2020	**18.4**	**23.7**	**42.1**
At 31 March 2019	11.8	33.8	45.6

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

Included within additions above is £0.5 million (2019: £1.1 million) of interest that has been capitalised on qualifying assets in accordance with IAS 23 ‘Borrowing costs’. The cumulative net book value of the borrowing costs capitalised amount to £1.5 million (2019: £1.4 million).

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

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2020

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 2019	1,576.5	3,359.9	2,774.4	657.7	660.6	**9,029.1**
Recognition of right-of-use assets at 1 April 2019 (note 3)	30.9	-	-	-	2.3	**33.2**
As restated at 1 April 2019	1,607.4	3,359.9	2,774.4	657.7	662.9	**9,062.3**
Additions	-	-	-	492.2	-	**492.2**
Transfers	1.8	130.2	70.0	(227.0)	25.0	**-**
Disposals	-	(24.8)	(1.1)	-	(30.8)	**(56.7)**
At 31 March 2020	1,609.2	3,465.3	2,843.3	922.9	657.1	**9,497.8**
Depreciation						
At 1 April 2019	766.1	1,415.9	150.3	-	468.7	**2,801.0**
Charge for the year	42.7	132.7	33.9	-	49.0	**258.3**
Disposals	-	(24.8)	(1.2)	-	(30.9)	**(56.9)**
At 31 March 2020	808.8	1,523.8	183.0	-	486.8	**3,002.4**
Net book amount						
At 31 March 2020	**800.4**	**1,941.5**	**2,660.3**	**922.9**	**170.3**	**6,495.4**
At 31 March 2019	810.4	1,944.0	2,624.1	657.7	191.9	6,228.1

Freehold land is stated at a cost of £51.7 million at 31 March 2020 and 31 March 2019 and is not depreciated.

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

Included within additions above is £32.3 million (2019: £21.9 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 £216.9 million (2019: £191.8 million).

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:

	Land & buildings £m	Other £m
As previously reported at 31 March 2019	**-**	2.9
Recognition of right-to-use assets at 1 April 2019 (note 3)	**30.9**	2.3
Depreciation charge for the year	**(2.0)**	(1.7)
Net book amount at 31 March 2020	**28.9**	3.5

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2020

15 Other non-current assets

	Company 2020 £m	Company 2019 £m
Amounts owed by group undertakings	**1,016.5**	1,016.6
Impairment	**(1,016.5)**	(779.7)
Amounts owed by group undertakings	**-**	236.9

All amounts due from group undertakings are unsecured, interest free and repayable on demand. The company has offered its support to group companies and is not intending to recall these balances within the next 12 months.

Please refer to note 7 for further details surrounding the impairment loss disclosed above.

16 Investments

	Group 2020 £m	Group 2019 £m
Other external investments		
At 1 April	**0.1**	0.1
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 receivables impairment.

	Company 2020 £m	Company 2019 £m
Greensands Europe Limited		
At 1 April	**-**	1.0
Impairment	**-**	(1.0)
Total investments at 31 March	**-**	-

A full list of subsidiaries is disclosed in note 37. Please refer to note 7 for further details surrounding the impairment loss disclosed above.

17 Inventories

	Group 2020 £m	Group 2019 £m
Raw materials	**4.3**	4.0
Work in progress	**0.8**	0.7
	5.1	4.7

The company does not hold any inventory.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2020

18 Trade and other receivables

	Group 2020 £m	Group 2019 £m
Trade receivables	**315.9**	299.1
Provision for impairment	**(213.3)**	(185.8)
Net trade receivables	**102.6**	113.3
Net accrued income	**77.3**	71.9
Prepayments	**14.6**	23.6
Other receivables	**18.0**	18.9
	212.5	227.7

Trade receivables comprise balances from contracts with customers where the company has performed some or all of its contractual obligations.

Accrued income as at 31 March 2020 includes water and sewerage income not yet billed of £62.4 million (2019: £58.3 million).

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

Provision for impairment

Movements on the impairment provision were as follows:

	Group 2020 £m	Group 2019 £m
At 1 April	**(188.7)**	(180.0)
Impairment charge	**(29.6)**	(10.7)
Amounts written off during the year	**1.9**	2.0
At 31 March	**(216.4)**	(188.7)

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

The Group does not include in revenue and trade receivables those accounts that are deemed irrecoverable.

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

	Group 2020 £m	Group 2019 £m
Current	**-**	0.3
1-2 years	**0.1**	0.2
2-3 years	**0.1**	0.3
3-4 years	**0.1**	0.4
more than 4 years	**2.4**	0.6
	2.7	1.8

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2020

18 Trade and other receivables (continued)

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

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

	Group 2020 £m	Group 2019 £m
Current	**76.8**	75.9
1-2 years	**44.4**	47.1
2-3 years	**38.9**	38.9
3-4 years	**33.8**	31.3
more than 4 years	**90.6**	73.9
	284.5	267.1

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

At 31 March 2020	**Gross £m**	**Provision £m**	**Group Net £m**
Accrued income – not due	**80.4**	**(3.1)**	**77.3**
Trade receivables			
Not due	**28.7**	**-**	**28.7**
Overdue not specifically provided	**284.5**	**(210.6)**	**73.9**
Overdue and specifically provided	**2.7**	**(2.7)**	**-**
	396.3	**(216.4)**	**179.9**

At 31 March 2019	Gross £m	Provision £m	Group Net £m
Accrued income – not due	74.8	(2.9)	71.9
Trade receivables			
Not due	30.2	-	30.2
Overdue not specifically provided	267.1	(184.0)	83.1
Overdue and specifically provided	1.8	(1.8)	-
	373.9	(188.7)	185.2

The company does not have any trade receivables.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2020

19 Trade and other payables

	Group 2020 £m	Group 2019 £m
Trade payables	**30.5**	18.1
Capital creditors and capital accruals	**104.2**	114.2
Corporation tax	**-**	0.1
Taxation and social security	**2.8**	2.6
Accruals	**95.0**	196.3
Deferred revenue	**30.6**	35.7
	263.1	367.0

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

	Company 2020 £m	Company 2019 £m
Amounts owed to group undertakings	**32.0**	32.0
	32.0	32.0

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

20 Current borrowings

	Group 2020 £m	Group 2019 £m
Current		
Revolving credit facilities – Libor plus margin	**430.0**	198.0
Loans and other borrowings - Class A £300m – 6.135% fixed rate 2019	**-**	300.0
Loans and other borrowings - £250m 8.500% Fixed Rate Notes 2019	**-**	250.0
Class A £350m – 5.010% fixed rate 2021	**349.5**	-
Premium deferred on issue	**0.7**	0.7
Deferred gilt lock proceeds (note 21 (ix))	**0.1**	0.1
Unamortised debt issuance costs (note 21 (vii))	**(1.9)**	(1.5)
Current borrowings excluding finance leases	**778.4**	747.3
Obligations under finance leases	**2.2**	0.2
Total current borrowings including finance leases	**780.6**	747.5

The Class A £300 million bond was repaid on 1 April 2019.

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 2020

21 Non- current borrowings

An analysis of the external loans is shown below:

Loans and other borrowings:	Notes	Group 2020 £m	Group 2019 £m
Class A £350m 6.192% fixed rate 2029	21(i),(ii),(iii)	**373.0**	375.0
Class A £150m 3.706% index linked 2034	21(iii),(iv)	**282.0**	275.3
Class A £35m 3.706% index linked 2034	21(iii),(iv)	**65.9**	64.3
Class A £350m 6.640% fixed rate 2026	21(i),(ii)	**368.2**	370.7
Class A £150m 3.816% index linked 2023	21(iii),(iv)	**252.0**	247.6
Class A £350m 5.000% fixed rate 2021	21(i),(ii)	**349.5**	349.0
Class A £150m 5.000% fixed rate 2041	21(i),(ii)	**146.0**	145.9
Class A £200m 4.500% fixed rate 2052	21(i),(ii)	**197.2**	197.2
Class A £300m 5.125% fixed rate 2056	21(i),(ii)	**292.9**	292.8
Class A £300m 6.125% fixed rate 2019	20,21(i),(ii)	**-**	300.0
Class A £175m 2.780% fixed rate 2031	21(ii)	**174.1**	174.0
Class A £75m 2.960% fixed rate 2036	21(ii)	**74.6**	74.6
Class A £60m – 0.000% index linked 2025	21(iv),(ix)	**51.7**	61.1
Class A £40m - 0.000% index linked 2026	21(iv),(ix)	**41.0**	43.7
Artesian £165m 4.076% index linked 2033	21(iii),(iv)	**314.4**	307.7
Artesian £156.5m 3.635% index linked 2032	21(iv)	**248.2**	241.5
Total Class A debt		**3,230.7**	3,520.4
Revolving credit facilities – Libor plus margin	21(xii)	**430.0**	198.0
£250m 8.500% Fixed Rate Notes 2019	21(ii)	**-**	250.0
£125m Facility Agreement 2022 – Libor plus 3.250%	21(v)	**123.4**	122.6
£75m Facility Agreement 2025 – Libor plus 4.000%	21(v)	**73.5**	73.3
£150m Facility Agreement 2025 – Libor plus 5.250%	21(v)	**146.7**	146.3
£100m Facility Agreement 2026 – Libor plus 5.250%	21(v)	**97.6**	97.5
£250m Facility Agreement 2025 – Libor plus 5.25%	21(v)	**244.4**	-
£50m Facility Agreement 2025 – Libor plus 2.500%	21(v)	**49.5**	49.5
£175m Facility Agreement 2025 – fixed rate 3.930%	21(ii)	**173.9**	173.7
£25m Facility Agreement 2025 – fixed rate 3.650%	21(ii)	**24.7**	24.7
£75m Facility Agreement 2028 – fixed rate 3.940%	21(ii)	**74.2**	74.1
£52m Facility Agreement 2030 – fixed rate 4.030%	21(ii)	**51.4**	51.4
£35.3m/($45m) Facility Agreement 2023 – fixed rate 3.384%	21(ii),(x)	**34.9**	34.9
£19.6m/($25m) Facility Agreement 2025 – fixed rate 3.681%	21(ii),(x)	**19.4**	19.3
£19.6m/($25m) Facility Agreement 2028 – fixed rate 4.020%	21(ii),(x)	**19.4**	19.4
Eurobonds 12.000% 2038 (note 35)	21(xi)	**1,401.4**	1,250.9
Unamortised debt issuance costs	21(vi)	**(159.3)**	(168.7)
Bond premium deferred on issue	21(vii)	**8.2**	8.8
Deferred gilt lock proceeds	21(viii)	**4.6**	4.8
Obligations under finance leases		**30.4**	1.0
Total borrowings		**6,079.0**	5,951.9
Disclosed as current borrowings	20	**780.6**	747.5
Disclosed as non-current borrowings		**5,298.4**	5,204.4

	Company 2020 £m	Company 2019 £m
Loans from group undertakings	**59.2**	59.2

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2020

21 Non-current borrowings (continued)

Class A 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 £29.2 million (2019: £34.7 million) has been taken to the income statement as part of finance costs.

(v) Floating rate funds have been recognised net of associated issue costs and are being carried at amortised cost using the effective interest rate method.

(vi) Unamortised debt issuance costs represent issue fees paid by SWSF and SWGF 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 2020 unamortised debt issuance costs amounted to £159.3 million (2019: £168.7 million) of which £1.5 million (2019: £1.5 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.

(vii) 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.

(viii) 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.

(ix) The Class A £60 million loan is index-linked with an interest rate of 0.00% until August 2025. The Class A £40 million loan is index-linked with an interest rate of 0.00% until May 2026.

(x) The Group has entered into cross currency swap agreements that fix the Sterling rate required to pay interest on loan funds drawn in US Dollars in accordance with the Group's financial risk management policy.

(xi) The Eurobond loan includes £1,041.6 million of accrued interest (2019: £891.1 million). Compound interest is charged at 12%. No interest was paid in the current or prior year.

(xii) Revolving credit facilities drawdowns accrue interest at Libor plus an applicable margin between 0.30% and 1.50%, determined by reference to the credit rating of the company.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2020

21 Non-current borrowings (continued)

Repayments fall due as follows:	2020 £m	2019 £m
Borrowings excluding finance leases:		
Between one and two years not by instalments	**122.8**	348.2
Between two and five years not by instalments	**327.8**	391.0
After five years not by instalments	**4,819.6**	4,464.4
	5,270.2	5,203.6
On demand or within one year not by instalments	**778.4**	747.3
	6,048.6	5,950.9
Finance leases:		
Between one and two years not by instalments	**2.2**	0.1
Between two and five years not by instalments	**6.2**	0.7
After five years not by instalments	**19.8**	-
	28.2	0.8
On demand or within one year not by instalments	**2.2**	0.2
	30.4	1.0
Borrowings including finance leases:		
Between one and two years not by instalments	**125.0**	348.3
Between two and five years not by instalments	**334.0**	391.7
After five years not by instalments	**4,839.4**	4,464.4
	5,298.4	5,204.4
On demand or within one year not by instalments including finance leases	**780.6**	747.5
	6,079.0	5,951.9

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.

For adjustments to finance leases following adoption of IFRS 16 in the current year, see note 3.

The average lease term is 30.2 years.

For the year ended 31 March 2020, the average effective borrowing rate on leases was 3.85% (2019: 4.17%). 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 2020

22 Leases

This note provides information for leases where the group is a lessee.

i) Amounts recognised in the statement of financial position

The statement of financial position shows the following amounts relating to leases:

	2020 £m	2019* £m
Right of use assets within Property, Plant and Equipment:		
Buildings	**28.9**	-
Other	**3.5**	2.9
	32.4	2.9
Lease liabilities		
Current	**2.2**	0.2
Non-current	**28.2**	0.8
	30.4	1.0

* In the previous year, the group only recognised lease assets and lease liabilities in relation to leases that were classified as 'finance leases' under IAS 17 Leases. The assets were presented in property, plant and equipment and the liabilities as part of the company's borrowings. For adjustments recognised on adoption of IFRS 16 on 1 April 2019, please refer to note 3.

Additions to the right-of-use assets during the financial year to 31 March 2020 were £33.2 million.

ii) Amounts recognised in the income statement

The income statement shows the following amounts relating to leases:

	2020
Depreciation charge of right-of-use assets	
Buildings	**(2.0)**
Other	**(1.7)**
	(3.7)
Interest expense (included in finance costs)	**(1.2)**
Expense relating to short-term leases (included in operating costs)	**(1.3)**

iii) Amounts recognised in the cash flow statement

Total cash outflow for leases in the year to 31 March 2020	**(1.5)**

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2020

22 Leases (continued)

iv) The group's leasing activities and how these are accounted for

The group leases various offices and vehicles.

Rental contracts are typically made for fixed periods, but may have extension options.
Contracts may contain both lease and non-lease components. For leases of vehicles for which the group is a lessee, it has elected not to separate lease and non-lease components and instead accounts for these as a single lease component.

Lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions. The lease agreements do not impose any covenants other than the security interests in the leased assets that are held by the lessor. Leased assets may not be used as security for borrowing purposes.

Until the year to 31 March 2019, leases of property, plant and equipment were classified as either finance leases or operating leases, see note 1 for details. From 1 April 2019, leases are recognised as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use by the group.

Assets and liabilities arising from a lease are initially measured on a present value basis. Lease payments included in the measurement of the lease liability comprise (where applicable):

- fixed lease payments;
- variable lease payments that depend on an index or rate, initially measured using the index or rate at the commencement date;
- the amount expected to be payable by the lessee under residual value guarantees;
- the exercise price of purchase options, if the lessee is reasonably certain to exercise the options; and
- payments of penalties for terminating the lease, if the lease term reflects the exercise of an option to terminate the lease.
- the lease liability is presented as a separate line in the statement of financial position.

Lease payments to be made under reasonably certain extension options are also included in the measurement of the liability.

The lease payments are discounted using the interest rate implicit in the lease. If that rate cannot be readily determined, which is generally the case for leases in the group, the lessee's incremental borrowing rate is used, being the rate that the individual lessee would have to pay to borrow the funds necessary to obtain an asset of similar value to the right-of-use asset in a similar economic environment with similar terms, security and conditions.

Southern Water has a lease on its outfall pipes which contains variable lease payments. These payments will increase by RPI every 10 years. The next review date is on 1 April 2022 and the lease expires on 31 March 2096.

Right-of-use assets are measured at cost comprising the following:
- the amount of the initial measurement of lease liability
- any lease payments made at or before the commencement date less any lease incentives received
- any initial direct costs, and
- restoration costs.

Right-of-use assets are generally depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis. If the group is reasonably certain to exercise a purchase option, the right-of-use asset is depreciated over the underlying asset's useful life.

Payments associated with short-term leases of equipment and vehicles and all leases of low-value assets are recognised on a straight-line basis as an expense in profit or loss. Short-term leases are leases with a lease term of 12 months or less. Low-value assets comprise assets less than £5,000.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2020

23 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 2020 and 31 March 2019.

Financial assets and liabilities by category	**Group 2020 £m**	**Company 2020 £m**	Group 2019 £m	Company 2019 £m
Financial assets				
Derivative financial instruments designated as FVTPL*				
- Non-current	**203.0**	**-**	46.2	-
- Current	**-**	**-**	-	-
Held to maturity investments				
- Non-current	**0.1**	**-**	0.1	-
Trade and other receivables				
- Current (excluding prepayments)	**197.9**	**-**	204.1	-
Cash and cash equivalents				
- Current	**282.5**	**-**	514.8	-
Total financial asset	**683.5**	**-**	765.2	-
Financial liabilities				
Derivative financial instruments designated as FVTPL*				
- Non-current	**1,376.4**	**-**	1,429.0	-
Borrowings				
- Current (including lease liabilities)	**780.6**	**-**	747.5	-
- Non-current (including lease liabilities)	**5,298.4**	**59.2**	5,204.4	59.2
Trade and other payables				
- Current	**263.2**	**32.1**	367.0	32.0
Total financial liabilities	**7,718.6**	**91.3**	7,747.9	91.2

*Fair value through profit and loss.

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

Derivative financial instruments	**Group 2020 Assets £m**	**Group 2020 Liabilities £m**	Group 2019 Assets £m	Group 2019 Liabilities £m
Derivative financial instruments not designated as hedges:				
Interest rate swaps	**0.1**	**-**	0.1	-
RPI swaps	**194.2**	**(1,376.4)**	46.1	(1,428.2)
Cross currency swaps	**8.7**	**-**	-	(0.8)
Total derivative financial instruments	**203.0**	**(1,376.4)**	46.2	(1,429.0)
Derivative financial instruments can be analysed as follows:				
Current	**-**	**-**	-	-
Non-current	**203.0**	**(1,376.4)**	46.2	(1,429.0)
	203.0	**(1,376.4)**	46.2	(1,429.0)

The notional principal amount of the outstanding interest swap contracts at 31 March 2020 was £1,516.6 million (2019: £1,592.7 million).

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2020

23 Financial instruments (continued)

In accordance with IFRS 9 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 (based on loan book values including accrued accretion):

	Group 2020 %	Group 2019 %
By class of debt (all classed as financial liabilities)		
Class A	**4.49**	4.70
Class B	**-**	-
Artesian	**1.83**	1.90
Greensands	**5.35**	5.82

The weighted average interest costs at the statement of financial position dates were as follows (based on loan nominal values):

	Group 2020 %	Group 2019 %
Fixed	**8.51**	8.24
Floating	**4.20**	4.37
Indexed	**4.81**	4.81

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 Brexit and other economic matters such as COVID-19 will increase uncertainty around these risk areas in the short term.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2020

23 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 2020**	Group 2019
1% increase in interest rate	**(32.5)**	(29.7)
1% decrease in interest rate	**32.5**	29.7

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 2020**	Group 2019
1% increase in RPI	**(22.8)**	(22.6)
1% decrease in RPI	**22.8**	22.6

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 10.

ii) Maturity of financial liabilities and financial instruments

The maturity profile of the Group's financial liabilities at 31 March 2020 and 31 March 2019 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 2020					
Derivative financial instruments – asset	**0.1**	**24.5**	**28.4**	**150.0**	**203.0**
Derivative financial instruments – liability	**-**	**(11.4)**	**(597.0)**	**(768.0)**	**(1,376.4)**
	0.1	**13.1**	**(568.6)**	**(618.0)**	**(1,173.4)**

	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 2019					
Derivative financial instruments – asset	-	0.1	7.3	38.8	46.2
Derivative financial instruments – liability	-	(0.2)	(719.5)	(709.3)	(1,429.0)
	-	(0.1)	(712.2)	(670.5)	(1,382.8)

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2020

23 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 2020 and 2019.

	Group 2020 Book value £m	**Group 2020 Fair value £m**	Group 2019 Book value £m	Group 2019 Fair value £m
Financial assets				
Cash and cash equivalents	**282.5**	**282.5**	514.8	514.8
Current derivatives – interest rate swaps	**-**	**-**	-	-
Non-current asset investments	**0.1**	**0.1**	0.1	0.1
Non-current derivatives – interest rate swaps	**0.1**	**0.1**	0.1	0.1
Non-current derivatives – RPI swaps	**194.2**	**194.2**	46.1	46.1
Non-current derivatives – cross currency swaps	**8.7**	**8.7**	-	-
	485.6	**485.6**	561.1	561.1
Financial liabilities				
Current borrowings (including leases)	**780.6**	**793.4**	(747.5)	(747.5)
Non-current borrowings (including leases)	**5,298.4**	**6,223.3**	(5,204.4)	(6,091.8)
Non-current derivatives – interest rate swaps	**-**	**-**	-	-
Non-current derivatives - RPI swaps	**1,376.4**	**1,376.4**	(1,428.2)	(1,428.2)
Non-current derivatives – cross currency swaps	**-**	**-**	(0.8)	(0.8)
	7,455.4	**8,393.1**	(7,380.9)	(8,268.3)

Derivative activity is undertaken by subsidiaries in the Group, Greensands Senior Finance Limited, Southern Water (Greensands) Financing Plc, Southern Water Services Limited, Southern Water Services (Finance) Limited (SWSF), Greensands Financing Plc and Greensands Finance Limited, 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.

In November 2018 work was undertaken to amend the inflation-linked swaps held at Southern Water Services (Finance) Limited. Firstly, swaps were legally re-assigned from Southern Water Services (Finance) Limited to Southern Water Services Limited, before extending mandatory breaks from 2019 to 2025 on swaps with a notional value of £177.0 million, and re-couponing the receipt leg to increase the interest receivable of the extension period.

Other swaps with maturity dates of 2031, 2037, and 2041 were extended until 2046 by acquiring new instruments starting from the maturity date of the existing agreements.

These extensions, along with the existing remaining long-dated swaps, were then bifurcated with the result of increasing the interest receivable.

Upfront payments from Southern Water to the co-ordination bank/counterparties were required for all of these amendments, with the amounts totalling £113.6 million. The change in fair value of the related swap instruments immediately resulting from this restructure has been deferred to the balance sheet for amortisation in line with the related re-couponed period.

In December 2019 a further restructure took place to separate accretion related cash flows from the 2055 swap resulting in an upfront cash receipt of £140.0 million. The change in fair value of the related swap instrument immediately resulting from this restructure has been deferred to the balance sheet for amortisation in line with the term of the related new instrument.

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.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2020

23 Financial instruments (continued)

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.

The fair values of derivative instruments (interest rate swaps) at the reporting date are determined using quoted prices adjusted for credit risk and are stated net of the deferred fair values mentioned above.

iii) Fair values of financial assets and financial liabilities

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 2020

24 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 2018	545.0	(200.6)	(29.2)	13.0	328.2
(Credit)/charge to income statement	(5.7)	(27.2)	1.6	(2.4)	(33.7)
Prior year adjustment:					
- Charge to income statement	1.9	-	-	-	1.9
- Charge to other comprehensive income	-	-	(4.1)	-	(4.1)
At 1 April 2019	541.2	(227.8)	(31.7)	10.6	292.3
(Credit)/charge to income statement	(5.0)	73.1	2.7	(8.8)	61.9
Prior year adjustment:					
- Charge/(credit) to income statement	1.0	-	(1.8)	-	(0.7)
- Charge to other comprehensive income	-	-	19.0	-	19.0
Effect of change in tax rate					
- income statement	63.2	-	0.1	(18.0)	45.3
- other comprehensive income	-	-	(1.5)	-	(1.5)
At 31 March 2020	**600.4**	**(154.7)**	**(13.2)**	**(16.2)**	**416.3**

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:

	2020 £	2019 £
Deferred tax liabilities	**600.4**	541.1
Deferred tax assets	**(184.1)**	(248.8)
	416.3	292.3

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

At the reporting date the group has unused tax losses of £5.6 million (2019: £5.6 million) with a deferred tax asset of £1.1 million (2019: £0.9 million). A deferred tax asset has not been recognised due to the uncertainty of suitable taxable profits in the foreseeable future on which to utilise the losses.

Future tax relief of £215.7 million (2019: £171.0 million) 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.

The total amount of deferred tax asset un-provided is £41.0m (2019: £30.0m). 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.

Deferred tax liabilities have not been discounted.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2020

25 Retirement benefit obligations

The deficit associated with retirement benefit obligations has decreased to £62.5 million (2019: £186.7 million). The main reason for the decrease in the deficit over the year is a decrease in the level of expected future price inflation, which has reduced the value placed on the scheme liabilities, as well as higher than assumed asset returns over the year and Group contributions. This has been partially offset by an increase in assumed life expectancy and, less significantly, allowance for the Scheme closing to further accrual.

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 Scheme closed to accrual with effect from 31 March 2020.

   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, the group looks to agree a long-term funding and risk management strategy for the pension liability. Following on from regular dialogue with the Trustees, and discussions and correspondence with the Pension Regulator regarding the deficit, the SWS Board agreed with both the Trustees and the Pensions Regulator a long-term funding solution for the scheme in 2018.

   The main risks of the scheme are as follows:

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

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

      However, the 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.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2020

25 Retirement benefit obligations (continued)

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 scheme's assets do not provide a direct hedge against changes in inflation as they are either fixed-interest in nature, e.g. corporate bonds and government bonds, or have an indirect link to inflation, e.g. equities.

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

   Contributions made to the defined contribution scheme for the year ended 31 March 2020 amounted to £4.9 million (2019: £3.9 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 2019 using the projected unit method. For closed schemes under this method the current service cost will increase as the members of the schemes approach retirement.

The assumptions that have the most significant effect on the results of the valuation are those relating to the rate of return on investments, and the level of inflation, which drives pension increases in the SWPS.

The principal assumptions in the valuation were as follows:

	2019 **SWPS** % per annum (pa)
Return on investments: pre-retirement	FI Gilt curve + 65 bps
Return on investments: post-retirement (pensioner/non-pensioner)	
Salary growth	2.50%
Pension increases on the excess over guaranteed minimum pensions (where capped at 5% pa)	3.00%

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 2019 actuarial valuation.

The assets of the scheme had a market value of £755.6 million at 31 March 2019. This was sufficient to cover 76% of the scheme's benefits. The weighted average duration of the scheme liabilities is 17.5 years.

The timing and quantum of future contributions in relation to the deficit have now been agreed with the Trustees and Pensions Regulator. These contributions will be dependent on future levels of RPI, but if market breakeven rates are borne out at 31 March 2019 the expected base deficit contributions will be paid annually and total £211.8 million over the period from 1 April 2019 to 1 April 2029. The first payment was made in November 2018.

Expected employer and employee contributions to the defined benefit scheme for 2020-21 are £17.5 million under the current Schedule of Contributions.

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2020

25 Retirement benefit obligations (continued)

IAS 19 – assumptions, asset, liability and reserves disclosures

The group has employed an independent actuary to approximately update this valuation allowing for differences between the actuarial assumptions used by the scheme for funding purposes and those adopted by the group to measure the scheme's liabilities in the financial statements, as well as adjusting for benefit accrual and benefits paid by the scheme.

The major assumptions used by the actuary are set out in the table below:

	2020 % pa	2019 % pa
Price inflation (RPI)	**2.5**	3.2
Price inflation (CPI)	**1.7**	2.2
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)***	**1.7**	2.2
Rate of increase of pensions in payment (Old section** members only)***	**2.5**	3.2
Rate of increase of pensions in payment (New section and ex FSLP (RPI max 5%))***	**2.5**	3.1
Rate of increase of pensions in payment (Post 5 April 1988 GMP (CPI max 3%))***	**1.6**	2.0
Rate of increase of pensions in payment (All sections post 31 March 2013 service (RPI max 2.5%))***	**1.9**	2.2
Rate of increase for deferred pensions (MIS* members only)***	**1.7**	2.2
Rate of increase for deferred pensions (Old section** members only)***	**2.5**	3.1
Rate of increase for deferred pensions (New section and ex FSLP (RPI max 5%))***	**2.5**	3.1
Rate of increase for deferred pensions (Post 5 April 1988 GMP (CPI max 3%))***	**1.6**	2.0
Rate of increase for deferred pensions (All sections post 31 March 2013 service (RPI max 2.5%))***	**1.9**	2.2
Discount rate	**2.4**	2.4

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

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

*** Pension increase assumptions allow for caps and floors where appropriate based on a statistical model (the Black Scholes model).

Assumptions regarding future mortality experience are set based on advice, published statistics and experience. For 2019–20, base tables have been updated in line with best estimate basis from the Trustees' 2019 Actuarial Funding Valuation, together with future improvements in line with CMI 2018 improvements with a long-term improvement rate of 1.25% per annum. Improvements rates are the same as those used in the prior year, as assuming greater improvements is not considered appropriate in light of the ongoing COVID-19 pandemic.

	2020 Years	2019 Years
Longevity at age 65 for current pensioners		
Male	**23.0**	22.3
Female	**24.9**	24.0
Longevity at age 65 for future pensioners		
Male	**24.4**	23.7
Female	**26.4**	25.6

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2020

25 Retirement benefit obligations (continued)

The assets and liabilities in the scheme and the expected rates of return at 31 March 2020 and 31 March 2019 were:

	Value at 2020 £m	Value at 2019 £m
Equities	**176.0**	241.5
Government bonds	**239.7**	181.8
Non-government bonds	**343.5**	313.7
Cash	**18.4**	18.8
Total market value of plan assets	**777.6**	755.8
Total value of plan liabilities	**(840.1)**	(942.5)
Accrued deficit in the plan	**(62.5)**	(186.7)
Related deferred tax asset	**13.2**	29.2
Net retirement benefit obligations	**(49.3)**	(157.5)

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

The Government bond and cash allocation set out above includes £244.0 million held in a Liability Driven Investment (LDI) portfolio to mitigate interest rate risks arising from the liabilities.

Reconciliation of the present value of the scheme liabilities	**2020 £m**	2019 £m
At 1 April	**942.5**	908.4
Current service cost	**6.4**	6.2
Past service cost	**-**	1.8
Interest expense	**22.2**	24.1
Member contributions	**0.3**	0.1
Experience gain on liabilities	**(27.2)**	(3.3)
Actuarial loss/(gain) on liabilities:		
- due to changes in demographic assumptions	**12.7**	55.6
- due to changes in financial assumptions	**(78.2)**	(13.7)
Benefits paid	**(39.9)**	(36.7)
Settlements/Curtailment	**1.3**	-
Scheme liabilities at 31 March	**840.1**	942.5

Sensitivity analysis of the scheme liabilities

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

	Change in assumption	**Impact on scheme liabilities (£m)**
Discount rate	+ 0.1% p.a.	(13.4)
	- 0.1% p.a.	13.7
Price inflation (RPI measure)*	+ 0.1% p.a.	10.8
	- 0.1% p.a.	(11.0)
Mortality	+ 1 year	35.5
	- 1 year	(34.1)

* These movements have been calculated assuming that changes in the inflation assumption have a knock-on effect on the pension increase and salary growth assumptions (i.e. the ‘real’ increase rates are maintained).

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

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2020

25 Retirement benefit obligations (continued)

Reconciliation of the value of the scheme assets	2020 £m	2019 £m
At 1 April	**755.8**	736.7
Interest income	**18.0**	19.7
Gain on assets above interest	**19.0**	14.4
Employer contributions	**24.4**	21.6
Member contributions	**0.3**	0.1
Benefits paid	**(39.9)**	(36.7)
Bid value of scheme assets at 31 March	**777.6**	755.8

The total return on scheme assets was £40.7 million (2019: return of £34.0 million).

Total cost recognised as an expense	2020 £m	2019 £m
Current service cost	**6.4**	6.2
Past service cost	**-**	1.8
Curtailment	**1.3**	-
Net interest cost	**4.2**	4.4
Total income statement expense before deduction for tax	**11.9**	12.4

Analysis of the amounts recognised in other comprehensive income	2020 £m	2019 £m
Gain due to liability experience	**(27.2)**	(3.3)
Loss due to changes in demographic assumptions	**12.7**	55.6
Gain due to changes in financial assumptions	**(78.2)**	(13.7)
Return on plan assets greater than discount rate	**(19.0)**	(14.4)
Total (gain)/loss recognised in OCI before adjustment for tax	**(111.7)**	24.2

The cumulative amount of actuarial losses recognised in other comprehensive income is £164.0 million (2019: £279.4 million).

Analysis of the movement in the scheme deficit during the year	2020 £m	2019 £m
Deficit in the scheme at 1 April	**(186.7)**	(171.7)
Employer's contributions	**24.4**	21.6
Employer's current service cost	**(6.4)**	(6.2)
Employer's past service cost	**-**	(1.8)
Curtailment	**(1.3)**	-
Financing charge	**(4.2)**	(4.4)
Actuarial gain/(loss)	**111.7**	(24.2)
Deficit in the scheme at end of year	**(62.5)**	(186.7)

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2020

26 Regulatory settlement liability

	2020 £m	2019 £m
At 1 April	**138.5**	-
Settlements in year	**(3.0)**	-
Increase in year	**-**	**138.5**
At 31 March	**135.5**	**138.5**

Included in:	**2020 £m**	2019 £m
Current liabilities	**35.6**	3.0
Non-current liabilities	**99.9**	135.5
	135.5	138.5

In 2018-19 Ofwat concluded its investigation in relation to the management, operation and performance of Southern Water's wastewater treatment works. That investigation resulted in Ofwat taking enforcement action. Notice of Ofwat's intention to issue Southern Water with a financial penalty amounting to £3.0 million has been published on its website. To ensure that its customers are not disadvantaged as a result of these matters, the company has agreed to make direct customer rebates totalling £135.5 million in outturn prices (£129.9 million in 2017–18 prices) over the period 2020–25. This reflects the seriousness of the breaches identified in the investigation and these amounts have been provided for in the financial statements for 2018–19. Southern Water has given a number of formal undertakings to Ofwat in relation to the numerous measures it has put in place and are being put in place to ensure that the issues identified in the investigation have ceased and cannot be repeated.

27 Provisions for liabilities

	Environmental obligations	**Other**	**Total**
Balance 1 April 2018	3.4	-	**3.4**
Utilised in year	(0.1)	-	**(0.1)**
Increase in year	3.3	-	**3.3**
Balance at 31 March 2019	**6.6**	**-**	**6.6**
Balance 1 April 2019	6.6	-	**6.6**
Utilised in year	(1.0)	-	**(1.0)**
Increase in year	0.2	4.0	**4.2**
Balance at 31 March 2020	**5.8**	**4.0**	**9.8**

Included in:	**2020 £m**	2019 £m
Current liabilities	**5.1**	1.2
Non-current liabilities	**4.7**	5.4
	9.8	6.6

The environmental provision relates to management's best estimate for the decommissioning of abandoned sites and commitments made for environmental ecology work following the South Hampshire abstraction inquiry for the period up to 2030. No reimbursement is expected.

Other provisions includes £3.0 million relating to the payment of compensation for missed appointments under our Guaranteed Standards of Service Scheme and represent a best estimate of the value of payments to be made over the course of the coming year.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2020

27 Provisions for liabilities (continued)

Environment Agency

Like other wastewater operators, in the normal course of operations Southern Water occasionally faces Environment Agency investigations following wastewater incidents. In addition to those, Southern Water has been subject to a detailed investigation regarding permit breaches at some of our wastewater treatment works in two locations during the period 2010–15. In February 2020 the agency presented 51 charges before the court and Southern Water have entered guilty pleas to these charges. The exact nature and scale of the permit breaches over the period are still under investigation.

The Southern Water Board, supported by external legal advice, has concluded that it is not yet possible to make a reliable overall estimate for the obligation that will arise from this prosecution, notwithstanding Southern Water's guilty pleas and the Sentencing Council's Guidelines for Environmental Offences. However, it does recognise that there will be a minimum liability associated with the charges before the court and has therefore recognised a provision of £1.0 million reflecting a minimum amount as indicated in the sentencing guidelines and an allowance for legal costs.

There is a wide range of possible outcomes which reflects the uncertain and disputed levels of culpability and environmental harm (both being amongst a number of key criteria that the court uses to help determine the level of the fine), the lack of a similar precedent, and the extent of the applicability of the Sentencing Council's Guidelines to Southern Water which vary very widely. Further, as Southern Water is a Very Large Organisation, there is a requirement for the court to examine the financial circumstances of the organisation in the round. The court has a very broad discretion to assess the level of fine and the minimum provision Southern Water has made is not intended to indicate or predict any particular level. The Southern Water Board will continue to review the level of provision made as more information becomes available.

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

The Southern Water Board has taken these investigations extremely seriously and has continued to monitor and support the work of the Risk and Compliance directorate, which continues to deliver a programme of improvements to the Southern Water's non-financial regulatory reporting including the collection, verification, reporting and assurance of data.

28 Other non-current liabilities

	Deferred revenue £m	Grants & contributions £m	Group total £m
At 1 April 2019	13.4	14.0	**27.4**
Receivable in year	-	6.8	**6.8**
Released to income statement	(0.3)	(1.2)	**(1.5)**
At 31 March 2020	**13.1**	**19.6**	**32.7**

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

Deferred revenue of £13.1 million (2019: £13.4 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.

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2020

29 Called up share capital

	Group and Company 2020 £m	Group and Company 2019 £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.

30 Share premium account

	Group and Company 2020 £m	Group and Company 2019 £m
Share premium account	**4.5**	4.5

31 Non-distributable reserve

	Group 2020 £m
Balance at 1 April 2018	46.7
Profit for the financial year	8.5
Transfer to retained earnings	(1.4)
Balance at 1 April 2019	53.8
Profit for the financial year	7.8
Transfer to retained earnings	(1.4)
Balance at 31 March 2020	**60.2**

Non-distributable reserves are comprised of the value of sewer adoptions previously recognised at fair value, deferred and amortised to the income statement over the life of the related assets. Under IFRS 15 the group recognises the fair value upon adoption i.e. the point at which control of the asset is obtained, through profit and loss to non-distributable reserves and is released to retained earnings in line with the amortisation of the related assets.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2020

32 Retained losses

	Group 2020 £m
Balance at 1 April 2018	(1,749.8)
Loss for the financial year	(458.8)
Other comprehensive income for the year	(20.1)
Transfer from non-distributable reserve	1.4
Balance at 1 April 2019	(2,227.3)
Profit for the financial year	95.6
Other comprehensive income for the year	94.2
Transfer from non-distributable reserve	1.4
Balance at 31 March 2020	**(2,036.1)**

	Company 2020 £m	Company 2019 £m
Loss for the financial year	**(236.8)**	(780.7)
Balance at 31 March	**(236.8)**	(780.7)

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2020

33 Notes to the cash flow statement

	2020 £m	2019 £m
Continuing operations		
Operating profit	**201.6**	108.5
Adjustments for:		
Fair value of sewer adoptions	**(7.8)**	(8.5)
Depreciation of property, plant and equipment	**258.2**	257.0
Amortisation of intangible assets	**13.1**	22.3
Receipt of grants and contributions*	**6.8**	-
Difference between pension charge and cash contributions	**(16.7)**	(13.7)
Amortisation of grants and contributions	**(1.2)**	(1.1)
Operating cash flows before movements in working capital	**454.0**	364.5
Increase in inventories	**(0.3)**	(1.8)
Decrease/(increase) in receivables	**15.9**	(21.0)
Increase in payables	**7.0**	8.9
(Decrease)/increase in regulatory settlement liability	**(3.0)**	138.5
Increase in provisions	**3.2**	3.2
Cash from operations	**476.8**	492.3
Tax paid	**(0.1)**	(0.1)
Net cash from operating activities	**476.7**	492.2

* Contributions and grants received of £6.8 million have been presented as operating cash flows in 2019–20 (investing cash flows in 2018–19) as these credits are released to operating costs over the useful economic life of the non-current asset to which they relate. These were not material in 2018–19 therefore no change to prior period cash flow presentation was made.

Cash and cash equivalents	2020 £m	2019 £m
Cash and bank balances	**282.5**	514.8

Cash and cash equivalents comprise cash and short-term bank deposits. 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 2020

33 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 2019 £m	Cash Flow changes £m	Fair value adjust-ments £m	New finance leases £m	Other non-cash changes £m	At 31 March 2020 £m
Cash and cash equivalents	514.8	(232.3)	-	-	-	**282.5**
Net liabilities from financing activities:						
Term facilities/index linked loans (note 21)	(5,950.9)	80.8	(182.6)	-	4.1	**(6,048.6)**
Finance lease liabilities (note 21)	(1.0)	1.5	-	(30.9)	-	**(30.4)**
Foreign currency swaps (note 23)	(0.8)	-	9.5	-	-	**8.7**
Interest rate swaps (note 23)	(1,382.0)	(140.0)	339.9	-	-	**(1,182.1)**
Total liabilities from financing activities	(7,334.7)	(57.7)	166.8	(30.9)	4.1	**(7,252.4)**
Net debt	(6,819.9)	(290.0)	166.8	(30.9)	4.1	**(6,969.9)**

Other non-cash changes of £4.1 million relate to amortisation of loan issue costs, gilt lock proceeds and deferred proceeds. Bank loan fair value movements include Eurobond interest, indexation and effective interest.

Balances at 31 March 2020 comprise:	Non-current assets £m	Current assets £m	Current liabilities £m	Non-current liabilities £m	Total £m
Cash and cash equivalents	-	282.5	-	-	**282.5**
Derivative financial instruments	203.0	-	-	(1,376.4)	**(1,173.4)**
Unamortised debt issuance costs	-	-	1.9	157.4	**159.3**
Gilt lock proceeds	-	-	(0.1)	(4.5)	**(4.6)**
Borrowings due within one year	-	-	(780.2)	-	**(780.2)**
Borrowings due after one year	-	-	-	(5,423.1)	**(5,423.1)**
Finance leases	-	-	(2.2)	(28.2)	**(30.4)**
Net debt	203.0	282.5	(780.6)	(6,674.8)	**(6,969.9)**

Borrowings due within one year relate to amounts that are repayable on demand or within 12 months of the balance sheet date (see note 20).

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2020

34 Contingent liabilities

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

Separate consideration of the EA investigations is set out in note 27.

Following the South Hampshire abstraction inquiry, Southern Water Services Limited has committed to undertake certain environmental work on the rivers Itchen, Test and Candover Stream between 2018 and 2030. A provision has been made in the accounts of 2018–19 in relation to costs of the ecology work associated with this agreement and further details are disclosed in note 26 to the accounts. Certain compensatory costs may become due in the future, subject to conditions at that time and the impact of the ecology work undertaken. These have not been provided for and could increase the obligation by approximately £2 million.

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

The group had no contingent liabilities for capital claims at the year-end (2019: £nil).

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2020

35 Financial commitments

(a) Capital commitments are as follows:

	2020 £m	2019 £m
Contracted for but not provided for in respect of contracts placed in respect of property, plant and equipment	**301.3**	615.2
Contracted for but not provided for in respect of contracts placed in respect of intangible assets	**10.7**	15.8

(b) The group as lessee

	2020 £m	**2019 £m**
Lease payments under operating leases recognised as an expense in the year	**1.3**	4.4

As at 31 March 2020 and 2019, 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**	
	2020 £m	2019 £m	**2020 £m**	2019 £m
Within one year	**-**	1.7	**-**	-
In the second to fifth years inclusive	**-**	7.0	**-**	-
After five years	**-**	11.4	**-**	-
	-	20.1	**-**	-

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

In the previous year, operating lease payments represented rentals payable by the group for certain of its office properties and group vehicles, not classified as ‘finance leases’ under IAS 17 Leases. These are now presented in property, plant and equipment and the liabilities as part of the group’s borrowings. For adjustments recognised on adoption of IFRS 16 on 1 April 2019, please refer to note 3.

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.

36 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 2020, no single investor owned a controlling shareholding.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2020

36 Related party transactions (continued)

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

	2020 £m	2019 £m
Eurobond interest		
IIF Int'l SW UK Investment Ltd	**47.0**	41.9
Phildrew Nominees Ltd	**30.7**	27.3
National Nominees Ltd	**11.7**	10.4
Sky Brace Investments Ltd	**7.2**	6.4
Sumaya Investments Ltd	**7.1**	6.4
Falkirk Council - Falkirk Council Pension Fund	**0.6**	0.5
The City of Edinburgh Council – Lothian Pension Fund and Lothian Buses Pension Fund	**1.7**	1.5
Hermes Infrastructure Fund LP	**31.6**	28.1
SW Holdings LP	**2.9**	2.6
Simcoe Yeoman Water Ltd	**10.0**	8.9
Total Eurobond interest payable to related parties	**150.5**	134.0
Loans and other borrowings greater than one year:		
Eurobonds – Shareholder loans		
IIF Int'l SW UK Investment Ltd	**278.3**	278.3
Phildrew Nominees Ltd (UBS IIF)	**49.6**	49.6
Phildrew Nominees Ltd (UBS IINF)	**6.9**	6.9
Phildrew Nominees Ltd (UBS II4F)	**55.0**	55.0
Phildrew Nominees Ltd (UBS IIUSTEF)	**27.5**	27.5
Phildrew Nominees Ltd (UBS IIF (A) LP)	**12.9**	12.9
Phildrew Nominees Ltd (UBS IIF (B) LP)	**17.1**	17.1
Phildrew Nominees Ltd (UBS IIF (C) LP)	**12.4**	12.4
National Nominees Ltd - Motor Trades Association of Australia Super Fund	**21.4**	21.4
National Nominees Ltd – Prime Super	**6.5**	6.5
Sky Brace Investments Ltd	**42.3**	42.3
Sumaya Investments Ltd	**42.3**	42.3
Falkirk Council - Falkirk Council Pension Fund	**3.4**	3.4
The City of Edinburgh Council – Lothian Pension Fund and Lothian Buses Pension Fund	**10.3**	10.3
Hermes Infrastructure Fund LP	**34.7**	34.7
Hermes Infrastructure Fund Spring I LP	**19.2**	19.2
Hermes Infrastructure Fund Spring II LP	**113.9**	113.9
Hermes Infrastructure Fund Spring III LP	**19.2**	19.2
SW Holdings LP	**17.5**	17.5
Simcoe Yeoman Water Ltd	**59.1**	59.1
Accrued interest	**551.9**	401.4
Total Eurobonds – Shareholder loans	**1,401.4**	1,250.9

Greensands Europe Limited (the **Issuer)** has issued £359,725,975 in aggregate principal amount of notes (the Notes 'Eurobonds') to the shareholders of its ultimate parent company, Greensands Holdings Limited. In 2016 a Payment in Kind (PIK) exercise was undertaken, which capitalised £489,788,024 of accrued interest.

If not previously repaid or purchased, the Notes will be repaid by the Issuer at par on 31 March 2038 (the **Maturity Date).** The Maturity Date may at any time be extended by the Issuer with the approval of an Ordinary Resolution of the Noteholders passed in accordance with the relevant Conditions.

Interest for any Interest Period (the **Rate of Interest)** shall be paid at a rate of 12% per annum, being 31 March in each year. Interest is compounded if unpaid.

The Notes are unsecured, limited recourse obligations of the Issuer, at all times ranking *pari passu* and without any discrimination or preference between them, recourse in respect of which is limited to the assets (whether present or future) of the Issuer, to the extent that such assets are available after satisfaction of claims of the Issuer's creditors who rank ahead of the Noteholders (if any).

Notes to the consolidated financial statements (continued)
For the year ended 31 March 20

37 Subsidiaries

As at 31 March 2020 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
Greensands Finance Holdings Limited	Southern House, Yeoman Road, Worthing	Holding company
Greensands Finance Limited	Southern House, Yeoman Road, Worthing	Holding company
Greensands Financing Plc	Southern House, Yeoman Road, Worthing	To raise debt finance
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
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

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2020

37 Subsidiaries (continued)

*The country of incorporation for this company is the Cayman Island, but is UK tax resident.

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

38 Post balance sheet events

In May 2020 one of the group's subsidiaries Southern Water Services (Finance) Limited raised additional financing of £825 million (net £814.9 million) under a sustainability framework which ensures proceeds are used for environmental, green, and social purposes, including the repayment of debt issued for the same purpose. The use of the proceeds will include investment in the PR19 business plan of SWS, the operating company, and the repayment of a £350.0 million bond maturing 31 March 2021. This replaces a short-term revolving credit facility of £700.0 million that was in place from 31 March 2020.

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 2020 and of the group's profit 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 38.

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 parent company 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 Environment Agency investigation
We draw attention to note 27 concerning the uncertain outcome of the investigation from the Environment Agency regarding the performance of certain wastewater sites and the reporting of relevant compliance information. The ultimate obligation arising from this matter cannot presently be determined because of the very wide range of possible outcomes in the sentencing guidelines, the uncertain and disputed levels of culpability and environmental harm, the lack of precedence, and that Southern Water would be considered a very large organisation meaning that the court has broad discretion in determining the penalty that might be applied. Management, supported by legal advice, was not able to make a reliable overall estimate of the financial obligation that will arise from the EA investigation, notwithstanding the guilty pleas and the Sentencing Council's Guidelines for Environmental Offences. However, recognising that there will be a minimum liability associated with the permit breaches management have therefore recognised a provision of £1 million for the 51 cases brought to date, reflecting a minimum amount as indicated by the Sentencing Guidelines and an allowance for legal costs. Our opinion is not modified in respect of this matter.

Material uncertainty related to going concern

We draw attention to note 1 of the financial statements which indicates that there are possible scenarios where covenants applicable to the debt held in the group structure above Southern Water Services Limited may be stressed over the next 12 months and liquidity available to pay interest on this debt is scheduled to be exhausted by October 2021. As stated in note 1 to the financial statements these events or conditions, indicate that a material uncertainty exists that may cast significant doubt on the company's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

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.

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

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.

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 parent company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the group or parent company 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

Anthony Matthews FCA
for and on behalf of Deloitte LLP
London, United Kingdom
29 July 2020