South Staffs Water

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Annual Report and Accounts together with the Annual Performance Report

Year Ended 31 March 2017

Company Registration No: 2662742

South Staffs Water

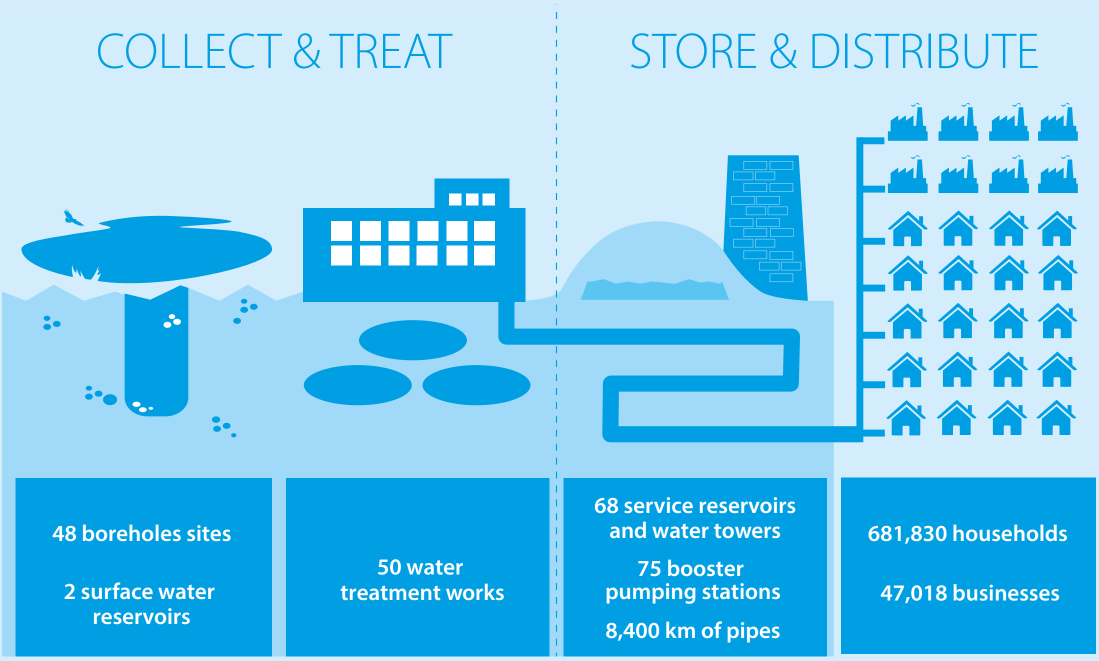
Annual Report and Accounts for the Year Ended 31 March 2017

Together with:

- The Strategic Report
- The Directors' Report
- The Independent Auditor's Report

At a glance

Business Model



Our Vision

To consistently deliver high quality water at great value with excellent service to our customers, communities, employees and wider stakeholders.

Our Mission

At South Staffs Water we deliver:

Excellent water quality and secure and reliable water supplies supported by an excellent customer experience to all customers and their communities.

As water is a precious resource we're committed to operations that are environmentally sustainable.

We innovatively manage our business to deliver a first class service and value for money for our customers.

This is achieved through the commitment of our employees, making South Staffs Water a great place to work.

Turnover

2017	2016
£123.7m	£123.9m

Operating Profit

2017	2016
£32.6m	£35.3m

Dividends

2017	2016
£11.1m	£12.1m

Corporation Tax

2017	2016
£1.6m	£1.3m

Contents

Highlights

Continued high performance in Interruptions to Supply.

Successful completion of installation of one of the largest UV clean water treatment plants in the UK at Seedy Mill Treatment Works.

New 'Assure' social tariff introduced to support customers who are struggling to afford their water bill.

Development of a new outreach education service.

Over £60k raised for WaterAid.

Disappointing performance on complaints, especially in our Cambridge region.

STRATEGIC REPORT

COMPANY OVERVIEW

South Staffordshire Water PLC ("the Company") is part of the South Staffordshire Plc group of companies, a privately owned integrated services group concentrating on regulated water supply and complementary specialist service businesses.

On 1 April 2013 South Staffordshire Water acquired Cambridge Water PLC by way of a Transfer Scheme in accordance with Schedule 2 of the Water Industry Act 1991. Both businesses now operate under one single water supply licence.

Across both the South Staffordshire and Cambridge regions we supply water to a population of approximately 1.6 million. The South Staffordshire region stretches over 1,490 square kilometres from the edge of Ashbourne in the north, to Halesowen in the south, and from Burton on Trent in the east to Kinver in the west and serves a population of nearly 1.3 million. The Cambridge region covers an area of 1,173 square kilometres in South Cambridgeshire and the City of Cambridge and supplies to a population of around 0.3 million.

The South Staffordshire region obtains its water resources from three main sources, Blithfield Reservoir, the River Severn and borehole sites across the region's area of supply. The Cambridge region supplies high quality underground water that is pumped from boreholes, all from chalk aquifers.

South Staffs Water (incorporating the transfer of Cambridge Water PLC) is a water only company and as such does not supply sewerage services. However, it does bill customers for these services on behalf of Severn Trent Water and Anglian Water Services.

The Strategic Report includes a detailed description of the Company's objectives and business model and its activities to generate value for its various stakeholders.

CHAIRMAN'S INTRODUCTION – SIR JAMES PEROWNE

Having started in role as Chairman in April of this year, I am heartened to find a business with a clear focus and understanding of its priorities and what it needs to do to perform to a consistent and high standard while delivering low prices.

I want to acknowledge the successes you will find in this report, most notably the efforts in ensuring a reliable supply of the highest quality water – without doubt, the number one deliverable for any water company. I look forward to being able to congratulate the business in maintaining and building upon this performance in the next 12 months and will do all I can to support them in doing so.

However, to properly fulfil my role, I need to challenge the business in all areas so will be questioning the Executive Team on their plans to address those areas of poor performance and asking for evidence of their actions and consequent improvements. I want the business to demonstrate collaboration, innovation, long-term planning and careful investment in its operations and people, building on its innate strengths and mitigating the weaker areas.

I will act as a reminder of the duty to our customers and the need to get it right with everyone in our two areas of supply – from big business owners and housing developers, to households in our communities.

All the signs so far are very encouraging. I am met by positivity, hard work and a commitment to success. I am proud to be Chairman of a business that aims high and I look forward to the year ahead and seeing how this ambition will flow through into the plans being developed for the Price Review Period 2020-2025.

MANAGING DIRECTOR'S REVIEW

Preface

Thank you for taking the time to read our annual performance report. I hope you find this document useful in helping to understand more about what South Staffs Water does and how well we are doing our job.

As a business we believe it's important to be transparent with our customers and stakeholders and are working hard to regularly share more information about our performance. This report is just one of the ways we are making this happen.

Over the coming pages we will provide you with an overview of how we're doing, including how we measure up against our financial and non-financial targets. We are also making increasingly detailed disclosures about remuneration and our ownership structure in particular.

On reflection, I am particularly proud of the improvements we made in the year in relation to water quality. The reliable supply of the highest quality water is the most important thing we do for our customers. I also want to acknowledge the efforts made in maintaining good performance in areas including interruptions to supply, encouraging and enhancing biodiversity; and providing support for customers in debt.

However, we must be honest in recognising that there are areas where we have not performed to the levels we set ourselves and those which our customers should expect as a norm. A particular disappointment is our Service Incentive Mechanism (SIM) score – the water industry customer service measure. Our efforts to drive efficiency so customers can continue to experience great service at a fair price have had an unfortunate impact on the overall customer experience with an accompanying increase in complaints. We understand what went wrong and we are on a mission to put this right as quickly as possible. As I write, I'm pleased to report that as a result of a lot of hard work, we are beginning to see improvements.

As we enter the year ahead our thoughts are increasingly turning to building our plans for all that we will deliver for customers in the period 2020-2025. Our objective is sustainably to be the industry leader on cost and service and to ensure our service is affordable and accessible for all. We will do this through ever greater efficiency, innovation and communication.

We will share much more of these plans over the next year and hopefully engage with many of you during that period. We need your ideas to help us shape the South Staffs Water of the future.

Introduction

The water industry is undergoing unprecedented transformation. With complex challenges including deregulation, environmental pressures and significant changes in the demands of the UK population we are developing a new flexibility in our operations that mean we can respond quickly and adapt as necessary to take full advantage of the new landscape.

Together with our financial results, the year has seen good performance in the key areas of water quality, supply interruptions, water efficiency and further improvement in our health and safety environment. Whilst we have faced disappointments around our SIM performance and leakage performance in the Cambridge region we feel that our flexibility and adaptability will allow us to tackle these head on and turn around performance in the coming year.

In the year preparations for the launch of the non-household retail market were a key area of focus. A readiness program was delivered ensuring that our operations were in place for the 1 April 2017 go live and that we could provide all the relevant assurances. We successfully operated in the ‘shadow’ market in the lead up to go live allowing us to further develop our operational capability. Another exciting development in this area was the creation of a Joint Venture between South Staffordshire Plc and South West Water which saw both Companies transfer their non-household retail services into Pennon Water Services. Our non-household retail operations were transferred to our fellow Group Company SSWB Ltd on the 1 April 2017 which immediately become part of the Joint Venture of which the South Staffordshire Group holds a 20% share.

The Outcome Delivery Incentive (ODI) targets, that were underpinned by significant customer engagement, alongside our own business targets continue to provide a real focus for delivery as we move through AMP6 and drive us to ensure that excellent customer service, reliable, high quality water supply and affordable bills, remains at the heart of everything we do.

The package comprises of five Outcomes and 15 specific ODIs, covering all aspects of operations from water quality, secure and reliable supplies, customer services, environmentally sustainable operations and fair customer bills. They are supplemented by the business targets that include a focus on, readiness for competition, employee satisfaction, safety and wellbeing.

The Highest Quality Water, Today and Tomorrow

The single most important area of our operation is ensuring the water we supply to customers every day is of the highest quality. Improving the quality of our water beyond simply meeting regulatory commitments is the principal objective for the business, with an aim to achieve 100% water quality compliance and an improved customer perception of water through appearance, taste and odour. We aspire to an unrestricted, uninterrupted supply of water of the highest possible quality.

Following a challenging period in the prior year we have seen an improvement in our acceptability of water measure driven by investments in the business' assets and processes. This can be seen in the movement of our both our compliance score (MZC) and a 15% fall in the number of water quality contacts from customers around appearance, taste or odour in their water supply. Whilst this means that we have not incurred a penalty this year in either area, we still did not achieve our contact performance commitment for acceptability of water and need to ensure that we drive continued improvement through the coming year as this target becomes more demanding.

Quality driven investment was undertaken across our assets including a number of borehole refurbishments. The most significant of these was undertaken at the Seedy Mill treatment works. A multimillion pound investment created the second largest clean water UV (Ultraviolet) treatment plant in the UK. The resulting benefit of enhanced water quality and compliance will be replicated with additional investment in the coming year, including the installation of UV treatment at our largest treatment works.

Seedy Mill UV – Case Study

Seedy Mill is South Staffs Water's second largest surface water treatment works. There had been numerous modifications and extensions to the facility but it was still principally operating using the same technology and processes since its initial construction in the 1950s.

As part of our commitment to the highest water quality standards, we chose to design and retro-fit a state-of-the-art UV treatment technology into the existing structure, in collaboration with Integrated Water Services and the UV specialist supplier, atg UV Technology, whilst keeping the works operational. The proven, regulated and environmentally friendly UV technology ensures water is free from harmful organisms, and means less chlorine is needed, reducing the risk of issues with taste and odour.

Underground wet contact tanks were converted into two dry chambers in separate phases to keep the plant operational, each housing two UV reactors, each then containing 30 glass tubes, making the facility one of the largest UV water treatment plants in the UK. A project of this scale would normally take two and a half years but it was completed in just ten months. The speed of the construction did not negatively impact on health and safety with eight main contractors and sub-contractors, over 90 suppliers and 200 plus craftsmen and technicians on site with no lost time injuries.

Fair and Affordable Bills for All of Our Customers

South Staffs Water's household customers continue to enjoy some of the lowest bills in England and Wales. We are committed to maintaining affordability of bills and supporting our most vulnerable customers with a range of help when they need it most. During the year, we exceeded our performance commitment in providing extra help to over 23,000 customers in debt by helping them manage their water accounts and take control of their consumption.

Our range of solutions for customers that struggle with bills was expanded with the introduction of the new "Assure" social tariff. It offers a discount of up to 80% on bills subject to eligibility which is based on income and expenditure. During the year 4,066 customers were signed up to Assure. In addition, we are seeing real benefit to some of our most vulnerable customers in providing sensitive face to face assistance to them in their own homes. We plan to expand on this valuable work in the year ahead.

Excellent Customer Service, Every Time

We recognise the importance of responding to lifestyle changes and offering greater choice and flexibility in how customers can access information and make contact with us. The expansion of the online account management service, MyAccount, into our Cambridge region was a key stage in the continued expansion of our digital offering.

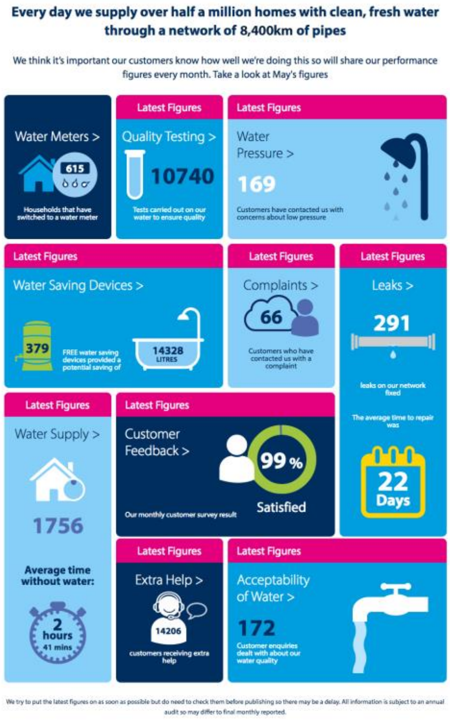
We have felt some negative impact on the customer experience as a result of changes in billing services and some of our operations in the field and contact centre. Whilst these changes will deliver long term sustainable efficiencies and improvements, the short term effect in the first half of the year was a deterioration in our level of customer service and, as a result, we do not expect to be in our targeted upper quartile position of Ofwat's SIM measure when the comparative results for the year are published.

As a result of this, significant efforts in training of staff and review of processes and systems were made to reverse this trend and ensure that we are consistently delivering the quality of service our customers expect. We were pleased to see our SIM performance start to step up again in the latter half of the year and correspondingly complaint numbers begin to glide back towards their traditional low levels.

We continue to find ways to better listen to our customers and respond to what we hear from them. More in-depth, regular research has been put in place to better understand customers' current and future needs as well as their views of our services. The results are being used to inform business decisions which match with what customers have told us they value. We will also involve them in the shaping and creation of a future services.

These research findings are being complemented by the contributions of the new Independent Water Customer Panel who meet up once a quarter. On the panel there are representatives from the Environment Agency, CCW water and other members with a variety of skills and expertise within public and private sectors. The use of their skills and expertise to actively challenge how we as a Company, engage with our customers and perform as a business has been a significant achievement this year. In addition, one of the Independent Non-Executive Directors attends the panel on rotation basis to compliment attendance by Senior Management and to ensure that the appropriate actions are being taken based on the meeting outcomes. We welcome the independent and challenging contribution the panel brings.

Early next year South Staffs Water will commence publishing in year performance results, initially for our South Staffordshire region, on our website. These will be unaudited but in a format which customers can easily follow. A draft format for this Interactive Dashboard is shown on the below.



[This picture is for illustrative purposes only and figures are not indicative of May performance]

We continue to seek ways in which we can increase the transparency of our performance to customers and engage them in dialogue about it. This is a further demonstration of our innovative thinking around how we share information and encourage customer comment and input.

Secure and Reliable Supplies, Now and in The Future

Water efficiency is fundamental to safeguarding supplies and the business remains committed to helping customers change the way they value and use water every day through an ongoing programme of educational engagement.

We have maintained a strong performance on minimising supply interruptions and as is shown in our ODI results in table 3A on page 122 we have achieved a reward outcome for the second year running. Our focus will continue on ensuring our pipes and networks are well maintained and that decisions regarding our infrastructure place us in the best possible position to provide secure and reliable supplies.

Whilst leakage performance in our South Staffordshire region held at prior year levels we saw a disappointing performance within our Cambridge region which has resulted in a penalty being incurred under the ODI mechanism. We see this outcome as unacceptable, and have identified several contributing factors which are actively being investigated and addressed; these include an increased level of night flows since November 2015, some unanticipated knock on effects from system changes and a possible impact from the changes in information sources following the OpenWater programme. We have engaged additional specialist leakage resource to ensure that we understand each of these impacts and drive Cambridge leakage back to acceptable levels quickly.

We continue to focus a lot of time and effort in promoting water efficiency to our customer base, and have achieved our performance commitment again this year.

The benefits of addressing challenges across these areas are increasingly evident. We will continue to work closely with the Environment Agency to maintain practices that are environmentally responsible as well as develop appropriate partnerships that will provide innovative solutions.

Successful collaboration with the University of Cambridge will see completion of phase 1 of the award winning £1 billion Eddington development in North West Cambridge supplying 3,000 homes, 2,000 student rooms and other community facilities from the UK's largest rainwater recycling scheme this coming year. We see this as a living example of how future developments in a water scarce area which is also seeing continued and significant population growth should be approached.

Our continuing commitment to water efficiency has led us into an exciting and innovative pilot in our drier Cambridge region. This involves software from a company based in California called WaterSmart. This leading tool is designed to produce customer level analysis around personalised water consumption trends. Available across multiple channels (e-mail, text / SMS, Mobile App) the reports aim to educate the customer on the value of water, providing tips around reducing consumption and even indicating if there may be a leakage problem. For the Company, this approach is seen as integral to improving and encouraging customer engagement in water efficiency. We hope the analysis should also help the Company address affordability and vulnerability within the customer base and ultimately improve debt management.

Connecting with Our Communities

South Staffs Water aims to make a positive difference and develop strong and lasting partnerships with the communities in which we live and work through education about water usage and efficiency, enhancing biodiversity and charitable support.

We have an ambitious target to deliver at least 400 days of support in our communities through initiatives including an education programme, biodiversity projects and our employee volunteering scheme. This remains a challenge as, whilst we have made a difference in supporting schools, charities and other organisations, we ended the year on a total of 222 days.

A change in how we approach engagement with schools has been introduced during the year. We believe that in switching from a location based offering in the South Staffs region alone to an outreach service in both regions, we are better placed to meet the needs of educational institutions, be able to increase our work in this area and also start to build meaningful relationships with our future customers.

Environmentally Sustainable Operations

The business understands and recognises the impact of its operations and is dedicated to protecting our environment. We work hard to maintain our good long term track record on leakage and ensure we continue to meet our targets. This includes fitting additional flow-meters to automatically monitor consumption and support leak detection performance improvements.

Our active approach to catchment management as a long term solution to improving the quality of raw water includes developing partnerships with key stakeholders, undertaking relevant research, participating in initiatives and acting as an education resource.

Our new SPRING Environmental Protection Scheme has built on previous success to further support arable farmers in the Blithe catchment area. Grants are made available by the Company towards the costs of voluntary on-farm infrastructural improvements and agricultural management schemes designed to protect the environment and improve water quality, such as contour cropping and pesticide sprayer washdown.

We also work to deliver innovative projects that will enhance biodiversity across our region. The first round of funding from our PEBBLE fund (Projects that Explore Biodiversity Benefits in the Local Environment) has rewarded applications ranging from creating a wildlife walk, and clearing scrubland to supporting a school keen to raise awareness of the environment and local wildlife among pupils.

Valuing Our People

We are committed to making South Staffs Water a great place to work with a safe, positive and rewarding working environment.

We maintained our performance on accidents in the workplace last year and continue to place a strong focus on ensuring the highest employee safety standards with a target to further reduce accidents in the coming year. In measuring our performance over the last 3 years we are pleased that our trend is one of improvement and that there is a significant change in behaviours and culture. The rate of lost time due to accidents has also reduced and was just 6 days this year.

	2014/15	2015/16	2016/17
Accidents	96	19	20
Lost Time (Days)	30	137	6

The health of our workforce is just as significantly important. Our safety performance is supported by a staff health surveillance programme. This benefit supports risk management and also provides wellbeing assurance and appropriate interventions where health support is identified.

The recruitment of seven apprentices in this year represents a commitment to investing in future talent and a recognition of the importance of succession planning. The apprentices each have a mentor to support them as they gain experience from rotating across all functions of the business alongside gaining formal qualifications.

Our annual employee survey plays an important role in helping us to understand the feelings and motivations of our people. The results provide direction for change and improvement in areas such as training and development and the working environment. The training and development of our employees plays an important role in our day to day operations, with training programmes being undertaken regularly at all levels of the business, in respect of statutory, competency and development requirements.

Gender Profile of Directors, Senior Managers and Other Employees

The split between male and female employees as at March 2017 is as follows (March 2016 figures in Brackets):

	Directors and Executive Team	Senior Managers	Other Employees
Male	10 (10)	7 (11)	302 (308)
Female	2 (2)	5 (4)	98 (103)

Also shown in the table below is an age and length of service profile for male and female employees:

Years	Male	Female	Total
Average Age	45.2	40.9	**44.2**
Average Length of Service	13	11	**12**

Our workforce is made up of highly experienced and skilled professionals across a range of disciplines, from engineers and technicians, through to scientists, analysts, managers and support staff. We are committed to employing a diverse workforce and very conscious that we need to encourage more women in to what is primarily an engineering service business. We are actively working more closely with schools and universities to educate and encourage a more diverse approach to some of the jobs that have traditionally been male dominated. It is a challenge that we will continue to address through our brand advertising and all communications. We have family friendly policies and a site nursery in Walsall, providing the right support and benefits to also encourage more female applicants.

Readiness for OpenWater

This year saw a focus on ensuring our systems, processes and organisational structures were in place for non-household retail business opening up to competition in April 2017. Robust preparation ensured both the risks and opportunities associated with the significant changes were identified and planned for appropriately and the business met all compliance requirements at Go Live.

On 1 April 2017, we transferred our non-household retail operations and related assets to SSWB Ltd, a fellow Group company, and therefore exited the non-household retail water market. On the same day our parent company, South Staffordshire Plc, transferred SSWB to Pennon Water Services (PWS), in return for a 20% equity share in PWS. South West Water transferred its non-household retail operations to PWS on the same day, therefore forming a Joint Venture to operate in the non-household retail market.

We are delighted to be working with Pennon Group. The newly formed Joint Venture is the fourth largest retailer in this sector, meaning that it will be well placed to offer a wider range of innovative services and deliver value for money to its customers.

Our Future Focus

Much of our activity is mapped out and we must continue our focus on ensuring that the predicted benefits of our planned investments are fully realised. However, AMP6 and the period beyond demand a degree of flexibility and responsiveness not previously seen in the water industry. To meet our commitments, we need to demonstrate a combination of collaboration, innovation, long term planning and careful investment.

The biggest single challenge we face is finding the best way to consistently deliver high quality water at great value with excellent service for future generations, as well as today's customers, in a sustainable way. We have to consider this whilst not ignoring the significant economic, social and environmental challenges this presents. We have begun significant planning to be able to submit our next five year business plan to the economic regulator, Ofwat, in September 2018. Amongst other matters, it will lay out what we want to do to ensure our network of pipes, reservoirs, pumping stations and water treatment facilities are fit for the future and how this will be paid for.

To make sure we get it right, we will need to work with everyone who is affected by water use in our region; from big business owners and housing developers to customers in our communities and other stakeholders. We will work to share our ideas, listen to opinions and ideas, learn from them and form a plan together. That way, we can be sure the commitments and measures we include in our plan truly reflect what's important to our customers.

Capital Investment

The Company has made good progress in delivering its capital programme, to ensure that its assets remain in good condition, maintain stable asset serviceability and good quality, reliable supplies to customers. Wholesale appointed capital expenditure for the year was £28.7m (net of contributions and excluding infrastructure renewals expenditure), £1.5m above the Final Determination reflecting increased expenditure on key treatment works to deal with water quality issues as required by the DWI.

Financial

Turnover in 2016/17 decreased by £0.2m to £123.7m reflecting a drop in retail income from reduced customer demand and the impact of negative K factor of 0.9% on customer bills. Operating profit of £32.6m was £2.7m lower than 2015/16 and reflects an increase in operating cost driven by uplifts in power costs, infrastructure renewals expenditure and depreciation. Other Operating Income decreased due to reduced profit on disposal of assets. Control of Other Operating Costs including manpower remains a key focus and these decreased by 0.4% from 2015/16.

Finance charges increased by £0.3m to £12.2m largely due to higher charges associated with the Company's index-linked debt in the year.

The tax charge for the year increased to £1.6m (2015/16: £1.3m). In both years the main reason for this being less than the statutory rate of 20% of profit was the inclusion of a deferred tax credit (2016/17: £2.3m, 2015/16: £4.4m) arising from the revaluation of deferred tax liabilities following a reduction in the future UK corporation tax rate.

Dividends paid during the year reduced to £11.1m, including £6.5m from appointed profits, £2.6m non-appointed and £2.0m to enable intra-group loan interest to be paid back to the Company (2015/16: £12.1m including £4.0m from appointed profit, £6.1m non-appointed and £2.0m for intra-group loan interest).

Net debt includes index-linked debt, debenture stock, finance leases and bank loans less cash. Net debt for covenant reporting purposes amounted to £219.7m at 31 March 2017 (31 March 2016: £213.4m). This represents 63.2% (2015/16: 64.3%) of the RCV of £347.6m (2015/16: £332.0m) being the PR14 Final Determination RCV uplifted for inflation. This reduction reflects the impact of better than expected free cash generation in the year and inflation (RPI) at March 2017 of 3.1% (March 2016: 1.6%), which is used to inflate RCV, whereas the majority of index-linked debt was inflated using RPI at July 2016 which was lower at 1.9% (July 2015: 1.0%). A reconciliation of this amount to that book debt included in the accounts is set out on page 62 along with a full analysis of the Company's borrowings. Going forward, the Board is targeting a net debt/RCV ratio of up to 66%. The Company has maintained and continues to forecast to maintain significant headroom in respect of all of its borrowing covenants as detailed below and as at 31 March 2017 had undrawn borrowing facilities of £25,000,000 along with cash balances of £8,723,000 providing significant liquidity.

Standard and Poor's continues to rate the Company as BBB+ with Moody's rating at Baa2, both are within investment grade.

Approach to Taxation

South Staffordshire Water PLC takes seriously its legal and social responsibilities for meeting its tax obligations. The Company has no operations outside the United Kingdom, and therefore the following has specific reference to UK taxation.

The Company is committed to complying with tax laws in a responsible manner, balancing its obligations to the Government and the public with its duty to manage its affairs efficiently in order to deliver cost-effective services to its customers while generating an economic return to its investors. The Company makes timely and accurate tax returns that reflect its fiscal obligations to the Government.

In particular, the Company:

- Will not engage in aggressive tax planning that is not linked with commercial and economic activity;
- Will not engage in artificial tax arrangements;
- Will seek to maintain a transparent and collaborative relationship with HM Revenue & Customs, principally through the Company's Customer Relationship Manager;
- Will seek independent professional tax advice on material matters where the application of tax law is complex or uncertain.

The Company will make use of applicable tax incentives provided by the Government within the terms outlined above. These may include, for example, preferential rates of capital allowances or enhanced tax relief for research and development costs and certain designated capital assets that add efficiency to the Company's operations. Such incentives have been put in place to encourage appropriate business investment.

It should be noted that, for the Company's regulated water supply business, such incentives will generally have the effect of reducing its customers' water bills under the funding model adopted by the economic water sector regulator, Ofwat.

In addition to corporation tax, the Company contributes to the UK Exchequer by means of a number of other taxes and levies, including but not limited to:

- Employment taxes, National Insurance and the Apprenticeship Levy
- Carbon taxes and other energy-related taxes and levies
- Fuel duty and other vehicle-related taxes

- Business rates
- Regulatory charges and licences such as water abstraction charges

The Company's approach to risk management applies to tax as it does to other business areas. Taxation compliance and advisory services are provided to the Company by its immediate parent company, South Staffordshire Plc, which is responsible for identifying, assessing and managing tax risk across the entire Group. All material tax matters are discussed with the Company's finance team and where appropriate, significant issues are escalated to the relevant members of the Board for consideration. The Group Internal Audit function will also review significant risk areas where considered appropriate.

The Company has identified economic uncertainty as a risk area. This includes risk in relation to the possibility of unexpected tax law and policy changes by the Government. The Company carefully monitors published tax legislation, guidance and policy documents to ensure it can assess the compliance requirements and the economic implications for the Company. The Company will engage with HM Revenue & Customs where its tax position is likely to be materially affected by such policy changes.

Treasury Policy

The main purpose of the Company's financial instruments is to finance the Company's operations and reduce risk to fluctuations in external indices outside the control of the Company. It is, and has been throughout the year and previous year under review, the Company's policy that no trading in financial instruments shall be undertaken. The Company's policy in respect of cash, loans receivable and borrowings is to maintain flexibility with both fixed and floating rates of interest and long and short-term debt.

Accounting Policies

The Company's accounting policies are disclosed in note 1 to the financial statements on page 63. With respect to depreciable fixed assets, the estimated useful lives adopted are based on engineering judgement by the Company's asset management team based on their experience and expertise. The asset lives adopted are similar to the rest of the water industry.

Principal Risks and Uncertainties and Risk Management

The Directors recognise that risks exist in all businesses and that the Company's approach to risk reflects its status as a regulated and licensed water undertaking providing essential public services.

As part of their normal activities, the Directors, assisted by the Executive Team, regularly carry out robust assessments of the principal risks facing the Company, including those risks that have the potential to threaten the business model, future operational or financial performance, solvency and liquidity. There is regular monitoring of the Company's risk management and material internal control systems to review their continuing relevance to the Company's business, their effectiveness and to ensure that appropriate risk management activities are in place or are planned to mitigate the risks identified. It is accepted that risks can emerge and change quickly and therefore that risk identification and mitigation activities will need to be able to respond to this and that at any given point in time, enhancements to mitigating actions may be required in response to change.

Risks are assessed both on a gross basis (likelihood and consequence before mitigating controls) and a net basis (likelihood and consequence after mitigating controls) so that the Directors and the Executive Team can properly assess the overall significance of the risk and the estimated effectiveness of mitigating actions and therefore if further actions are required.
The Directors accept that not all risks can be mitigated entirely but aim to ensure that risk management activities reduce the overall estimated impact of risks, on a net basis, to a level that is considered to be acceptable and that do not impact on the long-term viability of the Company. The Directors believe that the most significant risk areas currently faced by the Company along with the related mitigating actions are summarised below:

Health and Safety

Description

The risk to the health, safety and well-being of the Company's employees, contractors and members of the public who may be impacted by the Company's operations.

Mitigation

Continuing to improve health and safety in a practical and common sense way is a top priority for the Company, and is reported at all Board and Executive Management meetings.

At Group level, a Health and Safety Executive Committee is in place to drive Health and Safety strategy, performance and culture, encouraging training, targeted focus on hazards, prompt reporting, and best practice policy and improving behaviours.

The Company has a Management Strategy Committee and an Employee Representative Committee in place. Through these and at all levels of management it takes responsibility in this important area of the business. This includes producing an Annual Health and Safety Plan which focuses operational efforts on areas having the greatest impact on Health and Safety performance. The Company monitors and measures operational performance against these targets. Monthly Health and Safety statistics are published and discussed to further drive focus and improvements.

Water Quality

Description

The risk that the Company is unable to meet its legal and regulatory obligations for the supply of clean, safe drinking water or that water quality is not of an acceptable standard.

Mitigation

Each year the Company carries out thousands of samples taken from treatment works, reservoirs and homes across its areas of supply to monitor quality and respond to any matters arising from the sample results. In addition as part of our Drinking Water Safety Plan activities we undertake catchment monitoring. The results of water quality testing are regularly reported to both the Board and Executive Management.

The Company has sought to mitigate the risk of water quality failures at one of its key operational sites, Seedy Mill Treatment Works. A multi-million pound project to install a new ultra-violet (UV) water treatment facility has been completed.

Since April 2016 all water leaving Seedy Mill has been subject to this additional treatment process to significantly reduce the risk of water quality failures at this site.

Investigations as to the most appropriate long term solution have been carried out at our Hampton Loade water treatment facility with another UV treatment solution planned to commence in 2017/18. Alongside this is a continued commitment to invest in our borehole facilities across our estate.

Regulatory Environment and Competition

Description

The risk of non-compliance with, or the inability to respond to a regulatory environment which is complex and changing, and the risk of these changes having a detrimental impact on the success and financial position of the Company.

Mitigation

The Company has a dedicated regulation team that is focused on keeping abreast of regulatory changes, compliance with regulations and advising the business of changes so that it can respond. This team, members of the Board and Executive Management regularly attend focused water sector briefings and technical events to ensure that knowledge in this important area is up to date. Professional advice is taken on matters where it is considered that this will add value. Regulatory matters and changes are regularly reported to the Board and Executive Management.

Asset Quality and Maintenance

Description

The risk of failure of key infrastructure and other assets or processes which may result in the Company’s inability to provide a continuous supply of clean, safe drinking water

Mitigation

The Company is committed to a major investment programme over the five year asset management period (AMP) to continue to maintain and enhance its asset and infrastructure base so that it is able to meet demand and ensure customers continue to receive a high quality, reliable water supply and very high standards of customer service.

Availability of Adequate Water Resources

Description

The risk that due to inadequate water resources, the Company is unable to meet its legal and regulatory obligations for the secure and resilient supply of water.

Mitigation

The Company is creating the next version of its Water Resources Management Plan for the period 2020 to 2045, and beyond. This considers the impact that housing and industrial development, climate change and the potential for drought may have on both the water supply and the local environment.

The Company is actively involved in the design process for the new “Water Resources” price control to be introduced in April 2020, which introduces “upstream” market reform and abstraction reform.

Data is being collected to determine the environmental impact of increasing abstraction at sources where licences are due to be renewed in 2018.

Long-term planning is underway to address our wider supply requirements which includes understanding the future of Hampton Loade and Seedy Mill in the West Midlands. This includes a full range of demand management, resources and trading options. A similar review is underway in Cambridge to address growth and licence restriction.

The Company has invited customers to share opinions on how they think water resources should be managed in the future, these views will form part of future water resource plans.

The Company is actively engaging with WREA (Water Resources East Anglia) to identify regional water resource solutions.

Exploration of more extreme drought impacts has commenced which may identify the need for wider and more innovative options to be developed.

Customer service

Description

The risk of failure to maintain industry leading customer service levels to ensure that the Company is delivering what customers require.

Mitigation

An action plan is in place to deliver continued improvements to customer service (measured primarily by SIM scores). These scores are used as the measure of performance in this important area with the target being to be in the top quartile of the sector for SIM performance.

Customer engagement is continuing with a new Customer Challenge Group (Customer Panel). This was launched in April 2016 and is providing scrutiny and challenge to South Staffs Water.

Security and Availability of Information and Systems

Description

The risk that security over the Company's information and assets is breached and the risk to the Company of the loss of key systems.

Mitigation

Risk mitigation initiatives include:

- Segmentation of information technology infrastructure
- Removing single points of failure
- Moving from a Disaster Recovery to a Business Continuity infrastructure

Consistency is being progressively improved with a Group-led initiative to revise and enhance security policies, practices and awareness.

> The Central Shared IT operation, which is responsible for the security of the IT network, is currently going through the process of becoming ISO 27001 certified and is also seeking to become accredited against the Cyber Essentials technical controls.
>
> The Central Shared IT operation has also been strengthened by the recruitment of an Information Security Controller. Monitoring practices are also being enhanced to identify unusual behaviour or activity that could indicate a security risk.

Details of Company's principal financial risks are provided in note 24 to the accounts.

Long Term Viability and Financial Resilience

The Company has prepared a detailed business plan which states its mid-term strategic objectives and operational plans, and identifies the key business issues that the Company faces both now and those anticipated in the future, and considers how the Company proposes to address these issues.

The Company's detailed planning process extends to March 2020 which is the end of the current regulatory price control period. In order to give a longer term view the Company has also modelled a number of scenarios to the end of March 2025 based on the anticipated range of possible outcomes of the next price control, these are necessarily less certain.

Using the information available, the Company has prepared financial forecasts up to March 2025, which reflect its stated and anticipated strategic objectives and operational plans. These include but are not limited to trading forecasts comprising turnover, operating and capital maintenance costs, cash flow projections including operating cash flows, the planned investment programme, tax and finance related cash flows. The level of net debt is also projected through the period and is compared to the level of gearing as permitted in the Company's borrowing covenants as is interest cover and the return to investors.

The period to March 2025 has been selected as it includes the remainder of the current price control which is relatively predictable plus the full five years of the next price control. This combined period is considered to be appropriate for a long-term regulated business that provides an essential public service and invests for the long-term.

In order to assess the long-term viability and financial resilience of the Company to possible changing circumstances, sensitivity analysis has been applied to these financial forecasts to assess the impact on profitability, cash flows, liquidity, borrowing capacity, credit rating and compliance with borrowing covenants of a number of severe but plausible adverse changes to the most important assumptions made within these projections. Tests on the key exposures identified last year around capital investment, operational cost, inflation and interest rate fluctuations were re-performed as they are still a key focus in the risk planning of the Directors and Audit Committee. In addition this year, a range of emerging risk scenarios focusing on the level of Weighted Average Cost of Capital (WACC) have been modelled for the five years to March 2025 as the business is particularly sensitive to significant movements in this financial assumption and it is considered to have the most significant impact on the longer term viability of the Company if it was to materially deviate from the Company’s assumptions over the longer-term. Where appropriate, mitigating actions have also been modelled and considered as part of this process.

Based on the business plan, the related long-term financial projections and associated sensitivity analysis detailed above, the Board of Directors has a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due over the period of assessment to March 2025. This expectation is based on the assumption that the Company continues to have its existing access to capital markets to fund its required investment programme and provide sufficient liquidity.

The majority of the specialist work required to form this Board level expectation has been delegated to the Audit Committee with a further review carried out at Board level following completion of this work.
To provide assurance, the assessment has been independently reviewed and challenged at different levels by the Group Internal Audit function and by the Audit Committee. The Directors consider that this level of assurance is sufficient and have therefore not sought any further third party assurance.

Financial Covenants and Key Performance Indicators (KPIs)

There are two financial covenants relating to the Company's borrowings. These are set out below along with the actual ratios for the year and previous year and show that there is significant headroom in both covenants.

	Covenant Ratio	Actual Ratio 31 March 2017	Actual Ratio 31 March 2016
Historic net cashflow less total RAV run-off & infrastructure renewals expenditure/ Historic debt service	Greater than 1	3.4	3.8
Net Debt / Regulated Asset Value	Less than 0.90	0.63	0.64

A number of other financial KPIs are used by the Directors and Executive Team and are measured against the Company's budget for the year and the Final Determination as set by Ofwat including but not limited to:

- Turnover
- Operating Costs
- EBITDA (excluding Infrastructure Renewals Expenditure)
- Cash flow
- Trade debtors and associated collection rates
- Return on Capital Employed and Return on Equity
- Totex by Business Unit
- Retail Margin

The budget is set as part of an annual process by comparing and then setting activity against the required regulatory and operational targets. These are monitored on a monthly basis as presented to the Directors and the Executive Team.

Non-Financial Key Performance Indicators

Our Outcome Delivery Incentive (ODI) targets represent our commitment to deliver what our customers said was important to them in the last price review. This is captured within five Outcomes and 15 specific ODIs, covering all aspects of operations from water quality, secure and reliable supplies, customer services and environmentally sustainable operations to fair customer bills, that provide real focus for delivery and are constantly monitored. Recognising that what our business needs to achieve does not stand still, we have expanded the "Outcomes" into seven business targets which encompass the ODIs but also include a focus on readiness for non-household competition, employee satisfaction and safety and wellbeing.

The performance against the ODI targets is set out in table 3A of the Annual Performance Report.

The Strategic Report on pages 1 to 26 is approved on behalf of the Board of Directors.

The Directors, in preparing this Strategic Report, have complied with s414C of the Companies Act 2006.

P Newland
Managing Director
14 **July 2017**

DIRECTORS AND EXECUTIVE TEAM

<u>Board of Directors</u>

Sir James Perowne – Independent Chairman

Appointed Chairman in April 2017, and an Independent Non-Executive Director since January 2011. Sir James spent 37 years in the Royal Navy where he was appointed Flag Officer Submarines in 1996 and also served as Deputy Supreme Allied Commander Atlantic in NATO. He was Chairman of the Central Region of the Consumer Council for Water serving for 8 years prior to joining South Staffordshire Water.

Mr Phillip Newland – Managing Director

Appointed as Managing Director in April 2014. From 2006 Phil worked within South Staffordshire Plc as Managing Director of Echo Managed Services Ltd supplying technology and retail services to the water industry. Previously Phil was a Management Consultant with Automatic Data Processing (ADP) and Terence Chapman Associates.

Mr Adrian Page – Group Chief Executive South Staffordshire Plc

Appointed as a Director in July 1998. Adrian was appointed Group Chief Executive for South Staffordshire Plc in January 2013 having been Group Finance Director since April 2004. Previously he was Group Finance Director of South Staffordshire Group Plc from 1998 to 2002 and with ACT Group and KPMG. Adrian is also a Director of the Water Companies Pension Scheme Trustee Company.

Mr Keith Harris – Independent Non-Executive Director

Appointed as a Director in April 2015. Keith was the Deputy CEO and Director of Finance and Regulation at Wessex Water. He was also a member of OFWAT's Future Regulation Advisory Panel and a Director of WaterUK. Keith is currently an Independent Non-Executive Director of Ervia the parent company of Irish Water, Gas Networks Ireland and Aurora Telecom.

Mr Stephen Kay – Independent Non-Executive Director

Appointed as a Director in April 2013, Stephen is a Chartered Engineer who has spent his career in the water industry. He was the Managing Director of Cambridge Water PLC until March 2013 and is the current Chairman of the Water Regulation Advisory Scheme (WRAS). Stephen also serves as an Independent Non-Executive Director of the Jersey New Waterworks Company.

DIRECTORS AND EXECUTIVE TEAM

Mr Ram Kumar – Non-Executive Director and KKR Representative

Appointed as a Director in July 2013. Ram is an Engineer who joined KKR in 2009 and is a Director in the European Infrastructure team. He is also a Director of South Staffordshire Plc. Prior to joining KKR, he worked at Goldman Sachs for nearly seven years across mergers and acquisitions, leveraged and structured finance and infrastructure investments.

Mr Oleg Shamovsky – Non-Executive Director and KKR Representative

Appointed as a Director in July 2015. Oleg joined KKR in 2013 and is a member of the Energy and Infrastructure team. Prior to joining KKR, Oleg worked at Terra Firma Capital Partners in London where he was involved in a broad range of private equity investments.

Executive Team

Ms Rachel Barber – Customer Service Director

Rachel has more than 25 years' water industry experience. She joined South Staffs Water in 1990 and was Director of Customer Services and Director of Distribution before taking on the role as Customer Service Director.

Mr Timothy Orange – Finance, Regulation and Business Services Director

Tim joined Cambridge Water in March 2009 and South Staffs Water in April 2013. Tim has responsibility for the financial performance of the business. He graduated in geography from Downing College, Cambridge and went on to train as a chartered accountant with Grant Thornton. After four years in the British Virgin Islands with Deloitte, he returned to work for Scottish & Newcastle, ntl and more recently Enviros, an environmental consultancy which became part of Carillion Plc.

Mr Peter Aspley – Wholesale Service Delivery Director

Pete has a well-established background within the water industry having worked within the South Staffordshire Plc group for 25 years. In 2004 he set up and became managing director of Integrated Water Services Ltd (IWS), a Group company providing a wide range of specialist support services to water and related industries. Pete joined South Staffs Water in 2015.

Ms Marcella Nash – Director of Human Resources

Marcella was appointed in January 2014 previously having worked within South Staffordshire Plc as Head of Human Resources for Echo Managed Services Ltd. Prior to this she was a Senior HR Manager in Severn Trent Group and Severn Trent Water.

DIRECTORS' REPORT

The Directors have pleasure in presenting their report and accounts for the year ended 31 March 2017. The Directors confirm that they consider the report and accounts to be fair, balanced and understandable, providing the information necessary for shareholders and other stakeholders to assess the Company's performance for the year ended 31 March 2017, its business model and its strategy.

Directors

The Directors who held office during the year and subsequently along with the number of Board meetings attended by each Director while holding office during the year are as follows:

Director	Director Type	Date Appointed	Date Resigned	Attendance at Meetings
Sir James Perowne	Independent Chairman	01/01/2011		8/8
Mr Phillip Newland	Managing Director	01/04/2014		7/8
Mr Adrian Page	Group Chief Executive South Staffordshire Plc	01/07/1998		8/8
Mr Ram Kumar	Non-Executive Director	30/07/2013		6/8
Mr Oleg Shamovsky	Non-Executive Director	31/07/2015		8/8
Mr Keith Harris	Independent Non-Executive Director	30/04/2015		8/8
Mr Stephen Kay	Independent Non-Executive Director	01/04/2013		8/8

No Director had any material interest in any contract of significance with the Company.

Financial Results

The Company's financial results are shown in the accounts on pages 56 to 60 and in pages 15 and 16 of the Strategic Report.

Dividends of £11.1m were paid during the year (2015/16: £12.1m).

Payment of Creditors and Commercial Arrangements

The Company's policy is to pay suppliers in line with the terms of payment agreed with each of them when contracting for their products or services. Trade creditors at 31 March 2017 represent 56 days (31 March 2016: 46 days) of purchases. The change year on year is seen as timing with regards to the movement in the capital creditor due to uplifted capital expenditure at year end and is not considered a permanent movement in creditor payment days. The Company is not reliant on any single commercial arrangement.

Corporate Social Responsibility

South Staffordshire Water PLC regards compliance with relevant environmental laws and the adoption of responsible social and ethical standards and the health, safety, wellbeing and fair treatment of its employees, including disabled persons, as integral to the Company.

The Company has a policy of equal opportunities and non–discrimination in all forms of employment. Every reasonable effort is made to provide disabled people with equal opportunities for employment, training and promotion, having regard to their particular aptitudes and abilities.

We have judged that human rights issues are not a material risk for the business due to existing regulatory requirements in the UK and the nature of our supply chain.

Further information on the Company's practices is provided in the strategic report on pages 11 to 13.

Corporate Governance

A detailed report on Corporate Governance is set out on pages 32 to 47. The Group structure is shown in a diagram on page 33 and accompanying paragraphs on page 34 of this report.

Risk Management

The Company's practices in respect of risk management are provided on pages 18 and 23 of the Strategic Report.

Going Concern

The Company's statement on Going Concern and the basis for the Going Concern Assumption are provided on page 41.

Independent Auditor

In accordance with the provisions of s418 of the Companies Act 2006, the Directors confirm that, as far as they are aware, there is no relevant audit information of which the Company's auditor is unaware and that the Board has taken all reasonable steps to make itself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

A resolution proposing the reappointment of Deloitte LLP as independent auditor will be put to the Annual General Meeting.

By order of the Board

J.R. Goodwin
Company Secretary
14 July 2017
Registered Office: Green Lane, Walsall, WS2 7PD
Registered in England and Wales, number 2662742

CORPORATE GOVERNANCE REPORT

The Directors of South Staffordshire Water PLC have always placed good governance at the core of the business, are aware of their obligations to ensure effective leadership and ensure appropriate governance arrangements are in place within the Company. Following the publication of Ofwat's principles on board leadership, transparency and governance in January 2014 the Company developed its own Corporate Governance Code ("the SSW Code") which seeks to meet and exceed these principles. A copy of the SSW Code can be found on the Company's website (www.south-staffs-water.co.uk).

Although the Company is not a public listed company, its Board of Directors recognises that it should act as if it were and therefore the SSW Code has specifically drawn on Ofwat's principles and certain principles of the UK Corporate Governance Code ("the UK Code") where considered applicable and appropriate to a privately owned Company and believes that this approach allows the required effective leadership and appropriate governance arrangements. Details of how the Company follows the principles of the SSW Code are provided below. The Company also applies the Walker Guidelines on transparency and disclosure. The Company regularly monitors corporate governance best practice and the applicability of any developments to the Company. Any changes to the Company's governance arrangements considered appropriate are implemented within agreed timescales.

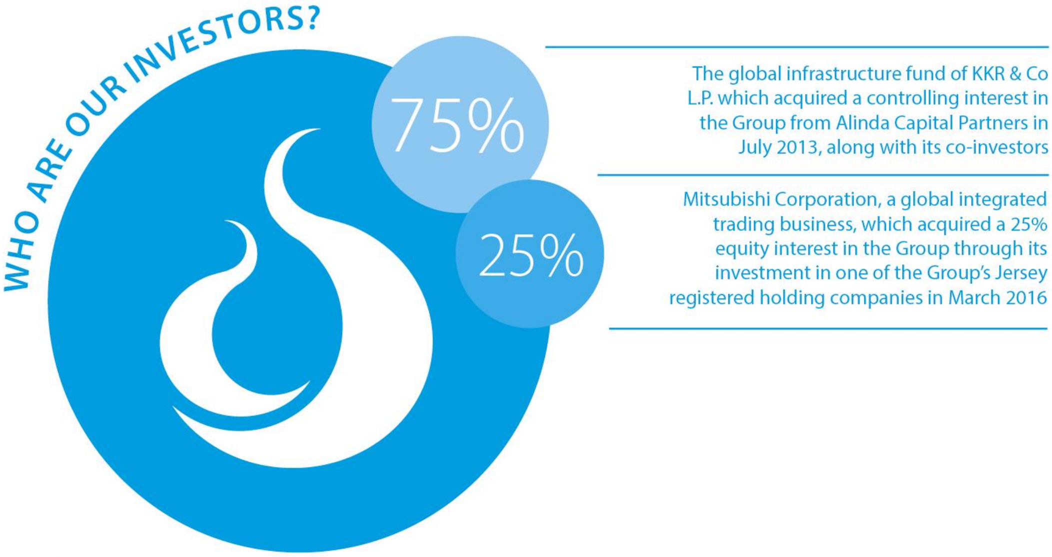
Details of how the Company preserves value over the long term, its business model and how it delivers this and its strategy are provided in the Strategic Report.

There have been no material changes to the Company's Corporate Governance arrangements during the year, although additional disclosure has been made in respect of:

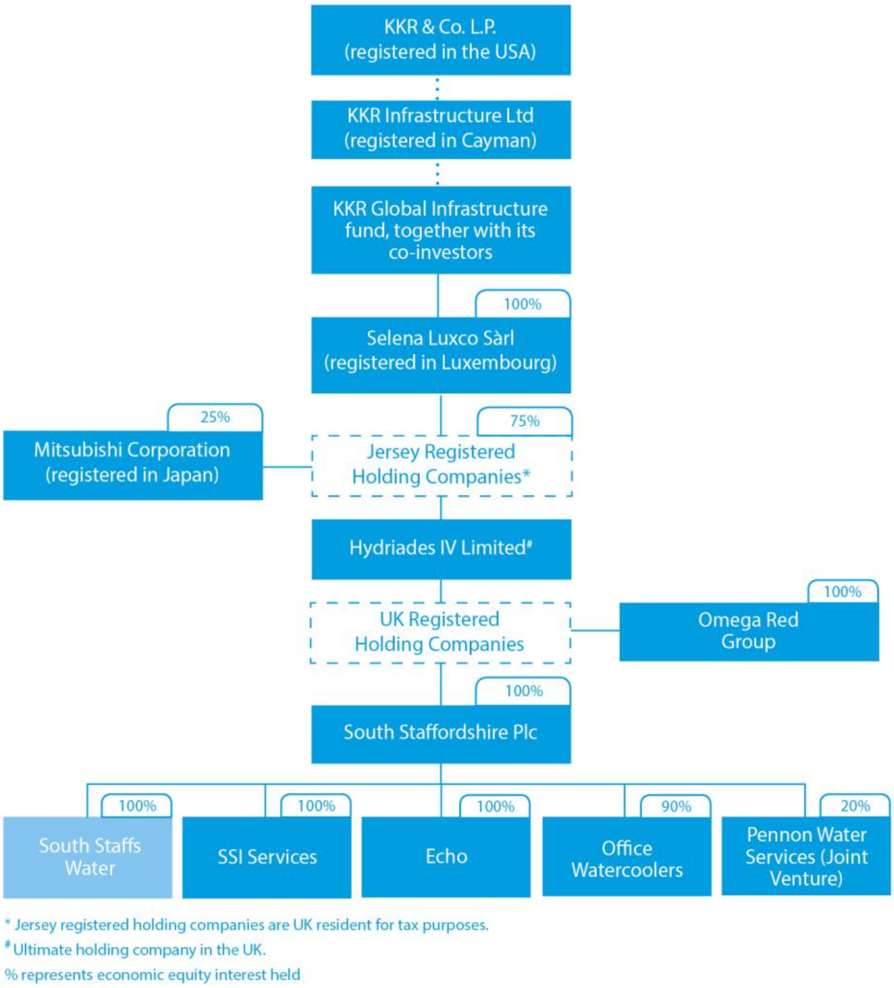
- The Group structure
- The roles of the Audit, Nomination and Remuneration Committees
- Directors and Executive Team remuneration
- Biographical details of the Directors and Executive Team

Group Structure

Who are our investors?



What does our Group structure look like?



* Jersey registered holding companies are UK resident for tax purposes.

\# Ultimate holding company in the UK.

% represents economic equity interest held

The Company is controlled by the Global Infrastructure Fund of the investment business KKR & Co. L.P. (KKR), which is quoted on the New York Stock Exchange, and which holds a majority controlling interest in the Group, together with certain co-investors of KKR. The KKR Infrastructure Fund is controlled and managed by its General Partner KKR Infrastructure Limited, a company registered in the Cayman Islands (the “Holding Company”).

South Staffordshire Plc, as the immediate parent company of South Staffordshire Water PLC, ensures through its detailed knowledge of all of its subsidiaries and the water industry that it understands the duties and obligations of a regulated company including Condition P of its licence and, although some Directors sit on both Boards, South Staffordshire Water PLC acts, with the support of the Group, as if it were a separate listed company. South Staffordshire Plc has processes in place to provide South Staffordshire Water PLC with information that it requires about the wider Group. South Staffordshire Plc provides management, professional and administrative support services to South Staffordshire Water PLC and other of its subsidiaries on a cost basis. There is no direct interaction between South Staffordshire Water PLC and the Holding Company.

Details of the borrowings of South Staffordshire Water PLC are provided in the accompanying reported accounts and the finance section of the strategic report. Similarly, details of the borrowings of South Staffordshire Plc are provided in its own Annual Report and Accounts.

Relations with Shareholders and the Immediate Holding Company

There are a number of UK registered intermediate holding companies above South Staffordshire Plc in the Group structure, headed by Hydriades IV Limited, the ultimate holding company registered in the UK. There are also intermediate holding companies above Hydriades IV Limited which are registered in Jersey but which are resident in the UK for tax purposes. In March 2016, Mitsubishi Corporation acquired a 25% equity interest in one of these companies, Selena Bidco Limited, and therefore holds a 25% equity interest in the South Staffordshire Plc Group and the Company. In line with other KKR investments in Europe, the parent of the Jersey resident companies is a company registered in Luxembourg (Selena Luxco S.à.r.l.). The KKR fund investing in this company is controlled and managed by the Holding Company. Two of the UK holding companies have loans payable to South Staffordshire Water PLC, both of which bear interest which is paid in full each year. Any UK tax losses surrendered to South Staffordshire Water PLC from other companies in the structure are paid for at face value.

There is a regular and detailed dialogue between the Board and shareholders to ensure that their objectives and priorities are carefully considered. This dialogue is achieved through Board meetings that shareholders attend, with major shareholders having representation on the Board of Directors or who attend Board meetings, and through other less formal communication.

The Board of Directors

The Directors are collectively responsible for the long term success of the Company. The Board comprises the Independent Chairman, one Executive Director (being the Managing Director), the Group Chief Executive and four other Non-Executive Directors, two of which in addition to the Independent Chairman are considered to be independent. The largest single group of Directors on the Board is that of Independent Non-Executive Directors including the Independent Chairman. Details of the skills and experience of the Directors are contained in their biographies on pages 27 to 28.

Directors may be appointed by the Company by Ordinary Resolution or by the Board. As set out in the Company's Articles of Association, a Director appointed by the Board will hold office until the next Annual General Meeting (AGM). At each AGM one third of the Directors will retire by rotation and will submit themselves for re-election at least once every three years.

All Directors are aware of the procedure for those wishing to seek independent legal and other professional advice. The Board also has access to the advice and services of the Company Secretary, who is also responsible for monitoring corporate governance matters. Indemnities have been given to all of the Directors to the extent permitted by the Companies Act 2006. All Directors and Senior Management are covered by a Directors' & Officers' insurance policy against any actions taken against them as Officers of the Company.

Board Membership

Senior Executives of KKR who held positions on the Board of the Company at 31 March 2017 were Ram Kumar and Oleg Shamovsky, both of whom are also Directors of certain holding companies above South Staffordshire Plc in the Group structure. Ram Kumar is also a non-executive Director of the Company's immediate parent, South Staffordshire Plc. Adrian Page is also an Executive Director of the immediate parent and all of its UK subsidiaries and holding companies.

During the year Adrian Page held the position of Executive Chairman and was not considered to be independent on appointment, under the provisions of the UK Corporate Governance Code ("the Code"), as he is also an Executive Director of the immediate parent company. However, the Board and the Company's shareholder believed that he had the appropriate objectivity and, as a long-term Executive of the Group, the necessary industry knowledge, skills and experience to perform the role of Chairman, Ofwat were also consulted prior to Adrian's appointment. As of 1 April 2017 Sir James Perowne, who is considered an Independent Non-Executive Director and has been a member of the board since January 2011, was appointed Independent Chairman.

Stephen Kay is considered by the Board to be independent in both character and judgement. While Stephen Kay is a former Managing Director of Cambridge Water PLC, he has never served as an Executive Director of South Staffordshire Water PLC. It is considered that he brings to the Board valuable industry knowledge, engineering skills and experience and extensive links and knowledge of the Cambridge supply region, all of which are important attributes to the balance of the Board's composition. In addition, the appointment of Stephen Kay is consistent with the commitment given to the Competition Commission and in the licence unification process to have a Non-Executive Director on the Board with links to the Cambridge region.

Functions of the Board

Under the SSW Code, the Company should have an effective Board, with its primary focus being to develop, implement and fulfil the strategy to deliver the service and performance to meet the needs of customers, the environment, the business, employees, shareholders and other stakeholders. The Board should also be in a position to make well-informed and high quality sustainable decisions that are based on a thorough understanding of the business, and to make decisions that are in the best interests of the Company, and are consistent with its statutory and regulatory duties.

The Board sets standards of conduct to promote the success of the Company, provides leadership, and reviews the Company's internal controls, risk management activities and governance structure. It approves major financial and investment decisions over senior management thresholds and evaluates the performance of the Company as a whole by monitoring reports received directly from Senior Management and also from Directors. The Non–Executive Directors led by the Independent Chairman, are responsible for overseeing this work, and scrutinising management performance. They constructively challenge and help develop proposals on strategy.

In conjunction with the Audit Committee, the Board is also responsible for the Company's systems of internal control and for evaluating and managing significant risks to the Company.

On joining the Board, Directors receive induction material appropriate to their needs and responsibilities. This may include, but is not limited to, information on the regulatory framework of the Company, operational activities, financing structure, strategic and financial plans and the wider Group structure. The Directors and Executive Team carry out site visits to maintain familiarity with the Company's operations and to refresh their skills and knowledge. The Directors also keep up to date with legal and regulatory changes and developments by receiving written and verbal updates from both internal and external advisers and regulators.

The Directors are supported by an Executive Team and by other senior managers, who have responsibility for assisting them in the development and achievement of the Company's strategy and reviewing the financial and operational performance of the Company. The Executive Team is responsible, along with the Directors, for monitoring policies and procedures and other matters that are not reserved for the Board. There are procedures providing a regime of authorisation levels for key decision-making. Details of the skills and experience of the Executive Team are contained in their biographies on page 28.

In accordance with the SSW code, a formal evaluation of Board performance is carried out. The evaluation of the Chairman's performance is undertaken by Non-Executive Directors.

Matters Reserved for the Board

A schedule of matters specifically reserved for the Board's decision has been adopted based on the Institute of Chartered Secretaries and Administrators (ICSA) best practice. The terms include, but are not limited to:

- Ensuring observance of all matters required by the Company's Instrument of Appointment;
- Approval of Directors' assurance statements to Ofwat, including but not limited to; the Annual Performance Report, Annual Viability of the Business; the setting of water tariffs and other regulatory assurance as required;

- Material submissions to Ofwat, the Competition and Markets Authority and similar regulators, agencies or bodies;
- Reviewing and approving of capital and operating budgets;
- Reviewing and approving the Company's strategy and performance;
- Reviewing and approving any significant changes to the Company's capital structure and borrowings;
- Reviewing and approving financial reports;
- Contracts that are material, either strategically or by reason of size, according to specified limits;
- Appointment and removal of any Director;
- Prosecution, defence or settlement of litigation above £1 million or being otherwise material;
- Material changes to the Company's pension arrangements;
- Ensuring maintenance of a sound system of internal control and risk management;
- Considering the balance of interests between shareholders, employees, customers and the community; and
- Powers to delegate authority.

The Directors maintain a flexible approach to Board matters with the delegation of power to a Committee, with precise terms of reference, being used for specific routine purposes. Both the terms of reference and composition of the Committees are regularly reviewed to ensure their ongoing effectiveness.

Whilst South Staffordshire Water PLC acts as though it were a separate public listed company, a limited number of matters in respect of this subsidiary company also need the approval of the Board of South Staffordshire Plc. These include:

- Material submissions to Ofwat, particularly in respect of Price Reviews and major structural reform;
- Contracts that are material either strategically or by reason of size, according to specified limits;
- Appointment and removal of any Director, in its role as shareholder;
- Prosecution, defence or settlement of litigation above £1 million or being otherwise material;
- Material changes to pension arrangements where operated on a Group basis

Board Meetings

The Board holds regular scheduled meetings throughout the year and during the year ended 31 March 2017 there were eight scheduled meetings of the Board.

In compliance with the SSW Code, all Directors are provided with sufficient information prior to any Board meeting to allow appropriate preparation to ensure that they can properly discharge their duties.

The attendance by individual Directors at scheduled meetings of the Board during the year ended 31 March 2017 is shown in the table with in the Directors' Report on page 29.

Organisational Structure

A defined organisational structure for the Company exists with clear lines of responsibility, accountability and appropriate division of duties.

The Directors set an overall strategy and has delegated the necessary authority to the Executive Team and business departments in order to deliver that strategy. This is communicated to employees by way of published policies and procedures and regular management and staff briefings.

The Company's extensive financial regulations specify authorisation limits for individual managers, with all material transactions being approved by a member of the Executive Team, a Director or by the Board collectively. In addition, formal treasury policies are in place. Where appropriate, commercial and financial responsibility is clearly delegated to the Executive Team and supported by the Directors.

Board Committees

Audit Committee

Details of the terms of reference of the Audit Committee, its membership and activities during the year are contained in the Audit Committee review on pages 42 to 45.

Nomination Committee

Details of the terms of reference of the Nomination Committee, its membership and activities during the year are contained in the Nomination Committee review on page 46.

Remuneration Committee

Details of the terms of reference of the Remuneration Committee, its membership, activities during the year, the remuneration policy and the remuneration paid to Directors and the Executive Team during the year are contained in the Remuneration Committee review on page 47.

Risk Management

The Company's approach to risk reflects its status as a regulated and licensed water undertaking providing essential public services and balances the need to effectively manage exposure to risk whilst at the same time aiming to deliver high standards of operational and financial performance. A strong risk management and control framework is therefore in place to understand and manage identified risks. Risk management and the effectiveness of the Company's risk management and internal controls systems is discussed and reviewed by the Board and Audit Committee on a regular basis. The Company's Executive Team are required to monitor risk and its management with any significant changes in business risk and any subsequent procedures or controls to mitigate the risk being reported to the Board and the Audit Committee. Further details of risk management and principal risks are provided in the Strategic Report.

Regulatory Reporting

South Staffordshire Water PLC makes significant efforts to produce regulatory documentation and information that is reliable, robust and accurate and is supported by suitable systems and procedures. The Board, including Independent Non-Executive Directors, are involved in the approval process for key regulatory information, and this process supports the governance in place and the review of information by an independent engineering assessor (Monson Engineering) and the audit work and certain agreed upon procedures in respect of the extraction of specific information performed by the external independent auditor (Deloitte LLP). Where considered appropriate, the Group's internal audit function will also review processes and data in this area to provide appropriate assurance.

The Company places great emphasis on regulatory reporting to ensure that it continues to have sufficient processes and internal systems of control to fully meet its obligation for the provision of information to Ofwat, other regulators and stakeholders. It is important to the Company that this information is robust, not just for its external credibility, but to also allow it to manage the performance of the business and make appropriate decisions with reference to this data.

The Company's Regulatory Accounts are contained within the Annual Performance Report set out on pages 94 to 166.

Going Concern and Basis for Assumption

The Directors consider that it is appropriate to prepare the accounts on a going concern basis. This is based upon a review of the Company's budget for the year ending 31 March 2018 and the longer term plan and financial forecasts to 31 March 2025 and the related sensitivity analysis performed on this plan as detailed in the Long Term Viability and Financial Resilience section on pages 23 to 25 of the Strategic Report. This assertion is also based on the Company's investment programme, the Final Determination for 2015-20 and the Company's plan in relation to it, the committed borrowing facilities available to the Company together with cash balances, actual and forecast compliance with borrowing covenants and other important financial metrics and ratios, and its access to capital markets. In addition, the Directors are required to certify to Ofwat under Condition F of its Instrument of Appointment that sufficient financial resources are available for at least the next 12 months.

The Company's business activities, its business model and strategy together with the factors likely to affect its future development, are set out in the Strategic Report on pages 1 to 26. The financial position of the Company, its liquidity position and available borrowing facilities are set out on pages 15 to 16 of the Strategic Report, the balance sheet on page 57 and in note 24 to the accounts, which includes the Company's objectives for managing its financial risks, details of its financial instruments and hedging activities and its exposure to interest, credit and liquidity risk. The Company has a large number of both domestic and commercial customers, none of which make up a significant proportion of the businesses turnover. The Company has significant undrawn borrowing facilities in addition to its cash balances and has significant headroom in respect of all of its borrowing covenants, both on a historic and forward looking basis.

Audit Committee Review

Meetings: 2
Chairman: Keith Harris (2/2)
Other Members: Stephen Kay (2/2); Sir James Perowne (2/2)

Meetings also regularly attended by: Deloitte LLP, the Company's external independent auditor, the Finance, Regulation and Business Services Director, Director of Regulation, Financial Controller, the Company Secretary, Group Financial Controller and the Group Internal Audit Manager.

Role and Responsibilities

In summary the Committee is responsible for reviewing and monitoring the Company's financial statements, internal controls and systems for mitigating the risk of financial and non-financial loss. This includes assessing the integrity of financial statements, including changes to accounting policies, reviewing financial reporting procedures and risk management processes and systems.

The Committee is responsible for recommending to the Board the appointment, reappointment and if necessary the removal of the external auditor and monitoring the auditor's independence, performance and effectiveness and approving the nature and scope of external audits and approving the auditor's remuneration.

The more detailed key terms of reference for the Committee are to:

- Review and appraise the work of the external auditor by meeting with the auditor twice a year, reviewing the results of its work, by discussing the quality of the audit with senior management, reviewing the level of non-audit fees and the nature of non-audit services provided and reviewing the auditor's own assessment of its independence;
- Monitor, review and challenge when necessary the integrity of the financial statements of the Company, including its Annual Accounts, Performance Report and any other formal announcement relating to its financial performance, and reviewing significant financial reporting issues and judgements which they contain;
- Keep under review the effectiveness of the Company's internal audit arrangements, internal controls and risk management policies and practices; and
- Report to the Board of Directors on how it has discharged its responsibilities.

Work of the Audit Committee

The key areas of management judgement and estimates that the Committee assessed and considered in respect of the 2016/17 annual financial statements included the recoverability of receivables, capitalisation of fixed assets, asset useful economic lives, revenue recognition, hedge accounting, long term inflation assumptions and the value of deferred tax liabilities.

The Committee review and challenge individual papers from management, external auditors' reports; and the Company risk register. The Committee also discusses areas of judgement and estimation and where appropriate makes comment; recommendations; and seeks further management clarification if required.

Accountability and Audit

A. Financial Reporting and Forecasting

The Board supported by the Audit Committee recognises the need to present a balanced, understandable and clearly defined assessment of the Company's operational and financial performance and position including its future prospects. This is provided by a review of the Company's operations and performance as set out in the Strategic Report.

Business plans, annual budgets, longer term financial forecasts and investment proposals for the Company have been formally prepared, reviewed and approved by the Board supported by the Audit Committee. These include profit and loss and cash flow budgets. Actual financial results and cash flows, including a comparison with budgets and forecasts, are regularly reported to the Board with variances being identified and used to initiate any action deemed appropriate. Details of the Company's actual and forecast future compliance with its borrowing covenants are also prepared on a regular basis, and forecasts of the Company's level of its undrawn and available borrowing facilities for liquidity purposes are also prepared and reported to the Board.

As detailed in the Strategic Report, sensitivity analysis has been carried out on the Company's longer term financial forecasts to ensure the Company has the ability to withstand certain severe but plausible events in order to demonstrate and provide the Board with evidence of its long term viability and financial resilience.

B. Internal Control

The Board supported by the Audit Committee attaches considerable importance to its system of internal control and for reviewing its effectiveness, including its responsibility for taking reasonable steps for the safeguarding of the assets of the Company and for preventing and detecting fraud and other irregularities. Such a system is designed to manage rather than eliminate the risk, and can nonetheless provide only reasonable and not absolute assurance against misstatement or loss. There is an established internal control framework within the Company that is continually reviewed and updated taking into account the nature of the Company's operations.

This process includes the identification, evaluation and management of the significant risks faced by the Company. Further details in respect of risk management are provided on pages 18 to 23 of the Strategic Report.

C. Internal Audit

There is an Internal Audit function operated by the Company's parent, which is dedicated to ensuring that internal control activities remain a priority within the Group. This function provides valuable support to South Staffordshire Water PLC in maintaining good systems of internal control, assurance over the quality of information and appropriate Corporate Governance.

A formal annual Internal Audit Plan for South Staffordshire Water PLC is presented to and approved by the Audit Committee. The Plan combines the need for regulatory assurance, financial reporting assurance and risk management and control with the desire to provide independent resource to provide assurance, improve the Company's operations and help manage risk. Progress against the Plan is monitored by the Audit Committee. Findings and recommendations arising from the work performed is reported to the Audit Committee at the appropriate time.

Due to the importance of the introduction of non-household competition in the Water Industry (OpenWater), the majority of Internal Audit's activities during the year have been focused in South Staffordshire Water PLC. Specific topics covered by Internal Audit during the year included but were not limited to:

- Provision of independent assurance to support the statements being made by the Company in Assurance Letters to Market Operator Services Limited and Ofwat in respect of OpenWater
- Review of indicative wholesale charges in respect of OpenWater
- Review of the Company's customer tariffs for the 2017/18 year

The internal audit arrangements in operation are considered to be appropriate to the size and complexity of the Company. The Board and the Audit Committee will continue to review these arrangements on a regular basis.

External Independent Auditor

As detailed above, the Board, assisted by the Audit Committee, reviews each year the external independent auditor's performance, effectiveness, independence and fees including the level of non-audit services and related non-audit fees.

In evaluating the external auditor, the Audit Committee assesses the calibre of the external audit firm, the audit scope and plan which is agreed in advance with the Audit Committee and the level and nature of audit communications, including the reporting to the Audit Committee of any significant issues.

The responsibilities of the external independent auditor in the area of financial reporting are set out in their report relating to each year's financial statements.

The current external audit firm, Deloitte LLP, has been the Company's auditor since 2002, with a change in the audit Partner occurring every 5 years. Based on current legislation, Deloitte LLP can be re-appointed for all financial years up to and including the year to 31 March 2023. Thereafter, auditor rotation is required once every 10 years with this extendable to 20 years if a tender is conducted after 10 years.

Nomination Committee Review

Meetings: 0
Chairman: Sir James Perowne (0/0)
Other Members: Stephen Kay (0/0); Keith Harris (0/0); Adrian Page (0/0); Ram Kumar (0/0)

Membership of the Committee

The majority of the Nomination Committee is comprised of Independent Non-Executive Directors and the Committee is chaired by the Company's Independent Chairman.

Meetings are convened as required to discuss changes and or appointments to the Board of Directors. In the year no meetings were required as there were no changes or proposed changes to the Board.

Role of the Committee

Considerable attention is given by the Nomination Committee to the composition of the Board of Directors including reviewing the balance of skills, knowledge, experience, gender and the level of non-executive and independent challenge.

External search advisors are appointed to assist the Nomination Committee where considered appropriate but are not considered necessary in all appointments.

The key terms of reference of the Nomination Committee include:

- Preparing an appropriate specification for the relevant Board position;
- Ensuring any appointment to the Board of Directors carefully considers the balance of the Board composition; and
- Ensuring successful candidates have the necessary skills, experience, information and knowledge to fulfil their duties.

Diversity

In considering appointments to the Board of Directors and Executive Team, the Nomination Committee will have consideration to a wide range of factors, including the balance of skills, experience and competencies, as well as gender and diversity. Details of the number of men and women employed by the Company can be found in the Strategic Report on page 13.

Remuneration Committee Review

Meetings: 1

Chairman: Sir James Perowne (1/1)

Other Members: Stephen Kay (1/1); Keith Harris (1/1); Adrian Page (1/1); Ram Kumar (1/1)

Membership of the Committee

The majority of the Committee is comprised of Independent Non-Executive Directors and is chaired by the Company's Independent Chairman.

Role of the Committee

The Remuneration Committee is responsible for the remuneration policy and setting the remuneration packages of the Board, the Executive Team and other senior management. The Committee meets at least once a year.

The key terms of reference for the Committee are to:

- Agree remuneration that will ensure that the Executive Directors and the Executive Team are provided with appropriate incentives to achieve high standards of performance and reward them for their individual contributions to the success of the Company;
- Determine remuneration packages and arrangements with regard to any relevant legal requirements and associated guidance and to obtain reliable, up-to-date information about remuneration in other companies;
- Ensure that contractual terms on termination are fair and that failure is not rewarded; and
- Oversee any material changes in employee benefits structures throughout the Company.

A detailed remuneration report is set out on pages 48 to 51.

REMUNERATION REPORT

Remuneration Policy

Remuneration packages and fees are designed to attract, retain and motivate high-calibre Board Directors and Executive Team members. The Remuneration Committee has overall responsibility for determining Board Director remuneration packages and those of the Executive Team.

The total remuneration packages of Board Directors and the Executive Team includes basic salary, benefits and annual and deferred bonuses that are linked to individual business targets and personal performance related objectives. Performance related objectives are designed to encourage and reward continuing improvement in the Company's performance over the longer term. Annual salary, benefits and annual bonus awards are normally pensionable whereas deferred bonuses are not normally pensionable.

In the remuneration of the total employee base at South Staffordshire Water PLC, the Company committed in 2016 through our annual pay negotiations, to fully paying the foundation living wage rate across the Company. All our staff (excluding modern apprentices) are paid at or higher than the foundation rate.

Board and Executive Terms of Engagement

As Group Chief Executive Adrian Page is appointed to the Board of the Company in accordance with the requirements of his Group wide role.

Ram Kumar and Oleg Sharmovsky are appointed to the Board as representatives of KKR the majority shareholder and their appointments have no fixed term.

Sir James Perowne, Keith Harris and Stephen Kay as Independent Non-Executive Directors are appointed to Board for three year fixed terms. They can be re-appointed for a further two periods before being required to stand down after a maximum of nine years service. In accordance with their appointment the Independent Non-Executive Directors are required to commit the appropriate time required to sufficiently fulfil the required duties within a regulated utility business.

The Managing Director and Executive Team are employed on service contacts of no fixed term, with a notice periods of either 6 or 3 months. They are entitled to basic pay, private medical insurance, company car or car allowance, fuel allowance and payments made to a

Group money purchase pension scheme. In addition there is participation in the bonus scheme. Bonus awards are linked to personal objectives as well as being aligned to the Company's standards of performance in the areas of:

- Customer Service (Based upon the SIM Performance as reported to Ofwat)
- Achievement of ODI targets (As reported in Table 3A of the APR)
- Profitability (As reported in published accounts)
- Operating Costs (As reported in published accounts)
- Cash Generation (As reported in published accounts)

The standards of performance to which bonuses are linked are reviewed annually by the Remuneration Committee to ensure consistency is maintained.

Further details in respect of the Managing Director's and Executive Team's remuneration are provided in this report on page 50.

Board and Executive

More detailed biographies of the current Board and Executive Team are on pages 28 to 29. The Board of Directors and Executive team were made up as follows in the year:

The Board	
Name	**Role**
Sir James Perowne	Independent Chairman
Mr Phillip Newland	Managing Director
Mr Adrian Page	Group Chief Executive South Staffordshire Plc
Mr Keith Harris	Independent Non-Executive Director
Mr Stephen Kay	Independent Non-Executive Director
Mr Ram Kumar	Non-Executive Director KKR Representative
Mr Oleg Shamovsky	Non-Executive Director KKR Representative

The Executive Team	
Name	**Role**
Ms Rachel Barber	Customer Service Director
Mr Timothy Orange	Finance, Regulation and Business Services Director
Mr Peter Aspley	Wholesale Service Delivery Director
Ms Marcella Nash	Director of Human Resources
Mr Colin Wayper	Operations Director (Retired 30/04/2017)

Remuneration Details

The tables below detail remuneration in the year for the Board of Directors and the Executive Team.

The Executive Team table shows the total pay for all members as a Total with an average per member calculation shown below.

The Board £000							
Name	**Basic Salary**	**Bonus***	**Other Benefits****	**Fees**	**Total Emoluments**	**Pension*****	**Total Remuneration**
Sir James Perowne	-	-	-	30	**30**	-	**30**
Mr Phillip Newland	158	71	15	-	**244**	21	**265**
Mr Adrian Page	-	-	-	-	**-**	-	**-**
Mr Keith Harris	-	-	-	25	**25**	-	**25**
Mr Stephen Kay	-	-	-	25	**25**	-	**25**
Mr Ram Kumar	-	-	-	-	**-**	-	**-**
Mr Oleg Shamovsky	-	-	-	-	**-**	-	**-**
Total	**158**	**71**	**15**	**80**	**324**	**21**	**345**

The Executive Team £000							
Name	**Basic Salary**	**Bonus***	**Other Benefits****	**Fees**	**Total Emoluments**	**Pension*****	**Total Remuneration**
Total	463	85	78	-	**626**	64	**690**
Average	*93*	*17*	*15*	-	**125**	*13*	***138***

* Bonus figures include any deferred amounts paid in the year and accrued figures in respect of the year ended 31 March 2017

** Other Benefits combine company car benefit in kind, car cash and benefit allowances, fuel allowances, and the taxable value of private medical insurance provision.

*** Pension contributions are payments by the company to money purchase pension schemes.

Adrian Page is Group Chief Executive and an Executive Director of the parent company South Staffordshire Plc and is remunerated by South Staffordshire Plc principally based upon the performance of the Group reflecting his Group wide role. As part of his remuneration for the year a bonus of £35,000 was provided specifically linked to the performance of the Company including delivery of ODI targets, water quality enhancement and preparations for OpenWater.

Ram Kumar and Oleg Shamovsky are not remunerated by the Company or South Staffordshire Plc.

Executive Pay Ratio

There is increased scrutiny being placed upon the pay for Board members set against that of the lowest paid employees within an organisation.

A 20:1 ratio is being discussed within political and social forums as an acceptable maximum multiplier with regards to the gap between the lowest paid employees and highest paid Board members.

The Company is committed to paying the foundation living wage to employees; based on a 37 hour a week contract at £8.25 (2016 rate for outside London) this would give an annual salary of £15,873.

In comparison to Phil Newland, the highest paid directly employed Board member, this gives a ratio of 10:1 against basic salary and 17:1 against total remuneration both of which sit within the bounds of a 20:1 ratio.

DIRECTORS' RESPONSIBILITIES STATEMENT

The following statement, which should be read in conjunction with the auditor's statement of its responsibilities, set out on pages 53 to 55, is made with a view to distinguishing for shareholders the respective responsibilities of the Directors and of the auditor in relation to the accounts.

The Directors are required by Company Law, and under Condition F of the Instrument of Appointment by the Secretary of State for the Environment, as a water undertaker under the Water Industry Act 1991, to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company at the end of the financial year and of the profit or loss for the financial year. Under Company Law, the Directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law), including FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland".
In preparing the accounts the Directors are required to:

- Select suitable accounting policies (see pages 63 to 69) and then apply them consistently;
- Make judgements and estimates that are reasonable and prudent;
- State whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- Prepare the financial statements on a going concern basis unless it is inappropriate to presume that the Company will continue in business, in which case there should be supporting assumptions or qualifications as necessary.

The Directors have responsibility for ensuring that the Company keeps accounting records which disclose with reasonable accuracy at any time the financial position of the Company and which will enable them to ensure that the accounts comply with the Companies Act 2006. The Directors have responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to detect and prevent fraud and other irregularities. The Directors, having prepared the accounts, are required to provide the auditor with such information and explanations as the auditor thinks necessary for the performance of its duties.

The Directors have the responsibility for the maintenance and integrity of the Company's website. Information published on the Internet is accessible in many countries with different legal requirements. Legislation in the United Kingdom governing the preparation and dissemination of the financial statements may differ from legislation in other jurisdictions.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF SOUTH STAFFORDSHIRE WATER PLC

We have audited the financial statements of South Staffordshire Water PLC for the year ended 31 March 2017 which comprise the Profit and Loss Account, the Balance Sheet, the Statement of Comprehensive Income, the Statement of Changes in Equity, Statement of Cash Flows and the related notes 1 to 27. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 March 2017 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

INDEPENDENT AUDITOR'S REPORT

Opinion on other matter prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and Directors' Report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the Company and its environment obtained in the course of the audit, we have not identified any material misstatements in the Strategic Report and the Directors' Report.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

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

Jacqueline Holden

Jacqueline Holden FCA
(Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Statutory Auditor
London, United Kingdom
14 July 2017

PROFIT AND LOSS ACCOUNT

For the year ended 31 March 2017

	Note	2017 £'000	2016 £'000
Turnover	2	123,686	123,876
Operating costs (net)	3	(91,069)	(88,597)
Operating profit		**32,617**	35,279
Exceptional profit on disposal of rental income rights	7	**-**	4,590
Finance charges (net)	8	**(12,197)**	(11,872)
Profit on ordinary activities before taxation		**20,420**	27,997
Taxation on profit on ordinary activities	9	**(1,575)**	(1,323)
Profit on ordinary activities after taxation		**18,845**	26,674
Earnings per share			
Basic	11	**887.6p**	**1,256.3p**
Diluted	11	**887.6p**	**1,256.3p**

The results above are derived from continuing operations

The accompanying notes are an integral part of these financial statements.

BALANCE SHEET

As at 31 March 2017

	Note	2017	2016
		£'000	£'000
Fixed Assets			
Tangible assets	12	**488,985**	475,541
Current Assets			
Stocks	15	**1,747**	1,554
Debtors - amounts recoverable within one year	16	**32,320**	29,091
Debtors - amounts recoverable in more than one year	16	**43,667**	43,813
Investments	17	**2**	2
Cash at bank and in hand		**8,723**	11,379
		86,459	85,839
Creditors - amounts falling due within one year	18	**(60,533)**	(54,684)
Net current assets / (liabilities)		**25,926**	31,155
Total assets less current liabilities		**514,911**	506,696
Creditors - amounts falling due after more than one year	19	**(273,060)**	(276,732)
Accruals and deferred income - falling due after more than one year	14	**(138,862)**	(134,353)
Provisions for liabilities - falling due after more than one year	21	**(34,534)**	(34,531)
Net Assets		**68,455**	61,080
Capital and Reserves			
Called-up share capital	22	**2,123**	2,123
Share premium account		**495**	495
Hedging reserve		**(7,280)**	(6,930)
Revaluation reserve		**34,894**	35,347
Capital redemption reserve		**4,450**	4,450
Profit and loss account		**33,773**	25,595
Shareholders' Funds		**68,455**	61,080

The accompanying notes are an integral part of these financial statements.

The financial statements of South Staffordshire Water PLC (Company number 2662742) were approved by the Board of Directors and authorised for issue on 14 July 2017.

P. Newland

STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 March 2017

	2017	2016
	£'000	£'000
Profit on ordinary activities after taxation	**18,845**	26,674
Movement in hedging reserve (Gross of deferred tax)	**(320)**	(1,835)
Deferred tax impact of movement in hedging reserve	**54**	324
Deferred tax rate move impact in year	**(84)**	(126)
Total recognised gains and losses relating to the year	**18,495**	25,037

STATEMENT OF CHANGES IN EQUITY

As at 31 March 2017

	Called-up Share Capital	Share Premium Account	Capital Redemption Reserve	Revaluation Reserve	Profit & Loss Account	Hedging Reserve	Total
	£'000	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Balance at 1 April 2015	**2,123**	**495**	**4,450**	**35,800**	**9,653**	**(4,358)**	**48,163**
Profit for the financial period	-	-	-	-	26,674	-	26,674
Change in value of hedging instruments - cash flow hedges (Gross of deferred tax)	-	-	-	-	-	(2,019)	(2,019)
Deferred tax impact of change in value of hedging instruments	-	-	-	-	-	357	357
Amounts recycled to profit and loss (Gross of deferred tax)	-	-	-	-	-	184	184
Deferred tax impact of amounts recycled to profit and loss	-	-	-	-	-	(33)	(33)
Deferred tax rate move impact	-	-	-	-	-	(126)	(126)
Amounts transferred to profit and loss	-	-	-	(453)	1,388	(935)	-
Total comprehensive income	2,123	495	4,450	35,347	37,715	(6,930)	73,200
Dividends (Note 10)	-	-	-	-	(12,120)	-	(12,120)
Balance at 31 March 2016	**2,123**	**495**	**4,450**	**35,347**	**25,595**	**(6,930)**	**61,080**
Balance at 1 April 2016	**2,123**	**495**	**4,450**	**35,347**	**25,595**	**(6,930)**	**61,080**
Profit for the financial period	-	-	-	-	18,845	-	18,845
Change in value of hedging instruments - cash flow hedges (Gross of deferred tax)	-	-	-	-	-	(501)	(501)
Deferred tax impact of change in value of hedging instruments	-	-	-	-	-	85	85
Amounts recycled to profit and loss (Gross of deferred tax)	-	-	-	-	-	181	181
Deferred tax impact of amounts recycled to profit and loss	-	-	-	-	-	(31)	(31)
Deferred tax rate move impact	-	-	-	-	-	(84)	(84)
Amounts transferred to profit and loss	-	-	-	(453)	453	-	-
Total comprehensive income	2,123	495	4,450	34,894	44,893	(7,280)	79,575
Dividends (Note 10)					(11,120)		(11,120)
Balance at 31 March 2017	**2,123**	**495**	**4,450**	**34,894**	**33,773**	**(7,280)**	**68,455**

CASH FLOW STATEMENT

As at 31 March 2017

	Note	2017 £'000	2017 £'000	2016 £'000	2016 £'000
Cash inflow from operating activities			**52,953**		53,385
Corporation tax paid			**(2,786)**		(3,841)
Net cash inflow from operating activities	(a)		**50,167**		49,544
Cash flows from investing activities					
Purchase of tangible fixed assets		**(32,624)**		(29,638)	
Proceeds from sale of tangible fixed assets		**679**		1,087	
Capital contributions received		**6,827**		5,414	
Part repayment of long-term balance with group undertaking		**(10,200)**		(7,200)	
Interest received		**2,545**		2,545	
Proceeds from exceptional disposal of rental income rights		**-**		4,590	
Net cash outflow from investing activities			**(32,773)**		(23,202)
Cash flows from financing activities					
Interest paid		**(8,756)**		(8,353)	
Equity dividends paid		**(11,120)**		(12,120)	
Repayment of bank term loans		**-**		(26,500)	
Additions to bank term loans		**-**		30,000	
Bank term loan issue costs paid		**-**		(189)	
Capital element of finance lease and hire-purchase rental payments		**(174)**		(233)	
Net cash outflow from financing activities			**(20,050)**		(17,395)
(Decrease) / increase in cash			**(2,656)**		8,947
Cash or Cash Equivalents at the beginning of the year			**11,379**		2,432
Cash or Cash Equivalents at the end of the year			**8,723**		11,379

Purchase of tangible fixed assets relates to the cash paid out in the year in relation to fixed asset additions. The difference in that paid £32,624,000 and additions in the fixed asset note of £35,956,000 is due to an increase in year of creditors due relating to capital purchases of £3,332,000.

NOTES TO CASH FLOW STATEMENT

As at 31 March 2017

(a) Reconciliation of Operating Profit to Net Cash Inflow from Operating Activities

	2017		2016	
	£'000	£'000	£'000	£'000
Total operating profit		**32,617**		35,279
Depreciation	**22,275**		21,355	
Amortisation of capital contributions	**(2,318)**		(2,283)	
Profit on disposal of tangible fixed assets	**(590)**		(1,045)	
		19,367		18,027
(Increase) / decrease in stocks	**(193)**		36	
Increase in debtors	**(3,083)**		(3,352)	
Increase in creditors	**4,245**		3,395	
		969		79
Corporation tax paid		**(2,786)**		(3,841)
Net cash inflow from operating activities		**50,167**		49,544

(b) Reconciliation in Movement in Net Debt

	2017	2016
	£'000	£'000
(Decrease) / increase in cash	**(2,656)**	8,947
Finance lease repayments (cash)	**174**	233
Repayment of bank term loans (cash)	**-**	26,500
Issue of bank term loans (cash)	**-**	(30,000)
Payment of bank term loan issue costs (cash)	**-**	188
Bank term loan issue cost amortisation (non-cash)	**(85)**	(51)
Movement on index-linked debt (non-cash)	**(6,269)**	(6,068)
Increase in net debt in year	**(8,836)**	**(251)**
Net debt brought forward	**(232,494)**	(232,243)
Net debt carried forward	**(241,330)**	**(232,494)**

NOTES TO CASH FLOW STATEMENT

As at 31 March 2017

	Balance at 1 April 2016 £'000	Cash Flow £'000	Non-Cash Movements £'000	**Balance at 31 March 2017 £'000**
Cash at bank and in hand	11,379	(2,656)	-	**8,723**
Irredeemable debenture stock	(1,652)	-	-	**(1,652)**
Obligations under finance leases and hire purchase contracts	(392)	174	-	**(218)**
Bank loans (net of issue costs)	(29,783)	-	(85)	**(29,868)**
Index-linked debt (net of issue costs)	(212,046)	-	(6,269)	**(218,315)**
Net debt	(232,494)	(2,482)	(6,354)	**(241,330)**

Reconciliation of book net debt (as reported above) to net debt for covenant purposes

	31 March 2017 £'000	31 March 2016 £'000
Book net debt (as reported above)	**(241,330)**	(232,494)
Exclude book premium on issue of index-linked debt	**14,079**	14,381
Difference between long-term RPI assumption and actual RPI inflation	**9,199**	6,559
Exclude unamortised issue costs	**(1,890)**	(2,011)
Exclude accrued interest	**202**	196
Net debt reported for borrowing covenants	**(219,740)**	(213,369)
Regulated Asset Value	**347,600**	331,984
Covenant Net Debt / Regulated Asset Value	**63.2%**	64.3%

It is noted that the covenant net debt value as opposed to the book net debt value is used by stakeholders, including investors, lenders and rating agencies, to monitor key financial metrics such as the Net Debt / Regulated Asset Value as shown above.

1. Statement of Accounting Policies

The principal accounting policies are summarised below. The Company meets the definition of a qualifying entity under FRS 102 and has therefore taken advantage of the disclosure exemptions available to it in respect of its separate financial statements. Exemptions have been taken in these separate Company financial statements in relation to financial instruments. South Staffordshire Water PLC is consolidated in the financial statements of its ultimate holding company in the United Company, Hydriades IV Limited which may be obtained from Companies House in the UK.

a) Basis of Accounting

The accounts have been prepared under the historical cost convention and in accordance with applicable United Kingdom accounting standards on a going concern basis as stated in the Corporate Governance Report on page 41.

b) Turnover

Turnover comprises the value of sales (excluding VAT and similar taxes) of goods and services in the normal course of business. For water supplied Turnover includes amounts billed for water supplied in the year together with an estimation of amounts supplied but unbilled at the year end and the variance to allowable wholesale income that is recoverable or payable.

Further information on the Company's revenue recognition policy is shown on pages 110 and 111 of the APR.

c) Tangible Fixed Assets and Depreciation

Tangible fixed assets comprise infrastructure assets (water mains, impounding and pumped raw water storage reservoirs and dams), operational structures (pumping stations, treatment stations, boreholes and service reservoirs) and other assets.

Infrastructure Assets

Infrastructure assets comprise a network of systems include two regional network assets that, as a whole, are intended to be maintained in perpetuity at a specified level of serviceability by the continuing replacement and refurbishment of their components. Expenditure on infrastructure assets relating to increases in capacity or enhancements of the networks is treated as additions which are capitalised at cost.

Infrastructure renewals expenditure which is the annual expenditure required to maintain the operating capability of the network is not capitalised within tangible fixed assets but is expensed within operating costs for the year. In accordance with FRS 102, new infrastructure assets are depreciated over their useful economic life of 100 years.

The deemed cost of existing infrastructure assets determined as part of the transition to FRS 102 in the prior year is being depreciated over the estimated remaining economic life of 80 years.

Operational Structures and Other Fixed Assets

Operational structures and other fixed assets are stated at cost less accumulated depreciation and provisions for impairment. Depreciation is provided on a straight-line basis to write off the cost, less estimated residual value, over the estimated useful lives of the assets, with the exception of land, which is not depreciated. The estimated useful lives of the assets are as follows:

Buildings and Service Reservoirs	50-80 years
Boreholes	100 years
Fixed Plant	20-30 years
Meters	15 years
Mobile Plant	5 years
Motor Vehicles	3-7 years
Office Equipment	5-7 years

d) Capital Contributions

Capital contributions, including those in respect of infrastructure assets, are treated as deferred income and released to operating costs over the useful lives of the assets concerned.

e) Leased Assets

Assets financed by leasing agreements, which transfer substantially all of the risks and rewards of ownership to the Company, are included within fixed assets, and the net obligation to pay future rentals is included in creditors. Rentals are apportioned between finance charges and a reduction of the outstanding liability for future rentals so as to produce a constant charge to the profit and loss account based upon the capital outstanding.

f) Stocks

Stocks and work in progress are valued at the lower of cost and net realisable value. Cost includes materials and an appropriate element of overheads. Provision is made for obsolete, slow-moving or defective items where appropriate.

g) Pensions

For the defined contribution schemes the amount charged to the profit and loss account is the contributions payable in the year. Both sections (South Staffs and Cambridge) of the defined benefit scheme are closed to new entrants and have ceased future accruals. In accordance with the agreed policy in the Company and the Group, as the scheme is a multi-employer scheme with deferred members of the scheme also being employees of other Group companies the Company is not able to identify its share of the scheme's assets and liabilities on a reasonable and consistent basis. Therefore, in accordance with the stated policy the amount charged to the profit and loss account of the Company is equivalent to the deficit contributions payable in the year by the Company with the profit and loss items, actuarial gains and losses and assets and liabilities relating to the scheme being accounted for in the accounts of South Staffordshire Plc, the immediate holding company.

h) Research and Development

Research and development is charged to the profit and loss account in the year in which it is incurred.

i) Taxation

Current tax is charged on estimated taxable profits at the current rate.

Deferred taxation is provided in respect of capital allowances in excess of depreciation and all other timing differences that have originated but not reversed at the balance sheet date using the future rate of tax anticipated at the time of reversal based on legislation changing rates enacted or substantively enacted at the balance sheet date.

j) Financial Instruments

Financial Assets

All financial assets, being cash and cash equivalents, trade debtors and loans receivable are measured at amortised cost. Cash and cash equivalents comprise cash at bank and in hand and short-term deposits.

Financial Liabilities

Financial liabilities are initially measured at fair value and subsequently measured at amortised cost. The premium/discount and costs of issue are amortised over the life of the instrument, with the amortisation being included in the effective interest rate of the instrument which is included in finance charges (net) in the profit and loss account.

k) Hedge Accounting

The Company has entered into derivative financial instruments to hedge exposure to floating interest rates. These derivative financial instruments are recorded on the balance sheet at fair value on inception and at each balance sheet date. Movements in fair value are recorded in the profit and loss account except where hedge accounting has been adopted by the Company.

The Company designates certain hedging instruments as cash flow hedges. At inception of the hedge relationships, the Company documents the relationships between the hedging instruments and the hedged items along with the Company's risk management strategy and objectives in relation to each hedge. At the inception of the hedges, and on an ongoing basis, the Company documents whether the hedging instruments are highly effective in offsetting changes in cash flows of hedged items.

The effective proportion of changes in fair value of hedging instruments that are designated and qualify as cash flow hedges are deferred in equity in a hedging reserve net of deferred tax. The gain or loss relating to the ineffective proportion is recognised immediately in the profit and loss account. Hedge accounting is discontinued when the Company de-designates the hedging relationships, the hedging instruments expire, are terminated or are sold or they no longer qualify for hedge accounting. Amounts deferred in the hedging reserve are recycled to the profit and loss account in the periods when the hedged items are recognised in the profit and loss account. When forecast transactions are no longer expected to occur, the cumulative gains or losses are recognised immediately in the profit and loss account.

l) Dividends

Dividends are recognised in the profit and loss account if they have been paid or if they have been approved by the Company's Board and shareholders before the period end.

m) Exceptional Items

The Company separately presents certain items on the face of the profit and loss account as exceptional. Exceptional items are material items of income or expense that, because of their size or incidence, are presented separately to allow an understanding of the Company's financial performance and comparison to the prior year. They are not expected to be incurred on a recurring basis. Additional details of exceptional items are set out in Note 7.

Principal accounting judgements, estimates and assumptions

In the application of the accounting policies, which are described above, the Directors are required to make judgements, estimates and assumptions in respect of the carrying amounts of assets and liabilities recognised in the financial statements. These are based on historical experience, future forecasts and other factors that are considered to be relevant. It is recognised that historical experience and forecasts change over time and these judgements, estimates and assumptions are therefore reviewed and amended where necessary on a regular basis. However, it is also recognised that the actual outcomes may still differ to the judgements, estimates and assumptions made. Provided below are details of the principal accounting judgements, estimates and assumptions that the Directors have made when applying the Company's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

The more significant judgements were:

Hedge accounting

In applying the Company's interest rate hedging strategy and the corresponding hedge accounting applied in the financial statements a judgement has been made that there will be highly probable floating interest rate payments over the term of the interest rate derivatives. Underlying this judgement is the assessment that the future refinancing of bank facilities is highly probable. The basis for this judgement includes the Company's long-term 25-year water supply licence, its related long-term business model and regulated asset base, its ability to access capital markets including the bank debt market, its strong investment grade credit rating and also the stability and predictability of the regulated UK water sector as a whole.

Tangible fixed assets – Determining costs which are capital in nature

Judgment is required to determine whether costs incurred when work is carried out on Company assets are capital or revenue in nature. This work includes repairs, like-for-like replacement, new assets or replacement of assets with an element of asset enhancement or increased capacity. Identifying which element of expenditure represents capital expenditure rather than revenue expenditure may include judgement that the Company's two regional infrastructure networks each represent single infrastructure assets. In order to apply the appropriate accounting, a judgement is made as to whether it is probable that the expenditure will generate future economic benefits and also if the costs can be measured reliably.

The key accounting estimates were:

Accrued income

An estimate of water consumption by metered customers since the date of the last water bill and an estimate of the corresponding income that remains unbilled at the end of the year (accrued income) is required to be made each year. This estimate uses a historical water consumption rate for each customer from the Company's billing system and applies this consumption rate to the unbilled period and the related tariff to estimate unbilled income for that period. The accrued income for metered customers as at 31 March 2017 was £14,190,000 (2016: £14,600,000).

Amortised cost of index-linked borrowings

In order to record the Company's index-linked borrowings at amortised cost an estimate of the long-term average inflation rate (Retail Price Index - RPI) per annum is required to be made. In forming this estimate, financial market data such as the long-term yields for fixed rate and index-linked (RPI) gilts is obtained and considered with the difference between these yields being the market implied long-term inflation assumption. The net book value of index-linked borrowings as at 31 March 2017 was £218,315,000 (2016: £212,046,000).

Bad and doubtful debt provision

The recoverability of trade debtors, and therefore the amount of bad and doubtful debt provision held against trade debtors in the balance sheet at each year-end, requires judgement. This judgement requires consideration of the historical and forecast debt collection rates in respect of different categories of customers and trade debt, usually calculated as a percentage of the total amount billed in each year. This information is used in order to estimate the level of debt outstanding at the end of the year which is expected to be irrecoverable after following the processes of collection that the Company adopts. This estimate represents the year-end bad and doubtful debt provision which was £33,558,000 as at 31 March 2017 (2016: £29,790,000).

Tangible fixed assets – Assessment of useful economic lives

There is a requirement to estimate the useful economic lives of the Company's tangible fixed assets in order to depreciate the cost or deemed cost of these assets and make an appropriate charge to the profit and loss account over that period for each asset. This estimate is based on a combination of engineering data, experience of similar assets and on the businesses forecast replacement or rehabilitation cycle and its investment plan. Industry practice is also considered as part of the overall estimate of assets lives.

The total net book value of tangible fixed assets as at 31 March 2017 is £488,985,000 (2016: £475,541,000)

2. Segmental Information

The Directors consider that the Company operates substantially in the UK in one class of business, that being water supply. No analysis of turnover, profit before tax or net assets, by geographical area or class of business, is considered necessary. Revenue from UK operations in the year was £123,686,000 (2015/16: £123,876,000).

On 1 April 2017 the OpenWater market commenced allowing competition in the non-household market for water supply. As a consequence of this the retail element of non-household water will no longer form part of the turnover of South Staffordshire Water PLC moving forward in to the next year. The value of this in 2017 was £2.9m. The detail regarding the exit from non-household retail operations form part of note 25 on page 90.

3. Operating Costs (Net)

	2017 £'000	2016 £'000
Operating costs (net) were as follows:		
Other operating income (see note 6)	**(985)**	(1,587)
Raw materials and consumables	**4,219**	4,150
Staff costs (see note 4)	**20,058**	19,681
Own work capitalised	**(8,014)**	(7,934)
Depreciation : non-infrastructure assets	**18,803**	17,916
Depreciation : infrastructure assets	**3,472**	3,439
Infrastructure renewals expenditure	**8,736**	7,510
Amortisation of capital contributions	**(2,318)**	(2,283)
Other operating costs	**47,098**	47,705
	91,069	88,597

Auditor remuneration is analysed as follows:

	2017 £'000	2016 £'000
Fees payable to the Company's auditor for the audit of the Company's annual accounts	**67**	83
Other services pursuant to legislation	**47**	45
	114	**128**

4. Staff Costs

	2017 £'000	2016 £'000
Wages and salaries	**15,416**	15,091
Social security costs	**1,506**	1,465
Pension costs (see note 23)	**3,136**	3,125
	20,058	19,681

	2017 Number	2016 Number
Average number of employees	**407**	430

5. Directors' Remuneration

	2017	2016
	£'000	£'000
Emoluments	**324**	**310**

Contributions made by the Company to money purchase pension schemes in respect of directly employed Directors was £21,000 (2016:£21,000).

The highest paid directly employed Director received emoluments of £244,000 (2016: £230,000) and was not a member of a defined benefit pension scheme and had contributions of £21,000 (2016:£21,000) paid by the Company in respect of defined contribution pension schemes during the year.

During the year and the prior year, certain Directors received no emoluments as Directors of this Company. These directors were remunerated by the immediate parent company, South Staffordshire Plc, (or received no remuneration for their services) and the total of their emoluments received during the year was £383,000 (2016: £362,000). Contributions to the money purchase pension scheme in respect of these Directors was £61,000 (2016: £61,000).

No Directors (2016: Nil) who held office at the end of the year were accruing benefits due in the year under a defined benefit pension scheme and 2 Directors (2016: 2) were contributing members under a money purchase scheme.

The remuneration report on pages 48 to 51 gives further detail around the remuneration of the Directors and Executive Team.

6. Other Operating Income

	2017 £'000	2016 £'000
Profit on disposal of fixed assets	**590**	1,045
Rental income	**395**	542
	985	1,587

7. Exceptional Item

	2017 £'000	2016 £'000
Exceptional profit on disposal of rental income rights	-	4,590

During the year the Company has not generated any profit with respect to transactions that would be deemed as exceptional and non-recurring in nature (2016: £4,590,000).

8. Finance Charges (Net)

	2017	2016
	£'000	£'000
Interest payable and similar charges:		
Index-linked debt (Cash)	**7,131**	7,049
Index-linked debt (Non-cash)	**6,269**	6,068
Bank loan and other interest	**1,141**	1,176
Finance charges in respect of finance leases	**1**	5
Debenture interest	**68**	68
	14,610	14,366
Interest receivable:		
Loans to parent undertakings	**(2,545)**	(2,545)
Bank and other interest receivable	**(50)**	(133)
	12,015	11,688
Other finance charges:		
Amounts recycled from hedging reserve	**182**	184
	12,197	11,872

9. Taxation on Profit on Ordinary Activities

Tax on profit on ordinary activities

	2017	2016
	£'000	£'000
Current tax:		
UK corporation tax at 20% (2016: 20%)	**4,243**	6,087
Adjustments in respect of prior periods	**(2,641)**	(162)
Total current tax charge	**1,602**	5,925
Deferred tax:		
Origination and reversal of timing differences	**(30)**	(418)
Impact of changes in future tax rates	**(2,349)**	(4,424)
Adjustments in respect of prior periods	**2,352**	240
Total deferred tax credit	**(27)**	(4,602)
Total tax charge	**1,575**	1,323

Tax included in statement of total other comprehensive income

Deferred tax:		
Movement in hedging reserve	**(54)**	(330)
Effect of change in deferred tax rate	**84**	133
Total tax (credit) / charge	**30**	(197)

The adjustments to prior year current and deferred tax arise primarily as a result of the transition to FRS102 in the prior year. The change of basis of accounting for certain historical items gave rise to deferred tax temporary differences and the Company has revised its estimate of the impact of this transitional adjustment.

Factors affecting the total tax charge

The tax assessed on the profit on ordinary activities for the year is lower than the standard rate of corporation tax in the UK of 20% (2016 - 20%). The differences are reconciled below.

	2017	2016
	£'000	£'000
Profit on ordinary activities before tax	20,420	27,997
Profit on ordinary activies multiplied by standard UK corporation tax rate of 20% (2016: 20%)	4,084	5,600
Expenses not deductible for tax purposes (net)	123	23
Deferred tax provided at lower rate	6	46
Effect of changes in deferred tax rate	(2,349)	(4,424)
Adjustments in respect of prior years	(289)	78
Total tax charge	1,575	1,323

Factors that may affect the future tax charge

A reduction in the future UK corporation tax rate from 18% to 17% was substantively enacted in October 2016 and will take effect in April 2020. A reduction in the rate of corporation tax from 20% to 19% was previously enacted and took effect in April 2017. Deferred tax has been recognised at 17% or 19% depending on the expected reversal period.

No deferred tax has been recognised on capital gains rolled over against the cost of acquisition of certain property and structures owned by South Staffordshire Water PLC. The gains will come into charge if the assets are sold and not replaced by suitable qualifying assets. As the properties are essential assets of the water supply business it is regarded as unlikely that the gains will come into charge. The potential deferred tax amounts to £1,847,000 (2016: £1,879,000).

10. Dividends Paid

	2017 £'000	2016 £'000
Equity interests:		
Ordinary dividends paid of 523.7p (2016: 570.8p) per share	**11,120**	12,120

11. Earnings per Share

The calculation of earnings per share is based on the profit on ordinary activities after taxation divided by the weighted average number of shares in issue during the year.

The calculations of earnings per share are based on the following profits and number of shares:

	2017 £'000	2016 £'000
Profit on ordinary activities after taxation and profit for earnings per share	**18,845**	26,674

	2017 Number of Shares	2016 Number of Shares
Weighted average number of shares for basic and diluted earnings per share	**2,123,210**	2,123,210

12. Tangible Fixed Assets

	Specialised Operational Assets	Non Specialised Operational Assets	Infrastructure Assets	Other Tangible Assets	Total
	£'000	£'000	£'000	£'000	£'000
Cost					
At 1 April 2016	189,550	23,365	448,605	180,254	841,774
Additions	13,379	27	9,805	12,745	35,956
Disposals	-	(132)	-	(622)	(754)
At 31 March 2017	**202,929**	**23,260**	**458,410**	**192,377**	**876,976**
Depreciation					
At 1 April 2016	86,970	6,938	174,466	97,858	366,232
Charge for the year	6,668	364	3,472	11,771	22,275
Disposals	-	(54)	-	(462)	(516)
At 31 March 2017	**93,638**	**7,248**	**177,938**	**109,167**	**387,991**
Net Book Value					
At 31 March 2017					
Owned	108,743	16,012	276,245	82,729	483,729
Leased	548	0	4,227	481	5,256
	109,291	**16,012**	**280,472**	**83,210**	**488,985**
Net Book Value					
At 31 March 2016					
Owned	101,876	16,427	269,911	81,745	469,959
Leased	704	-	4,227	651	5,582
	102,580	**16,427**	**274,138**	**82,396**	**475,541**

Tangible fixed assets financed by leasing and hire-purchase contracts amounted to £12,060,000 (2016: £12,502,000) less accumulated depreciation of £6,857,000 (2016: £6,920,000). Depreciation charged to the profit and loss account for the year in respect of leased assets amounted to £221,000 (2016: £296,000). Tangible fixed assets include freehold land of £2,465,000 (2016: £2,465,000) which is not subject to depreciation.

Tangible fixed assets in the course of construction or commissioning included in the above table had a cost of £16,928,000 at 31 March 2017 (2016: £19,725,000).

13. Commitments

Capital commitments outstanding at 31 March 2017 were £6,700,000 (2016: £2,936,000).

14. Capital Contributions – Accruals and Deferred Income

	Infrastructure Assets £'000	Other Assets £'000	Total £'000
Balance at 1 April 2016	125,856	8,497	134,353
Capital contributions received	6,135	692	6,827
Amortised in year	(1,590)	(728)	(2,318)
Balance at 31 March 2017	**130,401**	**8,461**	**138,862**

An amount is expected to be amortised in the next year however, there is a degree of uncertainty in reliably estimating this figure based on the timing of receipts, the movement of associated projects from work in progress to completion, and general changes in the work undertaken as part of the capital programme.

15. Stocks

	2017 £'000	2016 £'000
Raw materials and consumables	**1,747**	1,554

There is no material difference between the balance sheet value of stocks and their replacement cost.

16. Debtors

	2017 £'000	2016 £'000
Amounts recoverable within one year:		
Trade debtors (Net)	**16,262**	12,380
Other debtors	**9**	68
Amounts due from other group undertakings	**1,916**	2,035
Amounts due from parent undertakings	**364**	364
Prepayments and accrued income	**13,769**	14,244
	32,320	29,091
Amounts recoverable in more than one year:		
Loans receivable from parent undertakings	**40,000**	40,000
Other amounts owed by parent undertakings	**3,667**	3,786
Other debtors	**-**	27
	43,667	43,813
	75,987	72,904

Detail of provisions against bad debt are shown in note 24 on pages 89 to 90.

17. Investments

	2017 £'000	2016 £'000
Investments	**2**	2

The balance represents the cost of investment of £1,596 related to 798 "A" ordinary shares and 8% of unsecured loan stock of WRc PLC, a research-based group, providing consultancy in the water, waste and environment sectors, incorporated in England and Wales.

18. Creditors – amount falling due within one year

	2017	2016
	£'000	£'000
Obligations under finance leases	**218**	392
Payments received in advance	**22,114**	21,308
Trade creditors	**19,637**	15,005
Other creditors	**7,719**	6,747
Amounts owed to other Group undertakings	**6,205**	5,395
Corporation tax payable	**4,103**	5,317
Other taxation and social security	**537**	520
	60,533	54,684

Obligations under finance leases are secured on the assets to which they relate.

19. Creditors – amounts falling due after more than one year

	2017	2016
	£'000	£'000
Irredeemable debenture stock (unsecured) (note 20)	**1,633**	1,633
Perpetual debenture stock (unsecured)	**19**	19
Amounts owed to other Group undertakings	**10,296**	20,495
Other creditors	**10,083**	10,412
Derivative financial liabilities	**2,846**	2,344
Bank loans (unsecured and net of issue costs):		
payable between two and five years	**29,868**	29,783
Retail Price Index-linked debt (unsecured)	**218,315**	212,046
	273,060	276,732

The gross bank loans (unsecured) of £30,000,000 (2016: £30,000,000 included in amounts falling due after more than one year) is used for covenant reporting purposes but, in accordance with FRS102, is stated above net of unamortised issue costs.

Derivative financial liabilities represent the market value of floating to fixed rate interest rate swaps designated as cash flow hedges.

The book value index-linked debt of £218,315,000 (2016: £212,046,000) is stated above at amortised cost in accordance with FRS102. The indexed principal of £196,594,000 (2016: £192,706,000) is used for borrowing covenant reporting purposes.

20. Irredeemable Debenture Stock

	2017 £'000	2016 £'000
3.5%	**476**	476
4.0%	**627**	627
5.0%	**500**	500
	1,603	1,603
Net premium on irredeemable debenture stock	**30**	30
	1,633	1,633

21. Provisions for Liabilities

	Deferred Taxation £'000
At 1 April 2016	**34,531**
Charged to profit and loss account	(27)
Charged to other comprehensive income	30
At 31 March 2017	**34,534**

	2017 £'000	2016 £'000
Accelerated Capital Allowances	36,315	36,360
Timing differences in respect of hedging reserves	(1,491)	(1,521)
Timing differences in respect of finance charges	(179)	(195)
Other timing differences	(111)	(113)
Provision for deferred tax	**34,534**	**34,531**

Deferred tax assets and liabilities are offset only where the Company has a legally enforceable right to do so and where the assets and liabilities relate to income taxes levied by the same taxation authority.

22. Share Capital

	2017	2016
	£'000	£'000
Authorised:		
8,800,000 Ordinary shares of £1 each	**8,800**	8,800
Allotted, called-up and fully-paid:		
2,123,210 Ordinary shares of £1 each	**2,123**	2,123

23. Pension Retirement Benefits

The Company operates a number of funded pension schemes for the benefit of its employees. The Company participates in the Water Companies Pension Scheme, by way of a separate section (the South Staffordshire Section of the Scheme) which provides benefits based on pensionable pay. The scheme was closed to all future benefit accrual with effect 1 April 2015 and as such only funding deficit contributions are now being paid into the Scheme (with these being £1,778,000 in the year ended 31 March 2017 and £1,764,000 in the year ended 31 March 2016) with an equivalent amount charged to the profit and loss account in the year. No current service contributions are now paid. There was also £433,000 (2016: £430,000) charged to the profit and loss account in relation to the Cambridge section of the Water Companies Pension Scheme. The assets and liabilities of the South Staffordshire section of the Scheme are accounted for in the accounts of the immediate parent undertaking, South Staffordshire Plc. The assets and liabilities for the Cambridge section of the scheme are accounted for with in Cambridge Water Plc. In addition, the Company participates in a defined contribution Money Purchase Pension Scheme. The assets of all schemes are held separate from those of the Company, and are invested by discretionary fund managers.

The contributions to the defined contribution schemes are charged against profits as incurred. The amount charged to the profit and loss account for the defined contribution scheme for the year ended 31 March 2017 was £925,000 (2016: £931,000).

Additional disclosures regarding the defined benefit pension scheme are required by FRS102. The latest actuarial valuation of the South Staffordshire section of the scheme as at 31 March

2017, prepared for the purposes of the consolidated financial statements of the parent company under FRS 102 rather than on the actuarial basis used for funding purposes, shows a surplus before deferred tax of £32,174,000 (2016: surplus of £28,093,000). The market value of the assets in this section of the scheme and the present value of the liabilities in the scheme that were accounted for in the parent company at the balance sheet date were:

	2017 Valuation	2016 Valuation	2015 Valuation
	£'000	£'000	£'000
Equities	**63,339**	61,018	71,970
High yield bonds / gilts and debt instruments	**136,390**	112,115	108,265
Diversified growth funds	**28,397**	26,789	28,174
Emerging markets multi-asset funds	**16,937**	14,762	14,138
(Overdraft) / Cash	**769**	(230)	(33)
Market value of assets	**245,832**	214,454	222,514
Present value of scheme liabilities	**(213,658)**	(186,361)	(203,342)
Surplus before deferred tax	**32,174**	28,093	19,172
Related deferred tax liability	**(5,470)**	(5,057)	(3,834)
Surplus after deferred tax	**26,704**	23,036	15,338

24. Financial Assets and Liabilities

The analysis of the Company's financial assets and liabilities included below includes cash, loans receivable, borrowings, trade creditors and trade debtors. Borrowings represent bank loans, finance lease obligations, index-linked borrowings and irredeemable and perpetual debenture stock. The main purpose of these financial instruments is to finance the Company's operations. It is, and has been throughout the period under review, the Company's policy that no trading in financial instruments shall be undertaken. The Company's policy in respect of cash, loans receivable and borrowings is to maintain flexibility with both long and short term debt while not exposing the Company to significant risk of market movements (see below). The Company is not exposed to any material foreign exchange risk.

Interest Rate Risk Profile

Borrowings

The interest rate profile of the borrowings (stated at book value) of the Company as at 31 March 2017 was as follows:

	Fixed rate financial liabilities	Floating rate financial liabilities	Retail Price Index-Linked debt
	£'000	£'000	£'000
31 March 2017	**31,738**	**-**	**218,315**
31 March 2016	31,827	-	212,046

Floating rate loans that are hedged by the floating to fixed interest rate swaps are shown above as fixed rate. The Company's cash balances earn interest at floating rates linked to LIBOR or the Bank of England base rate. The Company's trade debtors and trade creditors are not subject to interest unless considered to be overdue.

For all financial assets and liabilities, the book values and fair values are not materially different, except for the Retail Price Index-linked Loan and the Retail Price Index-linked Bond shown in the table below:

		2017	**2016**
		£'000	£'000
Retail Price Index-Linked Loan			
	Un-indexed Loan Value	111,400	111,400
	Indexed / Covenant Loan Value	153,146	150,355
	Book Value	172,134	167,350
	Fair Value	328,909	267,300
Retail Price Index-Linked Bond			
	Un-indexed Bond Value	35,000	35,000
	Indexed / Covenant Bond Value	43,448	42,351
	Book Value	46,181	44,696
	Fair Value	61,793	46,701

Fixed Rate Borrowings

	Weighted average interest rate %	Weighted average period for which rate is fixed Years
31 March 2017	**2.8**	**3.7**
31 March 2016	3.1	4.7

Borrowing Facilities

The Company has various borrowing facilities available to it. The undrawn committed facilities available at 31 March 2017 in respect of which all conditions precedent have been met were as follows:

	2017 £'000	2016 £'000
Expiring in one year or less	**-**	-
Expiring in more than one year but not more than two years	**15,000**	-
Expiring in more than two years but not more than five years	**10,000**	25,000
	25,000	25,000

Financial Risks

The Company's activities result in it being subject to a limited number of financial risks, principally credit risk as the Company has financial assets receivable from third parties. Management of financial risks focuses on reducing the likely impact of these risks to a level that is considered acceptable. The Company has formal principles for overall risk management as well as specific policies to manage individual risks.

1) Interest Rate Risk

Interest rate risk arises from borrowings issued at floating rates including those linked to LIBOR and the Retail Price Index (RPI) that expose the Company’s earnings and cash flows to changes in LIBOR and RPI. Risks of increases in LIBOR are managed by limiting the value and proportion of the Company’s borrowings that are linked to this variable and by entering into floating to fixed rate swap contracts. Risks associated with increases in RPI are effectively hedged against the revenues and the Regulatory Asset Value of the regulated water business, both of which are also linked to RPI.

2) Credit Risk

As is market practice, the Company grants customers credit on amounts due for the services it supplies, leading to limited risk over the recovery of the amounts receivable from these customers. Full details of the way this risk is managed are provided below. Credit risk also includes the risk of over recovery of loans receivable. This risk is managed by ensuring that loans are only made to entities with sufficient financial resources to both service and repay the loans.

3) Liquidity Risk

Liquidity risk represents the risk of the Company having insufficient liquid resources to meet its obligations as they fall due. The Company manages this risk by regularly monitoring actual and forecast cash flows and ensuring that the payment of its obligations are at least matched with cash inflows and availability of adequate banking facilities including sufficient headroom. The table above details the undrawn committed borrowing facilities available to the Company to manage this risk.

Sensitivity Analysis

The following analysis illustrates the sensitivity to reasonably possible movements during the year, in variables affecting financial liabilities, being LIBOR and the long term forecast for the UK Retail Price Index (RPI) on the pre-tax profit and loss account of the Company for the year ended 31 March 2017. There is no impact on reserves other than the impact on the profit and loss account after tax.

	2017	2016
	£'000	£'000
RPI +0.25%	**(508)**	(494)
RPI -0.25%	**508**	494
LIBOR +1.00%	**(137)**	48
LIBOR -1.00%	**137**	(48)

We have chosen a long term RPI forecast change of +/- 0.25% as “reasonably possible movements” in the year as a good estimate for possible variations in the long term forecast

RPI over the period based on market data. LIBOR has remained at particular low and stable levels over recent years, and + / - 1.0% is reasonable.

The impact on the pre-tax profit and loss account for 2017 detailed above has been calculated by assuming that the illustrated changes to the variables occurred on 1 April 2016 and remained different to the actual variables recorded by the stated amount during the year and with all other variables remaining at the actual amounts. The comparative figures have been calculated using the same methodology assuming the change to the variables occurred on 1 April 2015.

Maturity of Financial Assets and Liabilities

The maturity profile of the Company's financial liabilities at current repayment value, not the book value, at 31 March 2017 was as follows:

Borrowings	**2017**	2016
	£'000	£'000
In one year or less or on demand	**218**	392
In more than one year, but not more than two years	**-**	-
In more than two years, but not more than five years	**30,000**	30,000
In more than twenty years	**198,246**	194,358
	228,464	224,750
Other Financial Liabilities		
In one year or less or on demand	**60,315**	54,292
In more than one year, but not more than two years	**454**	430
In more than two years, but not more than five years	**11,812**	21,932
In more than five years, but not more than twenty years	**10,959**	10,889
	312,005	312,293

The table above excludes future interest payments and future indexation on financial liabilities. Index-linked borrowings of £196,594,000 (2016: £192,706,000) included in the table above are stated at the principal amount indexed by RPI to the balance sheet date. The estimated redemption value of index-linked borrowings at redemption in 2045 is £399,467,000 (2016: £399,467,000) and at redemption in 2051 is £139,996,000 (2016: £139,996,000).

Debtors recoverable in more than one year of £43,667,000 (2016: £43,813,000) principally represent loans receivable from the Company's parent companies of £40,000,000 (2016:

£40,000,000) with £15,000,000 (2016: £15,000,000) due to be repaid within two to five years and £25,000,000 having no fixed repayment date (2016: £25,000,000).

Trade Debtors

Before accepting sales for new non-domestic customers and offering credit terms, the Company undertakes appropriate credit assessments and uses this information to determine if the transaction is accepted and the credit terms that will be offered. Provision is made within the trade debtor values detailed below, based on judgement by senior management for amounts considered to be unrecoverable due either to their nature or age. The total amount charged to the profit and loss account in the year to March 2017 in respect of such provisions was £3,525,000 (2016: £2,427,000). Total trade debtors as at 31 March 2017 were £16,262,000 (2016: £12,380,000). The total amount of the provision included in the above, as at 31 March 2017 was £33,604,000 (2016: £29,790,000). The Company does not hold collateral over its trade debtors.

The Directors consider that debtors that are neither past due nor impaired are of a high quality and were considered, at the balance sheet date to be fully recoverable at their net book value. The largest balance outstanding from any single customer at 31 March 2017 was £147,000 (2016: £155,000), representing only 0.9% of the Company total (2016: 1.3%).

An ageing analysis of trade debtors that are invoiced but not impaired is provided below:

Regulated	< 1 year £'000	1 - 2 years £'000	2 - 3 years £'000	3 - 4 years £'000	4 - 5 years £'000	5 years + £'000	Total £'000
2017	**9,913**	**2,355**	**1,337**	**642**	**366**	**-**	**14,613**
2016	7,636	2,149	1,033	692	392	-	11,902

Non-Regulated	<1 month	1-2 months	>2 months	>3 months	Total
2017	**474**	**58**	**20**	**60**	**612**
2016	330	14	0	20	364

Non-regulated debtors that are considered to be impaired and so netted out of the figure above are to the value of £46,000 (2016: £70,000) and were all more than two months past due.

An ageing analysis of appointed debtors that are considered to be impaired is provided below:

Regulated	< 1 year £'000	1 - 2 years £'000	2 - 3 years £'000	3 - 4 years £'000	4 - 5 years £'000	5 years + £'000	Total £'000
2017	**3,973**	**3,566**	**3,553**	**3,437**	**3,352**	**15,677**	**33,558**
2016	3,894	3,475	3,299	3,181	2,949	12,922	29,720

The Directors consider that the carrying value of trade and other debtors including loans receivable, net of provisions, detailed in note 16 approximates to their fair value.

25. Post Balance Sheet Event

On 1st April 2017 the Company transferred its non-household retail operations and related assets to SSWB Limited, a fellow group company and subsidiary of South Staffordshire Plc (the Company's parent) and therefore exited the non-household retail water market.

On the same day, South Staffordshire Plc subsequently transferred the entire share capital of SSWB Limited to Pennon Water Services Limited (PWS), a subsidiary of Pennon Group Plc (the parent of South West Water Limited), in return for a 20% equity share in PWS for South Staffordshire Plc. Also on 1 April 2017, South West Water Limited transferred its non-household retail operations and related assets to PWS therefore forming the joint venture (PWS) to operate in the non-household retail market.

The Company transferred assets based on an agreed book value comprising; trade debtors; bad debt provisions, accrued income and some fixed assets to complete the transaction. As these were transferred at book value no profit or loss will be recorded in respect of the transaction.

26. Related Party Transactions

Historical agreements were put in place with a holding company in the Group structure to offset the impact on South Staffordshire Water PLC of certain hedging relationships entered into with a third party bank, on both cash flow and the profit and loss account. The balance due from Selena Bidco Limited in respect of these transactions at 31 March 2017 was £4,030,000 (2016: £4,150,000). In accordance with applicable accounting standards, the impact of both arrangements on the profit and loss account has been netted off with no overall impact.

Remuneration Report of key personnel is now included in starting on page 48.

27. Ultimate Controlling Party

The immediate parent company is South Staffordshire Plc which is registered in England and Wales and is the smallest group preparing consolidated accounts that include South Staffordshire Water PLC. The ultimate parent company in the United Kingdom is Hydriades IV Limited, also registered in England and Wales which is the largest UK group preparing consolidated accounts that include South Staffordshire Water PLC. The consolidated accounts for both these companies can be obtained from the Company's registered office. The ultimate controlling party is KKR Infrastructure Limited, which controls and manages, and is the General Partner of the Global Infrastructure Fund of the investment business KKR & Co L.P., which is quoted on the New Your Stock Exchange.

South Staffs Water

South Staffs Water

Annual Performance Report

For the Year Ended 31 March 2017

Contents

INTRODUCTION

Our Annual Performance Report (APR) is published each year and provides information for the Company's appointed business. It is split into four sections:

1. Regulatory financial reporting

2. Price control and additional segmental reporting

3. Outcome performance summary

4. Additional regulatory information

Our statutory accounts on their own are considered insufficient to assess the performance of a vertically integrated, price-controlled monopoly such as South Staffordshire Water PLC. This is particularly relevant in a water sector with long-life assets and where there is still an absence of competitive markets for different parts of the value chain. These regulatory accounting statements use audited information and comply with Ofwat's published Regulatory Accounting Guidelines (RAGs) that can be found on their website at www.Ofwat.gov.uk

Performance Commitments

At the heart of our performance reporting is a set of five Outcomes and 15 performance commitments that reflect the priorities of customers and benchmarking of water companies in England and Wales carried out in 2014. These outcomes and performance commitments provide broad coverage of our service provision, from water quality and reliability, through to environmental commitments, customer service and customer bills.

The 2014 price review set challenging targets for performance commitments based on industry benchmarking. Tough glide paths were imposed necessitating a review of how the business delivers the core aspects of our service. We are very pleased to report that the business has continued to make substantial progress against these measures, and in future years expects to see all stretching targets achieved or outperformed.

The Company has also published a separate performance report on our website and this can be found at the following link:

https://www.south-staffs-water.co.uk/publications/annual-reports

Five year targets

Our five outcomes and 15 performance commitments reflect what customers say is important to them. Some are financially incentivised over the five year period, meaning we may incur a penalty or reward. For the first two years of this period, we have accrued a total reward of approximately £1.3 million. At the next price review, in 2019, this accrued reward will be factored into our overall business plan to determine the customer charges for 2020 to 2025.

Outcome	ODI name	Unit of measurement	Year 2015/16 Actual	2016/17 Target	2016/17 Actual	2017/18 Target	2018/19 Target	2019/20 Target	Target achieved	Performance against last year
1 Excellent water quality	Mean Zone Compliance	%	99.884	99.970	99.982	100.00	100.00	100.00	✓	Improving
	Acceptability of water to customers	Contacts per thousand population	1.96	1.43	1.66	1.23	1.23	1.23	✗	Improving
2 Secure and reliable supplies	Interruptions to supply	Minutes and seconds per property	04:14	10:00	05:11	10:00	10:00	10:00	✓	Declining
	Asset health infrastructure	Category	Stable	Stable	Stable	Stable	Stable	Stable	✓	Stable
	Asset health non-infrastructure	Category	Stable	Stable	Stable	Stable	Stable	Stable	✓	Stable
3 Excellent customer experience	Service Incentive Mechanism	Score	86.3	90.0	84.4	90.0	90.0	90.0	✗	Declining
	Customer satisfaction	%	98	98	99	98	98	98	✓	Stable
	Community engagement	Days	256.5	400	222	400	400	400	✗	Declining
4 Environment	Leakage South Staffs region	Mega-litres per day	69.88	70.5	69.85	70.5	70.5	70.5	✓	Stable
	Leakage Cambridge region	Mega-litres per day	13.24	13.5	14.32	13.5	13.5	13.5	✗	Declining
	Water efficiency	Litres per person per day	129.59	130.15	129.85	129.52	128.91	128.31	✓	Stable
	Biodiversity	Hectares of land	76.2	91	92	106	116	116	✓	Improving
	Carbon emissions	Tonnes of carbon saved	178	1320	285	2428	3742	5210	✗	Improving
5 Fair customer bills	Value for money and affordability satisfaction	%	93	90	91	90	90	90	✓	Stable
	Support for customers in debt	Number of customers	19621	22200	23895	24800	27400	30000	✓	Improving

Excellent water quality

1 Outcome

99.98% water quality compliance

Contacts from less than **1.7** out of every 1,000 **people** regarding Acceptability of Water

Following a poor year in 2015/16 when we experienced a number of compliance failures, we are pleased to report that we have met our regulatory target for water quality compliance in 2016/17.

We have also made a 15% improvement in the number of contacts we receive from customers about their water quality. We have worked hard to achieve this, examining the root causes of customer contact and mitigating these risks as far as possible. Whilst we have not met our regulatory target this year, the improvements we have implemented put us on track to do so next year.

Investing in water quality

As part of our commitment to the highest water quality standards, we've installed state-of-the-art UV treatment technology within our Seedy Mill water treatment works. This proven, regulated and environmentally friendly UV technology ensures water is free from harmful organisms, and means less chlorine is needed, reducing the risk of issues with taste and odour.

Nitrate removal in our Cambridge region

We are also working through a multi-year programme in our Cambridge region to treat water for rising nitrate levels. Nitrates arise from the historical use of crop fertilisers. Over a long period of time these chemicals seep through the ground into our water sources, and we need to remove them from the public water supply through specialised treatment processes.

Improving the quality of the water is the number one priority for the business.

Secure and reliable supplies

2 Outcome

5 minutes 11 seconds
average supply interruption per customer

stable
asset health for **pipes, pumping stations & reservoirs**

One of our customers' highest priorities is that there is a continual supply of wholesome water from the tap. We have maintained our strong performance in supply interruptions to customers and remain an industry leading company. Our performance this year means that we will earn a financial reward under Ofwat's incentive mechanism. However, this will not be reflected in our charges to customers until after 2020.

It is not just today's customers that benefit from our strong performance. Our measures of asset health – for pipes, pumping stations and reservoirs – demonstrate that we are working hard to ensure that the vital service we provide can continue at the same levels of reliability in the future.

New drinking water storage reservoir ensures continued secure and reliable supply

A new drinking water storage reservoir, as part of our existing site at Outwoods in Burton-upon-Trent, is currently under construction. When complete, it will provide storage for up to 10 million litres of drinking water, helping to maintain supplies for around 38,000 properties in the area. This is the first reservoir we have constructed since the 1990s and is part of the commitment in our current five-year business plan to invest over £190m in assets to deliver a safe, secure and reliable supply of water to you 24 hours a day.

> *We expect the pressures on our water resources to increase in the future and we need to ensure our supply network can continue to operate, to provide a safe and reliable water supply for current and future generations.*

An excellent customer experience to customers and the community

3 Outcome

SIM score of **84.4**

99% customer satisfaction

222 days of community engagement activity

At our last price review in 2014 there were some significant retail challenges, which required us to cut our costs between 2015 to 2020. For this reason, we have implemented a lot of changes relatively quickly, some of which have negatively impacted on the customer experience. We have endeavoured to address these concerns quickly, but it does mean that 2016/17 saw an overall increase in customer complaints and a decline in our regulatory measure of customer service performance (SIM) from our previous industry leading levels.

We have mitigated the negative effects of the changes we implemented, but we know there is still more to do. We have developed and are implementing a detailed plan, to help us regain our previous industry leading position in customer service performance. We are pleased that we still have a strong customer satisfaction score of 99% from our annual tracker survey, and this demonstrates we are still moving in the right direction.

Key areas of the plan include our commitment to:

- Respond quickly when you contact us
- Ensure bills and supporting letters clearly provide you with the information you need
- Keep you informed when you have requested a visit and make sure we are on time for our appointments
- Carry out training with our customer service and field teams so that they deliver the right customer experience
- Improve the way we keep you up-to-date
- Develop our online MyAccount service to make things easy for you
- Provide support to those who need it through our new social tariff Assure, and other initiatives

Ensuring excellent customer service remains at the heart of everything we do.

Community work

As a provider of a vital service that we all rely on, and a large regional employer, we recognise the need to engage with the communities we serve in both regions. We work with local groups and trusts to deliver a wide range of community partnerships and projects. We have also introduced a new education outreach service where we visit schools to deliver assemblies and workshops on water related topics. Whilst we have not met our performance commitment in this area, the projects we have participated in have delivered real value and we will continue to seek opportunities for further involvement over the coming year.

Supporting Heritage Open Days

In September, we opened the Maplebrook pumping station in Burntwood as part of the national initiative, Heritage Open Days. The Grade II listed building is one of the few remaining pumping stations in England to retain its original triple expansion steam engines in situ, although the engines are no longer functioning.

Working with the Cambridge Wildlife Trust

As part of our on-going partnership with the Wildlife Trust, we have undertaken a number of projects over the last 12 months. These have included wildlife meadow planting and support for an environmental family fun day.

Our Employee Volunteer Scheme

We support staff to give up to three days paid time per year, to take part in work that will make a positive difference to their communities. Activities undertaken in 2016/17 include:

- Helping young people develop lifeskills through role-playing workplace scenarios
- Grounds repair work at a riding school for the disabled
- Helping with gardening projects, such as building bug hotels, plant clearance and preparation for wildlife meadow planting
- Supporting a local bird club by clearing reed beds and overgrown banksides, and cutting back overgrown trees

“

We want to make a positive difference within the communities where we live and work.

Operations that are environmentally sustainable

4 Outcome

129.85 litres of water per day used by each person we supply

92 hectares of land with a biodiversity initiative

285 tonnes of carbon reductions

69.85Ml/d leakage in South Staffs region

14.32Ml/d leakage in Cambridge region

Water is a precious and finite, natural resource and we must take care of it. We all have a part to play in protecting water supplies for future generations. We made a number of regulatory commitments on the environment at the last price review in 2014. We have met some of these targets, but we are disappointed to report that there are some we have missed.

In particular, our leakage performance has shown mixed results. Whilst we hit our target in our South Staffs region, we missed it in our Cambridge region. This was due to a range of operational factors and we have engaged additional specialist leakage resource to drive Cambridge leakage back to acceptable levels quickly. Our missed target means we have incurred a financial penalty under Ofwat's incentive mechanism, which will be reflected in customer charges from 2020 onwards.

Unfortunately, we also missed our carbon reduction target. In 2015 the Government cut the financial incentives available for renewable energy projects. This has resulted in our planned renewable energy projects no longer being economically viable. We are actively seeking replacement projects to deliver the commitment, but it is unlikely that we'll find sufficient cost effective projects to deliver the full target by 2020.

Encouraging water efficiency

Working with our customers and local communities we have continued to promote water efficiency. Projects range from promoting customer metering, supplying water saving devices for the home, and providing water efficiency education to communities and schools. Due to these efforts we have hit our regulatory targets for water efficiency.

We understand the impact of what we do and are committed to protecting our environment.

Developing strong environmental partnerships

As part of our new SPRING project, farmers in the Blithe catchment area can apply for a grant of up to £10,000 per farm. This can be used towards the costs of voluntary on-farm infrastructural improvements and agricultural management schemes designed to protect the environment, boost biodiversity and improve water quality.

A Uttoxeter farm has signed up, and together we are exploring ways of farming which will prove mutually beneficial. Funding is being provided to trial innovative farming practices and technology designed to reduce agricultural diffuse pollution and deliver environmental improvements. Ultimately, this means the raw water in the Blithe catchment will be of a higher quality, even before it is treated, reducing the requirement for advanced water treatment.

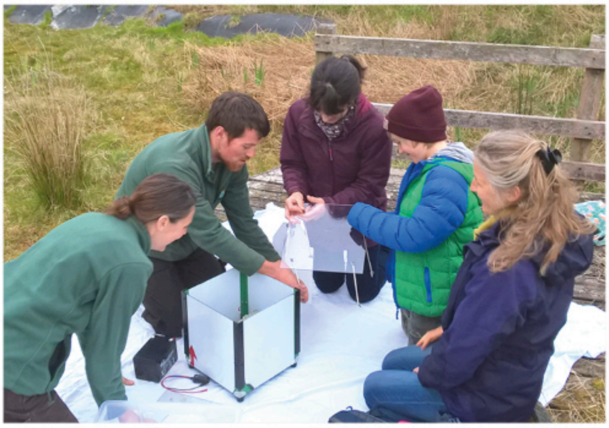
"I farm the land to make a living but I also want to do what I can for the environment… Farming has had some bad press when it comes to polluting the environment, but I think we need to do what we can to help organisations like South Staffs Water protect the water supply for future generations."

Cambridge PPF and the Pebble Fund

PEBBLE is a new fund created to actively encourage and enhance biodiversity in the local environment. This year we have awarded over £26,000 in grants to local initiatives.

Local charity Cambridge PPF was awarded £2000 towards its EMBLEM ecology project.

The money has been used to purchase essential equipment, including GPS units, bat detectors and recorders, butterfly nets, camera traps and a digital endoscope, which will be used in a range of monitoring programmes and surveys. The results, which include the recording of 137 new moth species since the project started, enables the charity to set a baseline from which to form a strong framework for its management works in the future and identify ongoing species and habitat improvement projects.



"We have been so delighted to have this support for our new ecology project. We have been able to greatly increase our monitoring capacity and accuracy with exciting results coming in already. The knock-on effect has also been an increase in public engagement and more volunteer opportunities, new training events and workshops for the public and our staff."

Fair customer bill and fair investor returns

5 Outcome

91% satisfaction score for value for money and affordability

23,895 customers helped with **debt support options**

We believe it's important to keep our bills as low as possible for our customers, and our household customers continue to have low water bills when compared to the other water companies in England and Wales. We think very carefully about how we spend money, and what we invest in. We try to find the right balance, ensuring that our bills are affordable for all, while investing enough in our assets to maintain our service for future generations.

We are pleased that our annual tracker survey shows 91% overall satisfaction with our value for money and the affordability of our service, meeting our regulatory commitment.

We are also committed to providing extra support for our most vulnerable customers when they need it most. We do this by providing a range of additional help schemes tailored to customers' individual circumstances. Through our range of debt support initiatives, we have helped nearly 24,000 customers, meeting our regulatory target.

Support for vulnerable customers

Providing extra support for our most vulnerable customers when they need it most is important to us. We do this by providing a range of additional help schemes tailored to customers' individual circumstances. Through our range of debt support initiatives, we have helped nearly 24,000 customers, meeting our regulatory target.

The uptake of our new Assure tariff is encouraging. Introduced in April 2016, we have already accepted over 4,000 customers onto the tariff designed to help our customers who struggle to pay their water bills by providing up to an 80% discount, depending on qualifying conditions.

We have undertaken extensive promotion of our new tariff to ensure that those who need it most know about it. This has included digital campaigns on our website and social media channels, as well as local advertising. We expect many of our existing Assure customers to renew for the next financial year, and our continued promotion will ensure an increase in customers being helped.

We have also invested in staff to allow us to visit customers in their own home where necessary. This helps us better understand their needs and support them in accessing extra help. We are visiting an average of 21 customers each month.

Mr Stanton is just one customer who has received extra help.

"I cannot thank you enough for this; it has made such a difference. My bill for next year is now £40.74 and that's not far off what I would have paid a month, I cannot thank you enough, I am so happy, it will make it easier for me to afford the other bills". Mr Stanton, South Staffs Water customer.

Water & sewerage charges for 2017/18:	£304.51
New bill after extra help discount:	£40.74
Overall annual saving:	**£263.77**

This year, we introduced Assure, a new social tariff to provide more help for those on low incomes.

1A – Income Statement
For the 12 months ended 31 March 2017

	Statutory £m	Differences between statutory and RAG definitions £m	Non-appointed £m	Total adjustments £m	Total appointed activities £m
Revenue	123.686	(0.656)	4.057	(4.713)	118.973
Operating costs	(92.054)	-	(2.225)	2.225	(89.829)
Other operating income	0.985	(0.395)	0.524	(0.919)	0.066
Operating profit	32.617	(1.051)	2.356	(3.407)	29.210
Other income	-	0.395	0.354	0.041	0.041
Interest income	2.595	-	0.004	(0.004)	2.591
Interest expense	(14.610)	-	-	-	(14.610)
Other interest expense	(0.182)	-	-	-	(0.182)
Profit before tax and fair value movements	20.420	(0.656)	2.714	(3.370)	17.050
Fair value gains/(losses) on financial instruments	-	-	-	-	-
Profit before tax	20.420	(0.656)	2.714	(3.370)	17.050
	-	-	-	-	-
UK Corporation tax	(1.602)	-	(0.543)	0.543	(1.059)
Deferred tax	0.027	-	-	-	0.027
Profit for the year	18.845	(0.656)	2.171	(2.827)	16.018
Dividends	(11.120)	-	(2.600)	2.600	(8.520)

Differences between statutory and RAG definitions

In the statutory accounts the Company classifies certain income in particular rental income as operating income. RAG definitions state that this should be classified as other income which is below the operating profit line. Profit before tax and fair value movements is unaffected by this reclassification.

In the regulatory accounts income is based on the value of bills and accrued income for measured customers raised in the year in line with RAGs. This is different to the statutory accounting policy on page 63.

Reconciliation of appointed current taxation to standard tax rate

This reconciliation of the appointed current tax charge resulting from applying the standard tax rate to the profit before tax as shown in table 1A.

	2017 £m		Current tax £m
PBT			
Appointed	17.050		1.059
Non appointed	2.714		0.543
	19.764		1.602
Appointed profit on ordinary activities before tax	**17.050**		
Appointed profit before tax at standard UK corporation tax rate of 20%	3.410		
Expenses not deductible for tax purposes		0.254	
Capital allowances less than depreciation		0.041	
Other timing differences		(0.006)	
	0.290		
Current year	**3.700**		
Adjustments in respect of prior years	(2.641)		
Appointed current tax charge	**1.059**		
Appointed total current tax charge allowed in price limits	**2.780**		
Variance			
Differences in profit before tax		(0.131)	
Interest income for which no tax allowance given		0.509	
Expenses not deductible for tax purposes		0.343	
Capital allowances in advance of depreciation		0.258	
Other timing differences		(0.060)	
	0.920		
Current year	**3.700**		
Adjustments in respect of prior years	(2.641)		
Appointed current tax charge	1.059		

The current tax charge in respect of the year at £3.7m was higher than that allowed in price limits by £0.9m and was offset by adjustments from prior years of £2.6m. These arise primarily as a result of the transition to FRS102 in the prior year. The change of basis of accounting for certain historical items gave rise to a current tax credit and a deferred tax charge, and the Company has revised its estimate of the impact of this transitional adjustment.

1B – Statement of Comprehensive Income

For the 12 months ended 31 March 2017

	Statutory £m	Differences between statutory and RAG definitions £m	Non-appointed £m	Total adjustments £m	Total appointed activities £m
Profit for the year	18.845	(0.656)	2.171	(2.827)	16.018
Actuarial gains/(losses) on post employment plans	-	-	-	-	-
Other comprehensive income	(0.350)	-	-	-	(0.350)
Total Comprehensive income for the year	18.495	(0.656)	2.171	(2.827)	15.668

Other comprehensive income relates to the movement in the hedging reserve net of deferred tax.

1C – Statement of Financial Position
As at 31 March 2017

	Statutory	Differences between statutory and RAG definitions	Non-appointed	Total adjustments	Total appointed activities
	£m	£m	£m	£m	£m
Non-current assets					
Fixed assets	488.985	-	1.547	(1.547)	487.438
Intangible assets	-	-	-	-	-
Investments - loans to group companies	-	40.000	-	40.000	40.000
Investments - other	-	-	-	-	-
Financial instruments	-	-	-	-	-
Retirement benefit assets	-	-	-	-	-
Total non-current assets	488.985	40.000	1.547	38.453	527.438
Current assets					
Inventories	1.747	-	0.045	(0.045)	1.702
Trade & other receivables	75.989	(40.656)	0.216	(40.872)	35.117
Financial instruments	-	-	-	-	-
Cash & cash equivalents	8.723	-	1.646	(1.646)	7.077
Total current assets	86.459	(40.656)	1.907	(42.563)	43.896
Current liabilities					
Trade & other payables	(50.110)	-	4.234	(4.234)	(54.344)
Capex creditor	(6.102)	-	-	-	(6.102)
Borrowings	(0.218)	-	-	-	(0.218)
Financial instruments	-	-	-	-	-
Current tax liabilities	(4.103)	-	(0.543)	0.543	(3.560)
Provisions	-	-	-	-	-
Total current liabilities	(60.533)	-	3.691	(3.691)	(64.224)
Net current assets / (liabilities)	25.926	(40.656)	5.598	(46.254)	(20.328)
Non-Current liabilities					
Trade & other payables	(20.379)	-	(0.387)	0.387	(19.992)
Borrowings	(249.835)	-	-	-	(249.835)
Financial instruments	(2.846)	-	-	-	(2.846)
Retirement benefit obligations	-	-	-	-	-
Provisions	-	-	-	-	-
Deferred income - G&C's	(138.862)	-	(0.008)	0.008	(138.854)
Preference share capital	-	-	-	-	-
Deferred tax	(34.534)	-	-	-	(34.534)
Total non-current liabilities	(446.456)	-	(0.395)	0.395	(446.061)
Net assets	68.455	(0.656)	6.750	(7.406)	61.049
Equity					
Called up share capital	2.123	-	-	-	2.123
Retained earnings & other reserves	66.332	(0.656)	6.750	(7.406)	58.926
Total Equity	68.455	(0.656)	6.750	(7.406)	61.049

Differences between statutory and RAG definitions

In the statutory accounts a long term group debtor of £40.000m is disclosed within debtors due after more than one year. The RAGs state that this should be classified as an investment.

The difference in statutory and regulatory income recognition is detailed in the notes on table 1A on page 104.

1D – Statement of Cash Flows

For the 12 months ended 31 March 2017

	Statutory £m	Differences between statutory and RAG definitions £m	Non-appointed £m	Total adjustments £m	Total appointed activities £m
Statement of cashflows					
Operating profit	32.617	(1.051)	2.356	(3.407)	29.210
Other income	-	0.395	0.354	0.041	0.041
Depreciation	22.275	-	0.118	(0.118)	22.157
Amortisation - G&C's	(2.318)	-	-	-	(2.318)
Changes in working capital	0.969	0.656	1.848	(1.192)	(0.223)
Pension contributions	-	-	-	-	-
Movement in provisions	-	-	-	-	-
Profit on sale of fixed assets	(0.590)	-	(0.524)	0.524	(0.066)
Cash generated from operations	52.953	0.000	4.152	(4.152)	48.801
Net interest paid	(6.211)	-	0.004	(0.004)	(6.215)
Tax paid	(2.786)	-	(1.515)	1.515	(1.271)
Net cash generated from operating activities	43.955	0.000	2.641	(2.641)	41.315
Investing activities	-	-	-	-	-
Capital expenditure	(32.624)	-	(0.213)	0.213	(32.411)
Grants & Contributions	6.827	-	-	-	6.827
Disposal of fixed assets	0.679	-	0.603	(0.603)	0.076
Other	(10.374)	-	-	-	(10.374)
Net cash used in investing activities	(35.492)	-	0.390	(0.390)	(35.882)
Net cash generated before financing activities	8.464	0.000	3.031	(3.031)	5.433
Cashflows from financing activities	-	-	-	-	-
Equity dividends paid	(11.120)	-	(2.600)	2.600	(8.520)
Net loans received	-	-	-	-	-
Cash inflow from equity financing	-	-	-	-	-
Net cash generated from financing activities	(11.120)	-	(2.600)	2.600	(8.520)
Increase (decrease) in net cash	(2.656)	0.000	0.431	(0.431)	(3.087)

Differences between statutory and RAG definitions

In the statutory accounts the Company classifies certain income in particular rental income as operating income. RAG definitions state that this should be classified as other income which is below the operating profit line.

Capital expenditure relates to the cash paid out in the year in relation to fixed asset additions. The difference in that paid for appointed assets of £32.411m and additions in the fixed asset table in 2D of £35.743m is due to an increase in year of creditors due relating to capital purchases of £3.332m.

The difference in statutory and regulatory income recognition is detailed in the notes to table 1A on page 104.

Pension contributions (including pension deficit contributions) of £3.1m are included as a cash cost within operating profit.

1E – Net Debt Analysis at 31 March
As at 31 March 2017

	Interest rate risk profile			
	Fixed rate £m	Floating rate £m	Index linked £m	Total £m
Borrowings (excluding preference shares)	31.738	-	218.315	250.053
Preference share capital				-
Total borrowings				250.053
Cash				(8.723)
Short term deposits				-
Net Debt				241.330
Gearing	-	-	-	69.4%
Adjusted gearing				63.2%
Full year equivalent nominal interest cost	0.898	-	13.648	14.546
Full year equivalent cash interest payment	0.898	-	7.046	7.944
Indicative weighted average nominal interest rate	2.82%	0.00%	6.94%	6.37%
Indicative weighted average cash interest rate	2.82%	0.00%	3.58%	3.48%
Weighted average years to maturity	4.120	-	29.326	25.810

Net debt comprises the book value of debt plus £1.6m of cash for the non-appointed business. In addition to the coupons payable, interest rates include the impact of hedging

The adjusted gearing of 63.2% is based on the Company's covenant debt of £219.7m which differs to the book debt of £241.3m. Covenant debt is the key metric used by investors, lenders and rating agencies in assessing gearing.

The difference between covenant and book debt includes £12.2m which relates to the unamortised premium and costs on issuance of the Company's index linked debt. The remaining £9.2m mainly relates to the difference in the long-term inflation assumption to maturity used for the book value of index-linked debt of 3.25% compared to the lower actual inflation rate used for covenant reporting. A full reconciliation between book net debt and covenant net debt is provided below.

	£'000
Regulated Asset Value at 31 March 2017	347,600

	31 March 2017	
	£'000	Gearing %
Book net debt (as reported above)	(241,330)	69.4%
Exclude book premium on issue of index-linked debt	14,079	(4.1%)
Difference between long-term RPI assumption and actual RPI inflation	9,199	(2.6%)
Exclude unamortised issue costs	(1,890)	0.5%
Exclude accrued interest	202	(0.1%)
Net debt reported for borrowing covenants	(219,740)	63.2%

ACCOUNTING POLICIES

1. Accounting policy for price control segments

The regulatory accounts have been prepared in accordance with RAG 2 (Guideline for the classification of costs across price controls) and follow the Company's accounting separation methodology statement. This statement is available on the Company's website at the link below:

https://www.south-staffs-water.co.uk/publications/annual-reports

Data for accounting separation is predominately taken from the Company's financial system, through downloads into spreadsheets. The financial information is captured at a location and activity level. Account codes are used to classify the expenditure to the correct cost lines within the relevant tables in section 2 and section 4 of the APR. Costs and assets are then attributed directly to business units in line with RAGs.

For general and support expenditure, a number of cost drivers have been identified for allocation of costs into the relevant business units. These include headcount, number of vehicles, floor space and asset values.

2. Revenue recognition

In the regulatory accounts, income is based on the value of bills and accrued income for measured customers raised in the year in line with RAGs. This is different to the statutory accounting policy on page 63.

For metered consumption not yet billed, an accrual is estimated. Where a property is unoccupied and fully furnished, charges are still applicable. Charges are also applicable where a property is renovated.

Charges may be waived in special circumstances, for example hospitalisation, probate and incarceration. Where a property is believed to be occupied, but the occupier details are not known, the income is not recognised until the occupant details are obtained. The Company uses Land Registry searches and void inspector visits to ascertain the identity of any occupier.

The Company does not bill unmetered void properties speculatively to 'the occupier'. Properties are visited by void inspectors to confirm that a property is unoccupied. For void metered properties, where consumption has been measured and the identity of the customer is not known following a void inspection, the property will be billed for the full charges in the name of 'the occupier'. Charges raised are realised as revenue in the same way as other metered income.

The first bill for a new connection is based on an actual meter reading. Where a customer has been connected during the year but has not had a meter reading, an estimate of the income is accrued based on the average household consumption.

Charges on income include charging orders and attachment of earnings. Cash received is applied against the outstanding debt with income being recognised from the billing date.

The Company operates an 'income maximisation' project that is used to identify properties not held on the Company's billing system. Any properties billed under this approach are not recognised as turnover until the running costs of the project have been covered.

Income recognised during the year is based on the value of bills raised. For metered consumption not yet billed, an accrual is estimated based on historical average daily consumption for each customer. The measured income accrual at March 2017 was £14.2m compared to £14.6m in the previous year.

The measured income accrual at March 2016 was £14.6m. Following comparison to the income actually billed for these customers in the year, there are no significant differences to report.

3. Capitalisation policy

Expenditure which results in the acquisition of an asset for continuing use within a business with a view to earning income or making profits from its use, either directly or indirectly.

Operating expenditure is expenditure incurred either for the purpose of the day to day running of the business or to maintain the existing capacity of fixed assets.

Costs are allocated between operating and capital expenditure in accordance with the Company's accounting policies and applicable accounting standards. The deminimis for capitalisation is £1,000 for minor assets and £5,000 for buildings.

4. Bad debt policy

Before passing an account for write-off, all debts will be pursued through every available recovery method and will usually include attempts by the Sheriff Officers or Debt Collection Agencies. Only where it is impossible, impractical or inefficient to collect debt, will a recommendation for a write-off be made.

There will be a variety of circumstances when it will be necessary to write off irrecoverable debts and these can be summarised below:

Absconded

- Where returned mail is received on accounts, no forwarding details are available and a final account is created, and where all recovery options have been exhausted.
- Where a debt has been passed to a "Trace and Collect Agency" and the agency is unable to trace the customer and therefore is unable to collect the debt outstanding.
- Where the total debt is less than £50, it is uneconomic to pass for trace and collection and therefore the debt outstanding is unable to be collected.
- Where a customer has debt greater than 6 years old and no billing activity or correspondence has been received in this period. (Statute Barred)

Bankruptcy

- A domestic customer where official and final notification has been received from the courts or a check has been made with the online insolvency website service.

Deceased

- Where the balance outstanding is less than £25 the amount is written off immediately.
- Where the balance outstanding is greater than £25, the estate is approached. Where written confirmation has been received in writing that the estate has insufficient funds, the balance is written off.
- In circumstances where a joint tenancy liability exists, the remaining party is pursued for the whole amount of the arrears.
- Where attempts to contact the Executors (or next of kin) have failed to produce a response, balances under £100 are written off after a period of 6 months.

Liquidation

- A commercial customer where final notification has been received from an Official Receiver, Insolvency Practitioner or Liquidator that the company has been liquidated.
- Debts where a company has ceased to trade leaving no assets.

Uneconomic to collect

- Final debt over 4 years will be written off where evidence exists that it has become non-collectable. A minimum of three attempts to contact a customer by telephone and / or letter in the prior 12 months has proved to be ineffective and there has been no payment or contact in the preceding 12 months.
- The debtor’s age, health or other social factors make it inappropriate to pursue the debt.
- Sums of less than £25 will be written-off as they are deemed to be uneconomic to collect.

2A – Segmental Income Statement
For the 12 months ended 31 March 2017

	Retail		Wholesale			
	Household £m	Non-Household £m	Water resources £m	Water Network+ £m	Water Total £m	Total £m
Revenue - price control	14.679	2.933		99.291	99.291	116.903
Revenue - non price control	-	-		2.070	2.070	2.070
Operating expenditure	(11.952)	(1.155)	(7.498)	(49.387)	(56.886)	(69.993)
Depreciation - tangible fixed assets	(1.041)	(0.070)	(0.226)	(20.820)	(21.046)	(22.157)
Amortisation - intangible fixed assets	-	-	-	-	-	-
Other operating income	-	-	-	0.066	0.066	0.066
Operating profit before recharges	1.685	1.709			23.495	26.889
Recharges from other segments	0.029	0.007	-	-	-	0.036
Recharges to other segments	-	-	-	(0.036)	(0.036)	(0.036)
Operating profit	1.714	1.716			23.459	26.889

The total of operating expenditure and depreciation – tangible fixed assets across retail and Wholesale in the table above totals £92.150m.

This is different to the operating costs in table 1A (£89.829m) relates to amortisation of capital grants and contribution (as per table 2E) as included in operating expenses in table 1A but excluded from the calculations above.

2B – Totex Analysis – Wholesale
For the 12 months ended 31 March 2017

	Water Resources £m	Water Network+ £m	Total £m
Operating expenditure			
Power	2.004	9.089	11.093
Income treated as negative expenditure	-	-	-
Service charges/ discharge consents	2.974	0.096	3.070
Bulk supply/ Bulk discharge	0.018	0.010	0.028
Other operating expenditure	2.311	33.315	35.626
Local authority and Cumulo rates	0.166	5.224	5.390
Total operating expenditure excluding third party services	7.472	47.734	55.207
Third party services	0.026	1.653	1.679
Total operating expenditure	7.498	49.387	56.886
Capital Expenditure			
Maintaining the long term capability of the assets - infra	-	-	-
Maintaining the long term capability of the assets - non- infra	1.391	13.776	15.167
Other capital expenditure - infra	-	8.964	8.964
Other capital expenditure - non-infra	1.466	9.963	11.428
Total gross capital expenditure excluding third party services	2.857	32.702	35.559
Third party services	0.000	(0.000)	0.000
Total gross capital expenditure	2.857	32.702	35.559
Grants and contributions	-	6.827	6.827
Totex	10.356	75.262	85.617
Cash Expenditure			
Pension deficit recovery payments	-	-	-
Other cash items	-	-	-
Totex including cash items	10.356	75.262	85.617

Pension deficit recovery payments of £2.212m are included in the totex lines within operating and capital expenditure.

Third party operating expenditure includes the costs of providing bulk supplies and other rechargeable works.

2C – Operating Cost Analysis – Retail
For the 12 months ended 31 March 2017

Operating expenditure	Household £m	Non-household £m	Total £m
Customer services	4.179	0.244	4.423
Debt management	0.702	0.096	0.798
Doubtful debts	3.114	0.427	3.541
Meter reading	0.794	0.089	0.883
Services to developers	-	-	-
Other operating expenditure	3.163	0.293	3.456
Total operating expenditure excluding third party services	11.952	1.150	13.102
Third party services operating expenditure	-	0.005	0.005
Total operating expenditure	11.952	1.155	13.107
Depreciation - tangible fixed assets	1.041	0.070	1.111
Amortisation - intangible fixed assets	-	-	-
Total operating costs	12.993	1.225	14.218
Debt written off	0.048	0.010	0.058

Total retail operating costs (before depreciation charges) of £13.1m were £2.6m lower than that allowed in price limits for the year. Efficiency savings have been made this year through changes in metering operations and the continued benefit seen from changes last year in transferring some non-voice back office functions offshore and the merging of the Cambridge customer contact centre operations with those in the South Staffs region. The Company has also successfully transferred all Cambridge region customers to the same billing system as the South Staffs region, providing a platform for further long term sustainable efficiencies and improvements in customer service.

2D – Historic Cost Analysis of Fixed Assets – Wholesale & Retail
For the 12 months ended 31 March 2017

	Wholesale		Retail		Total
	Water Resources	Water Network+	Household	Non-Household	
Cost	**£m**	**£m**	**£m**	**£m**	**£m**
At 1 April 2016	7.681	821.050	10.157	0.553	839.441
Disposals	-	(0.622)	-	-	(0.622)
Additions	2.857	32.702	0.172	0.012	35.743
Assets adopted at nil cost	-	-	-	-	-
At 31 March 2017	10.538	853.130	10.329	0.565	874.562
			-	-	-
Depreciation			-	-	-
At 1 April 2016	(2.328)	(356.380)	(6.368)	(0.352)	(365.428)
Disposals	-	0.460	-	-	0.460
Charge for the year	(0.226)	(20.820)	(1.041)	(0.070)	(22.157)
At 31 March 2017	(2.554)	(376.739)	(7.409)	(0.422)	(387.124)
			-	-	-
Net book amount at 31 March 2017	7.984	476.391	2.920	0.143	487.438
Net book amount at 1 April 2016	5.353	464.671	3.789	0.201	474.014
Depreciation charge for year					
Principal services	(0.226)	(20.820)	(1.041)	(0.070)	(22.157)
Third party services	-	-	-	-	-

2E – Analysis of Capital Contributions and Land Sales – Wholesale

	Fully recognised in income statement £m	Capitalised and amortised (in income statement) £m	Fully netted off capex £m	Total £m
Grants and contributions - water				
Connection charges (s45)	-	2.805	-	2.805
Infrastructure charge receipts (s146)	-	1.583	-	1.583
Requisitioned mains (s43, s55 & s56)	-	1.746	-	1.746
Diversions (s185)	1.503	-	-	1.503
Other Contributions	-	0.693	-	0.693
Total	1.503	6.827	-	8.330
Value of adopted assets		-		
Movements in capitalised grants and contributions				
Brought forward		134.346		
Capitalised in year		6.827		
Amortisation (in income statement)		(2.318)		
Carried forward		138.855		
Land sales				
Proceeds from disposals of protected land		-		

In line with current Regulatory Accounting Guidelines (RAGs), the Company nets the contributions for mains diversions against the cost of the work within operating costs shown in table 2B. Ofwat are currently consulting on regulatory reporting for 2017-18 and are suggesting a change in the RAGs requiring companies to show these contributions as other income within Table 1A.

2F – Household – Revenues by Customer Type

	Wholesale charges revenue £m	Retail revenue £m	Total revenue £m	Number of customers (000s)	Average household retail revenue per customer £
Unmeasured water only customer	45.874	8.573	54.447	375.452	22.83
Unmeasured wastewater only customer	-	-	-	-	-
Unmeasured water and wastewater customer	-	-	-	-	-
Measured water only customer	28.885	6.106	34.991	284.653	21.45
Measured wastewater only customer	-	-	-	-	-
Measured water and wastewater customer	-	-	-	-	-
Total	74.759	14.679	89.438	660.105	22.24

Household retail revenues are £0.4m lower than that assumed in the Final Determination. This is predominantly due to lower demand from metered customers during the year.

2G – Non-household Water – Revenues by Customer Type

	Wholesale charges revenue £m	Retail revenue £m	Total revenue £m	Number of connections (000s)	Average non-household retail revenue per connection £
Non-Default tariffs					
Total non-default tariffs	-	-	-	-	-
Default tariffs					
Unmeasured - South Staffs Region	1.063	0.246	1.309	3.089	79.57
Measured <50 Ml/yr - South Staffs Region	13.436	1.805	15.241	28.165	64.07
Medium User >=50 Ml/yr - South Staffs Region	1.883	0.047	1.930	0.029	1,606.74
Large User Up to 350 Ml/yr - South Staffs Region	1.144	0.027	1.171	0.011	2,493.31
Large User Over 350 Ml/yr - South Staffs Region	0.706	0.016	0.722	0.003	5,224.82
Measured >=150 Ml/yr - Cambridge region	0.493	0.013	0.506	0.002	6,360.73
Measured <150 Ml/yr - Cambridge region	5.197	0.702	5.899	9.324	75.24
Unmeasured BRV - Cambridge region	0.419	0.070	0.489	0.686	101.85
Unmeasured student rooms - Cambridge region	0.188	0.006	0.194	0.020	298.37
Unmeasured zero RV - Cambridge region	0.003	0.003	0.006	0.088	34.12
Total default tariffs	24.532	2.933	27.466	41.417	70.82
Total	24.532	2.933	27.466	41.417	70.82

	Number of customers (000s)	Average non-household retail revenue per customer £
Revenue per customer		
Total	41.417	70.82

Non-household revenue was £0.3m higher than that assumed in the Final Determination. This is due to higher consumption in the South Staffs region and a higher overall number of customers in charge.

2I – Revenue Analysis & Wholesale Control Reconciliation

	Household	Non-household	Total
Wholesale charge - water	**£m**	**£m**	**£m**
Unmeasured	45.874	1.673	47.547
Measured	28.885	22.859	51.744
Third party revenue	-	-	-
Total	74.759	24.532	99.291
Retail revenue			
Unmeasured	8.573	0.325	8.897
Measured	6.106	2.609	8.715
Other third party revenue	-	-	-
Retail total	14.679	2.933	17.612
Third party revenue - non-price control			
Bulk Supplies - water			0.397
Bulk Supplies - wastewater			-
Other third party revenue			0.874
Principal services - non-price control			-
Other appointed revenue			0.799
Total appointed revenue			118.973

	Water £m
Wholesale revenue governed by price control	99.291
Grants & contributions	6.134
Total revenue governed by wholesale price control	105.425
Amount assumed in wholesale determination	102.174
Adjustment for in-period ODI revenue	-
Adjustment for WRFIM	-
Total assumed revenue	102.174
Difference	3.251

Wholesale revenues were £3.3m higher than that assumed in the wholesale price control. Revenue from water customers was £0.9m (0.9%) lower due to lower customer demand from metered customers. Contributions predominantly from developer charges were £4.1m higher reflecting a higher number of new property connections in the year and higher costs incurred by the Company for a significant number of non-standard connections on brownfield sites and infill of smaller developments. The wholesale control assumed that all connections were large housing developments in greenfield sites.

The £0.9m under recovery of wholesale revenue from customers will be adjusted through the Wholesale Revenue Forecasting Incentive Mechanism (WRFIM) when setting wholesale charges for 2018/19.

The Company has had no net benefit from higher capital contributions from developers, which were as a result of higher costs incurred, and is currently awaiting guidance from Ofwat on how this should be treated.

3A – Outcome Performance Table

Unit	Unit description	Decimal places	2015-16 performance level - actual	2016-17 performance level - actual	2016-17 CPL met?	2016-17 reward or penalty (in-period ODIs)	2016-17 reward or penalty (in-period ODIs) £m (4 DPs)	2016-17 notional reward or penalty accrued	2016-17 notional reward or penalty accrued £m (4 DPs)	Total AMP6 reward or penalty 31 March 2020 forecast	Total AMP6 reward or penalty 31 March 2020 forecast £m (4 DPs)
%	Mean zonal compliance (%)	3	99.884	99.982	Yes	-	-	-	-	Penalty	-0.1620
nr	No. per 1,000 population	2	1.96	1.66	No	-	-	Penalty deadband	-	Penalty	-0.2029
time	Minutes / property / year	1	4.2	5.2	Yes	-	-	Reward	0.9060	Reward	1.8120
category	Asset health indicator	na	Stable	Stable	Yes	-	-	-	-	-	-
category	Asset health indicator	na	Stable	Stable	Yes	-	-	-	-	-	-
nr	Megalitres per day (Ml/d)	1	69.9	69.9	Yes	-	-	Reward deadband	-	Reward deadband	-
nr	Megalitres per day (Ml/d)	1	13.2	14.3	No	-	-	Penalty	-0.0976	Penalty	-0.0976
nr	Litres per head per day (l/h/d)	2	129.59	129.85	Yes	-	-	-	-	-	-
nr	Cumulative total hectares of land	0	76	92	Yes	-	-	-	-	-	-
nr	tCO2e (tonnes CO2e) in real savings	0	178	285	No	-	-	-	-	-	-
%	% customers satisfied with vfm & affordability	0	93	91	Yes	-	-	-	-	-	-
nr	No. of customers engaged with on debt	0	19621	23895	Yes	-	-	-	-	-	-
score	Service incentive mechanism (SIM) score	1	86.3	84.4	No	-	-	-	-	-	-
%	% customer satisfaction	0	98	99	Yes	-	-	-	-	-	-
nr	No. of employee days per year	0	257	222	No	-	-	-	-	-	-
									0.8084		1.3495

Outcomes, ODIs, performance commitments and financial incentives are discussed in more detail in the section on Performance Commitments starting on page 95 of this report.

We have also published a summary version of this APR, intended for customers and non-technical stakeholders, which can be found on our website at the following link:

https://www.south-staffs-water.co.uk/publications/annual-reports

This was also presented and discussed at a meeting of the Customer Panel in July 2017.

The forecast AMP6 reward of £1.3495m is based upon the net rewards and penalties accrued in respect of 2015/16 and 2016/17.

3B – Sub-measure Performance Table

PC / sub-measure	Unit	Decimal places	2015-16 performance level - actual	2016-17 performance level - actual
2.2: Serviceability infrastructure (combined company)	category	na	Stable	Stable
Mains bursts	nr	0	895	1013
Supply interruptions > 12 hours	nr	0	40	102
Properties with persistent low pressure	nr	0	1	1
Discolouration contacts per 1,000 customers	nr	2	0.846	0.835
TIM index non-compliance	score	2	0.106	0
2.3: Serviceability non-infrastructure (combined company)	category	na	Stable	Stable
WTW coliform non-compliance	%	2	0.033	0
Service reservoir coliform non-compliance	%	2	0	0
WTW turbidity non-compliance	nr	0	0	0
DWI enforcement actions	nr	0	2	0
Unplanned maintenance work orders	nr	0	3996	3058

Our assessment of stable serviceability for both infrastructure and non-infrastructure has followed the detailed methodology we set out in our publication 'Asset Health ODI Methodology November 2015' located on our website here:

https://www.south-staffs-water.co.uk/about-us/our-strategies-and-plans/our-assurance-framework.

Our calculation, and our resultant categorisation, has been externally assured by Monson Engineering, our external technical assessor.

For infrastructure, our headline indicator is bursts and our performance has been better than the reference level of performance for the past two years. We did see an increase in the number of properties exposed to a supply interruption of greater than 12 hours, due to a large burst on a strategic trunk main where 51 properties were affected. This indicator is therefore above the reference level of performance for 2016/17 but not sufficient in its own right to trigger a worsened serviceability rating overall when calculated as per our methodology. The remaining three indicators of properties with persistent low pressure, discolouration contacts per 1000 customers and TIM index non-compliance, are all relatively stable over time.

For non-infrastructure, our two headline indicators of WTW coliform non-compliance and service reservoir coliform non-compliance have both out turned at zero failures. We also had zero WTW turbidity non-compliance and zero DWI enforcements for microbiological parameters, an improvement on 2015/16 where two DWI notices were received at our two major treatment works in the South Staffs region. We are currently implementing treatment process improvements at these works to address these notices. Our final indicator, unplanned maintenance work orders, is lower than 2015/16 primarily reflecting a shift in resource from operational maintenance to capital maintenance projects.

3C – AIM Table
For the 12 months ended 31 March 2017

Abstraction site	Decimal places	2016-17 AIM performance [Ml]	2016-17 normalised AIM performance	Cumulative AIM performance 2016-17 [Ml]	Cumulative normalised AIM performance 2016-17	Contextual information relating to AIM performance
RIVEY B	0	-10	0	-10	0	licence changed agreed for 2020
LINTON	0	-20	-1	-20	-1	draft licence change proposed for 2020
HAGLEY	0	0	0	0	0	site has not been used since 2006 so no performance against AIM baseline to record

The Abstraction Incentive Mechanism (AIM) was introduced from April 2016 and encourages water companies to reduce the environmental impact of abstracting water at environmentally sensitive sites during certain periods of low surface water flows.

The Company has three sites under AIM and during the year two sites had average abstraction below the baseline for the periods when flows are below the relevant threshold. The third site, Hagley, has not been in use during the year and therefore had no performance against the baseline to record.

3D – SIM Table
For the 12 months ended 31 March 2017

Line description	Units	Decimal places	Score
Qualitative performance			
1st survey score	score	2	4.48
2nd survey score	score	2	4.32
3rd survey score	score	2	4.17
4th survey score	score	2	4.26
Qualitative SIM score (out of 75)	score	2	62.06
Quantitative performance			
Quantitative composite score	score	2	52.40
Quantitative SIM score (out of 25)	calc	2	22.38
SIM score			
Total annual SIM score (out of 100)	calc	0	84

The Service Incentive Mechanism (SIM) measures the levels of service that customers experience, by measuring performance across a number of contact channels, including telephone and written contacts, and also through a quarterly customer survey. SIM performance is financially incentivised, however the level of financial incentive each company receives is determined relative to other water companies at the next price review in 2019.

4A – Non-financial Information

Retail - household	Unmeasured	Measured
Household		
Number of void households	14.532	5.568
Per capita consumption (excluding supply pipe leakage) l/h/d	134.270	122.880

Volume (Ml/d)	Water
Bulk supply export	33.185
Bulk supply import	0.068
Distribution input	374.910

4B – Wholesale Totex Analysis

	Current year	Cumulative 2015-20
Actual totex	**£m**	**£m**
Actual totex	85.617	165.780
Items excluded from the menu		
Third party costs	1.679	3.321
Pension deficit recovery payments	1.602	3.172
Other 'Rule book' adjustments	-	-
Total items excluded from the menu	3.281	6.493
Transition expenditure	-	-
Adjusted Actual totex	82.336	159.287
Adjusted Actual totex base year prices	76.024	148.597
Allowed totex		
Allowed totex based on final menu choice – base year prices	77.522	154.312

The cumulative actual totex has been restated in line with changes to the RAGs to incorporate other capital contributions of £0.561m for 2015/16.

The Company's totex of £74.6m (2012/13 prices) was £1.5m (1.9%) lower than allowed in price limits for 2016-17. There was a £1.8m reprofiling of capital investment and infrastructure renewals expenditure into (IRE) future years. This was offset by a £0.3m overspend on operating costs, excluding IRE.

Actual wholesale operating costs per the regulatory accounts in 2016/17 are £2.9m lower than the fast money from the Final Determination (FD). IRE (which is included in both operating expenditure in the regulatory accounts and fast money in the FD) was £3.3m lower than the FD in 2016/17 following a decision to move some expenditure from infrastructure renewals to capital expenditure over the AMP period while maintaining the total level of expenditure across these two areas. As a result, wholesale capital expenditure was £1.5m over the FD reflecting increased expenditure on key treatment works to deal with water quality issues as required by the DWI. The remaining £0.3m overspend in operating costs was as a result of continued upward pressure in power costs as these increased by 5.7% on the previous year driven by higher pass through charge rates, and one off impacts due to our enforced change in laboratory supplier.

The cumulative position for the two years to 2016/17 shows totex of £5.7m (3.7%) below the FD with operating costs being £9.7m lower than the FD.

Ofwat adjusted the Pay As You Go (PAYG) rate in the FD to smooth bills in the period to 2020. The impact was to have an FD PAYG rate of 73.9% in 2015/16 compared to the average in the FD of 68.2%, which was in line with the expected allocation between capital and operating expenditure. This smoothing accelerated £4.6m of fast money into the FD for 2015/16 year from slow money and adjusted subsequent years as an offset. The resulting impact in 2016/17 was small, being an acceleration of a further £0.1m of fast money. IRE was £7.0m lower than the FD, partly offset by an overspend on capital expenditure of £4.1m. The remaining £2.0m overspend in operating costs was predominantly related to the ongoing upward pressure on power costs driven by higher pass through charge rates also seen as an in year impact.

Overall, ignoring the PAYG adjustment outlined above, there was a £2.9m reprofiling of capital investment and infrastructure renewals expenditure into future years. This was offset by a £2.0m overspend on operating costs.

4C – Forecast Impact of Performance on RCV

	£m
RCV determined at FD at 31 March	347.575
RCV element of cumulative totex over/underspend so far in the price control period	(2.050)
Adjustment for ODI rewards or penalties	-
Projected 'shadow' RCV	345.525

The RCV element of totex underspend has been calculated by comparing the actual totex for each year of the price control period (as shown in line 1 of table 4B less pension deficit repair costs rebased to March 2017 prices) to the totex allowed in the FD (as shown in line 10 of table A2.4 of the company specific report uplifted to March 2017 prices) multiplied by (1- the weighted average PAYG rate for the AMP)%.

The Company has no Outcome Delivery Incentive rewards that impact on the RCV.

4D – Wholesale Totex Analysis – Water

	Water resources			Network+			
	Abstraction licences	**Raw water abstraction**	**Raw water transport**	**Raw water storage**	**Water treatment**	**Treated water distribution**	**Total**
Operating expenditure	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Power	-	2.004	0.871	-	0.398	7.820	11.093
Income treated as negative expenditure	-	-	-	-	-	-	-
Abstraction charges	2.844	0.130	(0.001)	-	0.063	0.034	3.070
Bulk supply	-	0.018	-	-	0.010	-	0.028
Other operating expenditure	-	2.311	0.275	0.013	6.228	26.799	35.626
Local authority and Cumulo rates	-	0.166	0.253	-	0.436	4.535	5.390
Total operating expenditure excluding third party services	2.844	4.628	1.398	0.013	7.135	39.188	55.207
	-	-	-	-	-	-	-
Third party services	-	0.026	(0.001)	-	0.592	1.062	1.679
Total operating expenditure	2.844	4.654	1.397	0.013	7.727	40.250	56.886
Capital Expenditure							
Maintaining the long term capability of the assets - infra	-	-	-	-	-	-	-
Maintaining the long term capability of the assets - non-infra	1.391	-	-	-	2.829	10.947	15.167
Other capital expenditure - infra	-	-	-	-	-	8.964	8.964
Other capital expenditure - non-infra	1.466	-	-	-	5.337	4.625	11.428
Total gross capital expenditure (excluding third party)	2.857	-	-	-	8.166	24.536	35.559
Third party services	0.000	-	-	-	-	(0.000)	0.000
Total gross capital expenditure	2.857	-	-	-	8.166	24.536	35.559
Grants and contributions	-	-	-	-	0.685	6.142	6.827
Totex	5.701	4.654	1.397	0.013	15.208	58.644	85.617
Cash Expenditure							
Pension deficit recovery payments	-	-	-	-	-	-	-
Other cash items	-	-	-	-	-	-	-
Totex including cash items	5.701	4.654	1.397	0.013	15.208	58.644	85.617
Unit cost information (operating expenditure)							
Licenced volume available	230,121.550	-	-	-	-	-	
Volume abstracted	-	161,277.780	-	-	-	-	
Volume transported	-	-	24,853.360	-	-	-	
Average volume stored	-	-	-	2,867.019	-	-	
Distribution input volume - water treatment	-	-	-	-	136,842.150	-	
Distribution input volume - treated water	-	-	-	-	-	136,842.150	
Unit cost	12.359	28.860	56.209	4.651	56.468	294.132	
Population	1,666.453	1,666.453	1,666.453	1,666.453	1,666.453	1,666.453	
Unit cost	1.707	2.793	0.838	0.008	4.637	24.153	

4F – Operating Cost Analysis – Household Retail

	Household unmeasured £m	Household measured £m	Total £m
Operating expenditure			
Customer services	2.094	2.085	4.179
Debt management	0.501	0.201	0.702
Doubtful debts	2.221	0.893	3.114
Meter reading	-	0.794	0.794
Other operating expenditure	1.799	1.364	3.163
Total operating expenditure excluding third party services	6.615	5.337	11.952
Third party services operating expenditure	-	-	-
Total operating expenditure	6.615	5.337	11.952
Depreciation - tangible fixed assets	0.660	0.381	1.041
Amortisation - intangible fixed assets	-	-	-
Total operating costs	7.275	5.718	12.993

Demand-side efficiency and customer-side leaks analysis - Household	
Demand-side water efficiency - gross expenditure	-
Demand-side water efficiency - expenditure funded by wholesale	-
Demand-side water efficiency - net retail expenditure	-
Customer-side leak repairs - gross expenditure	0.435
Customer-side leak repairs - expenditure funded by wholesale	0.435
Customer-side leak repairs - net retail expenditure	-

4G – Wholesale Current Cost Financial Performance

	£m
Revenue	101.360
Operating expenditure	(56.886)
Capital maintenance charges	(23.270)
Other operating income	0.066
Current cost operating profit	21.271
	-
Other income	0.041
Interest income	2.591
Interest expense	(14.610)
Other interest expense	(0.182)
Current cost profit before tax and fair value movements	9.111
Fair value gains/(losses) on financial instruments	-
Current cost profit before tax	9.111

Note: Capital maintenance charges represent current cost depreciation

4H – Financial Metrics

Financial indicators	Units	Metric
Net debt	£m	241.330
Regulated equity	£m	106.245
Regulated gearing (Book Debt)	%	69.43%
Regulated gearing (Covenant Debt)	%	63.22%
Post tax return on regulated equity (Book Debt)	%	15.54%
Post tax return on regulated equity (Covenant Debt)	%	12.97%
RORE (return on regulated equity)	%	6.83%
Dividend yield	%	6.10%
Retail profit margin - Household	%	1.88%
Retail profit margin - Non household	%	6.2%
Credit rating	n/a	Baa2
Return on RCV	%	8.3%
Dividend cover	dec	2.47
Funds from operations (FFO)	£m	41.538
Interest cover (cash)	dec	5.77
Adjusted interest cover (cash)	dec	3.19
FFO/Debt	dec	0.17
Effective tax rate	%	21.70%
RCF	£m	33.018
RCF/capex	dec	1.02
Revenue and earnings		
Revenue (actual)	£m	116.903
EBITDA (actual)	£m	46.910
Borrowings		
Proportion of borrowings which are fixed rate	%	12.69%
Proportion of borrowings which are fixed rate	%	0.00%
Proportion of borrowings which are floating rate	%	87.31%
Proportion of borrowings which are index linked	%	0.10%
Proportion of borrowings due within 1 year or less	%	0.00%
Proportion of borrowings due in more than 1 year but no more than 2 years	%	13.36%
Proportion of borrowings due in more than 2 years but but no more than 5 years	%	0.00%
Proportion of borrowings due in more than 5 years but no more than 20 years	%	86.54%

Ofwat reporting requires the dividend yield and dividend cover metrics to be calculated after deducting £2.036m (net of tax) of dividends paid to the Company's holding company to enable payment of intra group loan interest to the Company.

Ofwat guidance also requires the Company’s regulated gearing to be based on book debt. The table above also shows the regulated gearing based on covenant debt which is the key metric for the Company’s borrowings.

The effective tax rate of 21.7% is before prior year adjustments of £2.641m, adjusting for these the effective tax rate is 6.2%.

Calculation of the Return on Regulated Equity (RORE)

The calculation of RORE follows the guidance issued by Ofwat in its letter of the 12 April 2017 and subsequent clarifications. This updated guidance has required the restatement of the 2015/16 RORE calculation. The outperformance figure for totex (and associated RCV runoff) has been recalculated to remove underspend due to the reprofiling of expenditure. The interest outperformance figure has also been amended to follow Ofwat's latest guidance which uses the nominal interest rate deflated to a real interest rate using actual year average inflation. We have engaged Jacobs UK Limited to review and audit our RORE calculation methodology and they have concluded that it is consistent with Ofwat’s guidance.

The reported figure of 6.83% is the simple arithmetic mean of RORE figures in 2015/16 (5.73%) and 2016/17 (7.93%). This is higher than that allowed in the FD of 5.98%. The main driver for this is outperformance on retail costs and ODIs offset by the difference between the interest rate assumed by Ofwat and the actual higher interest rate on the Company’s borrowings (which is predominantly made up of long term RPI index-linked debt).

12-13 prices

	15-16 Final Determination £m	Totex (Note 1) £m	Retail (Note 2) £m	RCV run off (Note 3) £m	ODI (Note 4) £m	Interest (Note 5) £m	Actual £m
Out / (under) performance reported in 2015-16 APR		1.812	2.412	(0.058)	0.541	(1.661)	
Restated out / (under) performance		(0.825)	2.450	0.026	0.541	(2.553)	
Less tax (20%)		0.165	(0.490)	(0.005)	(0.108)	0.511	
Appointed business: profit	6.923	(0.660)	1.960	0.021	0.433	(2.042)	6.635
Appointed business: regulated equity	115.775						115.775
Appointed business: RORE (actual)	5.98%						**5.73%**

	16-17 Final Determination £m	Totex (Note 1) £m	Retail (Note 2) £m	RCV run off (Note 3) £m	ODI (Note 4) £m	Interest (Note 5) £m	Actual £m
Out / (under) performance		(0.142)	2.767	0.006	0.808	(0.550)	
Less tax (20%)		0.028	(0.553)	(0.001)	(0.162)	0.110	
Appointed business: profit	7.065	(0.114)	2.213	0.004	0.647	(0.440)	9.375
Appointed business: regulated equity	118.205						118.205
Appointed business: RORE (actual)	5.98%						**7.93%**

Notes to RORE calculation

Note		2015-16 £m	2016-17 £m
1	**Totex outperformance**		
	Totex out / (under) performance (12/13 price)	(1.671)	(0.288)
	Cost sharing rate	49.35%	49.35%
	Out / (under) performance	(0.825)	(0.142)

Totex underperformance relates to operating costs excluding IRE as outlined in Table 4B

Note		2015-16 £m	2016-17 £m
2	**Retail outperformance**		
	Per FD (allowed retail service expenditure including depreciation on assets post April 2015)	15.894	16.123
	Actual retail costs (including depreciation on assets post April 2015)	13.443	13.356
	Out / (under) performance	2.450	2.767

Retail outperformance is outlined in Table 2C

Note		2015-16 £m	2016-17 £m
3	**Impact on RCV run off of totex outperformance**		
	Totex out / (under) performance (12/13 price)	(1.671)	(0.288)
	PAYG rate per FD	73.9%	68.3%
	RCV out / (under) performance	(0.436)	(0.091)
	Run off rate (per FD)	6.00%	6.10%
	Impact on RCV run off	0.026	0.006
4	**ODI reward (Per table 3A)**	0.541	0.808

Details of the ODI reward is set out in Table 3A

Notes to RORE calculation (continued)

		2015-16	2016-17
		£m	£m
5	**Interest (calculation as set out in Ofwat RD letter 12 April 2017)**		
	Net nominal interest paid	11.695	12.019
	March 2015 net debt (book value)	232.243	232.494
	March 2016 net debt (book value)	232.494	241.330
	Average net debt (book value)	232.368	236.912
	Nominal interest rate paid	5.03%	5.07%
	Year average RPI	1.08%	2.14%
	Deflate to real interest rate	3.91%	2.87%
	Cost of debt at PR14	2.59%	2.59%
	Difference	-1.32%	-0.28%
	Notional level of debt	192.959	197.008
	Financial out / (under) performance	(2.553)	(0.550)

The underperformance on interest is as a result of a single industry cost of debt at PR14 of 2.60% compared to the average interest rate on the Company's borrowings of 3.91% (2015/16) and 2.87% (2016/17). Most of the Company's debt is long-term RPI index-linked debt, the majority of which was issued in 2005. Since then, interest rates have fallen significantly. Therefore, the Company has not been able to benefit from these lower interest rates compared to larger water companies in the industry which due to their size issue new debt on a more regular basis.

4I – Financial Derivatives

		Nominal value by maturity (net)			Total value					Interest rate (weighted average)	
		1 to 2 years	2 to 5 years	Over 5 years	Nominal value (net)	Mark to Market	Total accretion £m	Units	DPs	Payable	Receivable
Derivative type											
Interest rate swap (sterling)											
Floating to fixed rate	£m	-	-	30.000	30.000	(2.846)	(2.846)	%	2	2.14	0.44
Floating from fixed rate	£m	-	-	-	-	-	-	%	2	0.00	0.00
Floating to index linked	£m	-	-	-	-	-	-	%	2	0.00	0.00
Floating from index linked	£m	-	-	-	-	-	-	%	2	0.00	0.00
Fixed to index-linked	£m	-	-	-	-	-	-	%	2	0.00	0.00
Fixed from index-linked	£m	-	-	-	-	-	-	%	2	0.00	0.00
Total	£m	-	-	30.000	30.000	(2.846)	(2.846)	0	0		
Foreign Exchange											
Cross currency swap USD	£m	-	-	-	-	-	-	%	2	0.00	0.00
Cross currency swap EUR	£m	-	-	-	-	-	-	%	2	0.00	0.00
Cross currency swap YEN	£m	-	-	-	-	-	-	%	2	0.00	0.00
Cross currency swap Other	£m	-	-	-	-	-	-	%	2	0.00	0.00
Total	£m	-	-	-	-	-	-	0	0		
Currency interest rate											
Currency interest rate swaps USD	£m	-	-	-	-	-	-	%	2	0.00	0.00
Currency interest rate swaps EUR	£m	-	-	-	-	-	-	%	2	0.00	0.00
Currency interest rate swaps YEN	£m	-	-	-	-	-	-	%	2	0.00	0.00
Currency interest rate swaps Other	£m	-	-	-	-	-	-	%	2	0.00	0.00
Total	£m	-	-	-	-	-	-	0	0		
Forward currency contracts											
Forward currency contracts USD	£m	-	-	-	-	-	-	£m	3	0.00	0.00
Forward currency contracts EUR	£m	-	-	-	-	-	-	£m	3	0.00	0.00
Forward currency contracts YEN	£m	-	-	-	-	-	-	£m	3	0.00	0.00
Forward currency contracts Other	£m	-	-	-	-	-	-	£m	3	0.00	0.00
Total	£m	-	-	-	-	-	-	0	0		
Other financial derivatives											
Other financial derivatives	£m	-	-	-	-	-	-	%	2	0.00	0.00
Total financial derivatives	£m	-	-	30.000	30.000	(2.846)	(2.846)				

Nominal values (net) above represents the nominal value of the interest rate swap of £30.0m that hedges the interest rate payments on £30.0m of bank loans. This does not equal the value reflected in total financial instruments in table 1C of £2.846m as the balance sheet value of the swap is recorded at mark to market value as described above.

The fixed payable element of the interest rate swap is 2.135% and the receivable floating rate element is 3-month LIBOR, shown above as the average for the 12 months to 31 March 2017 of 0.440%.

The receivable floating rate element of the swap exactly offsets the payable floating rate element (3-month LIBOR interest payment) of the related £30.000m bank loan. The effect of this is that the interest payable on the loan, when combined with the cash flows on the swap, is fixed to 2.135% per annum plus the agreed fixed bank margin percentage per annum.

Relationship between Director's remuneration and standards of performance

A detailed remuneration report covering the Board of Directors and the Executive Team can be found on pages 48 to 51.

The remuneration policy of the Company continues to provide remuneration packages designed to attract, retain and motivate good quality senior executives. Remuneration comprises salary, benefits and performance related bonus. Each Director receives a base salary which does not vary in relation to business or individual performance.

During the year ended 31 March 2017, Executive Directors had bonus arrangements in place which are payable upon achievement of certain performance objectives, with the intention of rewarding excellent performance. As part of the Company's policy on Corporate Governance, Independent Non-Executive Directors do not have bonus arrangements in place.

The annual bonuses awarded to Executive Directors are linked to the following standards of performance of the Company:

Customer service (based upon the SIM performance as reported to Ofwat)

Achievement of ODI targets (as reported in table 3A of the APR)

Profitability (as reported in published accounts)

Operating costs (as reported in published accounts)

Cash generation (as reported in published accounts)

Bonus awards are linked to the above standards of performance as the Remuneration Committee considers such arrangements will maintain consistency between the objectives of the Directors and principal stakeholders including customers and shareholders. The standards of performance to which bonuses are linked are reviewed annually by the Remuneration Committee to ensure this consistency continues to be maintained.

The bonus awarded to each Director in the above categories is based on a "sliding scale" with the bonus award in each category increasing with performance up to a specified maximum award for excellent performance. In addition, each Executive Director has a number of personal targets to achieve for the year, primarily focused on this year's water quality enhancements at key sites and preparations for OpenWater, in total worth 20% all of which is proposed to be paid.

The following performance against target was achieved during the year:

Standard of performance	Target	Actual	Average % of salary awarded
Customer Service	Maintain high SIM performance	Target not achieved	0%
Outcome Delivery Incentives	Achieve target	Target exceeded	5%
Profitibilty	Budget	Target exceeded	10%
Operating costs	Below Budget	Target not achieved	Nil
Cash Generation	Budget	Target exceeded	10%

Phillip Newland, as an Executive Director of the Company is due a bonus in respect of the above performance and individual targets in respect of the year ended 31 March 2017 accrued at £70,875 reflecting the strong performance of the business in the year. This bonus is payable following the year end.

Adrian Page who is Group Chief Executive of South Staffordshire Plc is remunerated by South Staffordshire Plc principally based upon the performance of the Group as a whole to reflect his Group wide role, however his remuneration for the year included a bonus of £35,000 specifically linked to the performance of the Company including delivery of ODI targets, water quality enhancement and preparations for OpenWater.

Disclosure of information to auditors

The Directors confirm that as far as they are aware, there is no relevant audit information of which the Company's auditor is unaware and that the Board has taken all reasonable steps to make itself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

Approach to Taxation

South Staffordshire Water PLC takes seriously its legal and social responsibilities for meeting its tax obligations. The Company has no operations outside the United Kingdom, and therefore the following has specific reference to UK taxation.

The Company is committed to complying with tax laws in a responsible manner, balancing its obligations to the Government and the public with its duty to manage its affairs efficiently in order to deliver cost-effective services to customers while generating an economic return to investors. The Company makes timely and accurate tax returns that reflect its fiscal obligations to the Government.

In particular, the Company:

- Will not engage in aggressive tax planning that is not linked with commercial and economic activity;
- Will not engage in artificial tax arrangements;
- Will seek to maintain a transparent and collaborative relationship with HM Revenue & Customs, principally through the Company's Customer Relationship Manager;
- Will seek independent professional tax advice on material matters where the application of tax law is complex or uncertain.

The Company will make use of applicable tax incentives provided by the Government within the terms outlined above. These may include, for example, preferential rates of capital allowances or enhanced tax relief for research and development costs and certain designated capital assets that add efficiency to the Company's operations. Such incentives have been put in place to encourage appropriate business investment.

It should be noted that, for the Company's regulated water supply business, such incentives will generally have the effect of reducing its customers' water bills under the funding model adopted by the economic water sector regulator, Ofwat.

In addition to corporation tax, the Company contributes to the UK Exchequer by means of a number of other taxes and levies, including but not limited to:

- Employment taxes, National Insurance and the Apprenticeship Levy
- Carbon taxes and other energy-related taxes and levies
- Fuel duty and other vehicle-related taxes
- Business rates
- Regulatory charges and licences such as water abstraction charges

The Company's approach to risk management applies to tax as it does to other business areas. Taxation compliance and advisory services are provided to the Company by its immediate parent company, South Staffordshire Plc, which is responsible for identifying, assessing and managing tax risk across the entire Group. All material tax matters are discussed with the Company's finance team and where appropriate, significant issues are escalated to the relevant members of the Board for consideration. The Group Internal Audit function will also review significant risk areas where considered appropriate.

The Company has identified economic uncertainty as a risk area. This includes risk in relation to the possibility of unexpected tax law and policy changes by the Government. The Company carefully monitors published tax legislation, guidance and policy documents to ensure it can assess the compliance requirements and the economic implications for the Company. The Company will engage with HM Revenue & Customs where its tax position is likely to be materially affected by such policy changes.

Dividend policy

Dividends of £8.5m were paid during the year for the appointed business (2015/16: £6.1m). This included £2.036m (net of tax) paid to the Company's holding company to enable it to pay intra group loan interest to the Company.

At 31 March 2017 the Company's ratio of net debt/RCV was 63.2% (2015/16: 64.3%) of its Regulated Capital Value (RCV) of £347.6m (2015/16: £332.0m) being the PR14 FD RCV uplifted for inflation. This ratio reflects the impact of better than expected free cash generation in the year and inflation (RPI) at March 2017 of 3.1% (March 2017: 1.6%), which is used to inflate RCV, whereas the majority of index-linked debt was inflated using RPI at July 2016 which was lower at 1.9% (July 2015: 1.0%). Going forward, the Board is targeting a net debt/RCV ratio of up to 66%.

Condition K

In the opinion of the Directors, the Company was in compliance with paragraph 3.1 of its Instrument of Appointment as at 31 March 2017.

Long term viability statement

The Company has prepared a detailed business plan which states its mid-term strategic objectives and operational plans, and identifies the key business issues that the Company faces both now and those anticipated in the future, and considers how the Company proposes to address these issues.

The Company's detailed planning process extends to March 2020 which is the end of the current regulatory price control period. In order to give a longer term view the Company has also modelled a number of scenarios to the end of March 2025 based on the anticipated range of possible outcomes of the next price control, these are necessarily less certain.

Using the information available, the Company has prepared financial forecasts up to March 2025, which reflect its stated and anticipated strategic objectives and operational plans. These include but are not limited to trading forecasts comprising turnover, operating and capital maintenance costs, cash flow projections including operating cash flows, the planned investment programme, tax and finance related cash flows. The level of net debt is also projected through the period and is compared to the level of gearing as permitted in the Company's borrowing covenants as is interest cover and the return to investors.

The period to March 2025 has been selected as it includes the remainder of the current price control which is relatively predictable plus the full five years of the next price control. This combined period is considered to be appropriate for a long-term regulated business that provides an essential public service and invests for the long-term.

In order to assess the long-term viability and financial resilience of the Company to possible changing circumstances, sensitivity analysis has been applied to these financial forecasts to assess the impact on profitability, cash flows, liquidity, borrowing capacity, credit rating and compliance with borrowing covenants of a number of severe but plausible adverse changes to the most important assumptions made within these projections. Tests on the key exposures identified last year around capital investment, operational cost, inflation and interest rate fluctuations were re-performed as they are still a key focus in the risk planning of the Directors and Audit Committee. In addition this year, a range of emerging risk scenarios focusing on the level of Weighted Average Cost of Capital (WACC) have been modelled for the five years to March 2025 as the business is particularly sensitive to significant movements in this financial assumption and it is considered to have the most significant impact on the longer term viability of the Company if it was to materially deviate from the Company's assumptions over the longer-term. Where appropriate, mitigating actions have also been modelled and considered as part of this process.

Based on the business plan, the related long-term financial projections and associated sensitivity analysis detailed above, the Board of Directors has a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due over the period of assessment to March 2025. This expectation is based on the assumption that the

Company continues to have its existing access to capital markets to fund its required investment programme and provide sufficient liquidity.

The majority of the specialist work required to form this Board level expectation has been delegated to the Audit Committee with a further review carried out at Board level following completion of this work.

To provide assurance, the assessment has been independently reviewed and challenged at different levels by the Group Internal Audit function and by the Audit Committee. The Directors consider that this level of assurance is sufficient and have therefore not sought any further third party assurance.

STATEMENT OF DIRECTOR’S RESPONSIBILITIES FOR REGULATORY INFORMATION

Further to the requirements of company law, the Directors are required to prepare accounting statements which comply with the requirements of Condition F of the Instrument of Appointment of the company as a water and sewerage undertaker under the Water Industry Act 1991 and Regulatory Accounting Guidelines issued by Ofwat.

This additionally requires the Directors to:

- Confirm that, in their opinion, the Company has sufficient financial resources and facilities, management resources and methods of planning and internal control for the next 12 months.
- Confirm that, in their opinion, the Company has sufficient rights and assets, which would enable a special administrator to manage the affairs, business and property of the company.
- Confirm that, in their opinion, the Company has contracts with any associated company with the necessary provisions and requirements concerning the standard of service to be supplied to ensure compliance with the Company’s obligations as a water and sewerage undertaker.
- Report to Ofwat changes in the Company’s activities, which may be material in relation to the Company’s ability to finance its regulated activities.
- Undertake transactions entered into by the appointed business, with or for the benefit of associated companies or other businesses or activities of the appointed business, at arm’s length.
- Keep proper accounting records, which comply with Condition F.

These responsibilities are additional to those already set out in the statutory financial statements.

DIVERSIFICATION AND PROTECTION OF THE CORE BUSINESS (F6A CERTIFICATE)

The Directors declare that in their opinion:

a) The Company will have available to it sufficient financial resources and facilities to enable it to carry out, for at least the next 12 months, the regulated activities (including the investment programme) necessary to fulfil the Company's obligations under its Instrument of Appointment.

b) The Company will, for at least the next 12 months, have available to it management resources which are sufficient to enable it to carry out its activities and fulfil its obligations.

c) All contracts entered into with any associated company include all necessary provisions and requirements concerning the standard of service to be supplied to the appointee, to ensure that it is able to meet all its obligations as a water undertaker.

d) The Company will, for at least the next 12 months, have available for it systems of internal control which are sufficient to enable it to carry out its functions.

In making this declaration, the Directors have taken into account:-

a) The Company's budget for 2017/18 and the investment programme;
b) The Final Determination for 2015-20 and the Company's plan in relation to it;
c) The investment grade credit rating in the 'BBB+' band;
d) The committed borrowing facilities available to the Company;
e) The depth of the management team and the succession planning in place;
f) The contracts in place with associated companies;
g) The Company's internal control process which identifies evaluates and manages risks faced by the Company.

P. Newland
14 **July 2017**

RISK AND COMPLIANCE STATEMENT

Background and requirements of the statement

South Staffordshire Water PLC has a number of statutory and regulatory obligations as a Water Undertaker. These obligations are predominantly set down in the Water Industry Act 1991 and our Instrument of Appointment (the 'Licence'). The purpose of the Risk and Compliance Statement is to demonstrate that we fully comply with these obligations.

Ofwat guidance requires each company to confirm that it has:

- a full understanding of, and is meeting, all its relevant statutory, licence and regulatory obligations;
- taken steps to understand and meet customer expectations;
- satisfied itself that it has sufficient processes and internal systems of control to fully meet its obligations;
- appropriate systems and processes in place to allow it to identify, manage, mitigate and review its risks.

Each of these is considered in the statement below along with how the Company has satisfied itself that it can confirm that the obligations have been met.

1. The Company confirms that it has a full understanding of, and is meeting, all its relevant statutory, licence and regulatory obligations

Each year, the Company considers its obligations as a water undertaker and that it understands and complies with them. This is done in a number of different ways:

- Assessing the impact of any licence changes or changes to the Water Industry Act made during the year and ensuring any new obligations are adopted;
- Reviewing and publishing relevant documents as required under its licence, for example Condition R compliance[1;]
- The use of appropriate assurance where required, either through internal audit or external technical audit;
- Requiring Board sign-off of all significant obligations, for example customer charges and the Annual Performance Report;
- An annual review of compliance undertaken by the Audit Committee.

[1] https://www.south-staffs-water.co.uk/media/1813/ssc-compliance-code-april-2017.pdf

In particular, at a meeting of Directors held on 29 June 2017 the Board confirmed, under license condition F6a, that South Staffordshire Water PLC:

- has adequate financial resources and facilities, management resources and systems of internal control (including those needed to manage risk) to enable it to carry out its regulated activities (including the investment programme necessary to fulfil its obligations under the Appointment);
- has maintained an investment grade rating from both Moody's and Standard and Poor's.
- can confirm that there are sufficient rights and assets available to enable a special administrator to run the business;
- has ensured that Executive Directors' remuneration packages are linked to the performance of the business, taking account of both financial and service performance:
- has ensured that each Director has confirmed that, in accordance with the Companies Act 2006, as far as they are aware, there is no relevant audit information of which South Staffordshire Water PLC's auditors are unaware. The Board has taken all reasonable steps to make itself aware of any relevant audit information and to establish that South Staffordshire Water PLC's auditors are aware of that information.
- complies with Condition F of its license. The Board can also confirm South Staffordshire Water PLC's compliance with the objectives and principles of RAG 5.06, namely that transactions with associate companies are at arm's length and that cross subsidy is not occurring.

Based on the work undertaken during the year, the Company has not identified any exceptions and can confirm that it has a full understanding of and is meeting all its relevant statutory, licence and regulatory obligations.

2. The Company confirms that it has taken steps to understand and meet customer expectations

The Company has a number of outcomes that reflect what our customers have expressed as what matters to them. These outcomes have performance commitments attached that customers can expect us to achieve. Each year we publish our performance in a customer specific report available on our website[2.] We also work with our Customer Panel and share detailed information on our performance on a quarterly basis.

[2] https://www.south-staffs-water.co.uk/publications/annual-reports

Good customer engagement to provide in-depth insight into our customers' needs and experiences is vital to delivering excellent customer service. We are continually working to be better enabled to listen to customers and act in response to what we hear from them.

For example, during the year we implemented a social tariff following research which identified our customers' willingness to support its introduction. We are now helping many more customers who are struggling to pay their water bill.

We also remain committed to investing in the training and development of all of our front line staff, in the contact centre and out in the field, to ensure we deliver a seamless experience of first time resolution of customer issues wherever possible.

The Company can therefore confirm that it has taken steps to understand and meet customer expectations.

3. The Company confirms that it has satisfied itself that it has sufficient processes and internal systems of control to fully meet its obligations

The Company has a number of processes and controls in place to ensure that it delivers its statutory, licence and regulatory obligations.

There is an established internal control framework that is continually reviewed and updated. This process includes the identification, evaluation and management of the significant risks faced by the Company as set out in the Strategic Report.

Alongside this, the Company also has robust and transparent assurance processes in place as set out in its company monitoring framework[3] and assurance plan[4]

[3] https://www.south-staffs-water.co.uk/media/1935/risks-strengths-and-weaknesses-publication-november-2016.pdf

[4] https://www.south-staffs-water.co.uk/media/2029/final-assurance-plan-april-17.pdf

There is an internal audit function operated by the Company's parent which provides support in maintaining good systems of internal control and assurance over the quality of information. In addition and as part of its terms of reference, the Audit Committee keep under review the effectiveness of the internal audit arrangements, internal controls and risk management policies and practices. This includes consideration of the statutory and regulatory obligations to ensure compliance.

Based on this, the Company is satisfied that it has sufficient processes and internal systems of control to fully meet its obligations

4. **The Company confirms that it has appropriate systems and processes in place to allow it to identify, manage, mitigate and review its risks.**

There is ongoing monitoring of the Company's risk management and internal control systems to review their continuing relevance to the business and their effectiveness and to ensure that appropriate risk management activities are in place or are planned to mitigate the risks identified.

It is accepted that risks can emerge and change quickly and therefore that risk identification and mitigation activities will need to be able to respond to this and that at any given point in time enhancements to mitigating actions may be required in response to changes. Risks are assessed both on a gross basis (likelihood and consequence before mitigating controls) and a net basis (likelihood and consequence after mitigating controls) so that the Directors can properly assess the overall significance of the risk and the estimated effectiveness of mitigating actions and therefore if further actions are required.

The Directors accept that not all risks can be mitigated entirely but aim to ensure that risk management activities reduce the overall impact of risks, on a net basis, to a level that is considered to be acceptable and that do not impact on the long-term viability of the Company.

Overall, the Company is satisfied that it has appropriate systems and processes in place to allow it to identify, manage, mitigate and review its risks.

RISK AND COMPLIANCE STATEMENT

This statement was approved at a meeting of Directors held on 29 June 2017 and duly signed on their behalf:

....	....
Phillip Newland	Sir James Perowne
Managing Director	Independent Chairman
South Staffordshire Water PLC	South Staffordshire Water PLC

TRANSACTIONS BETWEEN THE APPOINTEE AND ASSOCIATED COMPANIES

The Company is under a duty to trade at arm's length and to ensure that there is no cross-subsidy with respect to transactions with associated companies or between price control units. The Company's licence conditions require that all such transactions must be disclosed. In line with RAG 3.09, no single transaction exceeding £100,000 has been aggregated. These are set out on page 155.

Loans by or to the appointee

The Company has two loans to its parent undertaking, South Staffordshire Plc. In accordance with the Company's licence these loans were approved by Ofwat. The first loan is for £15.0m with interest payable at 5.3% and in the year the Company received £0.795m in interest. The second loan is for £25.0m with interest payable at 7% and in the year the Company received £1.750m in interest.

Dividends paid to associated companies

As a wholly owned subsidiary, the Company paid dividends of £11.1m in the year to its holding company, South Staffordshire plc. This included £2.036m (net of tax) to enable it to pay intra group loan interest to the Company.

Guarantees or other forms of security by the appointee

The Company confirms that there are no guarantees or other forms of security with any associated companies.

Transfers of any asset or liability by or to the appointee

During the year, the Company transferred no asset or liability to an associated company.

Transfer of any corporation tax group losses by or to the appointee

The Company anticipates that it will claim group loss relief of approximately £8.0m from group holding companies for the year ended 31 March 2017. On completion of the tax computations, any such losses will be paid for by the Company at the prevailing corporation tax rate of 20%, which is considered by both parties to be an arm's length rate. A payment of approximately £1.6m is therefore expected to be due and is included within the corporation tax creditor of £4.1m.

No group loss relief was claimed or surrendered in the prior year.

TRANSACTIONS BETWEEN THE APPOINTEE AND ASSOCIATED COMPANIES

Other transactions

The Company can confirm that there has been no omission to exercise a right as a result of which the value of the net assets of the appointee is decreased and that there has been no waiver of any consideration, remuneration or other payment by the appointee.

Supply of services by or to the appointee

All supplies of services by associated companies comply with the objectives and principles of RAG 5.06. Transactions with associated companies are at arm's length, either through competitive tender or at cost, and cross-subsidy is not occurring.

Competitive Tender

Whenever a tender process is undertaken and could potentially involve an associated business, the following procedures are followed:

- The procurement team must be involved from an early stage to ensure that a proper tender process is carried out. Where required, this must follow EU procurement rules.
- The tender process must be fully documented. This is to ensure that it is auditable and that the details can be reported in the Annual Performance Report.
- Appropriate approval of the award of contract must be given, usually through a meeting of the Executive Team or the Board of Directors. Any director of the Water Company who is also a director of an associated company tendering must declare an interest, take no part in the discussions and have no vote in the matters discussed.
- Once the award of contract to an associated business is approved, all transactions must be in line with the contract. Any variations to the contract must be approved separately.
- All transactions under a contract with an associated company must be signed off by the appropriate manager to confirm that it is in line with the contract terms.

'At cost' contracts

If work is undertaken by an associated company where no competitive tender has been undertaken, then those transactions must be at cost as per RAG 5.04. The following guidelines are followed:

TRANSACTIONS BETWEEN THE APPOINTEE AND ASSOCIATED COMPANIES

- All 'at cost' contracts are approved by the Executive Team or the Board of Directors every 12 months. The approval should outline why the contract should continue at cost (for example, performance of the associate during the year, strategic reasons).
- All transactions under the 'at cost' contract must be signed off by the appropriate project manager.
- The cost allocation of the associated company must be fully auditable to show that it is 'at cost'. Sample audits are undertaken by the Group Internal Audit function.

Transactions between price controls

Since the 2014 Price Review, there are now separate binding price controls in place for wholesale, retail household and retail non-household services. Companies need to ensure that there is no cross subsidy between price control units.

The Company has followed the RAGs to ensure that costs are allocated between price controls correctly. The tables in section 2 of this APR and the accompanying cost allocation methodology statement have been reviewed externally by Deloitte to ensure that the Company is compliant with the RAGs.

In addition, there are additional requirements set out in Condition R of the Company's licence in relation to arm's length trading with related licensees operating in the retail business market. This information has to be updated and published each year on its website. The latest version can be found at the following link:

https://www.south-staffs-water.co.uk/media/1813/ssc-compliance-code-april-2017.pdf

TRANSACTIONS BETWEEN THE APPOINTEE AND ASSOCIATED COMPANIES

The following transactions occurred during the 12 months to March 2017**:**

Services supplied by associated companies to the appointee

Associate	Turnover of Associate £m	Service	Value £m	Terms of Supply
Onsite	51.453	Mainlaying and repair of water mains	7.458	Competitive tendering
		Mains Rehabilitation	2.690	Competitive tendering
		Minor Civils	0.552	Competitive tendering
		Metering	0.566	Competitive tendering
Integrated Water Services Limited	52.359	Mainlaying and repair of water mains	3.397	Competitive tendering
		Mains Rehabilitation	1.269	Competitive tendering
		Minor Civils	0.148	Competitive tendering
		Metering	0.338	Competitive tendering
		Water Treatment	0.561	Cost
		Pump Refurbishment	0.314	Cost
		Minor Capital Works	9.119	Competitive tendering
SSI services UK Limited	2.554	Motor vehicle repair and maintenance	0.636	Cost
Hydrosave	17.966	Leakage detection	0.276	Cost
Echo Managed Services Limited	29.055	Customer Services	6.400	Cost
		Billing Software	0.550	Cost
South Staffordshire Plc	nil	Management services	3.321	Cost
		Parent company services	1.844	Cost
SSWB	0.100	Management services	0.101	Cost

Services supplied by the appointee to associated companies

Associate	Turnover of Associate £m	Service	Value £m	Terms of Supply
Echo	29.055	Sewerage collections support	0.313	Cost
Echo	29.055	Site Services	0.165	Cost
Echo	29.055	Recharges for the use of appointed assets	0.068	Cost
SSI Services UK Limited	2.554	Recharges for the use of appointed assets	0.023	Cost
South Staffs Water Non appointed	4.057	Recharges for the use of appointed assets	0.005	Cost
South Staffordshire Plc	nil	Communications and media support	0.029	cost
South Staffs Water Non appointed	4.057	Management fees	0.055	Cost
Integrated Water Services Limited	51.453	Operational training	0.034	Cost

DATA ASSURANCE SUMMARY

As a monopoly provider of a vital service, we recognise the importance of high quality assurance and governance to ensure that our customers and other stakeholders can have trust and confidence in the information that we publish and the services we provide to the people in our areas of supply on a daily basis.

In 2015 Ofwat published its Company Monitoring Framework, setting out its expectations for how water companies should demonstrate strong assurance and governance, and how Ofwat, as the industry regulator, would monitor this.

We have since worked with our major stakeholders to understand any areas of risk within our assurance processes, and to develop a holistic assurance framework that we use to assess our assurance requirements. Since 2015 we have consulted with our stakeholders each year to identify those risks and to put in place a plan to address them. Our latest assurance plan, covering this annual performance report and also other important submissions to take place this financial year, can be found on our website at:

https://www.south-staffswater.co.uk/about-us/our-strategies-and-plans/our-assurance-framework

Assurance of this Annual Performance Report (APR)

The APR is split into four sections. We summarise below our overall principles of assurance for each of those sections.

Sections 1 and 2 – Regulatory financial reporting, price review and other segmental reporting

Data reported in sections 1 and 2 is produced consistent with the RAGs published in October 2016. Deloitte LLP, our statutory auditor, audits this section of the APR and their audit opinion is contained within this APR document.

Section 3 – Performance summary

This section of the APR sets out our performance against our outcomes and ODIs. We have used Monson Engineering Ltd, our external technical auditors, to audit our financially incentivised ODIs, reward and penalty calculations, asset health sub measures and SIM performance. A statement from Monson Engineering Ltd is provided on page X.

Our ODIs which are non-financial, and our AIM table, have been audited by the independent internal audit function of our parent company.

Section 4 – Additional regulatory information

There is a mix of tables and data within section 4 of the APR. Where data in these tables is the same as used in other areas of the APR (for example property numbers) then these data items are covered by the audits in sections 1, 2 and 3. For tables 4D and 4F, we have engaged Deloitte to undertake additional agreed upon procedures due to the importance of accurate cost allocation in the current regulatory regime. Within table 4H, we have engaged Jacobs UK Limited to review and audit our RORE calculation and they have concluded that the methodology used is consistent with Ofwat's guidance.

Targeted Areas from Assurance Plan

In our Assurance Plan, published in April 2017, we defined a number of targeted areas that required extra focus this year. The table on the following page identifies those targeted areas that are relevant to this APR and explains how we have addressed them.

DATA ASSURANCE SUMMARY

Targeted area	How we have improved
Appropriate disclosure of debt and dividends	Net debt is disclosed in line with the RAGs in table 1E where we have additionally provided a reconciliation between book debt and debt reported for covenant compliance. Dividends paid to the Company's holding company to enable them to pay intra-group loan interest has been fully disclosed. We included information on dividends in our summary APR, intended for customers and non-technical stakeholders, to increase transparency.
Ensuring that critical elements of our financial reporting are in line with Ofwat guidance	We have introduced additional internal procedures throughout the whole of the APR to ensure that our reporting is fully in line with Ofwat's guidance. In addition we have gained external assurance on our RORE calculation from Jacobs UK Limited.
Publication of more detail on our ODI assurance carried out by our technical assessor	We have included a statement from our external technical assessor, Monson Engineering, who assured our financially incentivised ODIs, on page 160, and a statement from our independent internal auditor, who assured our reputational ODIs, on page 161.
Further information on our parent group structure to be published and accessible to stakeholders	We have improved the presentation of our parent group structure in the statutory accounts section of this report, on pages 33 to 34. We have also now added our simple shareholder diagram to our summary APR document, published alongside this document and intended for customers and non-technical stakeholders, as well as to the 'about us' section of our website.
Examination of best practice for published remuneration and corporate governance information	We have included detailed information in a Remuneration Report for both the Board and the Executive Team starting on page 48. We also include information on group structure, Board membership and Board committees in our Corporate Governance section on pages 32 to 47.
Examination of best practice for our Board's risk and compliance statement	Following feedback received from Ofwat in its Company Monitoring Framework review in November 2016, we undertook an extensive review of how our Board's risk and compliance statement is presented and made significant improvements to ensure it is consistent with Ofwat guidance and principles.
Examination of best practice for reporting of tax affairs	The Company's tax strategy is included in our Accounting Disclosures on pages 140 to 142. We have also included additional commentary explaining our tax structure, calculation of our tax figures reported in this APR and any further explanatory factors that are necessary. We have also included more information on tax in our summary APR document, intended for customers and non-technical stakeholders.
New APR tables 3B, 3C and 3D	We have undertaken external assurance of table 3B (serviceability sub-indicators) and 3D (SIM), and we have undertaken internal assurance of table 3C (AIM). This is in line with our assurance risk assessment.

Customer Panel

Throughout the year we have provided quarterly updates to our Customer Panel on our ODI performance and year end forecasts. We have also sought the views of the panel on our summary version of our APR, which is a significantly shortened version containing key information for customers and other stakeholders who do not need to read the full version of this document. There were no material changes as a result of this engagement.

Our publications

As well as this full version of the APR, containing the full narrative and statutory and regulatory accounts, we have also implemented again this year a summary version of the APR targeted at customers. We feel this is important as this full document is not easily absorbed by customers or non-technical stakeholders. We have substantially improved our customer targeted publication this year with more focus on assurance, governance and inclusion of some key financial metrics, as well as maintaining our PR14 commitment to include an ODI scorecard and relevant performance information.

Board Governance

Our Board have had extensive involvement in the production, audit and publication of our APR including the summary version intended for customers and non-technical stakeholders.

The Audit Committee has overseen the external and internal assurance that has been undertaken on the APR, and all audit reports produced internally and externally have been made available to them and to the full Board for review and challenge.

The Board has also satisfied itself that we have implemented the improvements to the APR that we committed to in our assurance plan, shown in the table above.

With sight of all of the above audit information, the Board has signed off the APR submission as being an accurate set of information on our 2016/17 regulatory accounts and performance.

EXTERNAL ASSURANCE OF FINANCIAL ODIS

South Staffs and Cambridge Water 2016/ 2017

As an independent technical verifier, with over fifteen years' experience of working on behalf of water regulators, I was asked by South Staffs Water to check the methodologies, processes and data collection for their Outcome Delivery Incentives (ODIs), as agreed between the Company and Ofwat, for 2016/17.

My audits covered those ODIs where the penalty and/or reward incentive was financial and did not cover those which were reputational. Those ODIs I covered were for;

Mean Zonal Compliance
Acceptability of Water
Supply Interruptions
Service Incentive Mechanism
Leakage
Serviceability, both Infrastructure and Non-Infrastructure

In all cases I can confirm that the Company methodologies and processes complied with the guidance and where that guidance was open to interpretation then the Company had been consistent in its approach between this year and previous years which I consider to be acceptable.

I also checked the property and population data used in the calculation for many of the ODIs. As part of my audits I checked the confidence in the data under the reliability and accuracy confidence grade bands previously set by Ofwat. All my checks suggested that the confidence grade of the data presented was well within the acceptable range as set by Ofwat except for leakage in Cambridge Region which, whilst being acceptable, was close to the acceptability borderline.

The Company showed me their completed Table 3A which reports performance, penalties and rewards. I can confirm that the correct performance figures had been rolled forward from the previous year and that the correct calculation had been made for 2016/17. In this year there was a penalty for Leakage in the CAM Region and a reward for the low level of Interruptions to Supply.

Financial incentives for the Service Incentive Mechanism are relative to the industry so cannot be established until all the industry figures have been reported.

Mike Reid,
Director
on Behalf of Monson Engineering Ltd June 2017

INTERNAL INDEPENDENT ASSURANCE OF REPUTATIONAL ODIS

South Staffs and Cambridge Water 2016/17

As the South Staffordshire Group Internal Audit Manager (with over twenty-five years' experience of working within the Water Industry), Internal Audit was requested to perform an independent review of the reporting of reputational ODIs below:

- Water Efficiency
- Biodiversity
- Carbon Emission savings
- Support for Customers in Debt
- Community Engagement
- Customer Satisfaction
- Value for Money and Affordability

The audit work carried out sought to review the methodology supporting the calculations to ensure accuracy, consistency and validity of the numbers provided.

Internal Audit has confirmed that that the figures reported have been validated and checked to supporting information.

Glyn Palmer BA (Hons) FCA
Group Internal Audit Manager
July 2017

Independent Auditor's report to the Water Services Regulation Authority (the WSRA) and the Directors of South Staffordshire Water PLC

Opinion on Annual Performance Report

In our opinion, South Staffordshire Water PLC's Regulatory Accounting Statements within the Annual Performance Report:

- have been properly prepared in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA (RAG 1.07, RAG 2.06, RAG 3.09, RAG 4.06 and RAG 5.06) and the accounting policies (including the company's published accounting methodology statement as defined in RAG 3.09, Appendix 3) set out in note 1.

Emphasis of matter – basis of preparation

Without modifying our opinion on the Regulatory Accounting Statements within the Annual Performance Report, we draw attention to the fact that the Annual Performance Report has been prepared in accordance with Condition F, the Regulatory Accounting Guidelines, the accounting policies (including the company's published accounting methodology statement, as defined in RAG 3.09, Appendix 3) set out in the statement of accounting policies and under the historical cost convention. The nature, form and content of the Regulatory Accounting Statements are determined by the WSRA. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the WSRA's purposes. Accordingly we make no such assessment.

The Annual Performance Report is separate from the statutory financial statements of the Company and has not been prepared under the basis of United Kingdom Generally Accepted Accounting Practice ("UK GAAP"). Financial information other than that prepared on the basis of UK GAAP does not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in statutory financial statements prepared in accordance with the Companies Act 2006.

The Regulatory Accounting Statements on pages 104 to 121 have been drawn up in accordance with Regulatory Accounting Guidelines with a number of departures from UK GAAP. A summary of the effect of these departures from Generally Accepted Accounting

Practice in the Company's statutory financial statements is included in the tables within section 1.

What we have audited

The tables within South Staffordshire Water PLC's Annual Performance Report that we have audited ("the Regulatory Accounting Statements") comprise:

- the regulatory financial reporting tables comprising the income statement (table 1A), the statement of comprehensive income (table 1B), the statement of financial position (table 1C), the statement of cash flows (table 1D) and the net debt analysis (table 1E) and the related notes; and
- the regulatory price review and other segmental reporting tables comprising the segmental income statement (table 2A), the totex analysis for wholesale water (table 2B), the operating cost analysis for retail (table 2C), the historical cost analysis of fixed assets for wholesale and retail (table 2D), the analysis of capital contributions and land sales for wholesale (table 2E), the household revenues by customer type (table 2F), the non-household water revenues by customer type (table 2G), and the revenue analysis by customer type (table 2I) and the related notes.

The financial reporting framework that has been applied in their preparation comprises Condition F, the Regulatory Accounting Guidelines issued by the WSRA and the accounting policies (including the accounting separation methodology) set out in note 1 to the Annual Performance Report.

In applying the financial reporting framework, the directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

We have not audited the Outcome performance tables (tables 3A to 3D) and the additional regulatory information in tables 4A to 4I.

This report is made, on terms that have been agreed, solely to the Company and the WSRA in order to meet the requirements of Condition F of the Instrument of Appointment granted by the Secretary of State for the Environment to the Company as a water and sewage undertaker under the Water Industry Act 1991 ("Condition F"). Our audit work has been undertaken so that we might state to the Company and the WSRA those matters that we have agreed to state to them in our report, in order (a) to assist the Company to meet its obligation under Condition F to procure such a report and (b) to facilitate the carrying out by the WSRA of its regulatory functions, 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 WRSA, for our audit work, for this report or for the opinions we have formed.

Respective responsibilities of the WSRA, the Directors and Auditors

As explained more fully in the Statement of Directors' Responsibilities set out on page 145, the directors are responsible for the preparation of the Annual Performance Report in accordance with Condition F, the Regulatory Accounting Guidelines issued by the Regulator and the Company's accounting policies (including the accounting separation methodology).

Our responsibility is to audit and express an opinion on the Regulatory Accounting Statements within the Annual Performance Report in accordance with International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)"), except as stated in the section on 'What an audit of the Annual Performance report involves' below, and having regard to the guidance contained in ICAEW Technical Release Tech 02/16 AAF 'Reporting to Regulators on Regulatory Accounts' issued by the Institute of Chartered Accountants in England & Wales. Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

What an audit of the Annual Performance Report involves

An audit involves obtaining evidence about the amounts and disclosures in the Regulatory Accounting Statements sufficient to give reasonable assurance that the Regulatory Accounting Statements within the Annual Performance Report are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; and the reasonableness of significant accounting estimates made by the directors. In addition, we read all the financial and non-financial information in the Annual Performance Report to identify material inconsistencies with the audited tables within the Annual Performance Report and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

We have not assessed whether the accounting policies are appropriate to the circumstances of the Company where these are laid down by Condition F. Where Condition F does not give specific guidance on the accounting policies to be followed, our audit includes an assessment of whether the accounting policies adopted in respect of the transactions and balances required to be included in the Annual Performance Report are consistent with those used in the preparation of the statutory financial statements of the company. Furthermore, as the nature, form and content of Annual Performance Report is determined by the WSRA, we did not evaluate the overall adequacy of the presentation of the information, which would have been required if we were to express an audit opinion under International Standards on Auditing (UK & Ireland).

The Company has presented the allocation of operating costs and assets in accordance with the accounting separation policy set out in note 1 and its Accounting Methodology Statement published on the Company's website on 14 July 2017. We are not required to assess whether the methods of cost allocation set out in the Methodology Statement are appropriate to the circumstances of the Company or whether they meet the requirements of the WSRA, which would have been required if we were to express an audit opinion under International Standards on Auditing (UK & Ireland).

Opinion on other matters prescribed by Condition F

Under the terms of our contract we have assumed responsibility to provide those additional opinions required by Condition F in relation to the accounting records. In our opinion:

- proper accounting records have been kept by the appointee as required by paragraph 3 of Condition F; and

- the Regulatory Accounting Statements are in agreement with the accounting records and returns retained for the purpose of preparing the Annual Performance Report.

Other matters

The nature, form and content of the Annual Performance Report is determined by the WSRA. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the WRSA's purposes. Accordingly we make no such assessment.

Our opinion on the Regulatory Accounting Statements within the Annual Performance Report is separate from our opinion on the statutory financial statements of the Company for the year ended 31 March 2017 on which we reported on 14 July 2017, which are prepared for a different purpose. Our audit report in relation to the statutory financial statements of the Company (our "Statutory audit") was made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our Statutory audit work was undertaken so that we might state to the Company's members those matters we are required to state to them in a statutory audit report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume responsibility for any other purpose or to any other person to whom our Statutory audit report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Deloitte LLP

Deloitte LLP
Statutory Auditors
London, United Kingdom
14 July 2017