Financial statements

Contents

Income statement

For the year ended 31 March 2021

	Note	2021 £m	2020 £m
Continuing operations			
Revenue	5	784.2	878.0
Amortisation of regulatory settlement	5	35.6	–
Total revenue		819.8	878.0
Other operating income	5	1.7	1.4
Operating costs before charge for bad and doubtful debts, depreciation and amortisation		(360.0)	(373.5)
Charge for bad and doubtful debts		(34.8)	(29.6)
Operating costs before depreciation and amortisation		(394.8)	(403.1)
Depreciation and amortisation	6	(287.9)	(264.0)
Total operating costs		(682.7)	(667.1)
Operating profit	6	138.8	212.3
Operating profit before regulatory settlement		103.2	212.3
Amortisation of regulatory settlement		35.6	–
Operating profit		138.8	212.3
Profit on disposal of fixed assets	6	0.8	0.9
Finance income	9	110.1	41.6
Finance costs	9	(161.7)	(160.8)
Fair value (losses)/gains on derivative financial instruments	9	(444.8)	339.9
Net finance (costs)/income	9	(496.4)	220.7
(Loss)/profit before taxation		(356.8)	433.9
Taxation	10	64.8	(105.2)
(Loss)/profit for the financial year		(292.0)	328.7

The notes on pages 227 to 265 form part of these financial statements.

Statement of other comprehensive income

For the year ended 31 March 2021

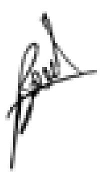
	Note	2021 £m	2020 £m
(Loss)/profit for the year		(292.0)	328.7
Other comprehensive (expense)/income:			
Items that cannot be reclassified to profit or loss:			
Actuarial (loss)/gain on pension scheme	24	(70.0)	111.7
Movement on deferred tax relating to retirement benefit obligations	23	13.3	(17.5)
Total other comprehensive (expense)/income for the year, net of tax		(56.7)	94.2
Total comprehensive (expense)/income for the year attributable to the owner of the company		(348.7)	422.9

Statement of financial position

As at 31 March 2021

	Note	2021 £m	2020 £m
Non-current assets			
Intangible assets	12	189.7	42.1
Property, plant and equipment	13	6,445.0	6,325.7
Investments	14	29.2	29.2
Derivative financial instruments	22	68.2	194.3
Other non-current assets	15	130.0	130.0
		6,862.1	6,721.3
Current assets			
Inventories	16	6.3	5.1
Trade and other receivables	17	214.2	273.2
Cash and cash equivalents	32	339.5	129.3
		560.0	407.6
Total assets		7,422.1	7,128.9
Current liabilities			
Trade and other payables	18	(289.5)	(260.8)
Borrowings	19	(34.3)	(713.8)
Lease liabilities	21	(2.5)	(2.2)
Regulatory settlement liability	25	(24.2)	(35.6)
Provision for liabilities	26	(3.9)	(5.1)
		(354.4)	(1,017.5)
Non-current liabilities			
Borrowings	20	(3,993.7)	(2,884.8)
Lease liabilities	21	(27.2)	(28.2)
Derivative financial instruments	22	(1,500.6)	(1,376.4)
Deferred tax liabilities	23	(289.7)	(368.7)
Retirement benefit obligations	24	(116.5)	(62.5)
Regulatory settlement liability	25	(75.6)	(99.9)
Provision for liabilities	26	(4.3)	(4.7)
Other non-current liabilities	27	(159.3)	(32.7)
		(6,166.9)	(4,857.9)
Total liabilities		(6,521.3)	(5,875.4)
Net assets		900.8	1,253.5
Equity			
Called up share capital	28	0.1	0.1
Share premium account	29	46.3	46.3
Non-distributable reserve	30	76.9	60.2
Retained earnings	31	777.5	1,146.9
Total equity		900.8	1,253.5

The financial statements of Southern Water Services Limited (Registered no. 02366670) on pages 220 to 265 were approved by the Board and authorised for issue on 30 June 2021. They were signed on its behalf by:



Sebastiaan Boelen
Chief Financial Officer

Statement of changes in equity

For the year ended 31 March 2021

	Called up share capital (note 28) £m	Share premium account (note 29) £m	Non-distributable reserve (note 30) £m	Retained earnings (note 31) £m	Total £m
Balance at 1 April 2019	0.1	46.3	53.8	737.5	837.7
Profit for the financial year	–	–	7.8	320.9	328.7
Other comprehensive income/(expense) for the year:					
Actuarial gain on pension scheme	–	–	–	111.7	111.7
Movement on deferred tax relating to retirement benefit obligations	–	–	–	(17.5)	(17.5)
Total comprehensive income for the year	–	–	7.8	415.1	422.9
Reserves transfer*	–	–	(1.4)	1.4	–
Equity dividends paid (note 11)	–	–	–	(7.1)	(7.1)
Balance at 31 March 2020	0.1	46.3	60.2	1,146.9	1,253.5
Profit/(loss) for the financial year			18.2	(310.2)	(292.0)
Other comprehensive income/(expense) for the year:					
Actuarial loss on pension scheme	–	–	–	(70.0)	(70.0)
Movement on deferred tax relating to retirement benefit obligations	–	–	–	13.3	13.3
Total comprehensive income/(expense) for the year	–	–	18.2	(366.9)	(348.7)
Reserves transfer*	–	–	(1.5)	1.5	–
Equity dividends paid (note 11)	–	–	–	(4.0)	(4.0)
Balance at 31 March 2021	0.1	46.3	76.9	777.5	900.8

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

Statement of cash flows

For the year ended 31 March 2021

	Note	2021 £m	2020 £m
Cash from operations	32	388.2	478.3
Tax paid		(0.9)	(1.7)
Net cash from operating activities		387.3	476.6
Investing activities			
Interest received		106.6	38.5
Purchase of property, plant and equipment		(344.8)	(461.6)
Purchase of intangible assets		(36.9)	(11.8)
Proceeds on disposal of property, plant and equipment		0.5	0.5
Repayments of inter-company loan receivables		39.4	54.4
Net cash used in investing activities		(235.2)	(380.0)
Financing activities			
Equity dividends paid		(4.0)	(7.1)
Interest paid		(152.6)	(258.9)
Preference share dividends		–	(9.0)
Repayment of borrowings		(696.2)	(417.8)
Repayments of principle on leases		(1.8)	(1.5)
Advances on restructure of derivative instruments		–	140.0
Payments on derivative instruments		(194.5)	–
Proceeds of new loans		1,107.2	215.0
Net cash generated from/(used) in financing activities		58.1	(339.3)
Net increase/(decrease) in cash and cash equivalents		210.2	(242.7)
Cash and cash equivalents at beginning of the year		129.3	372.0
Cash and cash equivalents at end of the year		339.5	129.3

Notes to the financial statements

For the year ended 31 March 2021

1 Accounting policies

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

Basis of preparation

Southern Water Services Limited is a company incorporated in the United Kingdom under the Companies Act 2006. The company is a private company limited by shares and is registered in England and Wales. The address of the registered office is given on page 1. The nature of the company's operations and its principal activities are set out in the Strategic Report on pages 22 to 100.

These financial statements have been prepared in accordance with FRS 101, incorporating the Amendments to FRS 101 issued by the FRC in July 2015 and the amendments to Company law made by The Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015.

The financial statements have been prepared on a going concern basis under the historical cost convention, as modified by the revaluation of financial assets and financial liabilities (including derivative instruments and retirement benefit obligations) at fair value through profit and loss or other comprehensive income.

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

Fair value is the price that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or estimated using another valuation technique. In estimating the fair value of an asset or a liability, the company takes into account the characteristics of the asset or liability as if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Fair value for measurement purposes in these financial statements is determined on such a basis, except leasing transactions that are within the scope of IFRS 16 'Leases', and measurements that have some similarities to fair value but are not fair value, such as net realisable value in IAS 2 'Inventories' or value in use in IAS 36 'Impairment of Assets'.

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

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

The financial statements contain information about Southern Water Services Limited (SWS) as an individual company and do not contain consolidated financial information as the parent of subsidiary companies. The company is exempt under Section 401 of the Companies Act 2006 from the requirement to prepare consolidated financial statements as it and its subsidiary undertaking are included by full consolidation in the consolidated financial statements of the ultimate holding company, Greensands Holdings Limited. The group financial statements of Greensands Holdings Limited are available to the public and can be obtained at **southernwater.co.uk/greensands-ownership-of-southern-water.**

As permitted by FRS 101, the company has taken advantage of the disclosure exemptions available under that standard in relation to standards not yet effective, financial instruments, fair value measurement, revenue from contracts with customers, leases, presentation of a statement of financial position as at the beginning of the preceding period following a retrospective accounting policy application or restatement, capital management, related party disclosures and impairment of assets. Where required, equivalent disclosures are given in the group financial statements of Greensands Holdings Limited.

The company has elected not to take advantage of the exemption regarding the requirements of IAS 7 'Statement of Cash Flows' in order to align with regulatory reporting requirements and provide additional transparency for users of the financial statements.

Adoption of new and revised accounting and financial reporting standards

There have been no new or revised accounting standards adopted in the current year that had a significant or material impact on the financial statements.

Notes to the financial statements continued

For the year ended 31 March 2021

1 Accounting policies continued

Going concern

The company's business activities, together with the factors likely to affect its future development and position, are set out in the Strategic Report pages 22 to 100.

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

On the basis of their assessment of the company's financial position, the directors have a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future, being a period of at least 12 months from the approval of these financial statements. For this reason, they continue to adopt the going concern basis of accounting in preparing the annual financial statements; further details can be found in the Directors' Report on page 217.

In addition and in accordance with provision C.2.2 of the UK Code and Ofwat's Information Notice IN 19/07, the Board has assessed the prospects of the business over a longer period than the 12 months required by the 'Going Concern' provision.

The Board has selected to conduct this review for the period to March 2030 and full details of the assessment and the viability statement are set out within the Strategic Report on page 140.

Segmental reporting

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

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

Revenue recognition

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

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

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

Revenue is recognised when the amount of revenue can be measured reliably, the performance obligation has been satisfied, and it is probable that the economic benefits associated with the transaction will flow to the company. Revenue is not recognised when it is considered probable that economic benefits will not be received. In these circumstances, revenue is only recognised when collectability is reasonably certain. Payments received in advance of revenue recognition are recorded as deferred income.

Water and wastewater services

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

For provisioning purposes, revenues and outstanding arrears are segmented based on customer characteristics. Since the company is under a statutory obligation to provide water and wastewater services to its domestic properties, these services could be provided to customers who are unlikely to pay. Should a group of customers attract a provision rate of 100%, i.e. assessed as not generating economic benefit, revenue would not be recognised. In 2019–20, no segment of customers met this criteria and so revenue relating to the provision of water and wastewater services has been recognised in full.

Unmetered income is based on either the rateable value of the property or on an assessed volume of water supplied. Metered income is based on actual or estimated water consumption. Customer rebates are shown as a reduction in revenue.

New connections and infrastructure charges

Under IFRS 15, the performance obligation is satisfied at the point of provision of the new connection to the network, so fees received in respect of the connection are recognised at this point.

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

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

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

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

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

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

Taxation
Taxation in the income statement represents the sum of the tax currently payable and deferred tax.

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

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

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

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

Intangible assets
Intangible assets comprises:

i. Assets in development.

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

iii. Future right to draw water from Portsmouth Water through the Havant Thicket reservoir scheme.

Intangible assets are measured at cost less subsequent amortisation and any impairment. Amortisation of intangible assets is calculated on a straight-line basis over the estimated useful lives, which are primarily three to 10 years*. The estimated useful life and amortisation method are reviewed at the end of each reporting period, with the effect of any changes in estimate being accounted for on a prospective basis.

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

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

* Amortisation of the Havant Thicket reservoir scheme will be over the period to 2100 and will commence on the earliest of 1 April 2029, the date Southern Water is entitled to receive water, and completion of construction.

Notes to the financial statements continued

For the year ended 31 March 2021

1 Accounting policies continued

Property, plant and equipment

Property, plant and equipment comprises:

i. Freehold land and buildings – comprising land and non-operational buildings.

ii. Plant and machinery – comprising structures at sites used for water and wastewater treatment; pumping or storage, where not classed as infrastructure, along with associated fixed plant.

iii. Infrastructure assets – comprising a network of systems consisting of mains and sewers, impounding and pumped raw water storage reservoirs, sludge pipelines and sea outfalls.

iv. Assets under construction.

v. Other assets – comprising vehicles, computers, mobile plant and meters.

All property, plant and equipment is stated in the statement of financial position at cost or at deemed cost on transition to FRS 101, less any subsequent accumulated depreciation and subsequent accumulated impairment losses.

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

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

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

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

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

Subsequent costs are included in the asset's carrying amount or recognised as separate assets, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the company and the cost of the item can be measured reliably. All other repairs and maintenance costs are charged to the income statement as incurred.

Assets are depreciated on a straight-line basis over their estimated operating lives, which are principally as follows:

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

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

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

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

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

Impairment of tangible and intangible assets

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

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

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

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

Grants and contributions

Grants and contributions received are treated as either revenue or deferred income in line with IFRS 15 as defined by the nature of the receipt.

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

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

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

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

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

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

Leases

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

The company as lessee

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

Notes to the financial statements continued

For the year ended 31 March 2021

1 Accounting policies continued

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

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

The lease liability is presented as a separate line in the statement of financial position.

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

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

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

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

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

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

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

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

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

The company as lessor

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

Non-current asset investments

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

Cash and cash equivalents

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

Inventories

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

Deferred revenue

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

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

Provisions

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

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

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

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

Retirement benefits

SWS operated a defined benefit pension scheme, which closed on 31 March 2020, the assets of which are held separately from those of the company in independently administered funds. An independent actuary conducts a valuation of this pension scheme every three years.

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

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

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

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

Notes to the financial statements continued

For the year ended 31 March 2021

1 Accounting policies continued

Financial instruments

IFRS 9 contains requirements for 1) the classification and measurement of financial assets and financial liabilities, 2) impairment for financial assets and 3) general hedge accounting.

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

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

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

Financial assets

(i) Loans receivable

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

(ii) Trade receivables and accrued income

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

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

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

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

Impairment of financial assets

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

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

Derecognition of financial assets

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

Financial liabilities

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

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

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

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

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

Derecognition of financial liabilities

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

Derivative financial instruments

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

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

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

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

Embedded derivatives

In accordance with IFRS 9, the company has reviewed all contracts for embedded derivatives that are required to be separately accounted for if they do not meet certain requirements set out in the standard.

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

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

The company did not have any embedded derivatives that were required to be separately accounted for in the current or previous years.

Notes to the financial statements continued

For the year ended 31 March 2021

2 Critical accounting judgments and key sources of estimation uncertainty

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

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

Judgments

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

Amortisation of regulatory settlement

In 2018–19, an accrual of £135.5 million was recognised for rebates to be made to customers through bills, over the period from 2020 to 2025, as part of a regulatory settlement agreed with Ofwat following its investigation into wastewater treatment compliance, as noted on page 30.

There is no clear accounting standard guidance for the income statement treatment of this regulatory settlement. It was considered whether the settlement should be recognised as an expense; however, given that this is an agreed reduction in customer bills in the future, with a requirement to show this separately on invoicing as required by Ofwat, the most appropriate treatment was concluded to be to treat the invoice reductions as a reduction in revenue in 2018–19. These rebates are now being made and recorded through revenue, and the accrual made in 2018–19 is being unwound on the face of the income statement, also through revenue, in line with the annual profile of the rebates to be made.

Provisions and contingent liabilities

The company evaluates its exposures to contingent liabilities relating to pending litigation or other outstanding claims subject to negotiated settlement, mediation, arbitration or government regulation. A provision is made when it is judged that it is probable that an obligation exists for which a reliable estimate can be made. Individual matters are considered carefully to assess the likelihood that a pending claim will succeed, or a liability will arise, and the point of recognition for the associated liability.

Matters that either are possible obligations or do not meet the recognition criteria for a provision are disclosed as contingent liabilities in note 33, unless the possibility of transferring economic benefits is remote.

Property, plant and equipment

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

Key sources of estimation uncertainty

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

Provisions

Provisions determined may change in the future due to new developments and as additional information becomes available. Reflecting the inherent uncertainty in this evaluation process, actual costs may be different from the estimated provision. Details of provisions are disclosed in note 26 and the value provided at 31 March 2021 was £8.2 million (2020: £9.8 million). Accordingly, if the amount provided was 50% under or over estimated, then the provision would change by £4.1 million (2020: £4.9 million).

Measured income accrual

The measured income accrual is an estimation of the amount of water and wastewater unbilled at the period end. The accrual is estimated using a defined methodology based upon historical billing and consumption information and the applicable tariff. The calculation is sensitive to estimated consumption for measured customers. Actual consumption may differ from the estimate made, which could impact future operating results positively or negatively. Given the nature of the balance it is not practical to assess how this estimate will change in the next 12 months.

Our sensitivity analysis suggests that the measured accrual would vary by £1.8 million and £5.5 million if consumption estimates were between 1% and 3% above or below those predicted.

Measured accrual sensitivity analysis	31 March 2021				Sensitivity
		1%	3%	–1%	–3%
Measured accrual balance (£m)	214.5	1.8	5.5	–1.8	–5.5

The value of household billings raised in the year ended 31 March 2021 for consumption in prior years was £245.4 million. The value of these billings was lower than the accrual made at 31 March 2020. The estimation difference was £2.2 million and this has been recognised in the current year's turnover. This difference is well within our view of acceptable tolerances for accounting estimates.

Impairment of trade receivables

The impairment of trade receivables at each reporting date is calculated by segmenting customer debt based on historic debt collection and payment performance, demographic information and the age of debt outstanding. In general for each segment, forecast cash collection rates are estimated using this range of data and other macroeconomic assumptions, which then determines a corresponding provision percentage. This assessment generates an expectation for the level of recovery of the outstanding receivables balance and therefore the lifetime expected credit loss.

The model considers current and forward looking macroeconomic events to the extent that the past response of customers to changes in the economy is built into the expected future cash collection performance for each customer segment. For the year to 31 March 2021, this includes a reflection of the impact of the COVID-19 pandemic to date. Our underlying charge to the income statement on this basis was £26.2 million.

To reflect the continuing significant impact that the COVID-19 pandemic is having on the macroeconomic environment, we have recognised an additional charge of £8.6 million, for the impairment of trade receivables, to the income statement in 2020–21. This is a significant judgment as the overall impact that the pandemic will have on the economy is continuing to evolve.

The value of the provision for doubtful debts as at 31 March 2021 was £253.9 million (2020: £216.4 million). The actual level of receivables collected may differ from the estimated levels of recovery, which could impact future operating results positively or negatively.

Our sensitivity analysis suggests that the impairment provision would vary by £2.3 million and £7.1 million if cash collections estimates were between 1% and 3% above or below those predicted.

Impairment provision sensitivity analysis	31 March 2021				Sensitivity
		1%	3%	–1%	–3%
Impairment provision estimate (£m)	253.9	2.3	7.1	–2.3	–7.1

Retirement benefit obligations

The company operates a defined benefit scheme as well as a defined contribution scheme. Under IAS 19 'Employee Benefits', the company has recognised an actuarial loss of £70.0 million (2020: gain of £111.7 million).

The pension cost and liabilities under IAS 19 are assessed in accordance with directors' best estimates, using the advice of an independent, qualified actuary and assumptions in the latest actuarial valuation. The assumptions are based on member data supplied to the actuary and market observations for interest rates and inflation, supplemented by discussions between the actuary and management. The mortality assumption uses a scheme-specific calculation based on the CMI 2020 model with a smoothing factor of 7.5 and a 1.25% p.a. allowance for future longevity improvement.

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

3 Changes in significant accounting policies

A number of new standards and amendments are effective for periods beginning from 1 January 2020. These changes had no material impact on the company's financial statements.

4 Segmental analysis

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

Notes to the financial statements continued

For the year ended 31 March 2021

5 Income

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

	2021 £m	2020 £m
Water and sewerage services:		
Household – measured	511.4	544.3
Household – unmeasured	110.6	130.7
Non-household – measured	100.3	140.4
Non-household – unmeasured	4.0	5.1
Total water and sewerage services	726.3	820.5
Bulk supplies	4.5	3.9
Infrastructure charge receipts	5.3	9.7
Trade effluent	7.5	11.2
Cesspools	5.2	5.7
New connections	4.0	4.3
Adoptions (see note (a) below)	18.2	7.8
Other services	13.2	14.9
Total revenue before amortisation of regulatory settlement	784.2	878.0
Amortisation of regulatory settlement (see note (b) below)	35.6	–
Total revenue	819.8	878.0
Other operating income (see note (c) below)	1.7	1.4
Profit on disposal of fixed assets	0.8	0.9
Interest receivable (note 9)	100.6	32.8
Interest revenue from Southern Water Services Group Limited	9.5	8.8
Total income	932.4	921.9

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

(b) As reported on page 30, the company co-operated with Ofwat in relation to its investigation into the management, operation and performance of our wastewater treatment works.

To ensure that our customers are not disadvantaged as a result of these matters, the company has agreed to make direct customer rebates totalling £135.5 million in forecast outturn prices (£122.9 million in 2017–18 prices) over the period 2020–25. This reflects the seriousness of the breaches identified in the investigation. These rebates are now being made and recorded through the water and sewerage services revenue shown above. The provision for these rebates made in the financial statements for 2018–19 is also being released through revenue in line with the annual profile of the rebates to be made.

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

6 Profit for the year

Profit for the year has been arrived at after charging/(crediting):	2021 £m	2020 £m
Depreciation on:		
– Owned assets	270.8	247.2
– Leased assets	3.4	3.7
	274.2	250.9
Included within *Operating costs:* Depreciation and amortisation in the income statement:		
Amortisation of intangible assets	13.7	13.1
Profit on disposal of fixed assets	0.8	0.9
Research and development expenditure	0.6	0.5
Rentals under operating leases (see note (a) below):		
— Properties	0.1	0.2
— Vehicles	1.7	1.1
Employee costs (note 7)	67.6	78.6
Amortisation of grants and contributions (see note 27)	(1.4)	(1.2)
Fees payable to the company's auditor in respect of:		
— Statutory audit of the company's financial statements	0.5	0.5
— Other services pursuant to legislation (see note (b) below)	0.1	0.1
— All other services	0.1	0.1

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

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

Notes to the financial statements continued

For the year ended 31 March 2021

7 Employee information

	2021 £m	2020 £m
(a) Employee costs (including directors' emoluments):		
Wages and salaries	101.3	105.2
Social security costs	10.9	11.3
Pension costs – Defined contribution	7.7	4.9
– Defined benefit	0.2	7.7
Total employee costs	120.1	129.1
Less: charged as capital expenditure	(52.5)	(50.5)
Charged to the income statement	67.6	78.6

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

(b) Average number of persons employed by activity

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

	2021 Number	2020 Number
Operations	1,176	1,169
Customer services	37	98
Corporate centre	925	937
	2,138	2,204

8 Directors' emoluments

	2021 £000	2020 £000
Aggregate emoluments (including benefits in kind)	2,428	2,317

No retirement benefits accrued to directors (2020: nil) under a Southern Water Services Limited defined benefit scheme. Retirement benefits of £14,833 accrued to directors (2020: £31,075) under a Southern Water Services Limited defined contribution scheme.

Further details can be found in the Directors' remuneration report on pages 194 to 211.

Details of emoluments and benefits for the highest paid director:

	2021 £000	2020 £000
Highest paid director's aggregate emoluments and benefits	1,082	1,069

During the year, the company made contributions of £4,000 (2020: £10,000) to a money purchase pension scheme in respect of the highest paid director's qualifying services.

9 Net finance income/(costs)

	2021 £m	2020 £m
Finance income		
Interest receivable on swap instruments	98.7	31.9
Interest revenue from Southern Water Services Group Limited	9.5	8.8
Deposit income on short-term bank deposits	1.9	0.9
	110.1	41.6
Finance costs		
Interest payable on bank loans	(1.3)	(3.0)
Interest payable on other loans	(2.1)	(7.5)
Interest paid to Southern Water Services (Finance) Ltd	(168.0)	(146.0)
Indexation	(20.5)	(29.3)
Amortisation of issue costs	(1.5)	(1.5)
Amortisation of gilt lock proceeds	0.1	0.1
Amortisation of deferred credits	4.7	4.8
Amortisation of bond premium	0.7	0.7
Interest on lease liabilities	(0.5)	(1.2)
Other finance expense (note 24)	(1.3)	(4.2)
Dividends on preference shares – see note (a) and (b) below	(4.9)	(6.5)
	(194.6)	(193.6)
Amounts capitalised on qualifying assets	32.9	32.8
	(161.7)	(160.8)
Fair value (losses)/gains on derivative financial instruments		
Derivative financial instruments not designated as hedges (note 22)	(444.8)	339.9
Net finance (costs)/income	(496.4)	220.7

The interest revenue from Southern Water Services Group Limited relates to the long-term loan disclosed in note 15.

Borrowing costs included in the cost of qualifying assets during the year arose on the general borrowing pool and are calculated by applying a capitalisation rate of 4.10% to expenditure on such assets (2020: 3.96%).

Dividends on preference shares

(a) Dividends due to Class B preference shareholders of £70 per share totalled £4.9 million (2020: £6.2 million). Of this amount £nil was paid during the year (2020: £3.8 million) with £4.9 million accrued at 31 March 2021 (2020: £2.4 million). The cumulative balance sheet liability for unpaid preference share dividends at 31 March 2021 was £7.3 million (2020: £2.4 million).

(b) The Class A1 and Class A2 preference shares were fully redeemed in the year to 31 March 2020, therefore no dividends were payable on these classes in the year to 31 March 2021 (2020: A1 £0.1 million and A2 £0.2 million).

Notes to the financial statements continued

For the year ended 31 March 2021

10 Taxation

	2021 £m	2020 £m
Current tax:		
Current year	0.9	1.7
Total current tax charge	0.9	1.7
Deferred tax:		
Origination and reversal of timing differences	(65.7)	64.0
Adjustment in respect of prior years	–	(0.8)
Effect of corporation tax rate change	–	40.3
Total deferred tax charge/(credit)	(65.7)	103.5
Total tax charge/(credit) on profit/(loss)	(64.8)	105.2

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

	2021 £m	2020 £m
Profit/(loss) before tax	(356.8)	433.9
Tax at the UK corporation tax rate of 19% (2020: 19%)	(67.8)	82.4
Permanent differences	3.0	2.2
Group relief received for nil payment	–	(11.4)
Differences between current and deferred tax rates	–	(7.5)
Impact of tax rate changes	–	40.3
Adjustment in respect of prior years:		
Deferred tax	–	(0.8)
Total tax charge/(credit) for year	(64.8)	105.2

Factors that may affect future tax charges:

In the March 2021 Budget it was announced that legislation will be introduced in Finance Bill 2021 to increase the main rate of UK corporation tax from 19% to 25%, effective 1 April 2023. As substantive enactment is after the balance sheet date, deferred tax balances as at 31 March 2021 continue to be measured at a rate of 19%. If the amended tax rate had been used, the deferred tax liability would have been £91.7m higher.

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

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

	2021 £m	2020 £m
Deferred tax		
Arising on income and expenses recognised in other comprehensive income:		
Tax charge/(credit) relating to retirement benefit obligations	(13.3)	19.0
Deferred tax movement due to rate change	–	(1.5)
Total deferred tax charge/(credit) recognised in other comprehensive income/(expense)	(13.3)	17.5

11 Dividends

	2021 £m	2020 £m
Dividends available for distribution to investors in the ultimate parent company:		
Current year interim dividend	–	–
	–	–
Dividends not available for distribution to investors in the ultimate parent company:		
Current year interim dividend of £37.95 per share	2.1	–
Current year interim dividend of £32.92 per share	1.9	–
Current year interim dividend of £126.64 per share	–	7.1
	4.0	7.1

The interim dividends of £4.0 million are paid to Southern Water Services Group Limited (SWSG). These dividends, along with associated group tax relief of £0.9 million, enable SWSG to pay £4.9 million of the interest of £9.5 million due to Southern Water Services Limited on an inter-company loan as disclosed in note 14. These transactions are illustrated in the diagram on page 117 of the Annual Report.

No additional interim or final dividend has been declared for the year ended 31 March 2021 (2020: interim additional – £nil, final – £nil).

12 Intangible assets

	Externally generated		
	Assets in development £m	Other £m	Total £m
Cost			
At 1 April 2020	18.4	119.3	137.7
Additions	161.3	–	161.3
Transfers	(25.8)	25.8	–
At 31 March 2021	153.9	145.1	299.0
Amortisation			
At 1 April 2020	–	95.6	95.6
Charge for the year	–	13.7	13.7
At 31 March 2021	–	109.3	109.3
Net book amount			
At 31 March 2021	153.9	35.8	189.7
At 31 March 2020	18.4	23.7	42.1

The company does not currently have any internally-generated intangible assets.

Included within additions above is £1.0 million of interest that has been capitalised on qualifying assets in accordance with IAS 23 ‘Borrowing Costs’. The cumulative net book value of the borrowing costs capitalised amount to £1.6 million (2020: £1.5 million).

Additions in the year also includes £131.1 million relating to the right to draw water from the capacity of Portsmouth Water Limited under a bulk supply agreement. A liability relating to the contractual obligation to make future payments to Portsmouth Water Limited in return for this right has also been recognised in other long-term liabilities. The right to draw water commences on 1 April 2029 and any water received will be subject to a volumetric charge and expensed at that time.

Other intangible assets include software, studies and development projects.

Notes to the financial statements continued

For the year ended 31 March 2021

13 Property, plant and equipment

	Land and buildings £m	Plant and machinery £m	Infra-structure assets £m	Assets under construction £m	Other £m	Total £m
Cost						
At 1 April 2020	1,570.9	3,369.4	2,780.1	922.9	647.9	9,291.2
Additions	–	–	–	393.5	–	393.5
Transfers	26.5	323.7	108.3	(534.2)	75.7	–
Disposals	–	(9.0)	(0.5)	–	(9.0)	(18.5)
At 31 March 2021	1,597.4	3,684.1	2,887.9	782.2	714.6	9,666.2
Depreciation						
At 1 April 2020	803.3	1,510.9	176.0	–	475.3	2,965.5
Charge for the year	41.8	144.4	33.2	–	54.8	274.2
Disposals	–	(9.0)	(0.5)	–	(9.0)	(18.5)
At 31 March 2021	845.1	1,646.3	208.7	–	521.1	3,221.2
Net book amount						
At 31 March 2021	**752.3**	**2,037.8**	**2,679.2**	**782.2**	**193.5**	**6,445.0**
At 31 March 2020	767.6	1,858.5	2,604.1	922.9	172.6	6,325.7

Freehold land is stated at a cost of £51.7 million at 31 March 2021 and 31 March 2020 and is not depreciated.

The company's interests in land and buildings are almost entirely freehold.

Included within additions above is £31.9 million (2020: £32.3 million) of interest that has been capitalised on qualifying assets in accordance with IAS 23 'Borrowing costs'. The cumulative net book value of the borrowing costs capitalised amount to £239.2 million (2020: £216.9 million).

Leased assets

Right-of-use assets included in the table above are as follows:

	Land and buildings £m	Infra-structure assets £m	Other £m	Total £m
Net book amount at 31 March 2020	28.9	–	3.5	32.4
Additions	–	–	1.1	1.1
Transfers	(11.7)	11.7	–	–
Depreciation charge for the year	(1.4)	(0.3)	(1.6)	(3.3)
Net book amount at 31 March 2021	**15.8**	**11.4**	**3.0**	**30.1**

14 Investments

Shares in subsidiary Southern Water Services (Finance) Limited	2021 £m	2020 £m
At the beginning and end of the year	**29.2**	29.2

The company has the following direct investments in subsidiary undertakings at 31 March 2021:

	Registered Office	Class of share capital	Activity
Southern Water Services (Finance) Ltd (SWSF)	Ugland House, PO Box 309, George Town, Grand Cayman	Ordinary (100%)	To raise debt finance
Southern Water Executive Pension Scheme Trustees Limited	Southern House, Yeoman Road, Worthing	Ordinary (100%)	Dormant
Southern Water Pension Trustees Limited	Southern House, Yeoman Road, Worthing	Ordinary (100%)	Dormant

SWSF is tax resident in the UK for tax purposes. The directors are satisfied that the carrying value of the investment in SWSF is supported by the underlying assets and activities of SWSF.

The company is currently in the process of transferring the assets and liabilities of SWSF to a UK company within the group with the aim of closing SWSF by the end 31 March 2022.

15 Other non-current assets

Non-current receivables	2021 £m	2020 £m
Amounts owed by group undertakings	130.0	130.0

Amounts owed by group undertakings represent a loan to Southern Water Services Group Limited which is secured on the assets held under the Southern Water Services Group Security agreement and repayable on 31 July 2052 with interest payable at 7% per annum.

16 Inventories

	2021 £m	2020 £m
Raw materials	4.3	4.3
Work in progress	2.0	0.8
	6.3	5.1

17 Trade and other receivables

	2021 £m	2020 £m
Trade receivables	334.4	315.9
Provision for impairment	(247.5)	(213.3)
Net trade receivables	86.9	102.6
Loan to Southern Water Services (Finance) Limited	16.9	56.3
Amounts owed by other group undertakings	10.7	4.8
VAT recoverable	11.0	10.2
Other amounts receivable	7.3	7.7
Net accrued income	64.7	77.3
Prepayments	16.7	14.3
	214.2	273.2

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

Amounts owed by group undertakings are unsecured, interest-free and settled regularly. All entities are wholly owned within the group.

Accrued income as at 31 March 2021 includes water and sewerage income not yet billed of £55.2 million (2020: £62.4 million).

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

Provision for impairment

Movements on the impairment provision were as follows:

	2021 £m	2020 £m
At 1 April	(216.4)	(188.7)
Impairment charge	(34.8)	(29.6)
Amounts written (back)/off during the year	(2.7)	1.9
At 31 March	(253.9)	(216.4)

Notes to the financial statements continued

For the year ended 31 March 2021

17 Trade and other receivables continued

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

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

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

	2021 £m	2020 £m
Current	0.1	–
1–2 years	0.1	0.1
2–3 years	0.2	0.1
3–4 years	0.6	0.1
More than 4 years	14.5	2.4
	15.5	2.7

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

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

	2021 £m	2020 £m
Current	72.7	76.8
1–2 years	45.5	44.4
2–3 years	37.4	38.9
3–4 years	33.9	33.8
More than 4 years	103.6	90.6
	293.1	284.5

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

At 31 March 2021	Gross £m	Provision £m	Net £m
Accrued income – not due	71.1	(6.4)	64.7
Trade receivables			
Not due	25.8	–	25.8
Overdue and not specifically provided	293.1	(232.0)	61.1
Overdue and specifically provided	15.5	(15.5)	–
	405.5	(253.9)	151.6

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

18 Trade and other payables

	2021 £m	2020 £m
Trade payables	32.4	30.5
Amounts owed to group undertakings	51.8	27.7
Capital creditors and capital accruals	100.5	104.2
Taxation and social security	4.0	2.8
Accruals	71.0	65.0
Deferred revenue	29.8	30.6
	289.5	260.8

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

All amounts owed to group undertakings due within one year are unsecured, interest-free and repayable on demand. All entities are wholly owned within the group.

Included in deferred revenue above are contract liabilities from contracts with customers where some or all of the performance obligations of the company have not yet been fulfilled of £1.3 million (2020: £0.3 million)

19 Current borrowings

	2021 £m	2020 £m
Unamortised debt issuance costs (note 20 (iii))	(1.5)	(1.5)
Bond premium deferred	0.7	0.7
Deferred gilt lock proceeds (note 20 (iv))	0.1	0.1
Deferred proceeds	4.7	4.7
Revolving credit facility	–	330.0
Class A £350m – 5.010% fixed rate 2021	–	349.5
Other loans from subsidiary SWSF (note (i) below)	30.3	30.3
Current borrowings excluding lease liabilities	34.3	713.8
Lease liabilities	2.5	2.2
Total current borrowings including lease liabilities	36.8	716.0

The Class A £350 million bond was repaid on 31 March 2021.

(i) The loan from SWSF is unsecured, interest-free, and shall be repayable in whole or part upon demand at any time, provided that:

(a) On the date of such demand, no class A debt is outstanding, no class B debt is outstanding and no mezzanine debt is outstanding; or

(b) The consent of the Security Trustee is given.

Notes to the financial statements continued

For the year ended 31 March 2021

20 Non-current borrowings

	Note	2021 £m	2020 £m
Loans from subsidiary Southern Water Services (Finance) Limited:	20(i)		
Class A £350m – 6.202% fixed rate 2029	20(ii)	348.8	348.7
Class A £150m – 3.716% index linked 2034	20(ii)	247.7	243.7
Class A £35m – 3.716% index linked 2034	20(ii)	57.7	56.8
Class A £350m – 6.650% fixed rate 2026	20(ii)	349.1	349.0
Class A £150m – 3.826% index linked 2023	20(ii)	247.7	243.7
Class A £350m – 5.010% fixed rate 2021	20(ii)	–	349.5
Class A £150m – 5.010% fixed rate 2041	20(ii)	147.2	147.1
Class A £200m – 4.510% fixed rate 2052	20(ii)	197.3	197.2
Class A £300m – 5.135% fixed rate 2056	20(ii)	292.8	292.7
Class A £375m – 2.385% fixed rate 2028	20(ii)	370.2	–
Class A £450m – 3.010% fixed rate 2037	20(ii)	443.5	–
Class A £300m – 1.626% fixed rate 2027	20(ii)	294.3	–
Class A £175m – 2.790% fixed rate 2031	20(ii)	174.1	174.0
Class A £75m – 2.970% fixed rate 2036	20(ii)	74.6	74.6
Artesian £165m – 4.086% index linked 2033	20(ii)	272.6	268.2
Artesian £156.5m – 3.645% index linked 2032	20(ii)	252.2	248.2
Total Class A debt from Southern Water Services (Finance) Limited		3,769.8	2,993.4
Unamortised debt issuance costs	20(iii)	(10.0)	(11.5)
Bond premium deferred		7.5	8.2
Deferred gilt lock proceeds	20(iv)	4.5	4.6
Deferred proceeds	20(v)	76.3	81.1
Other loans from Southern Water Services (Finance) Limited	20(vi)	30.3	30.3
Total loans and other borrowings from Southern Water Services (Finance) Limited		3,878.4	3,106.1
Revolving credit facility – LIBOR plus margin	20(vii)	–	330.0
Class A £60m – 0.000% index linked 2025	20(viii)	44.1	51.7
Class A £40m – 0.000% index linked 2026	20(viii)	35.7	41.0
Class B Preference shares	20(ix)	69.8	69.8
Lease liabilities	21	29.7	30.4
Total borrowings		4,057.7	3,629.0
Included in:			
Current liabilities			
Borrowings	19	34.3	713.8
Lease liabilities	21	2.5	2.2
		36.8	716.0
Non-current liabilities			
Borrowings		3,993.7	2,884.8
Lease liabilities	21	27.2	28.2
		4,020.9	2,913.0

These loans (excluding the preference shares) are guaranteed and secured pursuant to a guarantee and security agreement (the Security Agreement). The agreement is over the entire property, assets, rights and undertakings of each of SWS, Southern Water Services (Finance) Limited (SWSF), SWS Holdings Limited, and SWS Group Holdings Limited. In the case of SWS, this is to the extent permitted by the Water Industry Act 1991 and Licence.

Notes in respect of the specific instruments above:

(i) Under the loan agreements between SWS and SWSF, SWSF advances an amount equal to each bond or other debt raised at the same interest rate plus a margin of 0.01% or 0.001%. Therefore each individual back-to-back inter-company loan has been separately disclosed.

(ii) Fixed rate borrowings are recognised net of issue costs and discounts on issue and are carried at amortised cost using the effective interest rate method.

The value of the capital and interest elements of the index-linked loans is linked to movements in inflation. The increase in the capital value of index-linked loans during the year of £20.5 million (2020: £29.3 million) has been taken to the income statement as part of finance costs.

(iii) Unamortised debt issuance costs represent issue fees paid to SWSF that are not otherwise accounted for within the amortised cost of specific loans. Where these costs are attributable to a specific instrument they are being amortised over the life of that instrument. The remaining costs are being amortised over the weighted average life of the loans advanced at the time the costs were incurred. As at 31 March 2021 unamortised debt issuance costs amounted to £10.0 million of which £1.5 million represents the short-term amount which is disclosed separately in note 19.

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

(v) Deferred proceeds represent consideration received by the company in connection with taking on various debt obligations that were 'out of the money' at the time the debt obligations were entered into. The deferred proceeds are amortised over the lives of the related debt instruments.

(vi) The loan from SWSF is unsecured, interest-free, and shall be repayable in whole or part upon demand at any time, provided that:

(a) On the date of such demand, no Class A debt is outstanding, no Class B debt is outstanding and no mezzanine debt is outstanding; or

(b) The consent of the Security Trustee is given.

(vii) Revolving credit facility drawdowns accrue interest at LIBOR plus an applicable margin between 0.30% and 0.70%, determined by reference to the credit rating of the company.

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

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

(ix) The Class B preference shares are redeemable at the option of SWS at any time.

The shares, which do not carry voting rights, were issued on 23 July 2003 and are redeemable at their nominal value plus the share premium paid on 31 March 2038 or, at the company's option, anytime earlier. The shares were issued at £1,000 per share. Shareholders are entitled to receive dividends at £70 per share.

These dividends are payable on 31 March and 30 September each year.

On 11 December 2019, the company redeemed 20,831 of its Class B preference shares at nominal value plus the premium on issue, including settlement for fixed dividends due to that date. No dividends were paid to the shareholders in the year and at 31 March 2021 the cumulative accrual for unpaid dividends due was £7.3 million (2020: £2.4 million).

Notes to the financial statements continued

For the year ended 31 March 2021

20 Non-current borrowings continued

The maturity profile of borrowings disclosed within this note is given below:	2021 £m	2020 £m
Borrowings excluding leases:		
Between one and two years	251.7	4.0
Between two and five years	12.1	255.8
After five years	3,729.9	2,625.0
	3,993.7	2,884.8
On demand or within one year	34.3	713.8
	4,028.0	3,598.6
Leases:		
Between one and two years	2.9	2.2
Between two and five years	5.8	6.2
After five years	18.5	19.8
	27.2	28.2
On demand or within one year	2.5	2.2
	29.7	30.4
Borrowings including leases:		
Between one and two years	254.6	6.2
Between two and five years	17.9	262.0
After five years	3,748.4	2,644.8
	4,020.9	2,913.0
On demand or within one year	36.8	716.0
	4,057.7	3,629.0

The company leases various offices and vehicles and has a lease on its outfall pipes.

Vehicle leases have terms of between four and five years. Leases on office buildings have terms of between 15 and 99 years from commencement date. The outfall lease had an initial term of 99 years and commenced on 1 April 1997.

Obligations relating to vehicle leases includes some commercial vehicle leases with optional residual value balloon payments due at the end of the lease period, where the minimum lease payments (including finance charges) have been prepaid at the start of the lease. If the company opts not to pay the balloon payment, it must return the vehicle to the lessor.

All lease obligations are denominated in sterling.

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

Interest rates are fixed at the contract date. All leases (except outfalls (see note 21)) are on a fixed repayment basis and no arrangements have been entered into for contingent rental payments.

The company's lease obligations are secured by the lessors' rights over the leased assets disclosed in note 13.

21 Leases

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

i) Amounts recognised in the statement of financial position

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

	2021 £m	2020 £m
Right of use assets within 'Property, plant and equipment':		
Buildings	15.8	28.9
Infrastructure	11.4	–
Other	2.9	3.5
	30.1	32.4
Lease liabilities		
Current	2.5	2.2
Non-current	27.2	28.2
	29.7	30.4

Additions to the right-of-use assets during the financial year to 31 March 2021 were £1.1 million (2020: £33.2 million).

ii) Amounts recognised in the income statement

The income statement shows the following amounts relating to leases:

	Year to 31 March 2021 £m	Year to 31 March 2020 £m
Depreciation charge of right-of-use assets		
Buildings and infrastructure	(1.7)	(2.0)
Other	(1.7)	(1.7)
	(3.4)	(3.7)
Interest expense (included in finance costs)	(0.5)	(1.2)
Expense relating to short-term leases (included in operating costs)	(1.8)	(1.3)

iii) Amounts recognised in the statement of cash flows

	Year to 31 March 2021 £m	Year to 31 March 2020 £m
Total cash outflow for leases	(1.8)	(1.5)

Notes to the financial statements continued

For the year ended 31 March 2021

21 Leases continued

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

The company leases various offices and vehicles.

Rental contracts are typically made for fixed periods, but may have extension options.

Contracts may contain both lease and non-lease components. For leases of vehicles for which the company is a lessee, it has elected not to separate lease and non-lease components and instead accounts for these as a single lease component.

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

Leases are recognised as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use by the company.

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

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

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

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

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

Right-of-use assets are measured at cost comprising the following:

- the amount of the initial measurement of lease liability
- any lease payments made at or before the commencement date less any lease incentives received
- any initial direct costs
- restoration costs.

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

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

22 Derivative financial instruments

Categories of financial instruments at fair value

	2021 £m	2020 £m
Derivative assets carried at fair value through profit or loss (FVTPL):		
Interest rate swaps – not hedge accounted	68.2	194.3
Total derivative financial assets	68.2	194.3
Derivative liabilities carried at fair value through profit or loss (FVTPL):		
Interest rate swaps – not hedge accounted	(1,500.6)	(1,376.4)
Total derivative financial liabilities	(1,500.6)	(1,376.4)

Changes in value of financial instruments at fair value	2021 £m	2020 £m
Profit for the year has been arrived at after crediting/(charging):		
Financial assets at fair value		
Designated as FVTPL	(159.0)	148.1
Financial liabilities at fair value		
Designated as FVTPL	(285.8)	191.8
Fair value (losses)/gains on derivative financial instruments	(444.8)	339.9

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

The regulatory framework, under which revenues and the RCV are indexed, exposes the company to inflation risk. The company enters into inflation-linked derivative financial instruments to manage its exposure to that risk.

Under interest rate swap contracts, the company agrees to exchange the difference between fixed and floating rate interest amounts calculated on agreed notional principal amounts. Such contracts enable the company to mitigate inflation risk on issued fixed rate debt held.

Notes to the financial statements continued

For the year ended 31 March 2021

23 Deferred tax liabilities

Deferred tax is provided as follows:

	Accelerated tax depreciation £m	Revaluation of financial instruments £m	Retirement benefit obligations £m	Other – timing differences £m	Total £m
At 1 April 2019	511.0	(227.8)	(31.7)	(3.8)	247.7
(Credit)/charge to income statement	(3.7)	65.3	2.7	(0.3)	64.0
Prior year adjustment:					
– Charge/(credit) to income statement	1.0	–	(1.8)	–	(0.8)
– Credit to other comprehensive income	–	–	19.0	–	19.0
Effect of change in tax rate:					
– Income statement	59.8	(19.1)	0.1	(0.5)	40.3
– Other comprehensive income	–	–	(1.5)	–	(1.5)
At 1 April 2020	568.1	(181.6)	(13.2)	(4.6)	368.7
Charge/(credit) to income statement	10.6	(80.2)	3.7	0.2	(65.7)
Prior year adjustment:					
– Charge/(credit) to income statement	0.2	–	–	(0.2)	–
– Charge to other comprehensive income	–	–	(13.3)	–	(13.3)
At 31 March 2021	**578.9**	**(261.8)**	**(22.8)**	**(4.6)**	**289.7**

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

	2021 £m	2020 £m
Deferred tax liabilities	578.9	568.1
Deferred tax assets	(289.2)	(199.4)
	289.7	368.7

24 Retirement benefit obligations

The deficit associated with retirement benefit obligations has increased to £116.5 million (2020: £62.5 million). The main reason for the increase in the deficit over the year is principally due to the increase in the assumed rate of future price inflation, which results in higher projected future benefit payments, together with the decrease in AA corporate bond yields, which leads to a lower discount rate and therefore higher liabilities. These effects have been offset to a lesser extent by company contributions, higher than assumed investment returns and lower than assumed inflationary increases during the year.

Pension schemes operated

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

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

   The Scheme closed to accrual with effect from 31 March 2020.

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

   As part of the company's interactions with both the Trustees and when required The Pensions Regulator, the company looks to agree a long-term funding and risk management strategy for the pension liability. Following on from regular dialogue with the Trustees, and discussions and correspondence with The Pensions Regulator regarding the deficit, the Board agreed a long-term funding solution for the scheme in 2018.

The main risks of the scheme are as follows:

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

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

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

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

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

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

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

   Contributions made to the defined contribution scheme for the year ended 31 March 2021 amounted to £7.7 million (2020: £4.9 million). At the balance sheet date, £1.1 million of contributions were outstanding for payment and were paid on 7 April 2021 (2020: £nil outstanding at the balance sheet date).

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

The latest actuarial valuation of the SWPS was carried out as at 31 March 2019 using the projected unit method. For closed schemes under this method, the current service cost will increase as the members of the schemes approach retirement.

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

The principal assumptions in the valuation were as follows:

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

The term 'FI Gilt curve' refers to the generally available fixed interest gilt yield curve agreed by the Trustees and the company for the purposes of the 2019 actuarial valuation.

The assets of the scheme had a market value of £755.6 million at 31 March 2019. This was sufficient to cover 76% of the scheme's benefits. The weighted average duration of the scheme liabilities is 16.5 years.

Notes to the financial statements continued

For the year ended 31 March 2021

24 Retirement benefit obligations continued

The timing and quantum of future contributions in relation to the deficit were agreed with the Trustees and Pensions Regulator. These contributions will be dependent on future levels of RPI, but, if market breakeven rates are borne out at 31 March 2019, the expected base deficit contributions will be paid annually and total £177.2 million over the period from 1 April 2021 to 1 April 2029. The first payment was made in November 2018.

Expected employer contributions to the defined benefit scheme for 2021–22 are £18.1 million under the current Schedule of Contributions.

IAS 19 – assumptions, asset, liability and reserves disclosures

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

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

	2021 % p.a.	2020 % p.a.
Price inflation (RPI)	3.15	2.50
Price inflation (CPI)		
– RPI less 0.8%		1.70
– RPI less 1% pa up to 2030	2.15	
– Equal to RPI after 2030	3.15	
Rate of increase in salaries (no longer applicable following cessation of accrual)	N/A	2.40
Rate of increase of pensions in payment:		
– MIS* members only***	2.15	1.70
– Old section** members only***	3.15	2.50
– New section and ex FSLP (RPI max 5%)***	3.05	2.50
– Post 5 April 1988 GMP (CPI max 3%)***	1.90	1.60
– All sections post-31 March 2013 service (RPI max 2.5%)***	2.15	1.90
Rate of increase for deferred pensions:		
– MIS* members only***	2.15	1.70
– Old section** members only***	3.15	2.50
– New section and ex FSLP (RPI max 5%)***	3.05	2.50
– Post 5 April 1988 GMP (CPI max 3%)***	1.90	1.60
– All sections post-31 March 2013 service (RPI max 2.5%)***	2.15	1.90
Discount rate	2.15	2.40

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

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

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

Assumptions regarding future mortality experience are set based on advice, published statistics and experience. The base mortality tables are unchanged from 2020 and reflect the best estimate basis from the Trustees' 2019 Actuarial Funding Valuation. Improvements rates have been updated to use the most recently available CMI model (CMI 2020), using the same smoothing factor of 7.5 and long-term improvement rate of 1.25% as used in 2020, as assuming greater improvements is not considered appropriate in light of the ongoing COVID-19 pandemic.

Assumed future life expectancy at age 65	2021 Years	2020 Years
Currently aged 45:		
Male	24.3	24.4
Female	26.4	26.4
Currently aged 65:		
Male	23.0	23.0
Female	24.9	24.9

The assets and liabilities in the scheme and the expected rates of return at 31 March 2021 and 31 March 2020 were:

	Value at 2021 £m	Value at 2020 £m
Equities	197.1	176.0
Government bonds	173.1	239.7
Non-government bonds	367.3	343.5
Cash	34.0	18.4
Total market value of plan assets	771.5	777.6
Total value of plan liabilities	(888.0)	(840.1)
Accrued deficit in the plan	(116.5)	(62.5)
Related deferred tax asset	22.8	13.2
Net retirement benefit obligations	(93.7)	(49.3)

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

The government bond and cash allocation set out above includes £180.3 million held in a Liability Driven Investment (LDI) portfolio to mitigate interest rate risks arising from the liabilities.

Reconciliation of the present value of the scheme liabilities	2021 £m	2020 £m
At 1 April	840.1	942.5
Current service cost	–	6.4
Past service cost	0.2	–
Interest expense	19.3	22.2
Member contributions	–	0.3
Experience gain on liabilities	(15.8)	(27.2)
Actuarial loss/(gain) on liabilities:		
– Due to changes in demographic assumptions	0.2	12.7
– Due to changes in financial assumptions	114.1	(78.2)
Benefits paid	(70.1)	(39.9)
Curtailment	–	1.3
Scheme liabilities at 31 March	888.0	840.1

Notes to the financial statements continued

For the year ended 31 March 2021

24 Retirement benefit obligations continued

Sensitivity analysis of the scheme liabilities

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

	Change in assumption	Impact on scheme liabilities (£m)
Discount rate	+ 0.1% p.a.	(14.0)
	– 0.1% p.a.	14.5
Price inflation (RPI measure)*	+ 0.1% p.a.	11.3
	– 0.1% p.a.	(11.0)
Mortality	+ 1 year	37.6
	– 1 year	(36.0)

* These movements have been calculated assuming that changes in the inflation assumption affect all inflation linked assumptions.

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

Reconciliation of the value of the scheme assets	2021 £m	2020 £m
At 1 April	777.6	755.8
Interest income	18.0	18.0
Gain on assets above interest	28.5	19.0
Employer contributions	17.5	24.4
Member contributions	–	0.3
Benefits paid	(70.1)	(39.9)
Bid value of scheme assets at 31 March	771.5	777.6

The total return on scheme assets was £46.5 million (2020: return of £37.0 million).

Total cost recognised as an expense	2021 £m	2020 £m
Current service cost	–	6.4
Past service cost	0.2	–
Curtailment	–	1.3
Net interest cost	1.3	4.2
Total income statement expense before deduction for tax	1.5	11.9

Analysis of the amounts recognised in other comprehensive income	2021 £m	2020 £m
Gain due to liability experience	(15.8)	(27.2)
Loss due to changes in demographic assumptions	0.2	12.7
Loss/(gain) due to changes in financial assumptions	114.1	(78.2)
Return on plan assets greater than discount rate	(28.5)	(19.0)
Total loss/(gain) recognised in OCI before adjustment for tax	70.0	(111.7)

The cumulative amount of actuarial losses recognised in other comprehensive income is £237.7 million (2020: £167.7 million).

Analysis of the movement in the scheme deficit during the year	2021 £m	2020 £m
Deficit in the scheme at 1 April	(62.5)	(186.7)
Employer's contributions	17.5	24.4
Employer's current service cost	–	(6.4)
Employer's past service cost	(0.2)	–
Curtailment	–	(1.3)
Financing charge	(1.3)	(4.2)
Actuarial (loss)/gain	(70.0)	111.7
Deficit in the scheme at end of year	**(116.5)**	(62.5)

25 Regulatory settlement liability

	2021 £m	2020 £m
At 1 April	135.5	138.5
Settlements in year	(35.7)	(3.0)
At 31 March	**99.8**	135.5

Included in:	2021 £m	2020 £m
Current liabilities	24.2	35.6
Non-current liabilities	75.6	99.9
	99.8	135.5

In 2018–19, Ofwat concluded its investigation in relation to the management, operation and performance of the company's wastewater treatment works. That investigation resulted in Ofwat taking enforcement action. Ofwat issued Southern Water with a financial penalty amounting to £3.0 million as published on its website. To ensure that customers are not disadvantaged as a result of these matters, the company has agreed to make direct customer rebates totalling £135.5 million in outturn prices (£122.9 million in 2017–18 prices) over the period 2020–25. This reflects the seriousness of the breaches identified in the investigation and these amounts have been provided for in the financial statements for 2018–19. These rebates are now being made and the provision is being released through revenue in line with the annual profile. The company has given a number of formal undertakings to Ofwat in relation to the numerous measures that have been put in place and are being put in place to ensure that the issues identified in the investigation have ceased and cannot be repeated.

Notes to the financial statements continued

For the year ended 31 March 2021

26 Provisions for liabilities

	Environmental obligations £m	Other £m	Total £m
Balance 1 April 2019	6.6	–	6.6
Utilised in year	(1.0)	–	(1.0)
Increase in year	0.2	4.0	4.2
Balance at 31 March 2020	**5.8**	**4.0**	**9.8**
Balance 1 April 2020	5.8	4.0	9.8
Utilised in year	(0.8)	(1.5)	(2.3)
Increase in year	0.7	–	0.7
Balance at 31 March 2021	**5.7**	**2.5**	**8.2**

Included in:	2021 £m	2020 £m
Current liabilities	3.9	5.1
Non-current liabilities	4.3	4.7
	8.2	9.8

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

Other provisions includes £1.5 million (2020: £3.0 million) relating to the payment of compensation for missed appointments under our Guaranteed Standards of Service scheme and represent management's best estimate of the likely value of payments to be made. Payments of £1.5 million were made over the course of the year.

Environment Agency

Like other wastewater operators, in the normal course of operations, the company occasionally faces Environment Agency investigations. The company has been subject to a detailed investigation regarding permit breaches at some of its wastewater treatment works in two locations during the period 2010–15. In February 2020, the agency presented 51 charges before the court and the company entered guilty pleas to these charges. The company will continue to be open and transparent and is committed to working with the agency to ensure a swift conclusion to the case.

The Board, supported by external legal advice, has concluded that it is not yet possible to make a reliable overall estimate for the obligation that will arise from this prosecution, notwithstanding the company's guilty pleas and the Sentencing Council's Guidelines for Environmental Offences. However, the Board does recognise that there will be a minimum liability associated with the charges before the court and, having reviewed the latest information, has maintained the provision of £1.0 million, recognised in the accounts for 2019–20, reflecting a minimum amount as indicated in the sentencing guidelines and an allowance for legal costs.

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

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

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

27 Other non-current liabilities

	Grants & contributions £m	Deferred Revenue £m	Contractual obligations £m	Total £m
Balance at 1 April 2020	19.6	13.1	–	32.7
Increase in year	3.8	–	124.6	128.4
Released to income statement	(1.4)	(0.4)	–	(1.8)
Balance at 31 March 2021	**22.0**	**12.7**	**124.6**	**159.3**

Grants and contributions relate to property, plant and equipment.

Deferred revenue of £12.7 million (2020: £13.1 million) relates to the proceeds from the sale of income rights relating to aerial masts and sites owned by SWS. The income will be credited to the income statement evenly over the life of the lease.

Contractual obligations of £124.6 million relate to a liability to make future payments to Portsmouth Water Limited, giving Southern Water the right to draw water from the capacity of Portsmouth Water Limited under a bulk supply agreement. The right to draw water commences on 1 April 2029 and any water received will be subject to a volumetric charge and expensed at that time.

28 Called up share capital

	2021 £m	2020 £m
Equity shares		
Authorised		
46,050,000 ordinary shares of £1 each	46.1	46.1
Allotted and fully paid		
56,000 ordinary shares of £1 each	0.1	0.1
Non-equity shares		
Issued		
Preference shares		
69,829 (2020: 69,829) Class B shares of £1 each	0.1	0.1

The redeemable preference shares are presented as a liability (see note 20) at an amount of £69.8 million including share premium of £69.7 million and, accordingly, are excluded from called up share capital in the balance sheet. The total statutory company share premium of £116.0 million includes ordinary share premium of £46.3 million.

29 Share premium account

	2021 £m	2020 £m
Equity share premium		
Balance at 1 April and at 31 March	46.3	46.3

Notes to the financial statements continued

For the year ended 31 March 2021

30 Non-distributable reserve

	£m
Balance at 1 April 2019	53.8
Profit for the financial year	7.8
Transfer to retained earnings	(1.4)
Balance at 1 April 2020	60.2
Profit for the financial year	18.2
Transfer to retained earnings	(1.5)
Balance at 31 March 2021	**76.9**

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

31 Retained earnings

	£m
Balance at 1 April 2019	737.5
Equity dividends paid	(7.1)
Profit for the financial year	320.9
Other comprehensive income for the year	94.2
Transfer from non-distributable reserve	1.4
Balance at 1 April 2020	1,146.9
Equity dividends paid	(4.0)
Loss for the financial year	(310.2)
Other comprehensive loss for the year	(56.7)
Transfer from non-distributable reserve	1.5
Balance at 31 March 2021	**777.5**

32 Notes to the statement of cash flows

	2021 £m	2020 £m
Operating profit	138.8	212.3
Adjustments for:		
Fair value of sewer adoptions	(18.2)	(7.8)
Depreciation of property, plant and equipment	274.2	250.9
Amortisation of intangible assets	13.7	13.1
Receipt of grants and contributions	3.8	6.8
Difference between pension charge and cash contributions	(17.3)	(16.7)
Amortisation of grants and contributions	(1.4)	(1.2)
Operating cash flows before movements in working capital	393.6	457.4
Increase in inventories	(1.2)	(0.3)
Decrease in receivables	22.2	7.9
Increase in payables	10.9	13.1
Decrease in regulatory settlement liability	(35.7)	(3.0)
(Decrease)/increase in provisions	(1.6)	3.2
Cash from operations	388.2	478.3
Tax paid	(0.9)	(1.7)
Net cash from operating activities	387.3	476.6

Cash and cash equivalents	2021 £m	2020 £m
Cash and bank balances	339.5	129.3

Cash and cash equivalents comprise cash and short-term bank deposits. The carrying amount of these assets is equal to their fair value.

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

Analysis of net debt (including changes in liabilities from financing activities)	At 1 April 2020 £m	Cash flow changes £m	Fair value adjust-ments £m	New leases £m	Other non-cash changes £m	At 31 March 2021 £m
Cash and cash equivalents	129.3	210.2	–	–	–	339.5
Net liabilities from financing activities:						
Term facilities/index linked loans (note 20)	(422.7)	346.2	(3.3)	–	–	(79.8)
Loans from subsidiary (note 20)	(3,106.1)	(757.2)	(19.1)	–	4.0	(3,878.4)
Lease liabilities (note 20, 21)	(30.4)	1.8	–	(1.1)	–	(29.7)
Redeemable preference shares (note 20)	(69.8)	–	–	–	–	(69.8)
Net interest rate swaps (note 22)	(1,182.1)	194.5	(444.8)	–	–	(1,432.4)
Total liabilities from financing activities	(4,811.1)	(214.7)	(467.2)	(1.1)	4.0	(5,490.1)
Net debt	(4,681.8)	(4.5)	(467.2)	(1.1)	4.0	(5,150.6)

Other non-cash changes to loans from subsidiary of £4.0 million relate to the amortisation of loan issue costs, bond premium, gilt lock proceeds and deferred proceeds.

Balances at 31 March 2021 comprise:	Non-current assets £m	Current assets £m	Current liabilities £m	Non-current liabilities £m	Total £m
Cash and cash equivalents	–	339.5	–	–	339.5
Derivative financial instruments	68.2	–	–	(1,500.6)	(1,432.4)
Unamortised debt issuance costs	–	–	1.5	8.5	10.0
Gilt lock proceeds	–	–	(0.1)	(4.4)	(4.5)
Borrowings due within one year	–	–	(35.7)	–	(35.7)
Borrowings due after one year	–	–	–	(3,997.8)	(3,997.8)
Leases	–	–	(2.5)	(27.2)	(29.7)
Net debt	68.2	339.5	(36.8)	(5,521.5)	(5,150.6)

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

Notes to the financial statements continued

For the year ended 31 March 2021

33 Contingent liabilities

Companies of the size and scale of Southern Water Services Limited are sometimes subject to a number of claims, disputes and potential litigation. The significant ones currently include ongoing investigations by regulatory bodies (the EA and DWI) as well as a potential claim in respect of property search income. The directors consider that, where a liability is probable, and where it is possible to be estimated reasonably, an appropriate position has been taken in reflecting such items in these financial statements. Separate consideration of the EA investigations is set out in note 26.

Following the South Hampshire abstraction inquiry, Southern Water Services Limited has committed to undertake certain environmental work on the Rivers Itchen and Test and Candover Stream between 2018 and 2030. A provision was made in the accounts of 2018–19 in relation to costs of the ecology work associated with this agreement and further details are disclosed in note 26 to the accounts. Certain compensatory costs may become due in the future, subject to conditions at that time and the impact of the ecology work undertaken. These have not been provided for and could increase the obligation by approximately £1.2 million.

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

The company had no contingent liabilities for capital claims at the year-end (2020: £nil).

34 Financial commitments

(a) Capital commitments are as follows:

	2021 £m	2020 £m
Contracted for but not provided for in respect of contracts placed in respect of property, plant and equipment	518.0	301.3
Contracted for but not provided for in respect of contracts placed in respect of intangible assets	15.5	10.7

(b) The company as lessee

	2021 £m	2020 £m
Lease payments under operating leases recognised as an expense in the year	1.8	1.3

As at 31 March 2021 and 2020, the company had no outstanding commitments for future minimum lease payments under non-cancellable operating leases in respect of vehicles and land and buildings.

Operating leases are charged to the income statement over the lease term and comprise short-term leases (defined as leases with a lease term of 12 months or less) and leases of low value assets (£5,000 or less).

35 Related party transactions and ultimate controlling party

The immediate parent undertaking is SWS Holdings Limited.

The ultimate parent company and ultimate controlling party is Greensands Holdings Limited (GSH), a company incorporated in Jersey, which is the parent undertaking and controlling party of the smallest, largest and only group to consolidate these financial statements. Copies of the consolidated financial statements may be obtained from the registered office of GSH at Southern House, Yeoman Road, Worthing, BN13 3NX, or from the Southern Water website.

The largest shareholder in GSH as at 31 March 2021 is an institutional investment company advised by JP Morgan Asset Management owning 31.24%.

The company has taken advantage of the exemption under FRS 101 'Reduced Disclosure Framework' in not disclosing details of transactions with other companies which are 100% wholly owned. Equivalent disclosures are given in the group financial statements of GSH.

36 Post balance sheet events

There were no significant events after the statement of financial position date.

Independent Auditor’s report

to the members of Southern Water Services Limited

Report on the audit of the financial statements

1. Opinion

In our opinion the financial statements of Southern Water Services Limited (the ‘company’):

- **give a true and fair view of the state of the company’s affairs as at 31 March 2021 and of its loss for the year then ended;**
- **have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including Financial Reporting Standard 101 “Reduced Disclosure Framework”; and**
- **have been prepared in accordance with the requirements of the Companies Act 2006.**

We have audited the financial statements which comprise:

- the income statement;
- the statement of other comprehensive income;
- the statement of financial position;
- the statement of changes in equity;
- the statement of cash flows; and
- the related notes 1 to 36.

The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards including Financial Reporting Standard 101 “Reduced Disclosure Framework” (United Kingdom Generally Accepted Accounting Practice).

2. Basis for opinion

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

We are independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council’s (the ‘FRC’s’) Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

3. Summary of our audit approach

Key audit matters

The key audit matters that we identified in the current year were:

- Litigation and claims associated with the wastewater plants;
- Provision for impairment of trade receivables;
- Revenue recognition - estimating unbilled household revenue; and
- Classification of costs between operating and capital expenditure.

Within this report, key audit matters are identified as follows:

Newly identified

Increased level of risk

Similar level of risk

Decreased level of risk

3. Summary of our audit approach

Materiality	The materiality that we used in the current year was £11.8m which was determined on the basis of 3% of the forecast EBITDA and comprise 2.8% of the actual EBITDA as of 31 March 2021.
Scoping	Audit work to respond to the risks of material misstatement was performed directly by the audit engagement team.
Significant changes in our approach	We have used a different basis to determine materiality. EBITDA was used this year as this excludes the volatility of financial instruments and one-off items in the year which distort core performance.

4. Conclusions relating to going concern

In auditing the financial statements, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

Our evaluation of the directors' assessment of the company's ability to continue to adopt the going concern basis of accounting included:

- Obtained an understanding of relevant controls related to the management assessment of the going concern;
- Obtained third party confirmation for the group's borrowing facilities available, including drawn and undrawn amounts;
- Assessed the reasonableness of the cash flows projections and the appropriateness of the sensitivities performed by management;
- Performed integrity checks of management's going concern model, including checking for mathematical and clerical accuracy;
- Recalculated debt covenants and assessed compliance over the forecasted period, including consideration of the waiver from its Lenders in February 2021 which allows full use of available liquidity, plus the raising of new finance, even in a Trigger Event scenario of a credit rating downgrade or a breach of a trigger debt compliance ratio;
- Assessed consistency of the forecasted cash flows with the forecasts prepared for the goodwill and investments impairment models;
- Evaluated management's stress tests and performed independent sensitivity scenarios tests; and
- Assessed the appropriateness of the disclosures over going concern included within the financial statements in view of the latest guidance from the FRC.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the company's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report.

Independent Auditor's report continued

to the members of Southern Water Services Limited

5. Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

5.1 Litigation and claims associated with the wastewater plants

Key audit matter description

Consistent with the 31 March 2020 audit the company continues to be under investigation from the Environment Agency ('EA') in respect of two significant matters.

The first relates to permit breaches at wastewater treatment works during the period 2010-2015. In February 2020 the EA presented 51 charges before the court and the company has entered guilty pleas to these charges.

Management was not able to make a reliable overall estimate of the financial obligation that will arise from this EA prosecution, notwithstanding the guilty pleas and the Sentencing Council's Guidelines for Environmental Offences. However, recognising that there will be a minimum liability associated with the permit breaches management have therefore recognised a provision of £1m for the 51 cases in the prior year financial statements, reflecting a minimum amount as indicated by the Sentencing Guidelines and an allowance for legal costs. There were no significant developments in the prosecution process that would enable a reliable overall estimate to be determined. The next court hearing may take place in July 2021. As such, management continue to recognise the provision of £1m in the current year financial statements.

The second separate investigation is into sampling is ongoing. Management, supported by legal advice, have concluded that it is not yet possible to make a reliable estimate of the financial obligation providing reasons in the disclosure to the financial statements.

We have identified a potential risk of bias in relation to this audit matter due to its influence on key metrics which management utilise to monitor and report business performance.

Further details are included within the Audit Committee report on pages 176-177, critical accounting estimates and judgements note (note 2) and in note 25 to the financial statements.

How the scope of our audit responded to the key audit matter

We have:

- obtained an understanding of the relevant controls over the litigation and claims process;
- assessed relevant recent correspondence with the EA;
- performed enquiries of management regarding the status and views on the EA investigation and the charges announced;
- read Board minutes and considered the Board's assessment in relation to quantifying the risk of penalty, if any, arising from the EA investigations;
- evaluated the competence, capabilities and objectivity of external lawyers, performed enquiries and read documentation received to understand their views and position in regards to the EA investigation and charges;
- assessed whether there are any industry or legal precedents that are applicable in forming the judgements applied;
- challenged management on the provisioning basis assessing the determination of a probable outflow against precedent cases and advice from legal counsel, accounting approach for the EA liability, impact of the EA provision assumption on the going concern assessment and disclosures in the financial statements; and
- assessed the completeness and accuracy of the disclosures made by the company in respect of the regulatory matters.

Key observations

We are satisfied that the treatment of the EA investigations reflects the best available evidence at the time of issuing the financial statements and consider that the disclosures in the financial statements are appropriate.

5.2 Provision for impairment of trade receivables

Key audit matter description

At 31 March 2021 the company held a bad debt provision of £253.9m (2020: £216.4m) and accrued a bad debt charge during the year of £34.8m (including £8.6m estimate in relation to Covid-19 impact) that represents 4.6% of the company's revenue (2020: £29.6m and 3.6% of revenue).

The company has a significant domestic customer base and due to regulations is not allowed to interrupt water supply, including in the event of non-payment. A proportion of the company's customers do not or cannot pay their bills, which results in the need for a provision to be made for non-payment of the customer balance.

The bad debt provision is a key area of judgement and is based on assumptions made on the forecast collectability of debts across both invoiced amounts and accrued revenues.

We focused our work on the estimation of the bad debt provision on the following areas:

- Adherence of the management's methodology with the company's policy and IFRS 9;
- The accuracy of customer data included within the aged debt report, specifically whether customer data has been correctly classified based on the age of debt; and
- The reasonableness of the cash collection assumptions made by management, including the impact of Covid-19 while considering third party macro-economic data.

We have identified a potential risk for bias in relation to this audit matter due to its influence on key metrics which management use to monitor and report business performance.

Further details are included within the audit committee report on page 8, critical accounting estimates and judgements note (note 2) and in note 17 to the financial statements.

How the scope of our audit responded to the key audit matter

We have:

- obtained an understanding of the relevant controls within the bad debt estimation process;
- involved an IT specialist to test management's IT system logic and methodology;
- recalculated the system generated bad debt provision using data analytics;
- performed test of details to assess the accuracy of information within the aged debt report to assess whether customer debt is accurately categorised based on information contained within the company's billing cycle;
- assessed whether the final provision has been calculated in line with the policy of the company and considered the requirements of IFRS 9 Financial Instruments;
- challenged management's bad debt policy and methodology specifically on whether the recoverability assumptions are reflective of current cash collection rates and whether the final provision is in line with industry peers;
- assessed the cash collection performance in the year against management's budgets;
- analysed post balance sheet cash collection and direct debit cancellation trends;
- assessed whether the increase in bad debt due to Covid-19 is supported by macroeconomic metrics and forecasts and assessed contradictory evidence, including water industry reports; and
- assessed specific provisions and adjustments included in the total provision balance by understanding the rationale for the adjustment including agreement to supporting documentation.

Key observations

We are satisfied that management's methodology for assessing impairment of trade receivables is reasonable and have been applied appropriately to compute the bad debt provision.

Independent Auditor's report continued

to the members of Southern Water Services Limited

5.3 Revenue recognition – estimating unbilled household revenue

Key audit matter description	For customers with meters, the revenue recognised depends upon the volume of water supplied, including an estimate of the sales value of water supplied between the date of the last meter reading and the year end. The total unbilled income accrual for the year to 31 March 2021 is £2154.5m (2020: £241.0m). The most judgemental area of the estimation of unbilled revenue related to the usage estimate, which is based on historical data and assumptions around consumption patterns. Due to the level of management judgement, the estimation of unbilled household revenue has been identified as a key audit matter. Incorrect estimates of water consumption could lead to overstatement of revenue in the period. We have identified a potential risk for bias in relation to this audit matter due to its influence on key metrics which management utilise to monitor and report business performance. Further details are included in the critical accounting estimates and judgements note (note 2) and in note 5 to the financial statements.
How the scope of our audit responded to the key audit matter	We have: • obtained an understanding of key controls within the unbilled revenue estimation process; • reperformed management's analysis of the accrued income amount; • performed a retrospective assessment of the previous year's accrual by comparing bills raised during 2019/20 relating to the 2018/19 accrual to determine the accuracy of management's forecasting; • tested the accrued income balance by selecting a sample of individual properties and verified historical billing rates for each selection to confirm the appropriateness of the accrual; • performed substantive testing of manual adjustments applied by management to the period end accrued income balance; and • involved IT audit specialists to test the accuracy of the system generated reports utilised by management in determining the required accrual.
Key observations	We are satisfied that management's estimates in relation to the recognition of unbilled revenue are appropriate.

5.4 Classification of costs between operating and capital expenditure

Key audit matter description	The company continues to invest significantly in infrastructure renewal and replacement, with property, plant and equipment and intangible asset additions, of £554.8m (2020: £546.2m) in the period that includes £59.5m (2020: £56.5m) of capitalised overheads. Expenditure incurred to increase the capacity or enhance the network is treated as capital expenditure ("capex"). Expenditure incurred in maintaining the operating capability of the network is expensed in the year in which it is incurred ("opex"). Capital projects can contain a combination of enhancement and maintenance activity which are not distinct and hence the allocation of costs between capital and operating expenditure is inherently judgemental. This risk also includes the inappropriate capitalisation of overheads. We have identified a potential risk for bias in relation to this audit matter due to its influence on key metrics which management utilise to monitor and report business performance. Further details are included within critical accounting estimates and judgements note (note 2) and in note 13 to the financial statements.
How the scope of our audit responded to the key audit matter	We have: • obtained an understanding of the relevant controls surrounding the capitalisation of costs; • assessed the company's capitalisation policy to determine compliance with IAS 38; • assessed the application of the capitalisation policy to the costs incurred by selecting a sample and agreeing to third party invoices; • analysed and considered the changes from the prior year and performed detail audit testing on a sample basis of all the cost centres and agreeing the basis of the calculation to supporting documentation; • inspected the calculations behind the percentages applied to new cost centres and tested the calculations for accuracy and consistency across the business; and • tested the accuracy of the overheads' capitalisation by re-performing management's calculation for a sample of cost centres and agreeing key inputs to supporting documentation.
Key observations	We consider that the classification of costs between operating and capital expenditure is appropriate.

Independent Auditor's report continued

to the members of Southern Water Services Limited

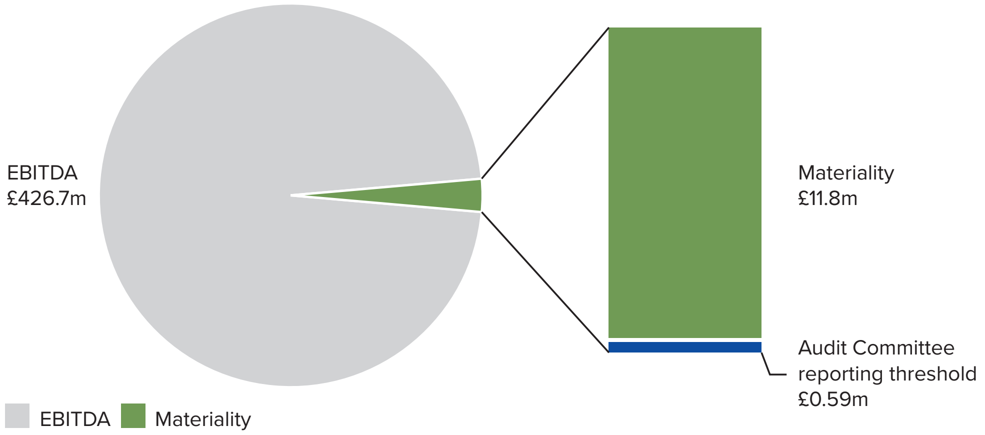
6. Our application of materiality

6.1 Materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Materiality	£11.8m (2020: £11.0m).
Basis for determining materiality	3% of EBITDA (2020: 5% of operating profit).
Rationale for the benchmark applied	This year we reassessed our approach and used EBITDA as a basis for determining materiality as this excludes the volatility of one-off items and finance costs in the year which distort core performance and is more aligned with free cash flows.



6.2 Performance materiality

We set performance materiality at a level lower than materiality to reduce the probability that, in aggregate, uncorrected and undetected misstatements exceed the materiality for the financial statements as a whole. Performance materiality was set at 60% of materiality for the 2021 audit (2020: 60%). In determining performance materiality, we considered factors including impact of Covid-19 on business operations and account balances, our ability to rely on general IT controls, management's willingness to make process improvements as well as to correct errors identified.

6.3 Error reporting threshold

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £0.59m (2020: £0.56m), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

7. An overview of the scope of our audit

7.1 Scoping

Our audit was scoped by obtaining an understanding of the entity and its environment, including internal control, and assessing the risks of material misstatement. Audit work to respond to the risks of material misstatement was performed directly by the audit engagement team.

8. Other information

The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. The directors are responsible for the other information contained in the annual report.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the course of the audit, or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether this gives rise to a material misstatement in the financial statements themselves. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in respect of these matters.

9. Responsibilities of directors

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

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

10. Auditor's responsibilities for the audit of the financial statements

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

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

Independent Auditor's report continued

to the members of Southern Water Services Limited

11. Extent to which the audit was considered capable of detecting irregularities, including fraud

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud is detailed below.

11.1 Identifying and assessing potential risks related to irregularities

In identifying and assessing risks of material misstatement in respect of irregularities, including fraud and non-compliance with laws and regulations, we considered the following:

- the nature of the industry and sector, control environment and business performance including the design of the company's remuneration policies, key drivers for directors' remuneration, bonus levels and performance targets;
- results of our enquiries of management, internal audit and the audit committee about their own identification and assessment of the risks of irregularities;
- any matters we identified having obtained and reviewed the company's documentation of their policies and procedures relating to:
  - identifying, evaluating and complying with laws and regulations and whether they were aware of any instances of non-compliance;
  - detecting and responding to the risks of fraud and whether they have knowledge of any actual, suspected or alleged fraud;
  - the internal controls established to mitigate risks of fraud or non-compliance with laws and regulations;
- the matters discussed among the audit engagement team and relevant internal specialists, including tax, pensions and IT specialists regarding how and where fraud might occur in the financial statements and any potential indicators of fraud.

As a result of these procedures, we considered the opportunities and incentives that may exist within the organisation for fraud and identified the greatest potential for fraud in the areas described in our key audit matters. In common with all audits under ISAs (UK), we are also required to perform specific procedures to respond to the risk of management override.

We also obtained an understanding of the legal and regulatory frameworks that the company operates in, focusing on provisions of those laws and regulations that had a direct effect on the determination of material amounts and disclosures in the financial statements. The key laws and regulations we considered in this context included the UK Companies Act, pensions legislation and tax legislation.

In addition, we considered provisions of other laws and regulations that do not have a direct effect on the financial statements but compliance with which may be fundamental to the company's ability to operate or to avoid a material penalty.

11.2 Audit response to risks identified

As a result of performing the above, we identified litigation and claims associated with the wastewater plants, provision for impairment of trade receivables, revenue recognition - estimating unbilled household revenue and classification of costs between operating and capital expenditure related to the potential risk of fraud. The key audit matters section of our report explains the matters in more detail and also describes the specific procedures we performed in response to those key audit matters.

In addition to the above, our procedures to respond to risks identified included the following:

- reviewing the financial statement disclosures and testing to supporting documentation to assess compliance with provisions of relevant laws and regulations described as having a direct effect on the financial statements;
- enquiring of management, the Audit Committee and external legal counsel concerning actual and potential litigation and claims;
- performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;
- reading minutes of meetings of those charged with governance; and
- in addressing the risk of fraud through management override of controls, testing the appropriateness of journal entries and other adjustments; assessing whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluating the business rationale of any significant transactions that are unusual or outside the normal course of business.

We also communicated relevant identified laws and regulations and potential fraud risks to all engagement team members including internal specialists, and remained alert to any indications of fraud or non-compliance with laws and regulations throughout the audit.

Report on other legal and regulatory requirements

12. Opinion on other matters prescribed by the Companies Act 2006

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

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

In the light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we have not identified any material misstatements in the strategic report or the directors' report.

Independent Auditor's report continued

to the members of Southern Water Services Limited

13. Matters on which we are required to report by exception

13.1 Adequacy of explanations received and accounting records

- Under the Companies Act 2006 we are required to report to you if, in our opinion:
- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns.

We have nothing to report in respect of these matters.

13.2 Directors' remuneration

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of directors' remuneration have not been made.

We have nothing to report in respect of this matter.

14. Use of our report

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

Anthony Matthews FCA (Senior statutory auditor)
For and on behalf of Deloitte LLP
Statutory Auditor
London, United Kingdom
30 June 2021