Annual Report and Financial Statements

For the year ended 31 March 2023

from Southern Water

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Contents

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Southern Water

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Welcome to our Annual Report and Financial Statements 2022–23

Our purpose is to provide water for life to enhance health and wellbeing, protect and improve the environment and sustain the economy

Look out for our key icons in this report:

Our long-term priorities

- Understanding and supporting our customers and communities
- Ensuring a supply of high-quality water for the future
- Protecting and improving the environment
- Enabling and empowering our people

Read more about our long-term priorities on pages 42 to 74.

Our strategy

These priorities guide our short and long-term plans and provide a framework for us to deliver essential water services to 2.7 million customers and wastewater services to more than 4.7 million customers across Kent, Sussex, Hampshire and the Isle of Wight.

Key stakeholders

There are five key stakeholder groups for which we create long-term value. It is essential we understand what matters most to them:

- Customers and communities
- The environment
- Our people and partners
- Regulators
- Investors

Read more about engagement with our stakeholders on pages 33 to 39.

Always improving, for the benefit of our customers, the environment and our communities

We are **committed** to making **sure** our customers have access to **high-quality,** affordable and efficient water and wastewater **services**, while we **protect** and **enhance** our **communities** and the **environment**.

Our reports this year

Becoming a more responsible and sustainable business is our priority. That is why this year we have used our long-term priorities to frame how we are improving our performance over time. By integrating our commentary in this way, we can better demonstrate how our customers and the environment sit at the heart of everything we do.

You can also read our Annual Performance Report for more detail about our current delivery strategy and targets: **southernwater.co.uk/our-performance/reports/annual-reporting**.

Our priorities can only be achieved with the **support of our people and communities.**

Throughout this report you can find out more about our company and the work we are doing. Follow the signposting below to learn more about our strategy in action.

Improving our services through a constant conversation with our customers
Nick Eves – Head of Insight

Read more on page 34.

Helping future generations understand the importance of saving water now
Joanne Wood – Education Officer

Read more on page 51.

Understanding and supporting **our customers and communities**

We have ambitious goals and can only reach them by working together with our partners in the community.

Ensuring a supply of high-quality water for **the future**

We plan and innovate to meet our promises, prioritising current and future needs of consumers.

Summer 2022 and our first drought for a decade
Paul Riordan – Drought Manager

Read more on page 57.

We work 24 hours a day, seven days a week to find and fix leaks on our network
Matt Foley – Operations Manager

Read more on page 58.

Protecting and improving **the environment**

Working in partnership we will deliver long-term environmental improvements.

Together we can improve our harbours

Kate Rice – Natural Capital Strategy Manager

Read more on page 67.

Taking a local approach to reducing storm overflows

Nicole McNab – Engagement and Communications Lead, Clean Rivers and Seas Task Force

Read more on page 68.

Enabling and empowering **our people**

We are building the skills and capabilities that our employees need to help create a resilient water future.

Using immersive experiences to provide groundbreaking health and safety training

James Hills – Health, Safety, Security and Wellbeing Assurance Adviser

Read more on page 73.

A women's network for everyone

Cath Jeffrey – Head of HR

Read more on page 74.

Read more about how our long-term priorities inform our current delivery strategy on pages 42 to 74.

Operational highlights

We are **making progress**

Our performance is measured through the value we generate for our stakeholders.

Customers and communities

We work hard every day to make sure that we are improving our services for customers and having a positive impact on our communities.

Progress we are making

We did not meet our target to improve our customer satisfaction ranking for 2022–23 and have put in place a Turnaround Plan to address this, see pages 17, 50, 56, 64 and 72.

We improved the effectiveness of our financial assistance 71% (2021–22: 67%) and maintained satisfaction with vulnerability support 73% (2021–22: 73%). We also increased the discount on bills from 20% to 45% for our vulnerable customers – an annual saving of £200 on dual service bills.

While we did not meet our community engagement target of 75%, we met our target for satisfaction at schools visited, achieving 98% (2021–22: 85%). We have also increased the number of customers receiving priority services to 8.3% of our customer base (2021–22: 2.9%).

We contributed £94,500 to regional charities, with our colleagues completing 2,534 volunteering hours.

Future plans to 2025

- Creating a new website.
- First-time fix improvements.
- A video assistant service.
- Improved complaint handling.
- A new education programme and water-saving campaign.
- Improved roadside signage.

Link to long-term priorities

Link to executive remuneration
Satisfaction – Direct. Other – Indirect.

The environment

While some metrics have improved, we know that we still have work to do to meet the expectations of our regulators and our customers.

Progress we are making

Internal and external flooding incidents reduced to 456 (2021–22: 614) and 3,748 (2021–22: 3,944) respectively. We met all our targets in the EA's Annual "Delivery of the Water Industry National Environment Programme (WINEP)" metric. Wastewater treatment works compliance improved to 98.22% (2021–22: 97.94%). The number of bathing waters at 'excellent' reduced to 57 (2021–22: 60). Increased beach activity during the summer heatwave may account for this decline.

We are reporting a provisional figure of 358 (2021–22: 372) Category 1 to 3 pollutions in the EA's Environmental Performance Assessment (EPA). This figure is currently under review with the EA. We fully expect to achieve a two-star rating for 2022–23.

Future plans to 2025

- Upgrades to the seven largest treatment works releasing into three harbours, improving water quality.
- Further investment to reduce the use of storm overflows.
- Improvements to wastewater treatment compliance.
- Review of our Pollution Incident Reduction Plan.
- Further digitalisation of networks.

Link to long-term priorities

Link to executive remuneration
Bathing and river waters – Direct.
Other measures – Indirect.

Our people and partners

We are continually building the skills that our people and contract partners need to enable them to create a sustainable future for our region.

Progress we are making

For the third year, we were in the Top 50 Inclusive Companies ranking 44th (2021: 46th and 2020: 49th).

We invested £1.5 million in training and development, introducing a new Inspire Leadership Programme, improving our frontline training and apprenticeships. A total of 21% of colleagues are being supported to undertake formal/informal learning as of March 2023 (+3% from 2022).

We also set up a menopause support group for colleagues.

We have developed a Supplier Relationship Management (SRM) Framework and carried out a review of our current contracts.

Future plans to 2025

- Development of our maternity re-onboarding programme.
- Expansion of our Inspire development programme.
- Virtual reality training for teams in more technical roles.
- New colleague resource groups.
- A behavioural safety programme, risk safety app and company-wide training.
- 20% reduction in lost-time injuries.

Link to long-term priorities

Link to executive remuneration
Ensuring our people and suppliers are trained, healthy and happy – Indirect.

Operational highlights continued

Regulators

To provide high-quality water and effective wastewater services for the South East, we must consider our economic, quality and environmental regulation and create medium and long-term plans that meet requirements.

Progress we are making

During 2022–23 we made a capital investment of £213.5 million in water and £443.6 million in wastewater on base maintenance and enhancement of our sites and networks, improving our performance in key areas including flooding prevention and delivery of our environmental programme. However, we know that we need to do more to meet expectations.

Future plans to 2025

Our long-term plans are ambitious, and they need to meet the challenges posed by climate change and rapid population growth. We must work closely with our regulators to make sure we take a pragmatic approach to planning and delivery, as we look to balance the cost of adapting our infrastructure with keeping bills affordable.

Link to long-term priorities

Link to executive remuneration More than 50% of bonus targets are linked to outcomes agreed with our regulators.

Investors

We aim to deliver a sustainable long-term return to investors. We do this through financial risk management, responsible practices and decision making. Regulatory price controls align shareholder value with customer and environmental priorities. As we have not met certain performance targets, we have not paid any dividends to shareholders since 2017.

Progress we are making

We have now published our second Sustainable Bond Impact Report, which outlines our investments and activities to reduce pollutions, improve compliance and reduce leakage. We have issued a total of £1.125 billion of sustainable bonds since 2020.

Our investors demand that we operate in a way that creates public value. We monitor a range of external reporting frameworks. This year we have submitted information to Global Real Estate Sustainability Benchmark (GRESB) for the seventh year, and participated for the first time in the Responsible Business Tracker of Business in the Community (BITC).

Future plans to 2025

Our website contains updates on pollution incidents, flow and spill reporting, wastewater treatment compliance, bathing water compliance, emissions and river levels. We will continue to keep investors informed.

Link to long-term priorities

Link to executive remuneration
Delivering on our operational delivery incentives and performance commitments ultimately increases market value for investors – Indirect.

Our long-term priorities key

- Understanding and supporting our customers and communities
- Ensuring a supply of high-quality water for the future
- Protecting and improving the environment
- Enabling and empowering our people

Link to executive remuneration:

Direct – there is a specific performance measure included within the bonus scheme that is link to the performance commitment.

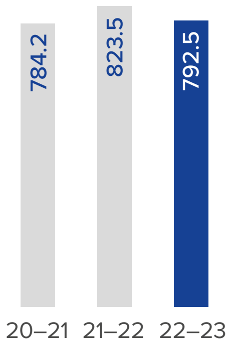
Indirect – there is a link to the performance measures in the bonus scheme but that it is a component of one of the metrics used for assessing performance rather than a specific/ individual metric.

Financial highlights

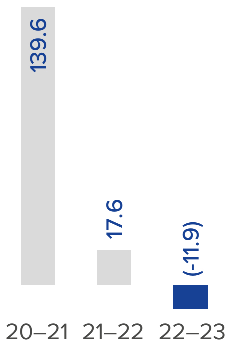
We recorded a loss before interest and tax of £11.9 million, due to lower revenues and increased costs largely from inflation, some significant operational incidents in the year, and ongoing activities to improve performance.

Read more on pages 102 to 113

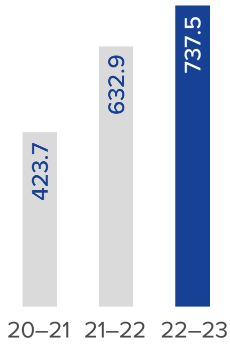
Revenue[1] (£m)
(before amortisation of regulatory settlement provision)



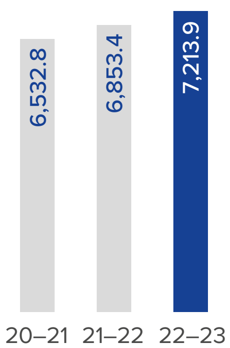
Profit/(loss) before interest and tax[1] (£m)



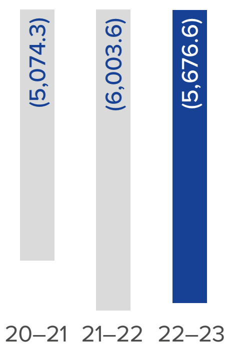
Capital investment[2] (£m)



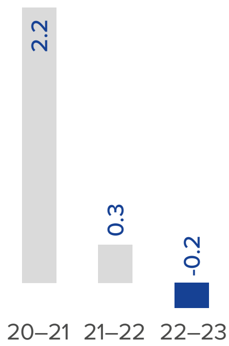
Non-current assets (£m)
(excluding debt)



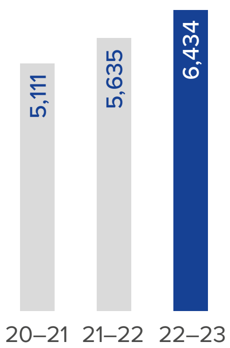
Net Debt (£m)



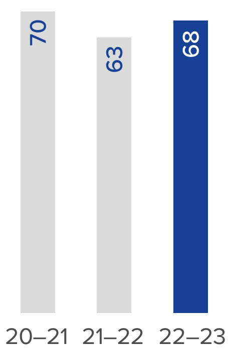
Return on capital employed (ROCE)[3] (%)



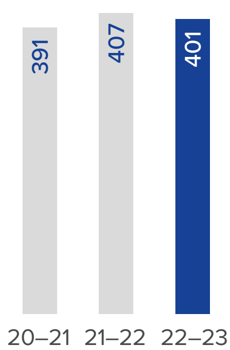
Regulatory Capital Value (RCV)[4] (£m)



Net debt/RCV[5] (%)



Average water and wastewater customer bill (£)



1. Following its investigation into our wastewater treatment works compliance reporting Ofwat imposed a penalty under Section 22A of the Water Industry Act. We provided in full for this proposed regulatory settlement in the financial statements for 2018–19 reducing profit in that year. We are now making rebates to customers, through revenue, over the period from 2020–25 and these are offset in the income statement by the amortisation of the provision made in 2018–19.
2. Capital investment for 2020–21 has been restated to remove the intangible asset recognised for the future payments to Portsmouth Water in relation to the right to water from the construction of the Havant Thicket reservoir as described in note 1 of our Annual Report for 2021–22.
3. ROCE is presented as the ratio of loss before interest and tax (£11.9 million) to non-current assets excluding debt (£7,213.9 million) less current liabilities excluding borrowings and lease liabilities (£507.2 million) from the Statement of Financial Position.
4. Regulatory Capital Value (RCV) a measure of the value of our regulatory capital asset base as published by Ofwat.
5. The net debt to RCV ratio is calculated as the ratio of short and long-term senior borrowings, less cash and short-term deposits to the RCV (all values taken from our Regulatory Accounts).

Regional highlights

Understanding the key matters impacting **our region**

Reducing storm overflows in Kent

The use of storm overflows is no longer acceptable. Our Clean Rivers and Seas Task Force, set up in 2021, is working with partners to install sustainable drainage solutions and reduce sewer flooding in six areas, including Deal, Margate and Swalecliffe in Kent. Pilots are also running in Hampshire, Sussex and the Isle of Wight. Read more on page 68.

Our response
Deal – pumping station upgrade; working with the local Water Action Task Force to upgrade sewers and roadside gullies; and 'slow the flow' trial with residents to provide smart water butts and raingarden planters.

Margate – sustainable drainage for local parks and working with local schools to reduce rainwater run-off and flooding.

Swalecliffe – installed water butts and planters; improved the efficiency of the local wastewater treatment plant; and extended the storm overflow, reducing the risk of pollution.

Our investment
In total we have invested around £5 million in these 'Pathfinder' pilots to date, and have plans to accelerate this work, investing around £35 million to 2025 to slow the flow of rainwater and groundwater entering the network.

Improving our sites and networks

We know our pollution performance is unacceptable and we are focused on reducing incidents caused by technical failure and blockages.

Our response
We review our Pollution Incident Reduction Plan (PIRP) annually. It explains where we are investing to make improvements and increase our resilience: **southernwater.co.uk/our-story/our-plans/pollution-reduction-programme**.

Event Duration Monitors measure spills caused by technical failures. We currently have 978 EDMs, increasing our self-reporting of incidents from 75% to 96% since 2018.

Our investment
We have invested £15 million to install 23,000 Sewer Level Monitors that we estimate will help us cut pollution incidents by up to 40% by 2025.

We also continue to publish details about our spills, as well as comprehensive flow data on our website.

Investing to improve supply resilience across Hampshire and the Isle of Wight

We have put in place agreements with our regulators to take less water from the protected chalk streams of the Rivers Test and Itchen in Hampshire, which currently provide a large proportion of the region's water supply. This is vital to protect these environments and these water sources for future generations. This means we would face a shortfall in water available for public supply unless we find alternative, more sustainable, sources. A range of solutions are needed.

Our response
We are working with Portsmouth Water to deliver the Havant Thicket Reservoir, which will be used to provide water to our customers. A consultation has also begun on our Hampshire Water Transfer and Water Recycling Project, which will see us take water directly from our wastewater treatment works, put it through a series of advanced treatment processes before returning it to supply. This tried and tested technology will make more water available to meet increased demand.

Work on network and storage improvements has also begun.

Our investment
We will be investing many hundreds of millions of pounds to transform the way we source, treat and supply water across Hampshire. During 2022–23 we spent £1.2 million on measures to support these rivers.

Protecting water sources in Sussex

We are facing a water availability challenge in our North Sussex area, which is driving discussions about water neutrality. In simple terms, neutrality means any new development must be proven to not increase the amount of water we take from the environment.

Our response
We have reduced the amount of groundwater we take to put into supply, rezoning areas to protect this sensitive habitat. We are working in partnership with government agencies, Local Planning Authorities and developers. Read our Water Resource Management Plan: **southernwater.co.uk/our-story/water-resources-management-plan** for more information.

Our investment
We continue to invest, and are committed to helping protect the delicate ecosystem of the Arun Valley.

Chair's statement

Welcome to our **Annual Report** and **Financial Statements** for 2022–23

Highlights

- The continued transformation of Southern Water is delivering progress.
- Our focused two-year Turnaround Plan prioritises areas for performance improvement.
- The role of our investors in enabling the acceleration of our activities continues to be crucial.
- The way we have learnt from five major incidents will help us serve our customers and communities better in the future.
- We have continued to listen to all our stakeholders during a period of intense public scrutiny.
- Water scarcity as a result of population growth and climate change is a reality in the South East, so resilience and protecting the environment are central to our plans.
- We fully expect to receive a two-star rating for the Environment Agency's annual Environmental Performance Assessment.

Southern Water recently published a Turnaround Plan for the final two years of this current delivery period. It is a recognition that we both remain a business in transformation and that we have a clear set of priorities to improve our performance and network resilience. We remain challenged by annual targets set for the business in 2019, but with reinvestment of all profits and additional shareholder support, well beyond funds agreed in our 2019 Final Determination from Ofwat, we are a much-improved, more rigorous and more innovative business.

We are currently in discussions with all the company's shareholders with respect to additional funding in the near term; see page 205 for further information regarding this funding and its effect on going concern, including the related material uncertainty.

The next two years are critical in delivering efficiencies and to prepare for what is understood to be a period of higher investment and customer bills, to tackle the challenges of water sourcing in the South East and the management of surface flows and wastewater into the wider environment. Read more on our Turnaround Plan on pages 17, 50, 56, 64 and 72.

We are not yet where we need to be as a business, but I commend the leadership, our colleagues and supportive stakeholders who are committed to helping us deliver our plans.

I have written before that the greatest risk that our region faces is water scarcity, and last summer's drought highlighted this challenge very sharply. Economic development in the South East and associated population growth make our efforts to preserve every drop of water as part of the water cycle, even more important. We have increased our efforts to reduce leakage and keep as much water in supply as we can, our water saving work with customers continues and we look to develop new sources of water, including water recycling.

Over the next decades, all of these initiatives need to succeed and our long-term water management plans make it clear that major infrastructure investments in regional transfers and new reservoirs require early approval and delivery.

Making sure we are resilient against drought in the longer term, while protecting our communities and

the green spaces around us, forms the basis of our Water Resources Management Plan (WRMP) and our commitments under the Water Industry National Environmental Programme (WINEP). These priorities are generational investments and challenge our traditional funding and planning methods; our priority is to focus on what is right for today and in the future.

Over the past year, public scrutiny of the water industry and Southern Water has been intense, focusing on the impacts of our activities on our customers and the environment. We listen to all our stakeholders as we plan, both for tomorrow and for the future. We have shareholder support and are committed to spend and invest significantly more than the capital investment of £2 billion set in our Final Determination for the period 2020–25.

We welcomed Defra's Storm Overflows Discharge Reduction Plan, published in August 2022. It sets targets for water companies to prevent overflows causing ecological harm, protect bathing waters and ensure no overflow activates above an average of 10 times per year by 2050. We are leading the way, already reducing the average number of spills to the 2025 target set by Defra.

Investing to improve customer service and experience

As a result of five major incidents in both Kent and Hampshire which left Southern Water customers without water for significant periods, we have worked with the Executive team to review the company's incident response, upgrading systems and improving communications.

We have also taken steps to support our customers in financial crisis due to the rising cost of living and increased energy prices, increasing the minimum discount on bills and providing energy grants and financial assistance.

Protecting and improving the environment

The region we serve is a precious natural environment that we want to help protect and improve. From unique chalk streams to national parks, areas of outstanding natural beauty, and more than 700 miles of coastline and 84 bathing waters, we have a responsibility to plan long into the future. That is why we are continuing to focus on driving down pollution incidents, improving leakage and engaging with stakeholders in our catchments with whom we can work and putting customers and communities at the heart of our plans. We wholly support bringing fragmented regulation and environmental investment together in a catchment-wide approach. Our Pathfinder projects to reduce the use of storm overflows point to customer and taxpayer cost benefits from co-operation.

Chair's statement continued

Our Clean Rivers and Seas Task Force is working in partnership to implement innovative sustainable drainage solutions, taking an integrated approach to the management of surface water in our communities by bringing different sectors together.

Our catchment projects also take this approach, partnering with a wide range of local stakeholders including businesses, local authorities and Rivers and Wildlife Trusts, to take practical, realistic and affordable action to tackle pollution and protect precious natural habitats, like our harbours.

This extends to championing sustainable site management to boost local biodiversity and honouring our commitment to the Environment Agency under the Water Industry National Environment Plan (WINEP) in areas such as invasive non-native species management, biosecurity and protected species awareness.

I am encouraged by the 'green shoots' of improvement in our environmental performance, which has been acknowledged by the EPA two-star rating we expect to receive this year.

Corporate governance and Board changes

We are quite rightly expected to uphold the highest standards of corporate governance in all that we do.

I am pleased that after a lengthy process, the distraction of our Cayman Islands subsidiary has finally been taken away, and will play no further part in our financing.

Over the past year we have seen a number of changes on the Board through succession planning, and this has continued into the start of the next period. We benefit significantly from the skills and experience brought to the Board by our non-executive directors, and I thank Martin Bradley, Kevin McCullough, Rosemary Boot and Paul Sheffield for their considerable contributions.

I am pleased that Gillian Guy has agreed to replace Paul Sheffield as our senior independent non-executive director. We have also welcomed Steve Fraser, and more recently, Christèle Delbé, Kerensa Jennings and Phil Swift to the Board as Non-Executive Directors. All will bring a fresh perspective and new skills.

We welcomed Lawrence Gosden to the Board on 1 July 2022, appointing him as CEO and bringing with him almost 30 years of water sector experience. His appointment will continue to move the company forwards, as his Turnaround Plan is implemented and the focus on health and safety as well as innovation are increased.

On behalf of the Board, I would also like to welcome our new Chief Financial Officer, Stuart Ledger, who joined Southern Water as CFO on 3 January 2023. He joined us from Affinity Water, where he was both CEO and CFO, and like Lawrence, he brings many years of sectoral experience. Last year I thanked retiring CEO, Ian McAulay, and I also take this opportunity to thank Sebastiaan Boelen and Nadim Ahmad, respectively CFO and Interim CFO.

All of these changes are more fully reflected in our corporate governance. I am particularly pleased that as our Board reshapes, we bring a greater diversity of membership and views.

I recognise that it is the hard work of our colleagues and partners that enables us to succeed together. My thanks go to each and every one of them for their commitment to serving our customers and caring for the environment. Together we can continue to serve our region, while planning for the future.

K G Lough

Keith Lough
Chair
7 July 2023

Our purpose, vision, values and strategy

Our **purpose** is the reason we exist. Our **vision** informs our **long-term priorities** and sets our **ambition**.

Our five-year delivery strategy and focused Turnaround Plan are guided by this long-term vision. Our core values then provide the foundation and ethical decision-making framework by which we operate.

Vision

To create a resilient water future for our customers in the South East.

Our purpose is to provide water for life to:

- enhance health and wellbeing
- protect and improve the environment
- sustain the economy

Long-term priorities

- Understanding and supporting our customers.
- Protecting and improving the environment.
- Ensuring a supply of high-quality water for the future.
- Enabling and empowering our people.

Five-year delivery strategy

- Deliver great service.
- Protect and improve the environment.
- Use water wisely.
- Fit for the future.

Turnaround Plan

Aims to deliver a short, sharp ambitious improvement by 2025, particularly in terms of our environmental performance. It includes four clear outcomes that we're promising to deliver, improving our service to customers and the environment.

Where we aim to be by 2025:

Improved customer experience
7.5/10 C-MeX score;

Improved water quality
3rd quartile performance against our peers;

Healthy rivers and seas
3 star performance awarded by the Environment Agency;

Health and safety excellence
0.2 Lost-time injury rate.

Read more on pages 17, 50, 56, 64 and 72.

Underpinned by our values

Our vision, purpose and values, alongside our ethical decision making and modern compliance frameworks, help our leadership team, employees and partners make better decisions every day.

SUCCEEDING TOGETHER
DOING THE RIGHT THING
ALWAYS IMPROVING
WORKING WITH CARE

Our strategy for 2020–25

Our five-year delivery strategy to 2025

Deliver great service

We are focused on delivering a great customer experience. This means resolving customer issues quickly and delivering clean, safe water, through a reliable, future-proof network, at a price that everyone can afford. We are creating assets for schools with the National Schools Partnership and opening sites across our region for school tours. We are improving online tools for customers and developers, via a new website. In terms of our operations, we will continue to upgrade our sites with a focus on improving water quality and preventing pollutions.

Read more on pages 42 to 50 and 52 to 55.

Use water wisely

We are investing in new technology to find and fix more leaks on our network, while we continue to upgrade and replace our mains. We are working with local authorities and developers to encourage the building of water-neutral homes. We are focused on supporting our customers to reduce their water use and we will continue to work with community partners, local businesses and customers to do this.

Read more on pages 46 to 48 and 54 to 55.

Protect and improve the environment

We know we need to go beyond our ambition of doing no harm to our environment and look to improve it where we can. To 2025 we are focused on delivering environmental benefits to the region's rivers and bathing waters, while reducing flood risk, cutting our carbon footprint, and supporting schemes that improve the biodiversity of the South East. We continue to transform our sewer network, using smart technologies to predict and prevent sewer blockages and burst pipes.

Read more on pages 59 to 68.

Fit for the future

We work with neighbouring water companies, local partners and our regulators to create regional water resource and drainage plans looking out to 2050. We do this so we can ensure future generations enjoy the same access to water and wastewater services in the years to come as we do today. Our region is already water stressed and population growth and climate change are real challenges.

Read more on pages 48 to 50, 55 and 64.

Our approach to reporting continued

Evolving ESG expectations

We have adopted frameworks such as the UN SDGs and TCFD to this report as we work towards being an integrated reporting organisation.

To increase transparency with all our stakeholders, we have adapted this report to answer increasing interest in our response to sustainability challenges and to meet expectations to disclose information about the impact of our operations on the communities we serve. We are focused on sharing information that supports our purpose and the topics identified as priorities by our customers and stakeholders.

Key frameworks

United Nations Sustainable Development Goals (SDGs)

Our approach to sustainability and being a responsible business aligns with the United Nations Sustainability Goals (UN SDGs). The SDGs comprise 17 global goals to be achieved by 2030 that were adopted by the UN in 2015. Of the 17 goals we have now identified nine that we feel we can contribute most to through our operations, investments and commitments.

The Task Force on Climate-related Financial Disclosures (TCFD)

Climate change impacts, amplified by population growth, present huge challenges to the water industry, particularly in the South East, and are a principal risk to our ability to operate. Mitigating this risk will make sure that we are able to maintain high-quality, resilient services for our customers.

External recognition and benchmaking

We supply information to independent ratings and indices on a range of ESG matters.

We performed well in the 2022 Global Real Estate Sustainability Benchmark (GRESB), which assesses the ESG performance of infrastructure assets. We were awarded a Green Star rating of five stars, the highest possible number of stars, and a score of 100 out of a possible 100 – an improvement on our 2021 score of 91.

We also improved our position in the 2022–23 Inclusive Top 50 UK Employers, moving to 44th from 46th in the previous year and from 49th in 2020.

We are also members of Business in the Community (BITC) and submit information to its Responsible Business Tracker, helping us to achieve our responsible business ambitions. In 2022 we scored 67% in our first ever submission (compared to the cohort average of 46%).

Read more about our approach to climate change on pages 75 to 95.

Our approach to reporting continued

Aligning our strategy with United Nations Sustainability Development Goals (UN SDGs)

Long-term priorities	Alignment to relevant UN SDGs	Commitments
Understanding and supporting our customers and communities	3 GOOD HEALTH AND WELL-BEING 8 DECENT WORK AND ECONOMIC GROWTH 9 INDUSTRY, INNOVATION AND INFRASTRUCTURE 11 SUSTAINABLE CITIES AND COMMUNITIES	• Supporting customers who are vulnerable due to circumstances – see page 46. • Protecting customers' homes from flooding – see page 61. • Supporting our communities – see page 46. • Managing population growth – see page 48 and 64. • Improving supply resilience – see page 55. • Working together to improve harbours – see case study page 67. • Reducing storm overflows – see case study page 68.
Ensuring a supply of high-quality water for the future	6 CLEAN WATER AND SANITATION 12 RESPONSIBLE CONSUMPTION AND PRODUCTION	• Improving water quality – see page 54. • Finding and fixing leaks – see case study page 58. • Drought planning and management – see case study page 57.
Protecting and improving the environment	6 CLEAN WATER AND SANITATION 12 RESPONSIBLE CONSUMPTION AND PRODUCTION 13 CLIMATE ACTION 14 LIFE BELOW WATER 15 LIFE ON LAND	• Improving pollutions performance – see page 61. • Water Industry National Environment Programme (WINEP) – see page 62. • Reducing storm overflows – see case study page 68. • Educating on water – see case study page 51. • Biodiversity – see page 65. • Natural capital – see case study page 31. • Adapting to climate change – see page 75. • Decarbonisation – see page 95.
Enabling and empowering our people	3 GOOD HEALTH AND WELL-BEING 8 DECENT WORK AND ECONOMIC GROWTH 9 INDUSTRY, INNOVATION AND INFRASTRUCTURE	• Diversity and inclusion – see page 70. • Meeting the needs of our partners – see page 71. • Using AI for health and safety – see case study page 73.

Strategic report

Chief executive's summary continued

My first year as CEO of Southern Water has been both **challenging and inspiring** in equal measure

Highlights

- Against the backdrop of increased public scrutiny, we are making solid progress and have completed 98% of the actions in the undertakings agreed with Ofwat in 2019.
- Our new two-year Turnaround Plan is focused on delivering performance improvements in water quality, environmental performance and customer satisfaction.
- These plans will also deliver a new Health and Safety Transformation Programme.
- A new fourth value, Working with Care, reinforces our cultural transformation.
- Our refreshed leadership team better reflects our turnaround agenda.
- We fully expect to receive a two-star rating for our Environmental Performance Assessment from the Environment Agency.

The water sector is changing, and public interest and scrutiny about the work we do and how it is financed increases on almost a daily basis. On top of that, we are dealing with the impacts of climate change and population growth on our sites and networks, which we recognise requires a reset of our working practices and our plans for our region's long-term future. Expectations about the way we treat water and return it to the environment safely have also rightly changed and we must listen and respond to them, recognising that we are at the beginning of a long journey to reduce our industry's reliance on storm overflows.

Even against this backdrop of increased scrutiny and public interest we have made significant progress over the past few years, the first phase of our transformation. Following the Ofwat investigation into sampling compliance which concluded in 2019, we agreed to a number of undertakings to change the way we work – our values, transparency, operational performance and governance. We have now completed 98% of what we agreed.

Over the past 12 months we entered the second phase of transformation, accelerating delivery of our business plan thanks to new investment from our shareholders. As a result we have improved our financial stability and our performance in some critical areas, namely flooding, vulnerability support for our customers and delivery of our environmental programme. We also introduced an innovative scheme for business consumers during the 2022 summer drought, incentivising them to save water and help us protect the environment.

We recognise that our performance in key areas – pollutions, water quality, leakage, customer service and supply interruptions – is not yet where it needs to be and that it will take time to improve. It is also clear that we cannot blame the weather for operational issues and water outages that we experienced this year. We know we need to

Chief executive's summary continued

continue to get better, proactively and reactively, and I am confident that thanks to the hard work of our teams this year, we know where we need to improve. We have started to put in place changes to processes, training and systems that are needed, and we are seeing real progress.

Where we have fallen short of the challenging performance targets set by our regulators, we have created a detailed Turnaround Plan taking us into the third phase of transformation.

This two-year acceleration of our business plan sets out our commitments to significantly improve our environmental performance and customer focus and includes a targeted set of actions to ensure we deliver our current commitments and set ourselves up for a fast start in 2025.

We are currently in discussions with the company's shareholders with respect to additional funding in the near term to support this plan; see page 205 for further information. I am committed to a fully transparent approach in our turnaround agenda and I have refreshed our executive team structure to better reflect it.

We are moving at pace, and alongside day-to-day business, our short and long-term plans are coming together strongly. Our water resource and drainage plans have now been submitted to our regulators after a series of consultations with our customers and regional stakeholders.

Using this valuable insight, we are now preparing our plans for the next investment period, 2025–30, which will take us into the final, fourth phase of our transformation. I am proud of these plans, created by our talented and committed teams, who are laser-focused on delivering resilient and efficient services now and in the future. Whether field or office-based, scientist or technician, engineer or financial analyst, the diversity of experience and knowledge in this company is what makes us who we are, and I have no doubt that these attributes will continue to enable improvements in our performance.

I am confident that reaching the goals set out in our plan, and demonstrating these tangible improvements to our customers and stakeholders will enable us to improve the balance of reporting about our company and build trust.

A fresh approach with new leadership

I became CEO in July of 2022 when Ian McAulay retired. At the same time, Bob Collington stepped into the role of Chief Operating Officer and our departing

A clear direction as we enter year four of this investment period

Our Turnaround Plan, which I have already referenced, includes clearly defined delivery timelines, and a set of commitments against four key themes:

Empowered and supported colleagues

Enabling our people to work in a safe, collaborative and inclusive workplace that offers rewarding careers at the heart of our communities.

A reliable supply of water for our customers

Safeguarding resources and making sure our customers have access to a supply of high-quality water now and into the future.

Healthy rivers and seas

Protecting and improving the environment, working transparently to enhance inland and coastal habitats.

Trusted and easy customer service

Supporting our customers with easy service and transparent communications that show we care for our communities.

Underpinning this will be a focus on our people, IT and digitalisation and financial resilience.

We will continue investing in our people through training at all levels, providing competitive career choices.

We will also continue to digitalise our network and our processes to support our operations, so we can act quicker and more effectively for our customers.

We will challenge our own decisions, operations and supply chain to drive value and spend every pound of our customers' money wisely.

Read more about our Turnaround Plan on pages 50, 56, 64 and 72.

Chief executive's summary continued

Getting the basics right, while facing challenges head on

Our Turnaround Plan will keep us focused on improving our performance over the next two years, working efficiently and with purpose so that we can start the next five-year investment cycle ready to deliver our ambitious business plan 2025–30. It will see us go beyond compliance by 2030, delivering the ambitious outcomes our stakeholders and customers are asking for. Over the past year, we have already started to get ourselves ready.

£15 million to install 23,000 sewer monitors – increasing resilience to blockages and reducing sewer flooding.

£5 million to deliver six regional Pathfinder projects (since 2021) – an industry leading, partnership approach to 'slow the flow' of rain and groundwater entering our sewers and reduce the use of storm overflows. Six projects in Kent, Sussex, Hampshire and the Isle of Wight, working with local councils, highways, schools and community organisations to install sustainable drainage solutions.

Around **£35** million further investment will see us expand our Pathfinder approach, working with our regional partners to slow the flow of rainwater and groundwater entering the network, reducing the use of storm overflows.

Read more about this on pages 7, 64 and 68.

£444 million in 2022–23 – to improve our wastewater treatment sites and networks, improving flow compliance and treatment capacity. It also funded the installation of UV plant to reduce the build-up of harmful bacteria in the water we put back into the environment in areas such as Chichester, Langstone and Pagham harbours.

Two rising mains repaired in Hastings and Lancing – had caused repeat sewer flooding issues for our customers.

Annual Pollution Incident Reduction Plan – delivering upgrades to pumping stations, treatment works and improving resilience to power failures (**southernwater.co.uk/our-story/our-plans/pollution-reduction-programme**).

Chief Financial Officer, Sebastiaan Boelen was also succeeded by an Interim, Nadim Ahmad. During the year, I was also very pleased to welcome both Usha Baidya as Chief People Officer and Deborah Binks-Moore as Interim Director of Corporate Relations from May, further strengthening our leadership team. With support from the Chair and the Board, I embarked on a wholesale review of the business to identify our strengths and weaknesses, and areas where we could make rapid improvements.

Although we have not seen immediate results of this targeted work in all of our end-of-year results, I am confident that the changes we have put in place are improving our performance. The results of our annual Environment Agency Performance Assessment, for which we fully expect to see our rating improve from a one-star to two-star, show me that we are taking steps in the right direction. I expect to see that positive improvement trajectory continued as we implement our Turnaround Plan for the remaining two years of this five-year investment period.

You can read more about our operational performance on pages 42 to 95 and I will let our new Chief Financial Officer Stuart Ledger explain our financial performance in more detail on page 103.

A year of supply challenges

A dry winter and spring, followed by a hot summer in 2022, presented a challenge for water companies up and down the country as we faced our first nationwide drought for a decade. Nowhere more so than in our water-stressed South East, where we were forced to introduce a Temporary Use Ban in Hampshire. For me, although this was a difficult step to take, it is an example of us living our values and doing the right thing; the primary reason for putting in place these restrictions was to protect the environment, namely local chalk streams.

At the same time, we lost water supply to 24,000 of our customers on the Isle of Sheppey during one of the hottest weeks of the year in July due to two large trunk main bursts that needed complex repairs. Through the collective efforts of the team, and alongside what was a very challenging operational fix, we tankered water to critical services, including the hospital and prisons, and we provided 835,000 litres of bottled water, which included over 12,000 deliveries to support our priority services customers. I am proud of the fact that, in the face of a very challenging situation, we returned our customers to service quickly in a way that also kept everyone's safety – colleagues, customers and partners – front of mind.

Since then, we have taken action and completed £4.5 million of emergency work to tunnel two new water mains across the Swale to Sheppey. The project began in autumn 2022 and has overcome huge engineering challenges due to the complex geology under the seabed. Now the pipes have been pulled through, we have multiple options to get water to the island.

Two further significant operational failures at our Otterbourne Water Treatment Works left around 23,000 customers in Hampshire without access to water in the run up to the Christmas holidays and then again in February. While I am again

Chief executive's summary continued

proud of the efforts of our colleagues who worked day and night to get customers back in supply, manned bottled water stations and kept our customers updated, I am also deeply aware of how frustrating and distressing this situation was for everyone without access to water during this time. An investigation has now concluded into the cause of this incident, and we are working with our regulators to make sure the proper preventative process and procedure reviews are put in place.

We have since made amends with customers for each of these incidents, providing a blend of direct payments, shopping vouchers and community grants, depending on the area and what customers told us they needed most. We have also put in place a detailed four-site improvement strategy, focusing on upgrading our largest and most critical water supply sites, that has been agreed with our regulators and will be delivered at pace.

Listening to our stakeholders

My colleagues and I have spoken to stakeholders and community groups across our region over the course of this year, whether in Whitstable with local MPs and councillors, Hampshire with our Water Futures panel or Three Harbours Technical Work Group or at our customer drop-in events at Sandown on the Isle of Wight and Broadstairs in Kent. We now have an Independent Climate and Environment Group of stakeholders that meets regularly to help understand their views and hold us to account on our environmental aims. These are all important opportunities to listen to our customers, and stakeholder groups, and to demonstrate the actions that we are taking now to address their concerns.

The tone of some of these meetings is rightfully challenging, but more often they are constructive and positive about the information we share, and participants welcome the investment planned and direct action we are taking.

Caring for colleagues and our communities

We have about 2,600 colleagues and many more who work as part of our business, most of whom live and work in the communities we serve. We expect everyone to live our company values of succeeding together, doing the right thing, always improving and working with care – our new value, introduced this year.

The decision to add this new value reflects a renewed focus on how we care for each other, our customers, communities and the environment. Working with care is about ensuring the health, safety and wellbeing of everyone who works for us and with us. It includes our suppliers and contractors, and this culture of care extends outwards from the better relationships we foster internally, to the stronger partnerships we build across our region.

One of the ways that colleagues live our values is through the hours they donate to volunteer at various community projects across our region. From supporting food banks, to helping renovate a charity's premises, our colleagues have provided more support than ever before. Our community team are also increasing their school talks and have developed a network of Community Ambassadors to engage young people and a refreshed education programme to encourage the next generation to learn about water.

I want everyone who works with us to feel that they can bring their authentic selves to work, and we aim to make sure that everyone is supported and cared for through our Equality, Diversity, and Inclusion (ED&I) policy, and the support groups we have in place. That is why I am pleased that we have improved our ranking in the Top 50 Inclusive Companies index for the third year in a row, moving from 46th to 44th place this year. Being a diverse and inclusive organisation enables us to connect our collective passion and capability across the business. Never has this been more important as we work together to deliver the step change that we need.

Changing behaviours to improve health and safety

We measure how engaged people feel about their work and we use our regular poll and pulse surveys to encourage teams to address any particular areas. I was pleased to learn that the strongest score from last year's survey was for managers caring about their team members' wellbeing.

The health, safety, security and wellbeing of our people is an overriding value. A core pillar of our strategy going forward will focus on how we make a behavioural shift to make sure we are always working with care. To do this it is important that everyone develops their understanding of the consequences if we get it wrong – for the individual, for their families and friends, and for colleagues and the community. It needs to become part of our DNA, an automatic behaviour that comes naturally.

To enable this, we are launching a company-wide training programme so that every colleague is given the same experience. We will also be launching a new set of safety campaigns and guidance materials for all colleagues.

The right people to deliver our plans

I know that we have a way to go to meet the expectations of our customers, stakeholders and regulators, but I am confident that we have laid further foundations this year, improving many of our key performance metrics. We are making progress and that is because of the hard work of every single one of my colleagues.

On behalf of the Executive team, I want to thank each of my colleagues for their unwavering commitment over the past year. Succeeding together has never been more important for our customers, communities and the environment.

Lawrence Gosden
Chief Executive Officer
7 July 2023

Our business at a glance continued

What we do

We work hard to **deliver on the priorities** of our stakeholders to benefit our local communities, customers and the environment

Engaging with our stakeholders

To create a resilient water future for our customers in the South East, we must understand the needs of the communities we serve and work with our stakeholders to find solutions to shared challenges.

Read more about how we engage with stakeholders on pages 33 to 39.

Together we are always improving

We actively collaborate with local, regional and international partners to foster innovation – whether seeking feedback and guidance on our plans and the design of our infrastructure or exploring new technologies to solve operational challenges.

Read more about how we are using satellites to find leaks on our network on pages 58.

Key facts about our operations

Cleaning and returning wastewater

1,248 million litres of wastewater received every day

363 treatment works

Treating and storing water

232 service reservoirs

75 supply works

Delivering water to customers

566 million litres are put into supply every day

2.7 million water customers served

Removing wastewater

4.7 million customers served

39,973km of sewers

3,499 pumping stations

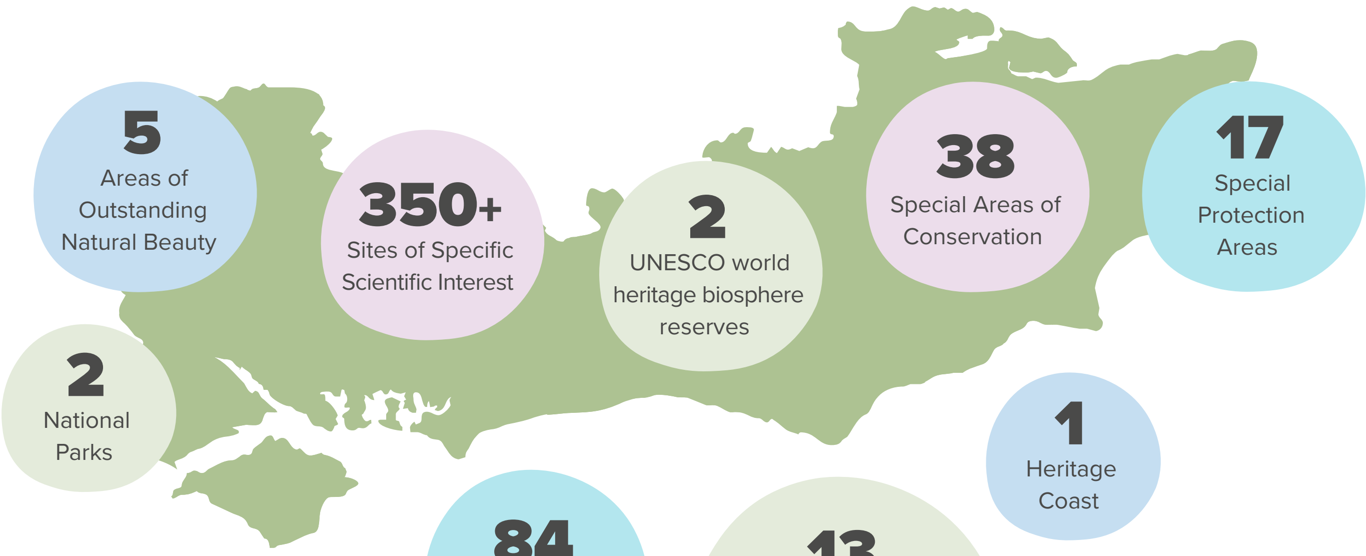
WATER for LIFE

from Southern Water

Our business at a glance continued

Where we do it

Our region is as diverse as the communities we serve



Environmental factors

Covering more than 700 miles, the stretch of coastline we help to look after includes chalk cliffs, shingle and sand beaches, harbours, estuaries and rich saltmarsh and mudflats. Out at sea we have a diverse range of marine habitats supporting kelp, dolphins, seals, reefs, vast swathes of sediment habitats, fish and shellfish populations.

The geology that helps to define the South East includes chalk block aquifers, north and south. As well as creating dramatic scenery they hold huge quantities of water that we take to put into supply. There are also chalk streams – perhaps the most famous of these are the Test and Itchen. Together with their counterparts in eastern England and France, they are recognised as an internationally important habitat.

We also have clay rivers deep within the Weald, which support populations of sea trout as they flow through the Ashdown Forest and the High Weald Area of Outstanding Beauty (AONB) before meandering through downland valleys and into the sea.

Economic factors

We are constantly working to build resilience into our operations so we can serve our growing population and support jobs and the tourism industry.

c.2,600 colleagues work directly for Southern Water with many more employed via our supply chain.

19-25% population growth expected by 2050.

£12 billion per year* in tourism revenue relied on by coastal and inland communities across our region.

*Source: tourismsoutheast.com.

Social factors

Our region is diverse, and our insight team works with our customers to identify their key priorities and concerns.

We offer a range of tariffs and services to customers who might find themselves in a vulnerable situation due to circumstances.

29% of our customers sometimes struggle to afford their outgoings*.

82% are concerned about the rising costs of household outgoings*.

41% are concerned with the cost of water bills in the future*.

*Source: Southern Water insight, March 2023.

Our business model continued

How we operate

Our vision is to create a resilient water future for our customers in the South East.

Water is collected

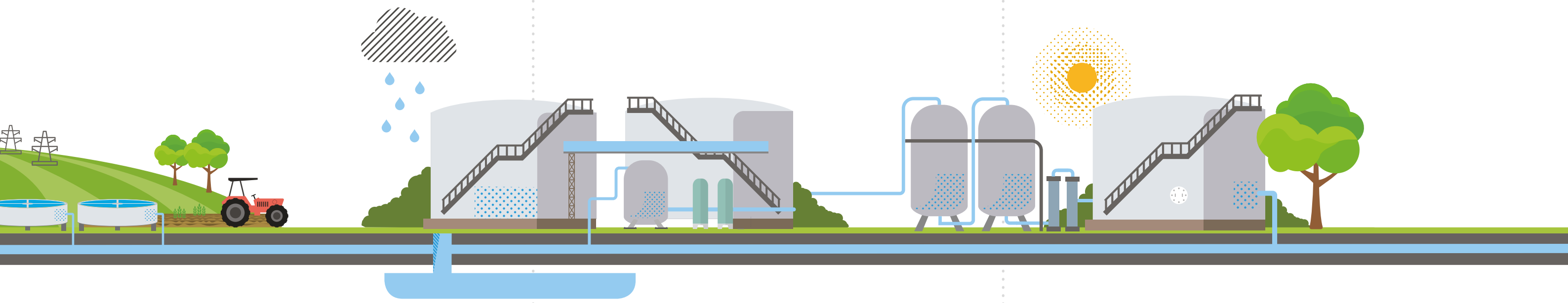
About 67.2% of the water we supply comes from groundwater (water stored underground in aquifers), 28.4% is taken from rivers and 4.4% comes from our reservoirs.

Water is cleaned

Our 75 water supply works treat raw water to the highest standards, making it safe to drink.

Clean water is put into supply

Our 13,919 kilometre network, 232 service reservoirs and 655 pumping stations deliver a continuous supply of clean water to our customers at a regulated pressure level.



Associated risk

In our densely populated and water-stressed region, we must balance the need to supply high-quality water to our customers with the need to preserve our natural resources, to help mitigate the risks posed by drought.

Associated risk

Failures at our treatment sites and across our network could result in a risk to public health due to reduced water quality and/or disruptions to supply. We use several chemicals in the treatment of water, which, if not handled correctly, could result in injuries to colleagues and/or customers. Area-specific risk assessments inform our monitoring programme, ensuring we are sampling for relevant substances to make sure we are treating water correctly.

Associated risk

We regularly test water that we pump into customers' homes and businesses to make sure it meets required standards. Our teams offer support on the installation of new pipework and notify customers when we find contaminants or lead pipes. We can experience increased leakage from our network and from customers' homes and businesses reducing available supplies.

Maintenance and development

We constantly monitor our sites and networks, carrying out maintenance and developing new assets and equipment to make sure they are meeting the standards set by our regulators. Failure to monitor, maintain and increase the capacity of our sites and networks could pose risks to public health, and result in disruptions to supply, injury to our employees or customers, and damage to property.

Our business model continued

Our use of water and its return to the environment is a continuous cycle. Managing our impact at every stage is critical to protecting future resources. Our environment is constantly changing, and it is essential that we continue to adapt and prepare for the challenges of population growth and climate change.

Customers enjoy our water

Customers across the South East go about their daily lives enabled by a supply of safe, clean drinking water and the removal of wastewater from their homes and businesses. In 2022–23, we put 566 million litres per day into supply.

Wastewater is collected and treated

Our 39,973 kilometres of sewers and 3,499 pumping stations collect wastewater from our customers' homes and businesses, and from the drains outside. Each day, 1,248 million litres of wastewater is received and cleaned at our 363 treatment works, meeting strict environmental standards before being returned to the environment.

Customers are billed

Our customer teams calculate and distribute customers' bills, handle payments and manage any related account queries.

Associated risk

If we do not constantly look to improve and maintain high levels of service and quality, we run the risk of not fulfilling our obligations to customers, to provide high-quality drinking water.

Associated risk

If we do not remove wastewater effectively and manage our network, we may cause sewer flooding, environmental pollution and unnecessary distress to our customers. Varying rainfall patterns, extreme weather events and rising sea levels all contribute to an increased risk of flooding if our infrastructure is overwhelmed. This could also lead to contamination of water supplies and infiltration/inundation of our sewers and sites.

Associated risk

Errors in our billing calculations or customer information could lead to poor levels of customer satisfaction, and a rise in contact and complaints, which could damage the company's reputation and increase operating costs. Failure to properly protect customer data could also lead to significant fines under Data Protection (GDPR) and Networks and Information Systems (NIS) directives.

Ensuring future supply

Climate change and population growth in the South East present very real challenges that initiatives like our Water for Life – Hampshire programme are looking to address through bulk water transfers with neighbouring water companies, water recycling projects and a host of other initiatives, all of which will be needed to secure reliable water supplies for the future. We are also working to reduce the amount of water lost through leaks on our network, and we are working with our customers to help them use less water.

Associated risks

If we fail to plan properly and take account of factors such as the impact of climate change, we risk not being able to maintain supplies to our customers, which in turn can lead to financial penalties and reputational damage.

Our business model continued

Living our purpose

Our purpose is why we exist. It drives our long and short-term decision making and is centred around the value we provide to our customers and stakeholders.

What we do and where

We provide essential water services to 2.7 million customers, and wastewater services to more than 4.7 million customers across Kent, Sussex, Hampshire and the Isle of Wight.

The external environment

The way we operate as a business is impacted by a number of external factors – social, political, environmental, economic, regulatory and technological – that we must consider and manage the impact of.

Environmental factors
Our natural environment is under pressure from population growth and climate change. We must continue to adapt and prepare to manage future impacts.

Economic environment
We are impacted by changes in financial markets, interest rates, inflation and other commodity prices, and we must manage these to reduce risk.

Regulatory environment
We must be responsive to regulatory requirements and prepare for future challenges.

Social environment
As a provider of essential services, we have a direct impact on our local communities. We must do all we can to support and understand our customers.

Innovation and technology
We are always improving our services, taking advantage of new technologies and innovations, wherever they come from.

Political environment
Decisions made by politicians and policymakers have the potential to impact our operations. We must follow any government directions, and adapt to policy developments.

Our key resources

For any business to be truly sustainable it needs to consider its impacts and dependencies, and this means going beyond tracking financial and operational measures to consider social and environmental resources and how they can affect our ability to create value over time.

Natural
Natural resources that we rely on, such as water.

People
Skills, capabilities and wellbeing of our employees and partners.

Financial
Financial health, including equity, debt and pensions.

Manufactured
Sites, equipment, networks and IT.

Social and relationship
Engagement, our reputation and the value we create for our communities.

Intellectual
Knowledge, systems, processes, procedures and the data we hold.

Underpinned by our risk and value process

Our risk and value (R&V) process improves our decision-making process, about how to invest, build and run our assets, and allows us to collaborate more effectively with our suppliers and partners. During the year, a number of environmental considerations were added to this process to make sure we are considering the natural capital (the wider value of services provided by nature) and carbon values in our decisions, so we can make them based on best value.

This approach triggers conversations and thinking about alternative sustainable solutions and drives innovation and partnership working. It is already showing us its value in supporting nature-based wetland solutions for wastewater treatment.

Our business model continued

How we do it

Our Water for Life Business Plan 2020–25 takes us one step closer to achieving our vision of a resilient water future for customers in the South East.

Developed following extensive consultation with our customers and stakeholders, over the five-year period it will deliver significant performance improvements, including a 15% reduction in leakage, improvements to 182.3 kilometres of rivers and a further 155,000 customers supported through financial assistance schemes, with bills reducing by 18% in real terms.

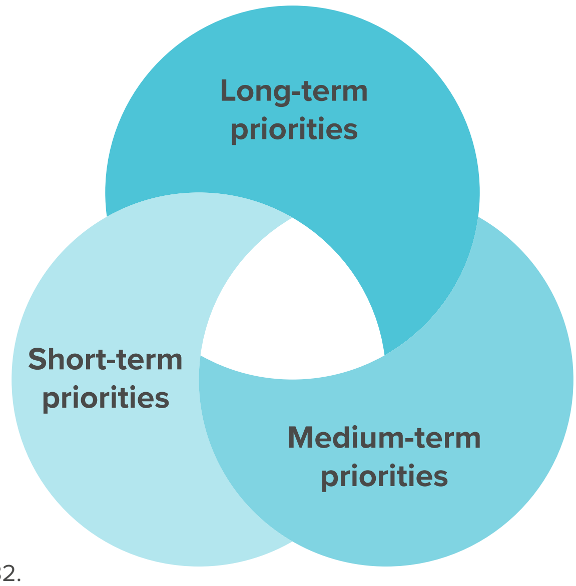
Who we deliver value for

The water cycle touches and enables every part of life, so our stakeholder base is diverse.

- **Customers and communities**
- **The environment**
- **Our people and partners**
- **Regulators**
- **Investors**

Our planning horizons and strategy

Our rigorous approach to planning across multiple horizons informs our strategy:



Read more about our planning horizons on page 32.

Our approach to sustainability

We operate in an environmentally and socially conscious manner and uphold the highest standards of corporate governance. Behaving in a responsible manner, ‘Doing the Right Thing’ and ‘Working with Care’ are core values that inform our decision making at every level of the organisation.

Read more about our corporate governance on pages 137 to 183.

Our business model continued

Our external **environment**

We consider and manage the impact of a number of external drivers.

Environmental factors

We must plan for, and mitigate, the impacts of climate change by reducing our own emissions and minimising the environmental impact of our operations. The water cycle is continuous so we must ensure that we are removing water from, and returning it to, the environment safely and responsibly. We must also make sure that we are engaging with stakeholders and future customers to reduce our collective impact on the water environment.

Economic environment

We are impacted by changes in financial markets, interest rates, general inflation and other commodity prices, and we must manage these to reduce risks to our financial resilience and protect our investors' interests. We must also pay attention to the economic climate as it will have a direct impact on our customers and their ability to pay their bills.

Regulatory environment

We must operate as a sustainable business. This means being responsive to regulatory requirements and engaging constructively with market reforms as well as understanding and preparing for future challenges.

Our relationships with our regulators – economic, drinking water quality and environmental – are vital to ensure the resilience of our business and we work closely with them to share our progress and our plans, as well as influencing market reform.

Over the next 25 years, our regulators expect us to deliver important improvements in outcomes, significantly increasing drought resilience, reducing abstraction of water, reducing leakage, reducing per capita consumption, improving environmental water quality, and meeting net zero emissions.

Social environment

As a provider of essential services, we have a direct impact on our local communities. We must be mindful of this and do all we can to support and understand our customers. We know that there are areas across the South East experiencing high levels of deprivation, particularly because of rising inflation and recent increases in energy costs. We make it a priority to offer support and advice to our customers who might find themselves in a vulnerable situation due to circumstances.

Innovation and technology

We are always improving our services, taking advantage of new technologies and innovative ideas, wherever they may come from. 'Always Improving' is one of our core values and our bluewave innovation hub supports teams across the business, bringing design thinking to a range of projects. New technology, of course, can bring with it a number of risks, and so we constantly monitor our cyber security to meet the needs of the business.

Political environment

Decisions made by politicians have the potential to significantly impact the way we operate. As a result, we work closely with regional and national organisations to understand the development of any policies that will influence our business, while ensuring they understand the economic, environmental and social value we deliver for our communities in the South East. Future customers want many of the environmental targets achieved earlier and expect more radical systemic change by both the government and organisations to address the climate crisis.

Our business model continued

The water sector

Water and wastewater services are provided by 11 licensed companies, and there are a number of smaller water-only companies, all serving more than 25 million households and commercial customers in England and Wales.

Since the industry was privatised in 1989, a regulatory framework has been in place to ensure that customers receive a good standard of service at a fair price, managed by the industry economic regulator Ofwat. This framework has seen these water and wastewater companies invest billions of pounds maintaining and improving sites, technology and services, and, in turn, improving drinking water quality and enhancing the environment.

The challenges of population growth and climate change mean that the water industry must significantly change the way it operates over the coming years. As a result, the policy landscape is continually evolving. The 25-Year Environment Plan, Environment Act, review of the Water Industry National Environment Programme and preparation for the next business plan period 2025–30, are just some of the key drivers for change in the water sector and beyond.

By 2050, within Southern Water's region, we are anticipating losing a third of our water sources as a result of climate change. To protect our sensitive environment, we will also see a reduction in the amount of water we are allowed to take from rivers and underground sources, and our population will have grown by 19-25%. Without action, we predict a supply deficit by 2030, equivalent to around 50% of our current supply.

We are working proactively with the rest of the sector, regulators, stakeholders and others on workable solutions to these challenges, which we simply cannot solve alone. Concerns around storm overflows and chalk streams are examples where a multi-sector approach is essential, and we fully support the government's efforts to facilitate a collective response. We are actively exploring new ways of working using natural capital approaches to deliver more nature-based solutions, such as constructed wetlands creation, sustainable urban drainage and river restoration projects.

We also support the government commitment to deliver net zero carbon water and waste services, and we are aiming to bring our services in line with these targets by 2050.

Working with our regulators

We are subject to regulation of our price and performance by economic, quality and environmental regulators, as outlined below.

The Department for Environment, Food and Rural Affairs (Defra) determines the overall water and sewerage policy framework in England, setting standards, drafting legislation and creating special permits, such as drought orders. **defra.gov.uk**

Ofwat is the economic regulator of the water and sewerage sectors. It protects the interests of consumers by promoting appropriate competition, making sure water companies properly carry out their functions and ensuring they have the adequate finance in place. **ofwat.gov.uk**

The Environment Agency is the environmental regulator of the water and wastewater sector in England. It is the principal adviser to the government on the environment, and the leading public body improving and protecting the environment of England. It works with a range of organisations to reduce flood risk, promote sustainable development, and secure environmental and social benefits. **gov.uk/government/organisations/environment-agency**

The Drinking Water Inspectorate is the drinking water quality regulator and enforces the Water Quality Regulations set by the government. To do this, it checks the tests carried out on drinking water by water companies, along with carrying out company inspections. **dwi.gov.uk**

CCW represents water and wastewater consumers. It also investigates consumer complaints that have not been satisfactorily resolved by water companies. **ccwater.org.uk**

Natural England advises the government by providing practical guidance, grounded in science, on how to best safeguard England's natural wealth. Its purpose is to protect and improve England's natural environment and encourage people to enjoy and get involved with their surroundings. **naturalengland.gov.uk**

Read more about how we engage with our regulators on pages 33 and 35.

Our business model continued

Our external **environment** continued

We have identified the main factors that affect our business.

A growing population

Population growth will place more pressure on limited resources.

- The UK's population has grown by 8.7 million people in 20 years.
- By 2050, the population in the South East is predicted to grow by another 19-25%.
- Increased housing development and reduced open spaces will require new water solutions.
- Greater demand for agricultural production.

Material issues: Climate change; public health; natural capital; responsible supply chain; water use; political and regulatory environment; local economies; energy use; stakeholder engagement; and networks.

Affected capitals:

How we are responding:

Through Water Resources South East, we are collaborating with our neighbouring water companies to manage the development of the region's water resources, ensuring an affordable, resilient and sustainable water supply to meet growing demand. Read more: **wrse.org.uk**.

We are already making connections to neighbouring water company networks in water-stressed areas to enable the sharing of water to increase supply and meet demand. Our Water for Life Hampshire programme is developing a new network of water mains across the region. Read more: **southernwater.co.uk/our-story/our-plans/water-for-life-hampshire**.

We have developed our water and wastewater plans to meet future demand. Read more: **southernwater.co.uk/dwmp** and **southernwater.co.uk/our-story/water-resources-management-plan.**

Changing communities

Communities are adapting due to demographics and societal changes.

- People are increasingly focused on health and wellbeing.
- More people are living alone.
- The average age of the population is predicted to be over 65 by 2050.
- Increasing mobility means that nearly three million households move each year.
- Hybrid working increases demand for local services.

Material issues: Health, safety, security and wellbeing; public health; affordability and vulnerability; trust, transparency and legitimacy; and water use.

Affected capitals:

How we are responding:

Every community is unique. During our ongoing engagement with customers and stakeholders, we make sure we recruit a representative range of customers from across our region – including demographics such as income, household size, customer segment and location.

This year, we have run research programmes across our main population areas such as Southampton, Isle of Wight, Brighton, Hastings, Chatham, Thanet and so on. This insight allows us to adapt to the changing shape of our communities, understanding their priorities and how best to engage with them.

From this work we create summaries, infographics, posters and a booklet for teams across the business so the insight we have gathered can be applied to projects and delivery plans.

Our business model continued

Key to our capitals

In order to create an integrated view of the value we create, we are starting to use the following stocks of value or 'capitals' that can be affected or transformed by our activities and outputs.

Natural People Financial Manufactured Social and relationship Intellectual

Evolving customer expectations

Customer expectations are evolving with technology and greater access to information.

- Increasing expectations on speed of service from other sectors.
- Increasing demand for real-time data that improves their lifestyle and finances.
- An expectation of 100% availability from their utility providers with lower tolerance of failure.
- A desire for personalised services tailored to customers' needs.

Material issues: Customer service; affordability and vulnerability; data protection; energy; and water use.

Affected capitals:

How we are responding:

During the year we have increased the number of customer newsletters circulated so we are keeping local communities updated about key construction schemes and upgrades to our services.

We have increased the quantity of information available via our signage for capital works. We recognise that this is particularly important in areas where we have ongoing or repeat issues, for example in Lancing, West Sussex.

We have updated our systems to allow us to send out more text message updates during an incident. Most of our customers told us this was how they wanted to hear from us.

We have continued to focus on improving our customers' ability to self-serve, as many of them have told us that they do not want to have to call or email us. This includes updates to our web chat service and increasing the number of people responding to queries on social media.

We are also starting to explore a video triage service for operational customer call outs across our water and wastewater teams. Allowing us to direct our resources to those that need them most.

Read more about our operational performance on pages 42 to 95.

Increasing use of technology

Big data, artificial intelligence (AI) and machine learning are all becoming increasingly common.

- Growing ability to unlock valuable insights from data.
- Data becoming increasingly open to all – customers, stakeholders and government.
- Increasing automation to simplify and speed up processes.
- Using AI to learn and adapt to changing environments.

Material issues: Water use; compliance; customer service; community engagement; trust; transparency; and legitimacy.

Affected capitals:

How we are responding:

Unlocking insights from data We have been building digital analytics to more accurately track website journeys, contact forms and call centre contact so we can identify improvements and customers in need of help.

Open data This year we participated in a range of open data initiatives, both independently and across the industry as part of the Ofwat Innovation Fund's Stream programme. We also delivered a series of open data projects independently including regional investment maps, and the Beachbuoy application, leading the industry in transparent publishing of spills data.

Process automation We have automated several processes to support our customers during water supply incidents. For example, we are now able to quickly compile lists of affected customers on our Priority Services Register, enabling us to offer support more quickly. We have also automated processes for customer contact, Guaranteed Standards of Service and compensation payments making claims quicker and easier.

Platforms We are in the process of implementing new data and analytics platforms to further enable machine learning and AI on a large scale. We have existing applications of advanced analytics in use at the moment. For example, we use machine learning to identify the most appropriate pathway for customers in our debt collection process enabling a more personalised approach and support.

Our business model continued

Our external environment continued

Rising concerns about the environment

Demand to protect the environment is driving change in government priorities.

- Social media rapidly exposing environmental harm.
- Any pollutions seen as unacceptable.
- Rare and fragile chalk streams under threat.
- Storm overflows not seen as acceptable.
- Open-water swimming increasing in popularity.

Material issues: Compliance; health, safety, security and wellbeing; public health; trust, transparency and legitimacy; political and regulatory environment; stakeholder engagement; and networks.

Affected capitals:

How we are responding:

Responding to this demand and future proofing our systems could require significant investment, however this needs to be balanced with the ability to provide our services to customers at a fair and affordable price.

People expect to be able to access clean beaches and healthy rivers throughout the year and are increasingly intolerant of organisations they perceive as preventing this. We have Event Duration Monitors (EDMs) on 98.6% of our storm overflows giving us visibility and, more importantly, the ability to report pollutions accurately. Further improvements have also been made to our Beachbuoy release monitoring service, which uses data from EDMs.

Our Clean Rivers and Seas Task Force has launched six projects across our region from Kent to the Isle of Wight, aimed at reducing excess water entering our sewers, limiting the use of storm overflows. Read more on pages 64 and 68.

Our latest Pollution Incident Reduction Plan details our investment and year-on-year improvements. Read more: **southernwater.co.uk/our-story/our-plans/pollution-reduction-programme**.

We are investing to develop new water sources and transfers in the Hampshire region to reduce pressure on the chalk streams of the Rivers Test and Itchen. Read more: **southernwater.co.uk/our-story/our-plans/water-for-life-hampshire**.

We have set up our Independent Climate and Environment Group that is scrutinising and informing our plans to 2050. Read more on page 38.

Climate change

Climate change is impacting our environment and the way we operate our water and wastewater services.

- Need to reduce carbon emissions.
- Forecasts of more extreme weather, warmer land, air and sea, polar ice melting, changes in ocean currents.
- Seasonal storms increasing in intensity and hyper-locality.
- Biodiversity reducing.

Material issues: Compliance; climate change; public health; energy use; natural capital; responsible supply chain; water use; materials; and solid waste.

Affected capitals:

How we are responding:

Our third Climate Change Adaptation Report (2021) highlighted the impacts that we would need to adapt to and mitigate for across our region. Read more about our approach to climate change on pages 75 to 95.

We have created a set of natural capital accounts that we are now using to assess the value of natural assets across our region and inform our decision making. Read our natural capital case study on page 31.

Our Water Resources Management Plan and Drainage and Wastewater Management Plan have been created in consultation with regional stakeholders and neighbouring water companies to address the impacts of climate change on our infrastructure. Read more: **southernwater.co.uk/dwmp** or **southernwater.co.uk/our-story/water-resources-management-plan**.

Our business model continued

Key resources

In order to create an integrated view of the value we create, we are starting to use the following capitals that can be affected or transformed by our activities and outputs.

CASE STUDY

Natural capital

"To deliver reliable, high-quality water and wastewater services to our customers now and in the future, we must protect and improve the natural environment, which underpins these services. We call these natural assets our natural capital and are considering them alongside our built asset base.

"Natural capital refers to the elements of nature (rivers, lakes, woodlands, wetlands) that deliver benefits to people by providing ecosystem services, such as providing fresh water, reducing flooding and providing health and wellbeing benefits. In the South East, this includes our rivers – such as the unique chalk streams of the Rivers Test and Itchen – and the coast.

"To help us understand the extent and condition of our natural capital and the ecosystem services supplied we have developed baseline natural capital accounts for three river catchments – the Arun and Western Streams, the Medway and the Test and Itchen. This information will be used to inform our planning and investment decisions, strengthening our resilience, reducing costs and building trust with our stakeholders. Read the full report: **southernwater.co.uk/water-for-life/protecting-the-environment/measuring-our-natural-capital**.

"The accounts will help us track changes in natural capital value over time, as we work in partnership with stakeholders to build, restore or improve the natural environment.

"Our next step is to extend the baseline accounts to all of our 11 river catchments. This will provide a full picture of natural capital across our operating area."

Sean Ashworth, Environment Strategy Manager

Stakeholders impacted:

- **Customers and communities**
- **The environment**
- **Our people and partners**
- **Regulators**
- **Investors**

CASE STUDY

Social and relationship capital

"To make sure that the environment, customers and our communities are at the heart of our decision making, we have been working more closely with our delivery partners to explore projects with social value reporting benchmarks as part of our reporting.

"The £28 million upgrade of our Horsham Wastewater Treatment Works started during 2022, and was identified as a project where we could work with our delivery partners CMDP-JV to explore the impact on the local community.

"An assessment of the key criteria to be measured has been carried out, such as localised procurement and employment, apprenticeships, volunteer hours and carbon reduction.

"The project has also launched a schools programme, in primary schools and after-school groups.

"It also co-funded a community centre energy grant to award 20 community centres with £1,000. The money was used to support their utility bills over the winter months to make sure they could stay open.

"The teams at Horsham have also been taking part in local volunteering projects. Providing 1,000 hours of their time and loaning of specialist equipment and skills to help local homeless charity Turning Tides to renovate a new building. The space has been turned into accommodation for 50 homeless people.

"The pilot aims to capture quarterly measurements using the national TOMS methodology and framework. We'll then use the findings to inform similar projects in our next investment period from 2025–30."

Alex Willumsen, Community Partnerships and Programme Manager

Stakeholders impacted:

- **Customers and communities**
- **The environment**
- **Our people and partners**
- **Regulators**
- **Investors**

Our business model continued

Our planning horizons and strategy

Vision
To create a resilient water future for our customers in the South East.

Long 25 years+

The nature of our business means we must think in long-term planning and investment cycles to make sure we can deliver on our ambitious vision:

Long-term priorities

- Understanding and supporting our customers
- Protecting and improving the environment
- Enabling and empowering our people
- Ensuring a supply of high quality water for the future

Medium five years+

Our medium-term planning reflects our five-year cycle of asset management planning (AMP) periods and supports our long-term priorities:

Current delivery strategy 2020–25

- Deliver great service
- Use water wisely
- Protect and improve the environment
- Fit for the future

Read more about our current performance on pages 42 to 95.

Short one to two years

We have created four workstreams as part of our Turnaround Plan to make sure we are in the best possible position to deliver our ambitious plans for 2025–30.

Turnaround Plan

- **Empowered and supported colleagues** – Enabling our people to work in a safe, collaborative and inclusive workplace that offers rewarding careers at the heart of our communities.
- **A reliable supply of water for our customers** – Safeguarding resources and making sure our customers have access to a supply of high-quality water now and into the future.
- **Healthy seas and rivers** – Protecting and improving the environment, working transparently to enhance inland and coastal habitats.
- **Trusted and easy customer service** – Supporting our customers with easy service and transparent communications that show we care for our communities.

These are underpinned by a focus on our people, IT and digitalisation and finance and efficiency.

Engagement with stakeholders

Delivering value to our stakeholders

Water enables everything we do so we have a responsibility to meet the needs of a range of stakeholders.

Customers and communities

Our customers expect us to deliver wholesome water and effectively remove wastewater. They want us to deliver services sustainably, at affordable prices, while supporting customers who might become vulnerable due to circumstances.

Water for life is a shared responsibility, which means we must build partnerships in our communities with interest groups and local charities as well as future customers. Our employee volunteering programme helps us to connect with our communities.

How we measure value:

Customer experience (C-MeX).

Other metrics include value for money, community engagement, developer experience (D-MeX), complaints, vulnerability support and financial assistance.

The environment

Our natural environment, including reservoirs, river catchments and bathing waters provide spaces for wildlife, recreation, and create value in terms of tourism. We work hard to protect and improve them, while delivering our essential services.

How we measure value:

Environmental Performance Assessment (EPA), conducted by the Environment Agency.

Other metrics include leakage, greenhouse gas emissions and natural capital value added. Read more about our natural capital accounts on page 31.

Our people and partners

We want to attract, develop and nurture an inclusive and diverse workforce, making sure we look after the health, safety and wellbeing of every colleague and partner. We invest in the region's infrastructure, generating jobs, improving skills and helping to sustain the local economy through our capital construction programme. We work in partnership with our suppliers; ensuring transparency and fair treatment.

How we measure value:

Colleague engagement (Gallup); and Voice of the Supply Chain (survey).

Other metrics include diversity and inclusion, learning and development, injuries and near misses.

Regulators

We have a number of regulators, and their priorities help define our business plans so we must constantly look to engage and influence them, where we can. Read more about our regulators on page 27.

How we measure value:

Ofwat Water Company Performance Assessment; and EPA.

Regulatory price controls help to align shareholder value with customer and environmental priorities.

Investors

To add value for our investors, we manage risk and provide an appropriate return, when we can. We invest their money to provide for growth and resilience.

How we measure value:

Return on regulated equity; outcome delivery incentives; and GRESB.

CASE STUDY

Understanding and supporting our customers and communities

Improving **our service** through a constant conversation with our customers

"Our region is diverse and the insight I lead on needs to reflect our communities.

"We developed a series of panels so we can work more closely with different audiences and better understand their perspectives. This has included a panel of households, businesses, future customers, those who are vulnerable due to circumstances and leaders who can represent communities from more diverse cultures.

"Through traditional research it's always been a challenge to engage when English isn't a customer's first language. Often these groups aren't reachable through our existing communication channels. We spoke with some of these customers, and they told us that community leaders were the best way to understand their needs. We then recruited representatives of the Chinese community, asylum seekers, Asian, Pakistani customers, and other cultures from across the South East.

"Following the research, we present the conclusions and results to these Diverse Culture community leaders every quarter. Through depth interviews we then spend time exploring where there are similarities and differences to the communities they represent. From this we are then able to better understand their needs and tailor future services to meet these needs.

"A key issue identified is around the low awareness of our Priority Services Register and our Essentials Tariff. Partly because of lower engagement with these groups and partly because of language and literacy barriers. During the drought in 2022, we also saw lower awareness and understanding of the Temporary Usage Bans.

"Following this, we worked with them to help share drought messaging in Hampshire and the Isle of Wight to their respective communities. We have also used this network to share information on our Priority Services Register and financial support in different languages, and we continue to work with leaders to help address these challenges.

"Our Diverse Cultures Panel is helping in improving these everyday challenges and is informing our plans for the future (such as our 2025–30 business plan)."

Nick Eves, Head of Insight

Engagement with stakeholders continued

What matters to our stakeholders

Customers and communities

We constantly seek feedback on what our customers think about our services – both domestic and wholesale – so we can be sure that we are addressing the issues that matter to them. Our aim is to provide a seamless service that they value. We want to work with our customers and communities so we can meet their short and long-term expectations and collaborate on solutions that benefit them.

Three material issues:

- Public health and compliance (environmental stewardship)
- Customer service and support
- Local economic impact

The environment

Central to our purpose is the need to protect and improve our natural environment. We depend on it and so it is vital that we work collaboratively with our environmental regulators, non-governmental organisations, campaigners and local communities to find quick solutions to environmental issues, such as climate change, pollution and land management.

Three material issues:

- Water resources and leakage
- Sewer flooding and storm overflows
- Climate change

Our people and partners

Our people are Southern Water, whether colleagues or partners, and we simply could not deliver our services without them. Most of them live in the South East and are also our customers, so we celebrate their diverse range of views and experience and use it to inform our decision making.

Three material issues:

- Health, safety, security and wellbeing
- Trust, transparency and legitimacy
- Local economy

Regulators

Through engagement with our economic, quality and environmental regulators, we agree commitments over specified time periods alongside requirements they have of us in terms of our plans and performance. In some cases, there are financial rewards and penalties attached to these commitments. We seek to influence policy and regulatory frameworks when we can to make sure they support us delivering the best outcomes for our customers and the environment.

Three material issues:

- Business performance
- Financial resilience and risk management
- Political and public opinion

Investors

It is important that our investors have confidence in the company and how it is managed, so we provide regular updates on our performance and progress. This also includes environmental, social and governance (ESG) updates alongside financial and performance data.

Three material issues:

- Business performance
- Financial resilience and risk management
- Corporate governance and ESG-related matters

Read our materiality assessment on pages 40 to 41.

Read our s172 Statement on page 96 to 99.

Engagement with stakeholders continued

How we have **engaged** throughout the year

Independent Customer Group (ICG)

Our challenge community – to help drive customer first improvements includes:

Our **Customer and Communities Challenge Group**. There to provide expertise and challenge on our proposed business plans, the group is made up of customer leaders, such as those that help vulnerable audiences, businesses and lower income households.

Customers from our panels. These customers become informed through continuous engagement and scrutiny of our plans. We then run engagement sessions that include these informed customers and our executive and leadership teams. This then provides open challenge directly to decision makers and helps put the customer at the centre of what we do.

The **Independent Climate and Environment Group**. There to provide specialist and technical challenge and advice on our environmental performance and strategy (see ICEG commentary below).

This is underpinned by our **external quality and assurance programme**, which provides insight to colleagues from across the business so they can focus on improving our delivery and performance.

Stakeholders involved: Customer leaders, informed customers, Southern Water leaders and colleagues, and see ICEG below.

Link to risk: Water; wastewater; customer; climate change; and people.

Independent Climate and Environment Group (ICEG)

Outcome of engagement To help build greater confidence in our commitment to the environment, we created the ICEG, with an independent Chair. The group has provided independent advice and challenge on our Drainage and Wastewater Management Plans, our Water Resource Management Plans and our Clean Rivers and Seas Task Force Pathfinder projects this year. They are also helping to shape our long-term environmental ambition and what we need to deliver as part of our business plan for 2025–30 to reach our goals.

Stakeholders involved Martin Hurst (Chair) is also Chair of the Southern Regional Flood and Coastal Committee and is a former environment advisor in Number 10 and water director in Defra. Members include Rivers Trusts, Wildlife Trusts, RSPB, Environment Agency, Natural England, NFE, Consumer Council for Water, Waterwise, Local Flood Authorities and Universities.

Link to risk: Water; wastewater; and climate change.

Engagement with stakeholders

The Living Coast (UNESCO Biosphere Reserve, Brighton and Lewes Downs)

Outcome of engagement: A designated urban biosphere reserve, The Living Coast stretches between Newhaven and Shoreham-by-Sea in Sussex. From the South Downs, through city streets and out to sea, it embraces everyone and everything that lives within this area and makes life here possible. UNESCO biospheres are areas with significant natural value, created to help us learn how to balance what people and nature need to flourish. Our interest focuses on the water aspects of the biosphere, including water efficiency and water quality and we collaborate to create opportunities for customer behaviour change and environmental enhancements.

Stakeholders involved: Brighton and Hove City Council, Lewes District Council, Adur and Worthing Councils. Local Health Trusts, Brighton and Hove Bus Company, University of Brighton, University of Sussex, and South Downs National Park.

Link to risk: Water; wastewater; and climate change.

Blean Primary School, Canterbury, Kent

Outcome of engagement In February 2023, we received letters from Blean Primary School's year five Eco Club members. They wanted to challenge us on 'a most serious matter concerning the actions you have committed towards the oceans surrounding Kent'. We approached the Eco Club leader and asked if we could visit the school to explain how combined sewers work and why storm overflows exist. We also wanted to tell them what we were doing to reduce the number of storm overflow releases. Our Education Officer, Joanne Wood and Nicole McNab, from our Clean Rivers and Seas Task Force, were invited to speak to the school and staff, and explain the impact of heavy rain on the sewer network, and how the task force is working on nature-based solutions to 'slow the flow' of water into the sewers. After the talk, the Eco Club leader fed back that it was 'very useful to hear the reasons behind the overflows'.

Stakeholders involved: 260+ school children and 20 staff from Blean Primary School, Canterbury, Kent.

Link to risk: Wastewater.

Engagement with stakeholders continued

How we have **engaged** throughout the year continued

Citizen Science in Sandown

Outcome of engagement: To conduct independent water quality testing with the aim of providing real-time data that will help people to make an informed decision about swimming in the sea. This data will either be published on our own website or shared with the organisations taking part in the trial.

The samples are taken by volunteers from Swim the Wight and the Wildheart Animal Sanctuary who wade out daily to a pre-determined point in Sandown Bay and return with a sample ready to calibrate in a water quality monitoring device (which is used by the Environment Agency). The 'Fluidion' device was pioneered in Paris to test the water quality of the River Seine prior to the Olympics in 2024.

Stakeholders involved: Swim the Wight (a Sandown-based social enterprise who aim to improve lives with 'vitamin sea') and the Wildheart Animal Sanctuary (who are based on the seafront).

Link to risk: Wastewater; and climate change.

Three Harbours Technical Working Group

Outcome of engagement: To bring together partners around Chichester, Langstone and Pagham Harbours to collaborate and co-deliver solutions to improve water quality and restore nature at scale. We have worked with them to develop our environmental programme for our Water Industry National Environment Programme (WINEP) submission and our business plan for 2025–30 and are developing detailed plans to drive collected action. Read our harbours case study on page 67.

Stakeholders involved: The Environment Agency, Natural England, Chichester Harbour Conservancy, Langstone Harbour Board, local Wildlife Trusts, the RSPB, Portsmouth Water, Hampshire County Council, West Sussex County Council, Chichester District Council, Solent Forum, Coastal Partners, the Sussex Inshore Fisheries and Conservation Authority, and the Royal Yachting Association.

Link to risk: Wastewater; water; and climate change.

Engagement with stakeholders continued

Local Nature Partnerships – regionwide

Outcome of engagement: To build relationships, share best practice and drive forward nature's recovery across the South East we have set up a series of local partnerships. Our business is reliant on a healthy and functioning natural environment and this means we need to be ready to react to emerging environmental regulations. Examples of projects under way include exploring nature-based solutions to reduce carbon and Sussex woodland opportunity mapping, both of which are informing our strategies and delivery plans.

Stakeholders involved: Local Authorities, environmental NGOs (including Wildlife Trusts, Rivers Trusts, Woodland Trust, RSPB and more), businesses (including other water companies), protected landscapes (national parks and Areas of Outstanding Natural Beauty), the Environment Agency, Natural England, the Forestry Commission, Inshore Fisheries and Conservation Authorities, the National Farmers Union, the Country Land and Business Association, and local landowners.

Link to risk: Wastewater; water; and climate change.

Water industry insight group

Outcome of engagement: To drive a much better understanding of what matters to our customers we have been sharing insight with our neighbouring water companies in the South East. This gives us a better understanding of the needs of our customers, and where there are differences and the drivers of them. It also means we have access to a greater breadth of insight so we can build from that existing knowledge base and that this insight is triangulated against other data sources. This means our understanding of customer needs is more robust and we can have greater confidence in any recommendations we make.

In October 2022 we spent the entire day in a session dedicated to sharing best practice and customer insight. The Consumer Council for Water and Ofwat also attended the session – bringing feedback they had collected from their research.

Stakeholders involved: South East Water, Thames Water, SES Water, Affinity Water, and Portsmouth Water.

Link to risk: Customer

Our focus areas

Our stakeholders' material issues inform our **business priorities**

Our approach to materiality

Having a thorough understanding of what matters most to our stakeholders is vital and we consider these material issues alongside our own priorities and their ability to create value. The materiality matrix on page 41 represents the output of that assessment. Having clear visibility of these issues is critical as it helps inform our business strategy and our ability to create long-term value.

Determining and prioritising material issues

To assess the strategic relevance of each material issue, we considered its effect on our ability to create value, internally (for the company, our investors and employees) or externally (for customers, communities, our suppliers and the environment). This value could be financial or non-financial.

The level of interest to stakeholders is based on views gathered through direct engagement throughout the year. This includes the insight gathered as part of the consultation process for the business plan period 2025–30.

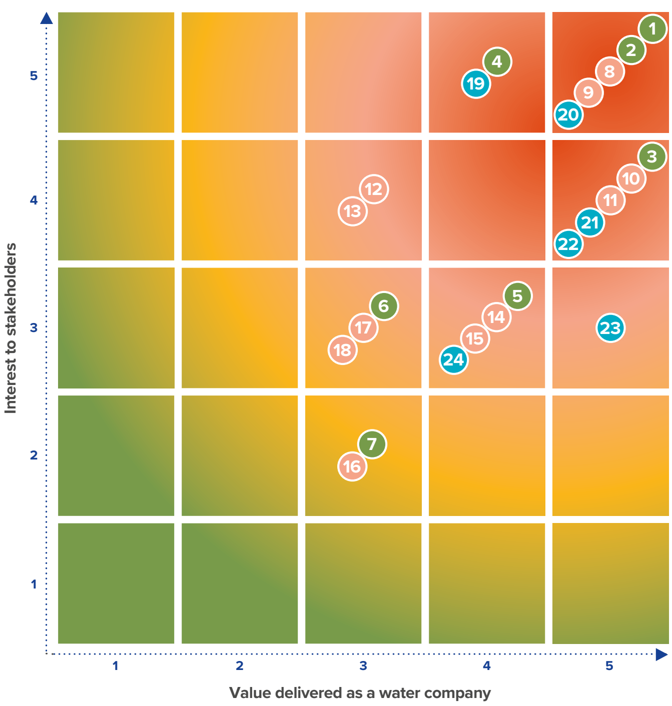
Material issues matrix

To compile our materiality assessment for 2022–23, we consolidated feedback from our various stakeholder groups, as detailed on page 33, which resulted in 26 key issues impacted by internal or external factors or sometimes both. These issues have been plotted on the next page, from low to high in terms of level of interest to stakeholders and how much each issue affects our ability to create value.

Our assessment process

Step one	Step two	Step three
Defining our issues The results of our stakeholder engagement activities, see pages 33 to 39, informed the selection of issues. We also considered our corporate strategy, vision and values. Further, we identified potentially material issues by monitoring external trends including the UN Sustainable Development Goals, assessing risks, and reviewing best practice including ESG frameworks such as the Global Real Estate Sustainability Benchmark (GRESB).	**Prioritising** The significance of the issues was assessed to prioritise them. We scored them on two scales: the importance of the issue to stakeholders, and the significance for us to create value. Each received a score from one to five, reflecting our existing Enterprise Risk Management process. One indicating no impact/negligible ability to influence and very infrequent stakeholder interest. Five indicating critical impact for all functions/high levels of control, and significant interest of many stakeholders.	**Test and review** We tested the prioritisation scores with internal groups to validate the process and ranking. Executive Team members were included in this process, as well as senior managers and subject matter experts across our business.

Focusing on what matters to **our stakeholders**



Our material issues

Environmental	Link to principal risks
1 Compliance	Compliance – see page 129
2 Climate change	Climate change – see page 129
3 Water use	Water – see page 127; Delivery – see page 130
4 Biodiversity and natural capital	Compliance and Climate change – see page 129
5 Materials and solid waste	Climate change – see page 129; Wastewater – see page 127; Resources – see page 131
6 Energy use	Climate change – see page 129
7 Land management and access	Compliance and Climate change – see page 129

Social	Link to principal risks
8 Health, safety, security, and wellbeing	Health and safety – see page 131
9 Public health	Water – see page 127
10 Customer service	Customer – see page 128
11 Affordability and vulnerability	Customer – see page 128
12 Local economies	Customer – see page 128; Wastewater – see page 127
13 Fair and equal pay	Community engagement – see page 132
14 Diversity and inclusion	People – see page 132
15 Community engagement	Customer – see page 132
16 Social mobility	People – see page 132
17 Skills and employment	People – see page 132
18 Human rights	Resources – see page 131

Governance	Link to principal risks
20 Trust, transparency, and legitimacy	Compliance – see page 129
19 Company structure, ownership	Compliance – see page 129
21 Data protection	Compliance – see page 129; IT – see page 130
22 Political and regulatory environments	Financial – see page 128; Corporate affairs – see page 132
23 Stakeholder engagement and networks	Customer – see page 128; Corporate affairs – see page 132; Delivery – see page 130
24 Responsible supply chain	Resources – see page 131

Our operational performance

How we measure **our progress**

Our Water for Life Business Plan 2020–25 is broad and ambitious and includes 47 clear customer commitments. We recognise that performance needs to be improved for our customers and the environment, therefore, we have detailed plans to turnaround performance. They explicitly target improvements across four areas: understanding and supporting our customers and communities; ensuring a supply of high-quality water for the future; protecting and improving the environment; and enabling and empowering our people. Read more about our performance measures in our Annual Performance Report.

Understanding and supporting our customers and communities

Outcome	Why it is important	Associated operational delivery incentive (ODI)	Performance			End of AMP target	End of AMP Status	Link to executive remuneration
			2022–23	Trend	2021–22			
Deliver great service								
Customer experience	Customers want to see us improve our customer service performance. They want us to minimise the impact of issues and disruptions to their daily life. When shown comparative information, they expect us to do better.	C-MeX	⊖	▬	⊖	Median	⊖	Direct
		Void properties	⊖	▲	⊖	2.56	✔	
		Gap sites	⊖	▲	⊖	65	✔	
Sewer flooding prevention	It is essential that our network stops homes being flooded with waste from sewers. There is strong support to ensure we continue to improve sewer flooding prevention.	Internal sewer flooding	⊖	▲	◎	274	✔	Indirect
Supporting the vulnerable	Customers find the concept of the social tariff acceptable. They want us to protect the most vulnerable in society, and find it acceptable to pay a little extra on their bill to help those in genuine need. They want us to partner and provide support by understanding and acting on customers' individual circumstances.	Customer satisfaction with vulnerability support	⊖	▬	⊖	90	✔	Indirect
		Effectiveness of financial assistance	⊖	▲	⊖	90	✔	
		Priority services for customers in vulnerable circumstances	✔	▲	⊖	7.0	✔	
		Value for money	⊖	▬	◎	80	✔	

Link to executive remuneration: Direct – there is a specific performance measure included within the bonus scheme that is linked to the performance commitment. Indirect – there is a link to the performance measures in the bonus scheme but that it is a component of one of the metrics used for assessing performance rather than a specific/individual metric.

Key:
- ✔ Ofwat target met or exceeded
- ⊖ Ofwat target missed but performance improved in relation to prior year outcome
- ◎ Ofwat target missed and performance was worse than prior year outcome
- ▲ Improving
- ▬ Static
- ▼ Deteriorating

Our operational performance continued

Outcome	Why it is important	Associated operational delivery incentive (ODI)	Performance 2022–23	Performance Trend	Performance 2021–22	End of AMP target	End of AMP status	Link to executive remuneration
Use water wisely								
Water consumption	Customers are interested in understanding more about their water usage. They see saving water as a partnership issue and are looking for us to help them save more.	Per capita consumption				118.8		Indirect
		Target 100				55.00		
		Water saved from water efficiency visits				2,500		
		Access to daily water consumption data				3,529		
Fit for the future								
Growth	Businesses think it is important to work with councils and developers on infrastructure. Customers recognise the challenge of new homes drawing on our network and expect us to ensure it is fit for the future.	D-MeX				Median		Direct
Community engagement	Keen for us to focus on our role in the community, our customers want us to collaborate with local groups on important issues, support community outreach programmes and educate the next generation in schools.	Community engagement				75		No link
		% of schools giving good or excellent feedback from visits				90		

Our operational performance continued

Understanding and supporting our customers and communities continued

Improving customer experience

We are working hard to improve customer satisfaction by making the experience of dealing with us easier and more efficient for our customers. We are also focused on better engagement with our communities, while demonstrating environmental leadership. It is, therefore, disappointing that we have not improved our customer satisfaction (C-MeX) score from last year, remaining in 16th place in the rankings out of 17 water companies, incurring an ODI penalty of approximately £4.8 million.

While we are disappointed with the lack of immediate improvement in our score, we are confident that the plans we have in place will produce results in both our customer and wholesale team measures in the long term. It is worth noting here that C-MeX is also strongly influenced by historic as well as current political, media and public attention around national issues, such as drought and storm overflows.

We continue to make improvements across our customer experience by increasing our self-serve options and enhancing the quality of our customer data. This, in turn, has allowed us to send our customers more personalised communications, at the right time.

We have also spent considerable time getting out into our communities to find out what customers really want from us. This has resulted in some significant improvements to our operational signage and has led to us hosting more face-to-face drop ins to provide information about the work we are carrying out locally.

Following water incidents over the past year, particularly the July 2022 incident in Sheppey, we increased our use of text messaging and changed the way we manage our bottled water stations, to improve access for customers. Insight surveys we have carried out since have told us that these measures were positively received by customers.

We have also made improvements to the way we work with customers who have been impacted by internal and external sewer flooding. This includes a new information leaflet given to customers at the time of a sewer flood, as well as 1:1 case management for the worst affected customers. We have also updated our website with better information and advice.

In addition, we have made improvements to our 'report a leak' service online, with a simplified reporting form and confirmation email. We are now designing a new 'report a problem' map, which will enable customers to self-report leaks and be provided with text updates on when they will be fixed.

We held various well attended stakeholder meetings, with local MPs as well as council members. Following water outages in Broadstairs, Ramsgate, Manston and Margate, we held a public drop-in session in March. We talked to around 40 customers about the cause of the supply disruption, what we were doing to improve resilience in the network – including tackling storm overflows and other discharges – and how to receive assistance in making compensation claims.

We also held two similar sessions for our customers on the Isle of Wight, at venues in Ryde and Newport. More than 250 people heard about our storm overflow reduction plans, saw how they could use water in the home more efficiently, and learnt about how our social tariffs can help customers to pay their water bills. We also had subject matter experts on hand to discuss the water recycling element of our Sandown Pathfinder project, explaining how we are working to find new sources of water.

Work to improve our processes has resulted in us removing 4,400 void properties from our records this year. This has reduced the percentage of void properties to 2.82% (2020–21: 3.12%). Unfortunately, despite this improvement, we did not meet our Ofwat target of 2.68% and we have incurred a regulatory penalty of £0.6 million. We are confident that we can remove 7,000 void property addresses over the next year.

Through our joint billing contract with South East Water, 37 gap sites (2020–21: 33) were identified against our overall target of 65. An address matching exercise completed by year-end will support processes to identify gap sites in our supply region during 2023–24.

Our operational performance continued

Understanding and supporting our customers and communities continued

Protecting our customers' homes from flooding

We want to avoid the distress and inconvenience that internal and external sewer flooding can cause to our customers' homes and businesses as well as the environment. Blockages remain the predominant cause, with heavy rainfall causing additional capacity issues. The digitalisation of our wastewater network will be key to monitoring and avoiding incidents going forwards.

In 2022–23, the number of internal sewer flooding incidents was 496 (2021–22: 614). This reduced from the previous year, however, we did not meet our Ofwat target of 321 and incurred a penalty of £3.7 million. For external sewer flooding though, we have outperformed our target for the third year in a row, achieving a total of 3,748 incidents (2021–22: 3,944), earning us a reward of £0.67 million.

Our Fat, Oil and Grease (FOG) and Unflushables team has been out meeting customers in our communities to explain the importance of keeping FOG out of drains and not flushing any items that may cause blockages, such as wet wipes. We have also carried out sewer network cleaning and other blockage reduction activities.

In 2022, we began the roll-out of over 23,000 sewer level monitors as part of a programme to digitalise our wastewater network. The monitors are installed in manholes across high-risk areas of our region, and they can connect digitally with our Control Centre to proactively detect potential blockages. This smart technology enables a quick clean-up of the wastewater pipes to take place before the blockage causes pollution. The software used is a machine learning tool that constantly improves its data monitoring.

In 2023 our flooding reduction plan aims to focus strongly on root cause analysis to drive a first-time fix approach to make sure that our customers do not suffer a repeat incident. This includes empowering our teams to deliver solutions and using insight to target our proactive interventions in a very precise way.

Our operational performance continued

Understanding and supporting our customers and communities continued

Supporting those customers who might be vulnerable due to circumstances

Customers that need greater support are a key focus for us in terms of engagement. Each year we survey a cross-section of our Priority Service Register (PSR) customers to understand their satisfaction level with the service and support we provide, and where this can be improved.

As part of our research panels, we have a bespoke group of vulnerable customers, recruited from across our region. We carry out in-depth interviews with them, which allows us to understand their unique circumstances. Additionally, we speak with a representative sample following major loss of supply incidents – to specifically understand how we can continue to improve.

We maintained the level of satisfaction with vulnerability support at 73% (2021–22: 73%). We also increased the number of customers on our Priority Services Register (PSR) to 166,384, representing 8.3% of our households, which is already above the target of 7% by March 2025 set by Ofwat.

During the year, our bills went up in line with inflation, increasing the average annual dual bill from £401 to £439. At the same time, recognising the challenge of the rising costs for households, we announced a £98 million support package and increased the minimum discount on bills from 20% to 45% for 104,000 vulnerable households, which is an average annual saving of almost £200 on a dual service bill. The effectiveness of this type of support has improved, with a score of 71% (2022: 67%), although this was below our target of 80%.

We provide a number of financial assistance packages to help customers, including Watersure, Water Direct, NewStart and Essentials. These offer customers access to payment holidays, debt write-offs and bill reductions.

We also continued to offer support to customers via our Hardship Fund during 2022–23, providing a total of £20,000 a month. This funds three main types of assistance: debt relief, bill reductions and support to purchase household items where needed. Each of these is aimed at helping different segments of our customers.

The percentage of customers surveyed by the Consumer Council for Water (CCW) that are satisfied with the value for money of water and sewerage services in their area is 71% (2021: 67%), falling short of our target of 77%.

Supporting our customers and communities to save water

We want to create a future where our customers and colleagues act as stewards of our water environment.

We continue to work with our customers year-round to help them save water. Our three-year rolling average for per capita consumption is 133.7 litres per person, per day (2021–22: 133.6 litres per person, per day) against our target of 119.5 litres per person, per day. Although water use is now decreasing, the three-year rolling average fully reflects increases that we saw during the pandemic. Since a peak in consumption of 139 litres per person, per day in 2021, the in-year average has now reduced to 128.4 litres per person, per day.

Our plans to reduce demand have evolved. We want to manage and reduce the amount of water our customers are using – household, businesses and developers – using behavioural science principles to create sustained change.

Helping our customers save water is the focus of our ongoing Target 100 campaign, aiming to reduce daily average daily water usage to 100 litres per person, per day. Over the past year, it has focused on water scarcity, to help build awareness that demand will soon outstrip supply, and that unless we all work together, we will face a supply deficit. This included the promotion of easy tips and advice on ways people can save water around the home.

The customer campaign included direct customer emails, social media posts and ads, press articles and radio and DAX (Digital Ad Exchange) advertising, as well as ads on buses. We also used social media influencers for the first time to also push water-saving products such as tap aerators and water-efficient shower heads. We reached over 298,000 people, delivering 352,000 impressions and received 25,000 engagements with customers.

We took a slightly different approach with the high consumption areas of Hampshire and Isle of Wight, with more targeted messaging about protecting the local environment, chiefly local rivers and chalk streams. This laid the foundations for when we went into drought in these areas in July and had to implement a Temporary Use Ban from August to November.

We had regular communications with customers, stakeholders, businesses and employees, keeping them up to date on restrictions, the work we were doing to mitigate drought, and ways they could save water. We also launched an industry leading 'You Save, We Pay' initiative with our business consumers, offering them incentives for saving water. Read our drought case study on page 57.

In May we launched a 12-month awareness campaign called 'Save a little water, make a lot of difference'. It represents the start of the journey we want to take customers on, right up to 2040, and uses seven triggers to accelerate behaviour change. These include things like water-saving

Our operational performance continued

Understanding and supporting our customers and communities continued

home visits, smart meter technology and new tariffs, as well as communications and marketing. We have also refreshed our education materials and will be pushing for changes in the way we all think about water in public policy.

We carried out 8,130 water-saving home visits during the year, delivering a cumulative saving in cubic metres per day (m^3/d) of 534 m^3/d against a target of 1,500 m^3/d. These visits targeted households using large amounts of water.

We also targeted those living in our Sussex North region where we are working with Local Planning Authorities to maintain water neutrality. This means making sure that any new homes built do not use more water, putting more pressure on the local environment. To support developers with their questions on water neutrality, we now offer them a dedicated point of contact and access to a monthly newsletter. We are also planning annual events and regular webinars.

A total of 10% of home visits had a check with any defects reported to our Leakage team. We fitted 279 waterbutts and over 500 leaky loos were fixed via home visit referrals, with over 3,000 save-a-flush bags sent to customers for use in their toilet cisterns. We also completed flow restrictor trials at 500 social housing properties in Hampshire, achieving a saving per household of 64 litres per year.

Following the visits, over 1,000 customers have been referred to our Affordability team from home visit engineers, to potentially move customers to a tariff that works better for them.

We are also collaborating on a five-year campaign with Hampshire and the Isle of Wight Wildlife Trust's Watercress and Winterbourne's 'Save Every Drop' campaign to promote water-saving visits and the link between waterways and the water we use every day.

One way to help customers understand their water use and to be able to save water, is through giving them access to daily water consumption data. We have, therefore, accelerated our plan to roll out smart metering to customers and 1,500 customers are now part of a pilot, which aligns with the trial of a smart clip-on device for an existing water meter.

Working with our communities to manage growth

We maintained our ranking of 15th out of 17 water companies for our Developer Services satisfaction score (D-MeX). We constantly monitor our service levels and over the year we have made regular updates to our website, launched a new easy-to-use budget estimate calculator and increased our direct technical support.

We have also improved the process for people to apply for new water connections, giving them the option to submit photos for virtual site inspections and allowing them to share their screen with our agents so we can better guide them through the process. There is also a checkpoint for wastewater applications, speeding up the process significantly.

Engaging with our communities and working with local charities

During 2022–23 we launched a new community engagement strategy, focused around four key pillars: building skills by sharing our expertise and supporting young people; making our communities stronger by making sure they feel valued and heard by us; caring for the environment together; and demonstrating our positive impact and responsibility. Built on customer insight, this strategy seeks to address some of the regional challenges faced by our customers and our business.

To deliver this new strategy we have expanded our community team, creating a new role for a dedicated Education Officer. Read all about our new education programme on page 49. We are also excited to have seen a huge increase in colleague volunteering hours this year – see page 72.

Building skills for our community

Over the year a particular area of focus for us was increasing our work in the community with young people. Ten colleagues started mentoring groups from the Bohunt School and St Andrews High School in Worthing, through Dare to Dream, a programme initiated by the Love Local Jobs Foundation. Aiming to provide local young people with experiences and tools to help them fulfil their potential, it works in partnership with local

Our operational performance continued

Understanding and supporting our customers and communities continued

employers and local radio celebrity Jack the Lad, using themes of self-awareness, mindset, gratitude, resilience, teamwork and employability to drive and motivate the students. Our mentors have been carefully matched to provide one-to-one support, helping to grow pupils' confidence and enable them to achieve their potential.

We continued our relationship with local charity Spear Brighton, which supports unemployed 16 to 24-year-olds to find sustainable employment. The charity was awarded a Community Grant in 2021–22 and as part of the agreement we also offered workplace visits at our Falmer offices.

Over the summer we provided free fire warden and health and safety training at two heritage sites – Twyford in Hampshire and Brede in East Sussex. We also supported the installation of a new defibrillator, in partnership with Twyford Parish Council and Hampshire County Council.

Making our communities stronger

We have been working with our supply chain partners to pilot a scheme to measure the 'social value' of the community outreach work we do. The scheme is running alongside the upgrade of our Horsham Wastewater Treatment Works and, so far, has seen us working with the local branch of homelessness charity Turning Tides as well as local schools and Scout groups. Read more on page 31.

We ran a targeted campaign in Horsham towards the end of 2022, with a monthly outreach event held in the centre of town. In October we also awarded Horsham Matters a £1,000 Energy Grant to help with the charity's energy costs.

In December we hosted several Christmas parties to celebrate community centres that had received our Community Energy Grants. It gave us the opportunity to meet customers and signpost our Priority Services Register and support schemes.

Caring for the environment

Building stronger links with our communities is vital, and in Seaford we have been working with the 'Friends of Seaford' on a project to redesign a green space next to our wastewater pumping station. We created information boards and offered our colleague volunteer support to plant trees and help develop the space.

Our work with the 'Pollinator Pioneers', who received a community grant this year, has seen us help to install beehives next to our wastewater treatment site in East Worthing. The group works with young people to educate them about the importance of pollinators.

Demonstrating our positive impact

We launched a new Community Energy Grant, delivered in partnership with CMDP (a joint venture between Costain and MWH Treatment), to offer independently run community centres, foodbanks, support groups and children's programmes £1,000 per county – awarding £20,000 in total.

We also supported the local Tonnes of Tins campaign in Sussex, collecting 4.8 tonnes of food from colleagues and local residents to support foodbanks before the school holidays started in June 2022. Our Board matched the amount raised by the campaign, and a further £12,000 was donated to local foodbanks.

Last year we invited registered charities to apply for a partnership grant, lasting 18 months, with a focus on improving outcomes for young people. We received 47 applications, and we awarded five Charity Partners in each of our regions.

Educating our communities

We were excited to launch our New Wave education programme this year. Created in partnership with curriculum experts at the National Schools Partnership, it provides opportunities for young people to learn about the water cycle and caring for our natural water sources at every stage of their time at school, providing a range of free online resources for teachers and trainers.

These resources challenge pupils to solve local water problems and make pledges, taking the lead from school materials teaching science, technology, engineering and mathematics (STEM) as well as geography and PSHE (personal, social, health and economic education). In the future, we also plan to offer workplace experiences including wastewater treatment works tours. The tours are already taking place for adults and are being adapted for children.

Our operational performance continued

Understanding and supporting our customers and communities continued

These tours will help to build on our current programme of school talks and workshops. We delivered a total of 120 talks this year reaching more than 30,000 young people and adults, covering a range of topics including the water cycle, water saving, the three 3Ps (pee, poo and paper), how wastewater is cleaned, protecting our rivers, how to prevent blockages by disposing of unflushable items correctly and climate change. We ask schools and community groups for feedback on these sessions and overall participants were 98% satisfied with the talks they received.

Alongside these regular school visits, we also continued our partnership with the South East Rivers Trust and Wessex Rivers Trust to spread our water-saving message, which helps to protect our environment and local rivers. The South East Rivers Trust and Wessex Rivers Trust are running 'Our River, Our Water' educational sessions on our behalf to support the curriculum. These sessions give primary school aged children the chance to study science on the riverbank and learn about the vital habitats that live, grow and thrive there.

Over the year we also completed some practical, problem-solving sessions with Girl Guide and Scout groups across Hampshire and Sussex, with groups taking part on water filtration and water supply challenges. We plan to combine these with the Our River, Our Water sessions over the coming months to reach more groups across our region.

A look ahead – our Turnaround Plan

We are committed to improving customer experience and our reputation. By 2025 we aim to have delivered an improved customer experience, increasing our C-MeX score. We will do this by:

- Making things easier for our customers by creating a new website, improving our data quality and complaints process. We will also introduce a video assistant for customers.
- Creating a customer culture. Making sure that every colleague understands our customers and their unique needs. This includes the introduction of customer promises and customer service training for all colleagues and partners.
- Better engagement with our communities through improved multi-channel and direct communications, education programmes and regular stakeholder forums.
- Supporting customers in vulnerable situations by improving our priority services during incidents and our social tariff offering.

CASE STUDY

Understanding and supporting our customers and communities

Helping **future generations** understand the importance of saving water now

"Teaching young people about water saving early in their school life, is the one of the best ways to make sure our water resources are protected long into the future. We've expanded our education programme over the past year to reach over 30,000 children, telling them how to save water and about where it comes from.

"When I arrive at a primary school, I know it's important to really engage the children to get their interest. I give talks on our key messages and enjoy hosting our water supply challenge game, where upper KS2 children can take part by building a network of pipes.

"We're working hard to introduce a more systematic approach to learning. By offering a variety of activities – curriculum-linked lessons, classroom talks, outdoor activities, specialist speakers and workplace visits to treatment works. We will have five to six opportunities to engage with young people throughout their time in school.

"Whether we're talking about how to save water at home or what it takes to clean up their wastewater, we want these young people to take our messages on board and use them as part of their everyday life.

"Through education, behaviour change will happen, and our water sources and the environment will be protected for future generations to enjoy."

Joanne Wood, Education Officer

Our operational performance continued

Ensuring a supply of high-quality water for the future

Outcome	Why it is important	Associated operational delivery incentive (ODI)	Performance			End of AMP target	End of AMP status	Link to executive remuneration
			2022–23	Trend	2021–22			
Deliver great service								
Water quality	It is essential to always provide clean, safe drinking water. This is seen as a basic service from a water company and the most important of the services we provide. Our customers' preference is for water to be as natural as possible.	DWI compliance risk index (CRI)	⊖	∧	◉	0.00	⊖	Indirect
		Drinking water appearance	◉	∨	⊖	0.46	⊖	
		Drinking water taste and odour	◉	∨	✓	0.21	⊖	
		Replace lead pipes	⊖	—	⊖	43	⊖	
Water supply interruption	Customers want us to be able to deal with problems, such as interruptions, quickly and efficiently. Any interruptions require clear communication, as they can cause inconvenience and distress to customers.	Water supply interruption	◉	∨	⊖	0:05:00	⊖	Indirect
Water pressure	Customers expect a standard of water pressure to be part of the basic service we provide.	Properties at risk of receiving low pressure	✓	∧	✓	182	⊖	Indirect
Use water wisely								
Leakage	Customers say it is essential to reduce the amount of water lost through leaks from our network. They believe water is a precious, natural resource and expect us to look after and use it wisely.	Leakage	◉	∨	⊖	84.9	◉	Indirect

Link to executive remuneration: Direct – there is a specific performance measure included within the bonus scheme that is linked to the performance commitment. Indirect – there is a link to the performance measures in the bonus scheme but that it is a component of one of the metrics used for assessing performance rather than a specific/individual metric.

Key:

✓ Ofwat target met or exceeded

⊖ Ofwat target missed but performance improved in relation to prior year outcome

◉ Ofwat target missed and performance was worse than prior year outcome

∧ Improving

— Static

∨ Deteriorating

Our operational performance continued

Outcome	Why it is important	Associated operational delivery incentive (ODI)	Performance			End of AMP target	End of AMP status	Link to executive remuneration
			2022–23	Trend	2021–22			
Fit for the future								
Asset health	It is essential to be investing in our sewer networks, pipes and drains. Our customers want us to upgrade where we can and use innovative and sustainable solutions.	Unplanned outage				3.25		Indirect
Water resilience	Customers want to ensure supply for future generations. They are willing to invest now to ensure that there is no deterioration of services in the future.	Water supply resilience				77,622		No link
		Long-term supply and demand schemes				0		
		Risk of severe restrictions in drought				0.00		
		Impounding reservoirs				100		

Our operational performance continued

Ensuring a supply of high-quality water for the future continued

Improving water quality

Any risk to water quality is measured by the Compliance Risk Index (CRI), with any failures being assessed by the Drinking Water Inspectorate (DWI). Our CRI score for 2022 was marginally better than the previous year, at 6.38 (2021: 6.69). The scores from treatment works and supply points remained fairly static, whereas service reservoirs dropped and breaches at customer taps rose.

The main causes of CRI at our works (70%) were damp and unused sections of pipe, which are being addressed through improved regular maintenance of water tanks. A further quarter was due to issues at our sampling facilities, which are regularly inspected. The increase in CRI at customer taps was due to sediment build up in the mains, which will be addressed by our wider replacement programme in the next seven years. Taste and odour of customers' water was also an issue in some areas of Hampshire, which will be improved by the planned installation of carbon treatment at Otterbourne Water Supply Works by 2031.

We achieved a score of 0.24 (2021–22: 0.23) for taste and odour – measured in contacts per 1,000 population, missing our target of no more than 0.23 contacts. For drinking water appearance, our score was 0.93 contacts per 1,000 population, against a target of 0.65 contacts. This meant we incurred a combined ODI penalty of £1.34 million.

In July, we started work in Deal, Kent to replace old water mains containing lead. The pilot project will take about 24 months and will see us replace pipes to the boundary of customers' properties, as well as offering sampling in their homes and advice and support if they want to get a plumber to replace internal lead pipes. As some customers might have been worried about the discovery of lead pipes in their homes, we also offered drop-in sessions so they could meet our team and ask any questions they might have. We also sent letters and leaflets out to those affected and created a central hub of information on our website: **southernwater.co.uk/deallead**.

This is a trial scheme, which will help shape the strategy for other lead replacement schemes across our region.

Working to limit the time our customers are without water

Our aim is to provide our customers with a reliable supply of high-quality water, so we were disappointed that several significant incidents during 2022–23 left our customers without supply for a longer than average time. This has taken the average number of minutes that our customers were without water shown in hours, minutes and seconds as 01:28:10 (2022: 00:09:22), exceeding our target of 00:05:45 by a significant margin.

In June 2022, we saw a decrease in water supply interruptions compared to June 2021 and a reduction in mains bursts in the same period. Since June, we had a number of atypical bursts which affected large numbers of customers. In July, a single event on the Isle of Sheppey contributed 34 minutes to the overall year total. In December and January, two events at Hampshire Yew Hill WSR and Broadstairs in Kent added a total of nearly 45 minutes to water supply interruption.

Since these incidents, we have improved our response by focusing on better communication with customers, such as using text messages to keep customers updated during an incident. We now provide more frequent updates on social media and the website, including our incident map. By increasing resources, we have been able to respond more quickly to customers' messages and posts. We have also made sure that bottled water availability and deliveries have been improved, so we can open bottled water stations more quickly when required, as well as providing more effective delivery to our vulnerable customers.

Managing water pressure and reducing leakage

We outperformed our Ofwat target of 212 properties at risk of low pressure with 207 properties (2021–22: 210). Targeted cleaning and flushing of pipes helped keep the number of properties affected to this level.

For leakage, we recorded 108.5 Ml/d (2021–22: 94.9 Ml/d) against a three-year rolling average target of 90.9 Ml/d, resulting in a regulatory penalty of

Our operational performance continued

Ensuring a supply of high-quality water for the future continued

£2.332 million. Unprecedented weather conditions over the drought in the summer and rapid changes in temperatures during the winter resulted in high leakage levels. We want to keep water in the network by working hard to reduce leakage.

We increased our find-and-fix teams by 20% and we are exploring new technology to locate leaks, including the use of satellite mapping. A programme of advanced pressure management schemes has been delivered, with further improvements planned over the next two years. You can read our case study on this new approach on page 58. Our approach has led to us repairing up to 500 leaks a week in 2023.

Improving the health of our assets

The percentage of production capacity lost due to unplanned maintenance work is measured in our performance commitment of unplanned outage. We outperformed our target of 7.33% for unplanned outage with 6.44% of production capacity lost due to unplanned maintenance work (2021–22: 7.19%).

Improving water supply resilience

We want to make sure that our water supply system is resilient for the future and this means limiting the number of properties at risk of long-term loss of water supply (>48 hours). We are pleased to report a reduction in the number of properties at risk at 129,111 (2021–22: 131,201). This means we outperformed on our target of 142,987 in the areas of Thanet, Brighton and the Isle of Wight. Further improvements will be driven through risk reduction schemes, with anticipated delivery in 2024–25.

The long-term supply and demand schemes address supply capacity, for delivery by 31 March 2027. We are on track to deliver schemes for the Southampton and Andover link mains, as well as Sandown water recycling scheme, East Woodhay and the other smaller transfers. We are forecasting delays on two water recycling schemes at Ford and Aylesford, and two schemes will no longer be going ahead at Shoreham and Knapps Mill. An alternative for the Shoreham scheme is being progressed through our Water Resource Management Plan 2024, and the Knapp Mill scheme is covered by the Hampshire Water Transfer & Water Recycling project.

No customers were at risk of severe restrictions from a 1-in-200-year drought, in line with our target. This risk is measured as an average, over 25 years.

For schemes under the programme of work enhancing the safety of four reservoirs (Bewl, Darwell, Powdermill and Weir Wood), enhancements at Bewl reservoir are on track, and Powdermill does not require enhancements (as per the 2019 inspection). The Section 10 independent inspections for Darwell and Weir Wood will not be taking place until the end of this programming period, so any upgrades to these reservoirs will only take place in the next programming period 2025–30.

Our operational performance continued

Ensuring a supply of high-quality water for the future continued

Progress on our Water for Life – Hampshire programme

Work on our Water for Life – Hampshire programme has continued apace this year as we develop our plans to protect the Test and Itchen rivers by developing new sources of water.

A number of projects are included under the programme's banner, due to the amount of water needed to make up the supply shortfall we expect to experience in the area. We will need to develop a range of measures to resolve it. We are working hard to reduce leakage and improve water efficiency, but we also need to find new sources of water to use for supply.

As part of our plans, we are funding the new Havant Thicket Reservoir, which Portsmouth Water is building as part of an innovative cross-company collaboration.

Last summer we held a public consultation on our plans to supplement the spring water in the reservoir with recycled water – to make sure there is more available during a drought. A further public consultation will be held next year.

Called the Hampshire Water Transfer and Water Recycling Project, it is the largest component part of the Water for Life – Hampshire programme.

While water recycling is well-established technology, it is relatively new to the UK, so we set up a water recycling pilot plant in Havant to better understand the treatment processes involved. Thousands of water quality tests are being taken and shared with our regulators. We will publish the results of these on our website in the coming months.

We also welcomed more than 100 representatives from local councils, environmental groups and our regulators to visit the pilot plant and find out more about how water recycling speeds up the natural water cycle to provide a safe, sustainable source of drinking water.

We have plans for four water recycling plants in our region. The three other potential sites for water recycling plants are Sandown on the Isle of Wight, Ford in Sussex and Aylesford in Kent.

A look ahead – our Turnaround Plan

We are committed to improving the reliability of our sites and networks. By 2025 we aim to have improved water quality, achieving 3rd quartile performance against our peers. We will do this by:

- Putting in place new assets and improving maintenance at our water supply works. This includes the complete overhaul of our four main sites, impacting 62% of our customers.
- Using digital technology to build smart networks with new loggers, sensors and smart meters to reduce leakage and enable our teams to respond more quickly.
- Upgrading our logistics capability so we can move people and materials around faster, 24/7. This includes a new tanker fleet, storage of critical spares and an overhaul of our work management processes.
- Improving our management and control of our sites and networks through a constant review of our core systems and processes.

CASE STUDY

Ensuring a supply of high-quality water for the future

Summer 2022 and our first drought for a decade

What happened and why did we need to introduce a Temporary Use Ban in Hampshire?

"Our water resources are under pressure in the South East due to changing weather patterns and a rapidly increasing population. The entire region is classed as an 'area of serious water stress' by the government.

"In Hampshire and on the Isle of Wight, the situation is even more critical as we rely on the protected chalk streams of the River Test and River Itchen for much of the supply. A few years ago, we agreed with the Environment Agency to lower our abstraction permits on these rivers, which means we can take less to put into supply than ever before.

"To make sure we are prepared, we regularly update, consult on and submit a Drought Plan to our regulators, which includes a wide range of plans, interventions and temporary restrictions that we can put in place when these water sources come under pressure. In severe droughts, we can also apply for Drought Permits and Orders which allow us to take more water from underground sources and rivers and, in extreme situations, introduce restrictions on businesses and homeowners.

"In July 2022, after one of the driest years on record and months of no rain, we applied to the Environment Agency for a drought permit to continue taking water from the River Test. For the first time since 2012, we had to impose temporary use restrictions on our customers. This was to protect the environments we take water from and make sure enough water was available to keep customers' taps running.

"We were also the first UK water company to introduce an incentive scheme for business consumers, to encourage and support them to save water – our You Save, We Pay initiative. In total, this programme helped businesses in Hampshire save eight million litres of water.

So how do we make sure that this doesn't keep happening?

"We have a Water Resources Management Plan in place to reduce our reliance on restrictions, and we're aiming to stop using them by 2040 at the latest. To do this, we need to find 120 million litres of extra water per day.

"There's no silver bullet, and in order to 'find' this extra water, we need to work with neighbouring water companies, our customers, partners in the community and our regulators to: reduce leakage by at least 50% by 2050, using new technology and replacing old water mains; continue to help customers to reduce their use to 100 litres per person, per day; and invest in two new reservoirs, including one at Havant Thicket in Hampshire. In total, we are spending £100 million on network and supply resilience improvements to 2025.

"We're also exploring new transfers with neighbouring water companies and how we can potentially use new technology like water recycling and desalination at sites across our region."

Paul Riordan – Drought Manager

CASE STUDY

Ensuring a supply of high-quality water for the future

We work **24 hours a day**, seven days a week to find and **fix leaks** on our network

"Our leakage teams work 24 hours a day, seven days a week to find and fix leaks on our 13,919 kilometre water network, and it's a huge challenge. We currently have around 185 leakage technicians fixing close to 500 leaks per week, that's 25,500 leaks a year. We've also trained 21 new technicians since April 2022.

"For years we have been using acoustic loggers (used to listen for leaks), which work well on metallic pipes. These listen for leaks at night while everyone is sleeping, and help our teams identify points of interest to investigate. We also use Hy-Q sensors on non-metallic pipes, which listen to the flow of water. Some of these loggers are fixed in certain areas, and others get moved around as the team cover the network.

"We're always looking into new technology, and we've started to trial using satellites to spot leaks. It's early days as the technology is very new, but we're working with two companies, called Suez and Asterra to convert satellite radar signals to detect leaks – even up to three metres below the surface of the ground. The other great thing is that these satellites can scan up to 350,000 km^2 in one pass.

"It's advanced technology that uses a series of filters and algorithms to interpret the data to show only 'drinking water mixed with soil'. It then overlays it onto our network maps showing us 'points of interest'. These satellite leak detection maps can then be displayed in an easy-to-use app, accessed on a smartphone by our teams out in the field. Our teams then carry out surveys across these highlighted areas.

"The technology was originally designed to find water on Mars so it's exciting to see how it will help us find more leaks, faster."

Matt Foley – Operations Manager

Our operational performance continued

Protecting and improving the environment

Outcome	Why it is important	Associated operational delivery incentive (ODI)	Performance 2022–23	Performance Trend	Performance 2021–22	End of AMP target	End of AMP Status	Link to executive remuneration
Deliver great service								
Sewer flooding prevention	It is essential that our network stops homes being flooded with waste from sewers. There is strong support to ensure we continue to improve sewer flooding prevention.	External sewer flooding	✓	↑	✓	3,525	✓	Indirect
Protect and improve the environment								
Pollution	Customers want us to treat and dispose of wastewater in a way that does not harm the environment. They rightly believe we have a duty to protect and improve the environment in which we operate, and ensuring we do no harm through pollution incidents is the minimum they expect.	Pollution incidents	–	↑	–	77	✓	Indirect
		Thanet sewers	✓	–	✓	0	✓	
High-quality bathing and river waters	Our customers want to see us do more to deliver excellent bathing and river water quality. They want us to recognise the importance of this to tourism.	Delivery of Water Industry National Environment Programme (WINEP) requirements	–	–	–	Met	✓	Direct and indirect
		River water quality	✓	↑	✓	182.30	✓	
		Maintaining bathing waters at 'excellent'	✓	↓	✓	57	✓	
		Improve the number of bathing waters at 'good'	✓	–	✓	5	–	
		Improve the number of bathing waters to 'excellent'	✓	–	✓	2	–	
		Treatment works compliance	–	↑	–	100.00	–	
		Combined sewer overflow monitoring	–	↑	–	100	–	

Our operational performance continued

Outcome	Why it is important	Associated operational delivery incentive (ODI)	Performance 2022–23	Performance Trend	Performance 2021–22	End of AMP target	End of AMP Status	Link to executive remuneration
Protect and improve the environment continued								
Water resource abstraction	Customers want us to use a range of sources to provide reliable services in the future and expect removal of water from the environment to be done in a sustainable way.	Distribution input	○	∨	–	506	–	Indirect
		Abstraction incentive mechanism	○	∨	✓	-15	✓	
		Effluent re-use	✓	∨	✓	0	✓	
Renewables	We should be increasing the amount of renewable energy we use in our operations. There is a growing expectation that we should be using our own wastewater services to generate more energy as well.	Renewable generation	○	∨	○	24.00	–	Indirect
		Natural capital	✓	∧	✓	3	✓	
		Satisfactory bioresources recycling	✓	–	✓	100	✓	
Fit for the future								
Asset health	It is essential to be investing in our sewer networks, pipes and drains. Our customers want us to upgrade where we can and use innovative and sustainable solutions.	Mains repairs	○	∨	✓	87.3	–	Indirect
		Risk of sewer flooding	✓	∨	✓	12.42	✓	
		Sewer collapses	–	∧	–	222	–	
Growth	Businesses think it is important to work with councils and developers on infrastructure. Customers recognise the challenge of new homes drawing on our network and expect us to ensure it is fit for the future.	Surface water management	–	–	–	39,730	–	Direct

Link to executive remuneration: Direct – there is a specific performance measure included within the bonus scheme that is linked to the performance commitment. Indirect – there is a link to the performance measures in the bonus scheme but that it is a component of one of the metrics used for assessing performance rather than a specific/individual metric.

Key:

✓ Ofwat target met or exceeded

– Ofwat target missed but performance improved in relation to prior year outcome

○ Ofwat target missed and performance was worse than prior year outcome

∧ Improving

– Static

∨ Deteriorating

Our operational performance continued

Protecting and improving the environment continued

Preventing sewer flooding

We want to protect the environment from any harm caused by sewer flooding. In 2022–23, the number of external sewer flooding incidents fell to 3,748 incidents (2021–22: 3,944), exceeding our Ofwat target of 3,887 and earning us a reward of £0.7 million. The number of internal sewer flooding incidents also fell to 456 (2020–21: 614), although we did not meet our Ofwat target of 321 and incurred a penalty of £3.7 million.

Working hard to reduce pollution

We are reporting a provisional figure of 358 pollution incidents in categories 1-3 (this figure is under review by the Environment Agency). This represents a slight improvement on our performance (2021–22: 372), but still falling outside our Ofwat target of no more than 91 incidents. Following guidance provided by the EA on 21 February 2023, we also tracked five pollutions associated with spills on a dry day in 2022, reported as a shadow metric to test the use of this type of spill reporting.

As part of our pollution reduction programme, we invested in proactive maintenance of our sewerage network and have undertaken extensive research into the root causes of pollutions.

Our root cause analysis of pollutions in 2022 identified that issues with pumping station vulnerabilities and higher than expected levels of seasonal rainfall were the main cause of pollution incidents. This analysis was carried out to inform the next stage of our Pollution Incident Reduction Plan (PIRP) to prioritise and target our activities until 2025.

The PIRP strategy has laid the foundations for a continued improvement in our performance, informing future plans by showing trends from all sources, including electrical and mechanical (MEICA), blockages and bursts, as well as pollutions from sewer blockages. Our 2023 Improvement Plans are focused into three main categories containing 18 separate initiatives delivering a benefit reduction of between 126–212 pollutions.

Digitalising our wastewater network will make a significant difference to our ability to detect and even predict blockages in pipes. We have installed 23,000 sewer level monitors to send water level data back to a powerful machine-learning tool, focusing on areas where blockages happen most frequently. By analysing the data, we can mobilise sewer crews, making it easier to plan ahead and get rid of blockages before they cause pollution incidents.

We are also using technology to make sure customers can access the latest information about bathing waters, in a clear and transparent way. The Beachbuoy online spill notification service provides information about water quality events in our coastal waters and has had a number of upgrades within the year to make the information it displays easier to understand.

Keeping our sewers in good repair will help protect the environment around them. The Thanet sewer enhancement scheme – a £34.5 million rehabilitation project of century-old Thanet sewers to protect customers' home and the environment from flooding and groundwater sources from pollution – is progressing and is on track to be completed by 2025.

Maintaining and enhancing bathing and river waters across the South East

The Water Industry Environment Programme (WINEP) enhances rivers, streams, coastal waters and groundwater sources, through a variety of schemes. We met our commitments for WINEP delivery this year. In total we delivered 348 individual schemes and investigations, including:

- Seven schemes improving water quality in 20.2 kilometres of rivers in our area. This is in addition to the 82.5 kilometres of river water quality improvements we delivered in 2021–22, making a total of 102.7 kilometres and meeting our commitment.
- New event and duration monitors (EDM) were installed on 31 storm overflows this year. This means that we now report on spills made from 98.6% of our combined sewer overflows (CSOs). By the end of December 2023, we will have completed our programme to install EDM monitors on 100% of our CSOs. This is

Our operational performance continued

Protecting and improving the environment continued

in line with government requirements. Our spill reporting data is available online for our customers to access on our website.

- Delivering 81 detailed site-specific investigations about river water quality, bathing water quality, shellfish water quality and water quality in designated areas such as Marine Conservation Zones (MCZs) and Sites of Special Scientific Interest (SSSIs). We carried out these investigations working closely with the Environment Agency and Natural England. These investigations were carried out to make sure that any future capital investment on our assets is targeted to reduce environmental impact.
- Capital schemes in Southampton (at Ensign Park CSO and Millbrook wastewater treatment works) to reduce the frequency and volume of storm water discharges made to Southampton Water. These two schemes were delivered as part of a larger programme of work to improve the quality of Southampton Water. By the end of 2024, we will also be adding new storm water storage at our treatment works at Slowhill Copse, Woolston and Ashlett Creek. New ultraviolet (UV) disinfection will be carried out of the continuous treated effluent flows we release from our Slowhill Copse and Millbrook treatment works. This UV disinfection is being installed here for the first time and will be operational by the end of 2023.

Part of our WINEP delivery is the improvement programme for the water quality in 537 kilometres of rivers in our region by 2030. We met our 2022–23 target for this programme for river water quality by improving 102.7 kilometres of rivers.

As well as river water quality, we monitor bathing water quality. We have over 700 miles of coastline with a total of 84 bathing waters. We met our target for bathing water standards with 57 out of the 84 bathing waters being classified as 'Excellent', compared to 60 last year. There is no obvious reason for this decline from Excellent to Good, except possible increased beach use in this country, during the very hot summer and when the pandemic made foreign travel difficult.

Our monitoring of bathing water samples has allowed us to understand if any high concentration samples are related to releases from assets, rainfall or particular tidal conditions. By monitoring in this way, we can identify any problems with our assets. We aim to improve the number of bathing waters classified as 'Excellent' and the number classified as 'Good'.

Under our bathing water enhancement programme, we continue to gather data at nine bathing waters to understand any sources of contamination. Part of this work includes finding misconnections, which are properties that are not connected to the main sewerage system. We then work with the Environment Agency and local Environmental Health Officers to fix them.

Our FOG (fat, oil and grease) team, and the Network Protection team, also work together to reduce releases to the environment from sewer blockages, as well as checking for any potentially defective sewers close to bathing water sites. We continue to work with a variety of local stakeholders too, liaising with local councils to get specific local knowledge on how to tackle litter, seabirds and controls on dogs. We also engage with farmers on how to reduce pollution from grazing livestock and liaise with holiday park owners to understand the integrity of their private sewerage, assets, treatment methods and disposal.

We achieved 98.22% (2021–22: 97.94%) in terms of our treatment works compliance, with a total of six failed works, one less than last year. The six failures were due to process failures recorded at these works. This performance equated to an 'amber' classification for the Environment Agency's annual Environmental Performance Assessment (EPA) as our target for treatment works compliance with discharge permits is 100%.

As a result of this and other improvements in the measures submitted for this assessment, we fully expect to receive a two-star EPA rating this year.

We currently have effective monitoring at 88% of our Combined Sewer Overflows (CSOs). The coverage for CSO monitoring is at 98.6%, however, a number of our monitors have not been transmitting correctly. In some instances it is possible to use non EDM telemetry signals to provide us with an alternative method to spot and react to operational alerts. While our target for effective CSO monitoring is

Our operational performance continued

Protecting and improving the environment continued

99%, we are on track to install them on 100% of our CSOs by the end of 2023.

The less water we take from our rivers and reservoirs, the better it is for the wildlife and the biodiversity there. The amount of clean water added to our water distribution network was 566 Ml/d (2021–22: 561.33 Ml/d), falling outside our target of 516 Ml/d. This represents an increase of 1.89% on last year. The freeze-thaw experienced in December has impacted this measure, with increased leakage requiring more water to be put into supply. Changes in customer water use brought on by the pandemic have also continued to have an impact.

In the summer of 2022, river levels were low due to a lack of rainfall and increased water use during the hot weather. We put in place a Temporary Use Ban (TUB) in Hampshire and the Isle of Wight, to reduce customers' water use. The TUB reduced demand in these areas by 5% per day. The effects of the drought lasted beyond the summer, and we requested permission to draw more water from the Rivers Test and Itchen. We aim to take 15 Ml/d less water than allowed by our abstraction licence from these rivers in September – when this performance commitment is measured due to the depth of the river being at its lowest. As a result of the drought, we did not achieve this, with abstraction at -14 Ml/d (2021–22: -16 Ml/d), 11.1 Ml/d below the permitted maximum. This meant we incurred a regulatory penalty of £0.634 million.

We can reduce the overall demand for fresh water by making more effluent available to local authorities, businesses and farmers for re-use. The amount of effluent we have made available for direct re-use has decreased due to a significant reduction in requests for tankered final effluent. We made 82 m^3 available (2021–22: 127 m^3).

Increasing our use of renewables

We are committed to using renewable sources of energy where we can. We generated 13.03% (2021–22: 15.85%) of the energy we use from renewable sources this year, falling below our target of 24%. The percentage of energy produced is affected by the amount of Combined Heat and Power (CHP) generation as well as the amount of overall electricity we use, which varies according to different weather conditions. Our CHP generation reduced due to a number of CHP failures, making the equipment unavailable, and we had to import more electricity than normal due to an increased use of pumps during the wet weather between November and January.

We have undertaken a number of energy efficiency measures, such as sub-metering our bioresources and an additional number of large assets. This enables us to evaluate asset health and look for efficiencies. We have also done some feasibility studies on green hydrogen production, proving that it was not currently commercially viable, and we are looking at a study on heat from boreholes at one of our offices.

We continue to design and develop solar sites, as well as recommissioning existing solar panels. The latest site to use solar power is Peel Common, where we have installed a 0.3MW array on the roof to generate enough electricity to power 5% of the site's needs. We have an additional 11 solar sites being designed and in development for 2023–25.

We met our target of establishing and publishing baseline natural capital accounts for three river catchments. The aim is to better understand the current condition of the environment that we own, or can influence, and the impact of our construction schemes and interventions. Read our natural capital accounts case study on page 31.

We met our target of 100% compliant sludge disposal, maintaining our Biosolids Assurance Scheme certification for a further 12-month period in July 2022. We made good progress on the construction of our first Advanced Anaerobic digestion plant, which will begin to output enhanced quality Biosolid products for the use of farmers in Sussex in 2023. We have also engaged in several constructive mutual sludge capacity trading arrangements with our neighbouring water companies, as part of the Bioresources Market established by Ofwat at PR19.

Our operational performance continued

Protecting and improving the environment continued

Going forward we:

- continue to work with the Environment Agency and colleagues across the industry on changing standards for biosolids recycling under proposed regulatory regime changes (Industrial Emissions Directive, Environmental Permitting Regulations, Appropriate Measures for the Biological Treatment of Wastes) and have increased the size of our Biosolids Compliance team to meet the anticipated challenges of this approach;
- take part in national discussions on the use of Biosolids products and support an approach that maximises net environmental gain; and
- have sought the opinions of farmers in our region about how we can improve the quality and versatility of our products and services.

Improving the health of our assets

We must keep our assets in good working order. During August and September we experienced a number of bursts, recording the highest total of monthly bursts since 2014–15. We recorded 152.8 repairs per 1,000 kilometres of our network (2022: 101.5), falling outside our target of 107.7, incurring a regulatory penalty of £3.8 million. The trend towards an increase in mains repairs was due to increased find and fix leakage activity and the persistent dry weather.

Increasing our activity by detecting leaks proactively means that more leaks, such as mains bursts, can be found, however, this increases the number of leaks overall. An increase in mains bursts was also seen during the extended periods of dry weather, when ground movement affected assets at a time when demand for water was also likely to be higher.

We outperformed the target for the percentage of the region's population at risk from flooding following a one-in-50-year storm, with a level of 11.55% (2022: 11.50%) compared to our target of no more than 12.42%. The percentage is based on modelled predictions for internal hydraulic flooding.

The number of sewer collapses, including mains bursts, was 247 collapses (2021–22: 314). This was an improvement on the previous year, however this was not enough of an improvement to meet our target of no more than 224 collapses.

Managing the amount of surface water entering our sewers

While our performance metric for surface water drainage remains at zero, our Clean Rivers and Seas Task Force is leading a programme to find sustainable solutions to the large amounts of surface water that run off our roads into drains. Work is already underway on six projects using innovative approaches to slow the flow, particularly after heavy rainfall, with the aim of reducing the use of storm overflows when the wastewater system gets overwhelmed. The projects use a variety of sustainable drainage solutions – or SuDS – including the use of water butts, planters (household and non-household), resolving misconnections and roadside schemes. Read more on page 68.

A look ahead – our Turnaround Plan

We are committed to improving our waste and environmental performance. By 2025 we aim to have been awarded a three-star performance rating from the Environment Agency. We will achieve this by:

- Building capacity and resilience at our wastewater treatment works to reach 99%+ compliance with treatment and permit standards. This means making sure our pumping stations and networks continue to operate effectively as our climate changes.
- Making sure our assets work to capacity. Updating our maintenance standards and proactive control to stop assets failing, and an improved emergency response.
- Digitalising our sewer network to reduce pollutions and flooding, using industry-leading monitors, artificial intelligence for prediction and maintenance.
- Improving training, development and productivity by upskilling our front-line colleagues. Making sure they are multi-skilled and externally accredited to deliver the service our customers expect.

Our operational performance continued

Our environmental disclosures

A joint project is helping schools to slow the flow of surface water. The project is funded by Southern Water and the Department for Education and aims to stop localised flooding after heavy rainfall. Nearly 50 schools are taking part across Hampshire, the Isle of Wight, Sussex and Kent. By installing water slowing technology for classroom roofs and playgrounds, excess rainwater run-off from hard surfaces can be kept from filling the sewage system too quickly. Rain gardens and rain planters will also be installed.

Increasing our focus on compliance

Our Environmental Management System is our most effective tool for managing environmental risk and is monitored throughout the year to flag compliance and performance risks. The system continues to be certified to the ISO 14001 standard and remains a successful mitigation for compliance risks in relation to waste management and control, pollution prevention, water quality, water resources, consumables (energy and chemicals), customer nuisance concerns, amenity, and global biodiversity.

Our environment policy reflects our environmental ambitions. As we rebuild trust and can evidence that compliance is just part of the way we work, we can focus more attention on our environmental performance improvement programmes.

Working to improve water quality by taking a Catchment First approach

The water reaching customers' taps continues to meet the Drinking Water Inspectorate's (DWI) stringent water quality tests, with 99.97% (2022: 99.97%) of samples meeting all the necessary standards. Our target was to achieve 100% compliance.

One of our key tasks is understanding our catchments and knowing what is happening near our drinking water abstraction points. This information helps us understand our catchments and who we need to work with to manage current and future risks to protect our drinking water quality.

To do this we carry out extensive monitoring of the environment and our water supplies. We monitor water quality at treatment works, treated water storage facilities and customers' taps, as well as in the water environment. Using this information, we create action plans to target problems that we identify. We work closely with the Environment Agency and the Drinking Water Inspectorate to make sure customers and the environment are protected.

Our Catchment First programme puts land management at the heart of our decision-making and takes a collaborative approach to delivering long-term resilience. By looking at problems with a wider catchment-area focus we are developing truly sustainable solutions with local landowners, farmers and Wildlife Trusts, Rivers Trusts and Catchment Partnerships.

The programme includes a range of actions we committed to take as part of the Water Industry National Environment Programme (WINEP) alongside further voluntary actions following environmental best practice. We can only influence land uses and activities in our drinking water catchments by working in partnership with those who manage the land, such as farmers, industry and domestic households.

In our investigations we look for activities that could affect nearby water sources – for example, pesticides used on certain crops, livestock grazing, muck spreading and manure heaps, golf courses, industrial sites, old and active landfills, car washes, allotments – anything that has the potential to pose a risk.

To reduce the risk of nitrates and pesticides reaching our drinking water abstractions, we are working in partnership with farmers and land managers and engaging with several farmer clusters across our supply area. We are also working with Local Authorities and Highways Agency to understand road run off and using Sustainable Drainage Solutions.

Boosting biodiversity across our region

One of the key outcomes of our Environment Strategy is to improve biodiversity. In partnership with regional Wildlife Trusts, this year we completed a desktop review of our own sites.

Our operational performance continued

Our environmental disclosures continued

It looked at their current biodiversity value and helped us identify opportunities to deliver biodiversity and increase the capture of carbon dioxide. We will do this by restoring and creating habitats and connecting our sites with areas of importance for wildlife.

As part of this review, we launched our Biodiversity toolkit for our operational teams to encourage them to make small, practical changes on our sites to benefit the ecosystems around us. This toolkit, which includes advice on everything from dealing with invasive non-native species to installing bird boxes and feeders, was developed by our team of Environmental Champions.

With a wide breadth of knowledge of the water industry, our champions are now responsible for helping to:

- raise awareness and understanding of our environmental obligations and the regulations that dictate them
- assist in supporting and continuously improving our ISO 14001 Certified Environmental Management System
- support our commitment to the Environment Agency under the Water Industry National Environment Plan (WINEP) in areas such as invasive non-native species management, biosecurity and protected species awareness;
- deliver, track and monitor biodiversity enhancements across our operational area;
- help ensure our contractors are environmentally focused and working in line with our environmental expectations; and
- create a workplace that is beneficial for our mental health and wellbeing.

To increase biodiversity, we are developing a biodiversity net gain strategy, which will help us to understand and plan how we can deliver at least 10% biodiversity net gain on all new developments (Environment Act 2021). We have used our Water for Life – Hampshire programme to understand how we can meet our needs and also work with farmers and environmental NGOs on third-party land.

Our capital delivery programme must include mitigation and compensation for any unavoidable impacts on the environment, including local wildlife and habitats. In December, with our partners CMDP, we received a Gold Level award for Environmental Best Practice in the Utilities: Habitat category at the 2022 Green Apple Awards. It focused on work done to upgrade Hailsham South Wastewater Treatment Works where we improved the wildlife value of three lagoons that were due to be decommissioned.

We met our target of establishing and publishing baseline natural capital accounts for three river catchments. The aim is to better understand the current condition of the environment that we own, or can influence, and the impact of its interventions. Read our natural capital accounts case study on page 31.

We are moving towards using more nature-based solutions as part of our treatment and pollution reduction programmes. A new integrated wetland is being designed for Staplefield wastewater treatment works to help reduce nutrients (phosphate) entering the river there – this solution will deliver benefits for nature and has a lower carbon cost than traditional treatment solutions.

At Lukely Brook on the Isle of Wight we have restored the river, which had previously been moved and straightened to make space for agriculture – the work followed an initial investigation which showed our groundwater abstractions in the area were potentially impacting on the river.

This restoration returns the river to a more naturally functioning system, more resilient to low flows and drought. A number of our treatment works have old reedbed systems that we are restoring and bringing back into use as part of our wastewater treatment process to reduce nutrients and to help manage storm overflows, for example at our Lavant treatment works.

CASE STUDY

Protecting and improving our environment

Together we can **improve our harbours**

"Forming part of our wider environmental programme (WINEP), we're investing £72 million to 2025 to upgrade the seven largest wastewater treatment works that release into Chichester, Langstone and Pagham harbours and nearby rivers that flow into them.

"Feeding into the wider Solent, these harbours have a high environmental importance, containing a diverse range of habitats, designated shellfish waters, SSSIs, SACs, SPAs, Ramsar sites and an Area of Outstanding Natural Beauty, among others. The area also contains groundwater sources used by Portsmouth Water to supply drinking water.

"Right now, Natural England has assessed the nature in some areas to be in an unfavourable or declining position, and we want to help to reverse this working with key partners in the area whose activities also have an impact on water quality. To do this we've supported the creation of a Three Harbours Project Development Manager, who reports into a collaborative Technical Working Group. This group is developing an integrated long-term plan to improve water quality, enhance natural capital, increase biodiversity and restore and connect these important habitats.

"Alongside more traditional solutions, we're working on a series of catchment and nature-based projects. Over the past year we've worked with 12 farms in the Chichester Harbour area, planting 800 hectares of overwinter cover crops and completing soil surveys in over 25 fields. This has achieved an estimated reduction in nitrogen losses to the harbour of approximately 20,000kg this year.

"Alongside this we've supported conservation planning advice on three farms and awarded farm capital grants on four farms supporting the costs of new equipment to improve the efficient use of fertiliser in areas that may impact on the harbour.

"We have also launched our new Community Conservation Grant for the harbours and in our first year we've made awards to Stansted Park Estate to plant a large area of woodland, the Manhood Wildlife and Heritage Group to plant hedgerows supporting habitat connectivity; and we've also contributed to the cost of a public access improvement project proposed by the RSPB.

"To better understand water quality issues and where they come from, we're funding a three-year PhD with the University of Brighton looking at the sources of nutrients and faecal coliforms within the harbours. By sampling our assets and the harbours and rivers draining into them, we hope to better understand where pollutants are coming from – e.g. from Southern Water or private discharges, from recreational activities, from farm animals or from wildlife. The PhD started in 2022 and will complete in 2025, but we'll use interim results to inform our work.

"Looking forwards we are taking a more holistic approach to our wastewater planning and have worked with partners to develop our plans for investment for 2025–30. Our Clean Rivers and Seas Task Force is looking to create integrated constructed wetlands at several sites to improve the quality of the water that is released and manage flows into the harbour where groundwater infiltration into our sewers is causing frequent spills. We are also planning to continue our work with farmers to deliver water quality and biodiversity benefits."

Kate Rice – Natural Capital Strategy Manager

CASE STUDY

Protecting and improving our environment

Taking a local approach to **reducing storm overflows**

"Finding sustainable drainage solutions (SuDS) that will work in the local community is a team effort. We want to explore innovative, nature-based and engineered solutions to slow the flow of surface water, and SuDS can be a great solution.

"Our Clean Rivers and Seas Task Force is working with partners and stakeholders from a range of sectors to trial six 'Pathfinder' projects across Kent, Hampshire, the Isle of Wight and Sussex. One of the six projects is in Cornwallis Circle in Canterbury, Kent.

"At the moment, this is an area where 74 hectares of the surface is non-permeable, which means rainwater can't soak into the ground, and it just runs off into the drains. During a typical 10mm storm, for every one hectare of non-permeable area, we'll see around 100,000 litres of run off. That's a lot of water!

"Working with Canterbury City Council and Kent County Council, we have been able to start developing a scheme to manage the area and install SuDS. The scheme aims to adapt the area into parkland supporting the wellbeing of the local community and wildlife, with easy accessibility and beautiful plants for everyone to enjoy.

"Designs are being prepared for public consultation before the scheme is implemented. This will be one scheme of many across the town.

"It's a good example of how the partnerships we have been putting in place can have a positive impact on the whole community."

Nicole McNab – Strategic Communications and Partnership Delivery Lead

Our operational performance continued

Enabling and empowering our people

The health, safety, security and wellbeing of our colleagues is a necessity

We want to make sure everyone puts health, safety, security and wellbeing at the forefront of everything we do. This will require a cultural shift in how we behave across the business and is a key outcome for the Health and Safety Transformation Programme. Our new company value – Working with Care – supports this cultural shift and goes hand in hand with the programme to make sure safety is, and remains, a core focus for us all. To embed this new value, we created an engaging internal communications campaign, which was rolled out from April 2023.

Over the past year, our strategic Health and Safety Transformation Programme has been gathering pace, with some elements already being delivered by our operational teams. The programme covers six broad areas:

- An updated Health and Safety Management System – All the guidance and documentation to keep our teams healthy and safe while at work. From procedures and processes built with our own subject matter experts to golden rules and life-saving habits for all our colleagues and supply chain partners.
- A new Health and Safety data system – Making reporting of accidents, near misses and observations easier than ever. Harnessing the power of this live data enables us to share best practice, monitor and mitigate risk and learn together.
- An enhanced Health, Safety, Security and Wellbeing team – Growing the team to ensure we have the right people in the right place to make these changes last and to support our new approach.
- Improved Health and Safety training – From an immersive state of the art behavioural training experience for all our colleagues including our supply chain to refresh our safety culture, to professional and recognised qualifications in workplace safety for our leaders – we are investing in our people at every level and across the business.
- Latest equipment and digital tools – We are investing in tools that make the steps to good safety simple, quick and accessible. We have a suite of tools and resources to support every colleague from the frontline to our offices. These include artificial intelligence learning support with risk assessments and work activities, to gas detector and lone working equipment with added security features. All colleagues will have easy access to a wealth of health and safety information on our new Health and Safety Hub.
- Internal and external communication – Safety is our priority and we want to talk about it. From the lessons learned to proactive support, learning and sharing of best practice, knowing what good looks like and starting every meeting with a safety moment. Good communication is key to embedding this culture change.

The transformation programme is already beginning to deliver and some of the early work on putting safety first and training our staff is beginning to yield positive results.

A key measure of our progress has been a reduction across the business of over 20% in our Lost Time Injury Accident Frequency Rate. This is a comparison of the number of accidents, which result in staff being off work with the number of hours worked. In the past 12 months we have seen this drop from 0.39 to 0.30, exceeding our initial target. Some of the projects or initiatives that have contributed to this change include our Point of Work Risk Assessment, our Site Standards scheme and the new Safety Reporting system.

Security and wellbeing are also very important to the business. We have already conducted a strategic review of wellbeing and are in the process of building both the Wellbeing and Security teams. A security review will be conducted early in this financial year, following the full review of our security infrastructure conducted in March 2023. The team have already begun to develop security golden rules and best practice guides.

We recognise the importance of the wellbeing of each and every one of our team members. It is why we have resources like our Employee Assistance Programme, Unmind, the Bupa Health Cash Plan

Our operational performance continued

Enabling and empowering our people continued

and guidance we share throughout the year to get those important conversations started.

Focusing on diversity and inclusion

We want to provide an inclusive workplace for everyone to bring their best and authentic selves to work every day. For the third year in a row, we have been ranked in the Top 50 Inclusive Companies, progressing to 44th place this year. This improvement in our ranking shows our continued commitment to Equality, Diversity and Inclusion (ED&I).

With our drive to welcome diversity and encourage inclusion we have also launched mandatory inclusion training for all colleagues, helping them to understand how to create a culture of inclusion in the workplace.

Making sure we have an inclusive culture includes our recruitment processes. We want to make sure that our approach to diversity and inclusion is visible from the moment that people consider our company as a possible employer, and once an offer to join us is accepted, new joiners are sent an induction pack that contains information about our values, our approach to ED&I and references to our key policies.

With the aim of being free from bias, we introduced a 'Licence to Hire' for all hiring managers so that we are embracing a diverse workforce that is reflective of the communities that we serve. We are also working to make diverse interview panels a business-as-usual approach.

To support to colleagues, we now have five employee resource groups and are planning more. The new Menopause group joins our four existing support groups: LGBTQ+, Neurodiversity, Women's Network and Working Parents. The groups hold activities, not just for the rising number of colleagues joining them, but for the whole company to take part in, with motivational speakers and partnerships.

Our LGBTQ+ group welcomed comedian Zoe Lyons and hosted a drag queen fundraiser with Ophelia Payne for Mindout. We were pleased to welcome a guest speaker during Pride month talking about their experience of becoming transgender and we celebrated National Inclusion week with a range of guest speakers. The Menopause group organised a company-wide webinar, partnering with Talking Menopause and our Neurodiversity group hosted a motivational speaker sharing her experience as a neurodiverse wheelchair user.

In line with our pledge, signed to support colleagues experiencing the menopause, a support group has been set up to provide a resource for colleagues and managers. We will also be rolling out our allyship and banter awareness training to our management community.

Our Gender Pay Gap Report (**southernwater.co.uk/our-performance/reports/gender-pay-gap-reports**) shows that the median pay gap remains in favour of female employees at -3.32%, and the bonus gap has seen a reduction from 16.1% to 14.95% in favour of male employees.

Our ambition is to make sure that by 2030, 35% of our workforce are women, 35% of our managers are women and 11% of our workforce are from a minority ethnic background. This year we welcomed seven graduates onto our Management Graduate programme, with a gender ratio of 37% women. As part of our celebrations for International Women's Day and continuing to build our Gender Action Plan, we launched a partnership with Women on Boards, which aims to help shape the future Board members' careers.

We are developing talent

We are committed to empowering our colleagues with Learning and Development opportunities that help people improve their skills and gain new knowledge and insights. Over the past year, we spent £1.5 million on structured training and development offerings for our colleagues. Our colleagues also have access to mentors, on the job training and opportunities to work on different projects or tasks that will help them to expand their skills.

The percentage of our employees currently being supported to take advantage of both formal and informal learning has increased by 3% to 21%. We also offer people access to 50 different apprenticeship standards, that cover both entry level and upskilling qualifications. Last year, we saw 166 of our people studying an apprenticeship standard. We

Our operational performance continued

Enabling and empowering our people continued

had 285 colleagues undertaking informal training and 111 colleagues taking formal training.

We introduced our new Inspire Leadership Programme for frontline, middle and senior managers this year and welcomed seven graduates onto our Management Graduate programme.

A great place to work

We want all our colleagues to be able to bring their best selves to work, so equality, diversity and inclusion (ED&I) are key. Creating and maintaining this positive culture and mindset means making sure colleagues see our company as a great place to work where they feel they belong and are able to be their authentic selves at work.

We measure engagement among our colleagues using regular engagement polls and pulse surveys. We had a 79% response rate for the latest annual engagement survey with 62% of colleagues rating their satisfaction at four or five, out of five. Our strongest result was ‘My manager cares about my wellbeing’ which was at 4.31 out of five, showing that our colleagues feel cared for. We share the results with our colleagues and use the scores to encourage teams to address any particular issues.

As for the day-to-day engagement, flexible working practices have now been embedded in the company, helping with work-life balance. Our Stars recognition scheme continues to acknowledge and reward colleagues for their hard work, culminating in an Annual Star Awards event, with prizes given in a variety of areas including Helping the Community and Succeeding Together.

Meeting the needs of our supply chain partners

We recognise the importance and reliance we have on our supply chain in terms of innovation, water security, managing risks, corporate and social responsibility, and operational efficiency. Our partners act as the face of our business for many customers and communities. It is vital that we foster, cultivate and nurture the relationships we have with them, so they remain connected to, and understand, our business priorities and culture.

As part of our strategy to enable this, we have developed a Supplier Relationship Management (SRM) Framework, the goal of which is to foster an environment in which we work in collaboration, build trust, encouraging open and honest communication. We want to be seen as a client of choice through our practices and behaviours, consistently positioning ourselves to receive preferential access to resources, ideas and the latest innovations.

The framework is organised around a set of design principles, informed by British Water Survey results. It includes a more detailed management diagnostic, an internal review of our supplier enablement capability and an independent assessment through a ‘Voice of the Supply Chain’ exercise. Principles include:

- Creating a system of governance to make sure there is regular engagement between all stakeholders.
- Providing an environment where constructive 360-degree feedback is gathered and shared.
- Promoting excellence by highlighting new areas of value and introduction of new initiatives.
- Recognising contributions and celebrating success.

Elements of the framework exist, having been rolled out as part of our current procurement programme. New framework elements will be rolled out during the remainder of this five-year investment period to allow content to mature and develop ahead of the next (2025–30). These “new” elements include:

- Performance benchmarks using a consistent set of metrics.
- Joint business plans to underpin engagement.
- Supplier Awards Programme to recognise success.
- Creation of open collaboration forums to better direct and harness our partners’ creative efforts.

Our operational performance continued

Enabling and empowering our people continued

Volunteering

All our employees have the opportunity to use two of their working days per year to volunteer in the local community. A total of 2,534 hours of employee volunteering took place within the year (2022: 1,438) and this included our teams' manning roadshows and working with charity partners across our region.

Our team of Community Ambassadors aim to support communities proactively and be visible and available to answer any questions they might have about our sites and networks, sustainable water use, leakage or problems with their bills or making payments. They also promote our priority services to those who might need to join our register. Over the past year, our ambassadors have engaged with almost 8,000 customers at 28 locations across the South East.

As part of our volunteering programmes this year teams have supported:

- Tree planting at Brooklands park and lake in Lancing and Cliff Gardens Seaford community partnership in Seaford.
- Wetlands restoration in partnership with Kent Wildlife Trust and South East Rivers.
- Removing invasive species habitat maintenance at Pagham harbour with RSPB.
- Helping with building renovation for Turning Tides who help fight homelessness.
- An army of volunteers were out collecting litter from five beaches on the Isle of Sheppey by supporting the Sheerness town team.

A look ahead – our Turnaround Plan

We are committed to creating a safe working environment with empowered and supported colleagues. By 2025 we aim to have achieved a 0.2 lost-time injury rate. We will have achieved this by:

- Improving the safety of our colleagues with the introduction of a new mobile risk safety app.
- Working with care to embed health and safety as a key way of working with upskilling, training and onboarding programmes.
- Managing our compliance through new systems, inspections and assurance.
- Supporting our colleagues to achieve our commitments through our Inspire Academy, internships and a graduate programme to make sure we upskill and develop each individual.

CASE STUDY

Enabling and empowering our people

Using immersive experiences to provide **groundbreaking** health and safety training

“We’re working on a new way to offer health and safety training, through an immersive experience that means you can observe and practice challenging safety behaviours in a realistic environment.

“My work in the Health and Safety Transformation Programme team has given me the chance to experience it first-hand. It allows you to be part of realistic environments and characters, and group workshops where safety-related behaviour is discussed and applied.

“It’s really something different. When you take part, you get a greater understanding of how external factors can affect how switched on someone is for work on any particular day. Also how team members with a singular rather than holistic view can multiply the pressures to deliver at any cost. It’s so realistic as you get the chance to interact with the characters advising them on the right course of action to take.

“In the workshops you can explore how everybody’s behaviours and actions affect the outcomes of events and you are given a selection of tools to instil good safety culture and behaviour in yourself and others, making everyone a safety leader

“Finally, you get to apply these methods, seemingly in the real-world. The realism of the experience and the opportunity to make a tangible difference to a series of events was very powerful.

“We’re all stakeholders in safety, so this training will be delivered to all of our colleagues and our supply chain partners.

“The ultimate goal of our Health, Safety, Security and Wellbeing team is to help make sure we all get home safe and well at the end of the day. And this training is about giving our colleagues a first-hand experience of how everybody’s actions can affect safety at work and home, as well as helping to give them the tools to contribute to continuously developing a safety culture in all corners of the business.”

James Hills – Health, Safety, Security and Wellbeing Assurance Adviser

CASE STUDY

Enabling and empowering our people

A **Women's Network** for everyone

"Our Women's Network is a place where colleagues can talk openly, build relationships, and are listened to. All gender identities are welcome to join, and we want to reach as many colleagues as possible through our regular meetings and online Teams channel.

"One of the main aims of our network is to help members develop their skills. Whether they're building confidence, gaining more presence in meetings or doing self-defence, it's important for our colleagues to have a space where they feel comfortable to develop themselves and talk to other like-minded individuals.

"When I became Chair of the Women's network in 2022, I was keen that members could take part to develop relationships, boost their confidence and develop their skills. We put together a programme of activities including guest speakers, and we decided to hold our first Women's Network conference in April 2023.

"At the conference, over 100 of our members joined us to network at the market stalls, where themes such as women's health and nutrition were discussed. There were also inspirational speakers and a panel discussion on 'how to attract women to a male dominated industry'.

"With over two hundred members and growing, it's great to see this network thriving and supporting colleagues from across the business."

Cath Jeffery – Head of HR

Our operational performance continued

Our approach to climate change

As we have already highlighted in this report, climate change impacts, amplified by population growth present huge challenges, particularly in the South East. This is why they are both listed as principal risks to our ability to operate. Mitigating their impacts will make sure that we are able to maintain high-quality, resilient services for our customers in the future.

An increase in the frequency of drought is one negative impact of climate change we are already experiencing. The beginning of 2022 was one of the driest years on record (for the past 131 years), and river flows were approximately 25% lower than they should have been. As a result, in Summer 2022 we introduced drought restrictions across part of our region, in Hampshire and on the Isle of Wight. A Temporary Use Ban was in place from 5 August 2022 to 4 November 2022. Our Drought Plan sets out how we would deal with a drought in our region and is regularly updated to make sure that we can maintain supplies of drinking water to our customers while minimising the impact on our rivers and the environment during drought events.

In 2023 we are voluntarily adopting the Task Force for Climate-related Financial Disclosures (TCFD) reporting recommendations and Guidance for All Sectors for UK large private companies and have enhanced our disclosure on the risks that climate change poses to our business.

The following sections address how we incorporate climate change into our governance processes, the potential impact on our business model, strategy and financial planning, the risk management processes, and the climate-related metrics and targets we use. The sections and subsection headings correspond to the four thematic areas and 11 recommendations of the TCFD framework. Given its complexity, and to aid readers of the accounts, at the end of each section we provide links to further disclosures that can be found separately on our website.

Our operational performance continued

TCFD index table:

Recommendation	Recommended disclosures	Disclosure level	Reference (Annual Report)	Reference (other reports)
1. Governance Disclose the organisation's governance around climate-related risks and opportunities.	a) Describe the board's oversight of climate-related risks and opportunities.	Full	Strategic Report • Our approach to climate change: Governance, pages 77 to 79. • Engagement with stakeholders, pages 33 to 39. Financial performance • Risk oversight and governance, pages 122 to 123. Governance • Remuneration policy, applicable in year (unaudited), pages 189 to 201.	
	b) Describe management's role in assessing and managing climate-related risks and opportunities.	Full		
2. Strategy Disclose the actual and potential impacts of climate-related risks and opportunities on the company's businesses, strategy, and financial planning where such information is material.	a) Describe the climate-related risks and opportunities the organisation has identified over the short, medium, and long term.	Partial	Strategic Report • Our approach to climate change: Strategy, pages 79 to 84.	Net Zero Plan Climate Change Adaptation Report, 2021 Long-Term Priorities Draft Water Resources Management Plan Drainage and Wastewater Management Plan
	b) Describe the impact of climate-related risks and opportunities on the organisation's business, strategy, and financial planning.	Partial		
	c) Describe the resilience of the organisation's strategy, taking into consideration different climate-related scenarios, including a two degree or lower scenario.	Partial		
3. Risk management Disclose how the company identifies, assesses, and manages climate-related risks.	a) Describe the organisation's processes for identifying and assessing climate-related risks.	Full	Strategic Report • Our approach to climate change: Risk management, pages 85 to 86. Financial performance • Risk management approach, pages 120 to 121.	Draft Water Resources Management Plan Drainage and Wastewater Management Plan Drought Plan Climate Change Adaptation Report, 2021
	b) Describe the organisation's processes for managing climate-related risks.	Full		
	c) Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organisation's overall risk management.	Full		
4. Metrics and targets Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.	a) Disclose the metrics used by the organisation to assess climate-related risks and opportunities in line with its strategy and risk management process.	Partial	Strategic Report Our approach to climate change: Metrics and targets, pages 87 to 92. Streamlined Energy and Carbon Report (SECR), pages 93 to 95. Our operational performance, pages 42 to 95.	Annual Performance Report, 2023 Net Zero Plan Sustainable Bond Impact Report 2022
	b) Disclose Scope 1, Scope 2, and if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks.	Full		
	c) Describe the targets used by the organisation to manage climate-related risks and opportunities and performance against targets.	Full		

Our operational performance continued

Our approach to climate change continued

Governance

TCFD recommendations: disclose the organisation's governance around climate-related risks and opportunities:

A. Describe the Board's oversight of climate-related risks and opportunities.

B. Describe management's role in assessing and managing climate-related risks and opportunities.

Board oversight

Our Board has ultimate oversight of our consideration of climate-related risks and opportunities and scrutiny of management's identification, assessment and management of these risks and opportunities. Our principal risks statement includes climate change, and the Board reviews this annually. It considers climate-related issues when reviewing our plans, risk profile and principal risks and performance. This year the Board was updated on climate-related issues at least twice during the year, regarding our Water Resource Management Plan (WRMP) and Drainage and Wastewater Management Plan (DWMP), and climate-related Outcome Delivery Incentives (ODIs) and performance commitments.

The Board approves governance arrangements for climate-related issues, including delegating to committees specifically discussing them. This includes the Audit Committee and the ESG Committee. The Audit Committee meets quarterly to maintain oversight of our reporting, internal controls and management system, and compliance. It discussed climate change-related issues concerning our regulators views on, and assurance of our WRMP and DWMP during the year.

The ESG Committee meets quarterly to support delivery of our ambitions, performance and plans related to material ESG matters. Climate change has been one of four focus areas during the past year, and the committee has discussed climate change matters, including our net zero carbon progress, climate adaptation activities, and natural capital on four occasions.

Executive management

Executive management, and its Executive Committee have day-to-day accountability for climate-related issues. The executive is supported by an Environment Steering Group. This was established during 2022 and is sponsored by executive members. Its purpose is to facilitate an effective response and deliver solutions to environmental matters across the business. Members include cross-function representatives from across the business, including executive management, asset strategy, and catchment management. This Steering Group is supported by an Environmental Working Group.

We engage with customers and stakeholders to understand their expectations on climate-related issues. This includes discussing our plans with members of our Independent Climate and Environment Group (ICEG) established in 2022, and our Customer and Communities Challenge Group (CCCG). These Groups also provide feedback to the executive and to the Board's ESG Committee.

Our operational performance continued

Climate-related governance framework:

Board of Directors			
Board delegates certain responsibilities to its committees.			
Audit Committee	**Nomination Committee**	**Remuneration Committee**	**ESG Committee**
Executive Committee (ExCo)			
Day-to-day running of our company by our executives, including matters related to ESG. The executive delegates oversight of certain climate-related matters to its committees.			
Risk Committee	**Performance Committee**	**Investment Committee**	**Environment Steering Group**
Independent stakeholder groups			
Independent Climate and Environment Group		**Customer and Communities Challenge Group**	

The Investment Committee, chaired by our Chief Finance Officer, considers climate-related matters as part of its decision making. During the year carbon risks, opportunities and values were embedded into our Risk and Value business planning process.

The Risk and Value (R&V) process is designed with the intention of delivering the best value for money for Totex (total expenditure) and whole-life cost (WLC). The R&V process is six stages; checkpoints that act as technical milestones to support investment decision points within our Asset Lifecycle Process (ALP). The ALP is the sequence of stages that our assets go through during their lifetime. The forecast operational and embedded carbon emissions of a potential investment project have been embedded in the R&V project scorecard and are used to inform investment decision-making. For more see our business model, page 22.

Climate-related risks are also considered by the Executive Risk Committee, which consists of our executive and cross-function senior management representation and is chaired by our General Counsel. Each directorate maintains a risk profile, which is reviewed quarterly by the Executive Risk Committee. The committee reviews climate change risks as part of its quarterly review as part of our ERM radar.

Identified climate-related risks are incorporated in our enterprise risk profile and managed by appropriate business areas. Progress against our net zero target is reported to the Environment Steering Group and Executive Committee. Climate-related disclosures in our annual report are reviewed by the ESG Committee and require approval of the Audit Committee.

Climate-related issues are documented in several of our regulatory plans including our DWMP, WRMP and operational resilience plans. These plans are considered by the PR24 Committee, which consists of our executive and cross-function senior managers and is chaired by our Chief Financial Officer.

Senior management and employees are incentivised to deliver on our ambitions in relation to climate-related issues. Objectives are applicable to all employees including executive management and are based on a range of stretch targets, with performance-related remuneration measures focused on climate-related matters including leakage, flooding and pollution incidents. Progress against these measures is monitored by the Performance Committee.

Our operational performance continued

For more information:

On how we engage with stakeholders, pages 33 to 39.

On the governance of enterprise risks, pages 120 to 132.

On the sustainability and climate-related discussions held at Board and its committees, pages 157 to 159 and 179 to 180.

On our performance targets for this year and how they relate to directors' remuneration, pages 184 to 201.

Next steps

We will review governance of climate-related matters across the business, including expanding our risk and value process to consider carbon across all the gateways of our investment decision-making process.

Strategy

TCFD Recommendations: Disclose the actual and potential impacts of climate-related risks and opportunities in the organisation's business, strategy, and financial planning, where such information is material.

A. Describe the climate-related risks and opportunities the organisation has identified over the short, medium, and long term.

B. Describe the impact of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning.

C. Describe the resilience of the organisation's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.

Overview of our approach

Our climate-related strategy has two approaches: mitigation aims to reduce the causes of climate change, while adaptation involves adjusting our decisions and activities to the changing climate.

Mitigating the causes of climate change: We have responded to the climate emergency by committing to reach the industry target of net zero carbon for the emissions associated with operating our services by 2030. We see this as an interim target on the path to achieving net zero emissions by 2050, aligned with the government's target. See page 89 for more on our net zero roadmap.

Adapting to a changing climate: Mitigation alone will not ensure resilience to the physical changes that will occur from the predicted future of warmer, wetter winters and hotter, drier summers. Even if the Paris Commitment goals of limiting global temperature increase to 1.5 degrees centigrade is met, we will face further changes to our climate to 2050 and beyond. We have continued to assess the resilience of our services to our changing climate, following publication in 2021 of our third risk assessment report to the Department for Environment, Food and Rural Affairs (Defra).

Read our Climate Adaptation Report at: **southernwater.co.uk/our-performance/reports/climate-adaptation-consultation**.

Our existing plans looking at the long-term impacts of climate change include our Resilience Action Plan, WRMP, Drought Plan, and DWMP. These plans consider a range of short and long-term time horizons. These reports are available on our website. As part of our business planning for 2025–30 we are reviewing these plans, and the underlying assessments and assumptions made.

We are working to understand how we, as a landowner, can maximise opportunities to mitigate climate change and encourage stakeholders to do likewise. Our strategic land management plan is seeking to consider the multiple potential benefits from how we use the relatively limited land we own, such as carbon sequestration, biodiversity and natural capital and ensuring the future operational resilience of services to our customers. We have also considered how our sites connect with other sites and habitats within the landscape, to enable habitats and species to better adapt to climate change.

Our operational performance continued

Our climate-related risks and opportunities

We have identified climate change as one our principal risks and apply an ongoing, iterative process to assess and manage the range of risks and opportunities. These are typically considered as part of a broader range of factors, to understand how they interconnect and impact our business.

We consider a variety of time horizons as part of our climate-related risk assessment processes, and these broadly align with our planning horizons. See the table below, and read more on page 32.

In addition to climate change itself being identified as one of our principal risks, it also has the potential to impact several of our other key risks. Most notably these are: our ability to provide customers with access to a supply of high-quality drinking water, now and in the future, and ensuring the capacity and resilience of our wastewater assets to effectively remove and treat wastewater.

The following tables summarise our climate-related key risks and opportunities and refers to published documents that contain more detail on our climate change processes and management plans, including risk assessments. There has been no material impact identified on the financial reporting judgments and estimates. It is expected that any impact identified through our business planning processes would materialise over a longer period of time, rather than a single year, no impact from this was identified in the current year. See page 228 in the Financial Statements for more on climate change financial considerations. For more on our approach to identify and manage risks, see pages 120 to 132.

<table>
<tr><th colspan="3">Broad planning horizons</th><th>Time horizons of our specific plans</th></tr>
<tr><td>Short term</td><td>One to two years</td><td>Imminent risks requiring a tactical response.</td><td rowspan="3">Operational resilience plans: 70 years
Water Resource Management Plan: 50 years
Drainage and Wastewater Management Plan: 25+ years
Drought Plan: Five years
Pollution Incident Reduction Plan: One year</td></tr>
<tr><td>Medium term</td><td>Five years+</td><td>The five-year business planning cycle set by our regulator, Ofwat.</td></tr>
<tr><td>Long term</td><td>25 years+</td><td>Risks related to our longer-term priorities and strategy.</td></tr>
</table>

Our operational performance continued

Our approach to climate change continued

Acute and chronic physical risks and opportunities	Drivers of risks and opportunities	Potential impacts on our business	How we are managing and mitigating the risks
Ability to provide customers with access to a supply of high-quality drinking water now and in the future	**Short to medium term:** Reduced water availability and higher demand due to chronic higher temperatures, with drier and hotter summers, and an increased frequency of drought. **Medium to long term:** Impacts on infrastructure and increased risks of contamination due to increase in number and severity of storms and floods.	Accelerated asset deterioration. Supply of water fails to meet demand. Financial penalty and reward position. Further investment in infrastructure and incident management.	• Comprehensive modelling and short- and long-term plans feed into our five-year asset management plans and capital investment programme: • Water Resources Management Plan (WRMP) forecasts how much water we will need in the future and proposes options to make sure we have enough. • Operational resilience framework and action planning to improve asset, system and service resilience and organisational capability monitoring. • Drought Plan outlines the steps we would take to make sure we can maintain supplies of drinking water to customers during drought events. • Water for Life Hampshire Phase 2 plan – a Strategic Resource Option (SRO) in our Western Area. • Incident preparedness and management planning to provide a continuous service to customers. • Target 100 water-saving customer engagement programme to encourage reductions in demand. • Increasing catchment resilience by working with farmers to protect and enhance natural capital and deliver a range of ecosystem services, including improved water quality.
Ability to ensure the capacity and resilience of our wastewater assets to effectively remove and treat wastewater.	**Short to medium term:** Increase in volumes of water entering the system due to increased intensity and frequency of storms. Drought/reduction in rainfall and temperature increase the risk of blockages and internal and external flooding. **Long term:** Increase in sea level and risk of river flooding of assets.	Accelerated asset deterioration. Financial penalty and reward position. Further investment in infrastructure and incident management. Pollution event fines or other penalties.	• Comprehensive business plans, including DWMP and operational resilience planning that feed into our business plans and capital investment programme. • Drainage and Wastewater Management Plan (DWMP) assesses and plans for future investment needs across our region, 11 river basin catchments, and 61 of the highest risk of our 381 wastewater systems. • Pollution Incident Reduction Plan details programme of activities to reduce pollution incidents to zero by 2040, including adapting to changing weather patterns. • Incident preparedness and management planning to provide a continuous service to customers and protect the environment. • Clean Rivers and Seas Task Force driving Pathfinder projects to manage surface water flooding and reduce storm overflow releases, including sustainable drainage systems SuDS and wetlands.
Ability to protect and enhance natural capital across our region.	**Medium to long term:** Increased run-off and higher volumes of water, leading to pollution of rivers and seas. Drought/reductions in water leading to impacts on habitats and species.	Financial penalty and reward position. Pollution event fines or other penalties. Stakeholder expectations not met. Less resilient assets.	• Programme engaging with farmers and other stakeholders to improve the water sources we rely on. • Ecologists within business focused on opportunities to enhance biodiversity and comply with Biodiversity Net Gain. • Measuring and evaluating our natural assets by catchment to understand the state of our land and water sites and help prioritise improvements. First three baseline accounts published, • Draft WRMP adaptive planning approach represented a range of future scenarios. Environmental assessment included biodiversity net gain and natural capital. Options included nature-based solutions. • Our plans under the Water Industry National Environment Programme (WINEP) for water and wastewater, including increasing focus on catchment and nature-based solutions.

Our operational performance continued

Transition risks (by TCFD risk type)	Risk description	Potential impacts on business	How we are managing and mitigating the risks
Policy and Legal	**Medium to long term:** Changing public sentiment driving changes in regulatory targets, permits, licenses, and enforcements, leading to increased non-compliance.	Financial penalty and reward position. Increased risk of fines from non-compliance. Increased cost of carbon emissions, such as a carbon tax.	• Strong engagement programme with regulators, MPs, and other stakeholders. • Engagement with our partners and supply chain to support delivery of our ambitions. • Governance framework including policies and risk management, that document accountabilities, processes and policies to aid decision making during business planning and delivery.
Technology	**Medium to long term:** Emerging technologies, creating operational risks including changes to skills required and operational ways of working.	Investment in new technologies, skills enhancement and new ways of working.	• Bluewave. Our research, innovation and development lab. • Engagement with our partners and supply chain to support delivery of our ambitions. • Work includes pilots for the monitoring and extraction of process carbon emissions.
Market	**Medium to long term:** Changes in energy market and management, including cost increases, additional taxation, decarbonisation of fuel sources.	Increased costs. Increased focus on self-generation. Investment in new infrastructure.	• Energy and fleet strategy and market, monitoring part of net zero roadmap. • Engagement with our partners and supply chain to support delivery of our ambitions.
Reputation	**Medium term:** Changing customer sentiment on the pace and scale of ambition and solutions.	Further investment required. Investment funding challenged.	• Strong customer insights, engagement and consultation programmes. • Publishing our long-term plans including decarbonisation and adaptation, such as our WRMP.

Opportunities (by TCFD risk type)	Opportunity description	Potential impacts on business	How we are realising the opportunities
Resource efficiency	**Short to medium term:** Technology innovations and changes in customer sentiment supporting improvements such as water demand reductions. Leakage reduction, and circular economy e.g. water recycling.	Effect financial penalty/ incentive position.	• Target 100 commitment and programme to support customers to reduce personal daily water use to an average of 100 litres each per day by 2040. • Leakage reduction programme. • Identifying alternative water sources, such as water recycling projects.
Energy source	**Medium to long term:** A shift to low emission energy sources; technological, planning, infrastructure and policy changes.	Effect financial penalty/ incentive position.	• New framework with suppliers supporting a solar panel installation programme across some of our sites. • Business planning for fleet transition to electric and other low-carbon fuels.
Products and services	**Short term:** Support for customers to reduce their water use. **Medium to long term:** Supply chain carbon reductions. Water recycling.	Effect financial penalty/ incentive position.	• Target 100 commitment and programme. • Customer meter installation programme.
Markets	**Medium term:** Escalation in sustainable bonds and other financial instruments.	Effect financial penalty/ incentive position.	• Sustainable Finance Framework.
Resilience	**Medium to long term:** Ensure ongoing security of water supply. Enhancing asset resilience.	Effect financial penalty/ incentive position.	• Operational Resilience assessments and planning. • Adaptive pathways for business planning.

Our operational performance continued

Our approach to climate change continued

How climate risks inform our business planning

Being resilient to the changing climate is critical for us to deliver services to customers. So, it is vital we understand the risks, so we can plan and adapt to the future. Responding to climate-related issues is embedded in our vision, policies, and long-term business plans. We are also working to better embed these issues in our investment decision-making processes.

Earlier in 2022 we published our Long-Term Priorities, consulting on our plans for providing water and wastewater services, and what our priorities should be in the medium term. The document presented our views on key trends and resulting challenges, as well as opportunities that will influence the future and our priorities in response, which will guide our future business planning and strategy. We are developing our priorities and plans, learning from the consultation feedback and the results of our adaptive planning and scenario assessments. This will inform our business plan for the period 2025–30.

Our Long-Term Priorities (published June 2022)

Our long-term strategy and business planning is informed by regular studies which consider longer-term horizons and external trends and challenges. Our Water Resource Management Plan (WRMP) has now been refined and submitted for further consultation. Our updated WRMP will be published later in 2023, and we will outline any key changes to our plans in our Annual Report for 2023–24.

We have assessed a range of climate scenarios to look at the impacts on water supply, specifically examining rainfall and evapotranspiration, and incorporated this into our planning. Our assessment approach aligns with that followed by all Water Resources South East companies and modelling includes use of UK Climate Projections 2018 (UKCP18) climate scenarios that are based on the on the Intergovernmental Panel on Climate Change (IPPC) Representative Concentration Pathway (RCP) climate scenarios, specifically RCP8.5 (the highest baseline emissions scenario) and RCP2.6 (the lowest baseline emissions scenario).

Our operational performance continued

We also published our Drainage and Wastewater Management Plan (DWMP) in May 2023, and will report further on how this plan is progressing in our annual report for 2023–24.

Our approach to assessing the impacts is set out by Water UK guidance, which includes IPPC RCP climate scenario RCP8.5 and RCP2.6. Modelling focused on the impacts related to flooding, storm overflows and on wastewater assets such as risk of sewer collapse or rising main bursts.

Our plans to ensure operational resilience also consider climate change impact scenarios. These plans build on the qualitative adaptation risk assessment undertaken in 2021 and have assessed the susceptibility of around 18,000 of our operational assets to the potential impacts of climate change.

The review considered the latest UK Climate Predictions, in UKCP18, to assess vulnerability to six shocks and stresses: flooding risk, coastal erosion, heat, subsidence, saline intrusion and risks to natural capital. We are now finalising our mitigation plans for a refined list of sites that will be included in our business plan for 2025–30.

Note 2 of the Notes to Financial Statements includes critical accounting judgments related to climate change in the context of the assessments described here. See page 228.

For more information:

On our decarbonisation transition plan, visit:
southernwater.co.uk/our-story/our-plans/net-zero-plan.

On our third-round climate adaptation report, published in 2021, visit:
southernwater.co.uk/media/8259/5670_climatechangeadaptation_2021_v13.pdf.

On our longer-term trends, challenges and priorities, visit:
southernwater.co.uk/media/7224/5951_long-term_strategic_plan_v12.pdf.

On our plans to secure water out to 2075, visit:
southernwater.co.uk/our-story/water-resources-management-plan.

On our plans to secure a resilient drainage and wastewater system, visit:
southernwater.co.uk/dwmp.

Next steps

We will share further details on our climate-related scenario assessments through the publication of our business plans in October 2023. We will continue to evolve our understanding and reporting of how specific climate-related issues potentially arise over specific time horizons, and how we determine which risks and opportunities could have material financial impact.

We will further develop our long-term decarbonisation plan, including gaining a better understanding of our Scope 3 emissions and embodied carbon, to enable us to produce a more accurate and complete picture of our entire footprint. This insight will help us engage with our supply chain to identify opportunities to reduce emissions. Finally, we will work to expand embedment of carbon impact considerations across all investment decision making.

Our operational performance continued

Our approach to climate change continued

Risk management

TCFD Recommendations: Disclose how the organisation identifies, assesses, and manages climate-related risks.

A. Describe the organisation's processes for identifying and assessing climate-related risks.

B. Describe the organisation's processes for managing climate-related risks.

C. Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organisation's overall risk management.

We operate an Enterprise Risk Management (ERM) process that is a core component of our governance and internal control framework. It supports us to make better decisions through an improved understanding of risk across the business. Our risk management framework is the totality of systems, structures, policies, processes and people that identify, measure, monitor, report and control or mitigate internal and external sources of risk, for all risks including climate-related risks.

Climate change is identified as one of our 12 principal risks. These are treated with equal weighting. Our risk appetite defines the risks and opportunities we are willing to accept for identified categories. Seven risk components are identified for the principal risk of climate change, with the risk appetite set at 'moderate' for all. Principal risks are monitored by the Executive Risk Committee, reporting to the Audit Committee and ultimately the Board.

We identify, assess, and agree control options for climate-related risks across the business. The ERM process requires identification of the significant risks to the business, and classification of them using a scale of low to major impact. The criteria defined in our risk profile are:

- Business disruption/customer experience
- Brand and reputation/legal and regulatory
- People/health, safety, environmental and security
- Financial – within year and lifetime.

We disclose climate-related risks and management arrangements in our five-year business plan and produce business-specific risks assessments and management plans that are often regulatory documents. These include our Water Resources WRMP, DWMP, Drought Plan, Climate Adaptation Report and operational resilience plans.

Our draft WRMP 2024 sets out how we plan to maintain a high-quality and reliable supply of water for customers and improve the water environment.

Long-term planning requires making decisions for an uncertain future. To manage uncertainty, we have used an adaptive planning approach. We have looked at multiple supply-demand balance scenarios in view of the uncertainties associated with growth forecasts, the level of reductions required in the water we take from the environment and climate change impacts.

We are also working on our first DWMP that sets out how we will make sure our drainage and wastewater systems resilient over the next 25 years. One of the key challenges the plan addresses is climate change.

We conducted a review of the operational resilience of our sites, including an assessment of the impact of climate-related risks, as part of our business planning for 2025–30. Six shocks and stresses were considered: flooding; asset heat stress; subsidence; coastal erosion; water source salination; and resource availability (natural capital). The assessed scenario conditions included a representative concentration pathway 'RCP8.5' as an 'adverse' scenario for subsidence, saline intrusion, and heat stress and 'RCP2.6' as a 'benign' scenario for coastal flooding.

The work categorised sites into either: further work required to enhance resilience; sites where further investigations were required; or sites for which no further enhancement was required. Work continues to create a list of priorities for 2025–30.

Our operational performance continued

For more information:

On our ERM approach, see Risks – pages 120 to 132.

On our plans to secure water out to 2075, visit:
southernwater.co.uk/our-story/water-resources-management-plan.

On our plans to secure a resilient drainage and wastewater system, visit:
southernwater.co.uk/dwmp.

On our plans to maintain a secure water supply and protect the environment during dry weather and drought, visit:
southernwater.co.uk/our-story/water-resources-management-plan/our-drought-plan.

On our third-round climate adaptation report, published in 2021, visit:
southernwater.co.uk/media/8259/5670_climatechangeadaptation_2021_v13.pdf.

Next steps

We continually assess how climate-related risks impact our enterprise risk profile, as we build on our understanding, including those under different scenarios. We are embedding climate change, specifically mitigation, into our assessment of suppliers for our business plan period 2025–30.

Our operational performance continued

Our approach to climate change continued

Metrics and targets

TCFD Recommendations: Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.

A. Disclose the metrics used by the organisation to assess climate-related risks and opportunities in line with its strategy and risk management process.

B. Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks.

C. Describe the targets used by the organisation to manage climate-related risks and opportunities and performance against targets.

We measure our climate-related performance using a range of metrics and targets, and report on these in our Annual Report and Annual Performance Report. These metrics focus on our key risks related to water supply, wastewater removal, and natural capital. We also report on our carbon emissions, in alignment with regulatory requirements, and to report progress on our decarbonisation target.

The following tables summarise the key metrics we use. This includes reporting on our alignment with the suggested metrics in the TCFD cross-industry guidance. Further information on our performance can be found on pages 42 to 95 and in our Annual Performance Report.

TCFD's cross-industry metric categories

Metric category (defined in TCFD guidance)	Metrics		Notes
GHG emissions Absolute Scope 1, Scope 2, and Scope 3; emissions intensity	MT of CO_2e	See data tables in the Streamlined Energy and Carbon Reporting section, pages 93 to 95.	We disclose Scope 1 and 2 emissions, a proportion of our Scope 3 emissions, and emissions intensity figures.
Transition risks Amount and extent of assets or business activities vulnerable to transition risks	N/A	Not available	We do not consider a quantitative metric. We will consider the suitability of such and report on our conclusions in 2024.
Physical risks Amount and extent of assets or business activities vulnerable to physical risks	N/A	Not available	We are finalising our latest modelling and assessments for operational resilience, WRMP and DWMP. We will report findings next year.
Climate-related opportunities Proportion of revenue, assets, or other business activities aligned with climate-related opportunities	N/A	Not available	We do not consider a quantitative metric. We will consider the suitability of such and report on our conclusions in 2024.
Capital deployment Amount of capital expenditure, financing or investment deployed toward climate-related risks and opportunities	N/A	Not available	We do not calculate this metric currently. We will consider the suitability and a methodology for such and report on our conclusions in 2024.
Internal carbon prices Price on each tonne of GHG emissions used internally by an organisation	N/A	Not available	We do not apply an internal carbon price (notional or actual) currently. We are monitoring use of such and consider its suitability.
Remuneration Proportion of executive management remuneration linked to climate considerations	The following 2022–23 metrics are examples of those key to our climate change resilience and are measures included in our Annual Bonus Plan (for our executive and all employees): Internal sewer flooding incidents and Leakage.		For more detail see Directors' Remuneration Report, pages 184 to 201.

Our operational performance continued

Other climate-related risk metrics and targets

Metric category	Metrics and performance	
Targets set by our regulator Ofwat (as performance commitments for 2020–25)		
Leakage	Leakage – Ml/d	See pages 42 to 95. For further details on our regulated metrics and targets see our Annual Performance Report.
Water consumption	Per capita consumption – l/p/d	
Internal sewer flooding	Number of incidents per 10,000 sewer connections	
Pollution	Number of incidents per 10,000km of sewer	
Water resource abstraction	Distribution input – Ml/d Abstraction incentive mechanism – Ml/d Effluent re-use – m^3	
Renewable generation	% energy generated from renewable source	
Asset health	Unplanned water outage – % Risk of sewer flooding in a storm – % Number of sewer collapses per 1,000 kilometres of all sewers	
Natural capital	Number of river catchments with natural capital accounts	
Net zero transition plan target and pledges		
Operational net zero carbon by 2030	tCO_2e	See Our Net Zero Transition Plan below
Energy used in the reporting period	MWh	We report absolute energy use, energy by source and intensity. See the data tables in the Streamlined Energy and Carbon Reporting (SECR) section, pages 93 to 95.
100% renewable-backed power from April 2021	% electricity from fully accredited renewable source	100% since April 2021.
Generate 24% of own renewable energy by 2025	% energy generated by on-site renewables	13.30%
Fleet electrified or low carbon fuels by 2030	% of fleet	0%. A study has started with UK Power Networks to develop our fleet electrification roadmap.
Aim for nature-based solutions and work in partnership	Not applicable	We have embedded nature in our risk and value investment process and are working in partnership to deliver solutions.

Our operational performance continued

Our approach to climate change continued

For each of our regulated metrics described above a target is set for the business plan period (2020–25). Information on these targets and our performance is described in the pages referenced in the metrics tables above, and in more detail in our Annual Performance Report.

Our greenhouse gas emissions and associated energy use data is available in the Streamlined Energy and Carbon Reporting (SECR) on pages 93 to 95.

This year we implemented a process to expand the scope of our measured Scope 3 emissions to include our construction and refurbishment projects. We also completed a project to review the wider Scope 3 emissions from our value chain and investigated how our plans and targets align to a 1.5 degrees centigrade pathway. We are planning how these findings are integrated in our longer-term decarbonisation roadmap, and ongoing carbon emission disclosures.

Our Net Zero Transition Plan

We published a Net Zero Plan in 2021, confirming our commitment to the Water UK Public Interest Commitment to net zero operational emissions by 2030. We see this as an interim target in our long-term strategy to reach net zero by 2050. We recognise the important role we, and the water sector must play in reducing emissions while balancing this with the need to provide our services at an affordable price to our customers. Our decarbonisation approach remains to follow the carbon hierarchy:

Reduce and avoid

emissions through efficiency savings.

Replace:

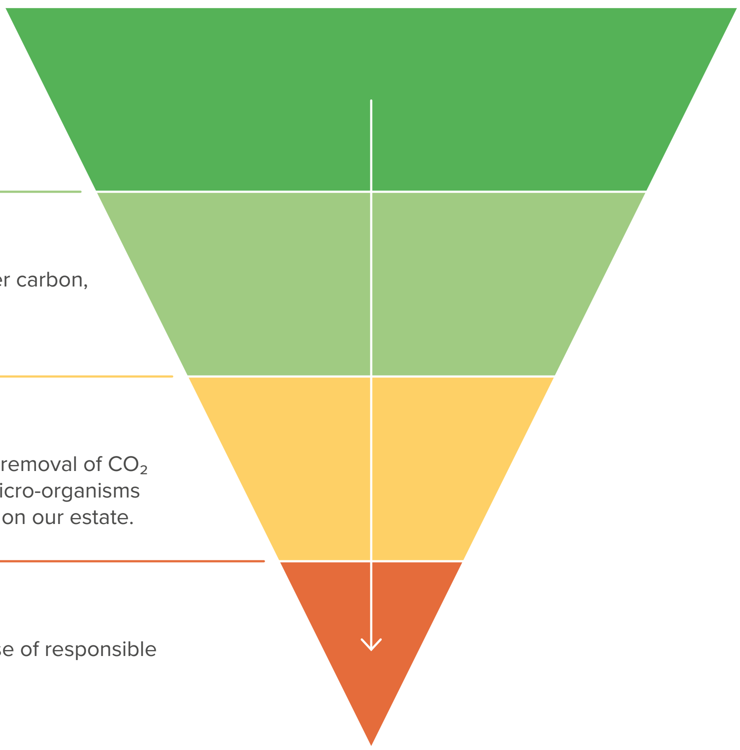
use alternative solutions that are lower carbon, for example technology change.

Remove

emissions through sequestration (the removal of CO_2 from the atmosphere by plants and micro-organisms and its storage in biomass or the soil) on our estate.

Offset

any residual emissions through the use of responsible carbon offsetting.



Our operational performance continued

Forecasts against our 2030 commitment indicate that our plans to 2030 will mean we cannot achieve net zero without the use of offsets for residual emissions.

We face significant challenges to deliver our net zero 2030 commitment; these challenges are both in terms of feasibility and deployment. We believe best value to our customers will not be served by purchasing external offsets and our strategy is not to purchase these on the external market. As an alternative we are continuing to explore how we could support over the medium- to long-term carbon sequestration through our strategic land management plan and work to employ nature-based solutions. We are working with the wider water sector to understand the range and scale of carbon offsetting opportunities.

Our Executive team remains committed to decarbonisation over the long term and has tasked our teams to extend the horizon of our net zero planning from 2030 to 2050. We will better align our net zero transition planning with our long-term delivery strategy and look beyond solely operational emissions. This means we will align our plans with the government's 2050 net zero target and regulator Ofwat's direction to focus on location-based Scopes 1, 2 and 3 emissions.

Our operational performance continued

Our approach to climate change continued

Our operational carbon emissions

In 2023 we expanded the scope of operational emissions we are able to report; the sources of operational emissions are listed below. In 2023 our reported net market-based operational emissions were 109.5 kilotonnes of CO_2e (2023 like-for-like emissions with 2022: 72.9 kilotonnes CO_2e) (2022: 81.6 kilotonnes CO_2e). Our net location-based emissions for 2023 were 215.2 kilotonnes of CO_2e (2023 like-for-like emissions with 2022: 157.7 kilotonnes CO_2e) (2022: 161.2 kilotonnes CO_2e.

Scope 1 emissions:

- Direct emissions from burning of fossil fuels (including CHP generated onsite)
- Process and fugitive emissions
- Transport: Company owned or leased vehicles

Scope 2 emissions:

- Electricity use: For the location-based approach this is the average grid emission factor for power from the electricity grid.
- Electricity use: For the market-based approach this uses the carbon intensity of the energy we procure from the electricity grid.

Scope 3 emissions:

- Transmission and distribution losses from the supply of total grid electricity we use
- Business travel on public transport and private vehicles used for company business
- Outsourced activities (not included in Scope 1 or 2)
- Purchased electricity; extraction, production, transmission and distribution (so-called "well to tank" emissions) (for the location based approach only) (*first reported in 2023).
- Purchased fuels; extraction, production, transmission and distribution so-called "fuels well to tank" emissions) (*first reported in 2023).
- Chemicals purchased (*first reported in 2023).
- Waste disposal (*first reported in 2023).

For details on our emissions footprint see pages 94 to 95.

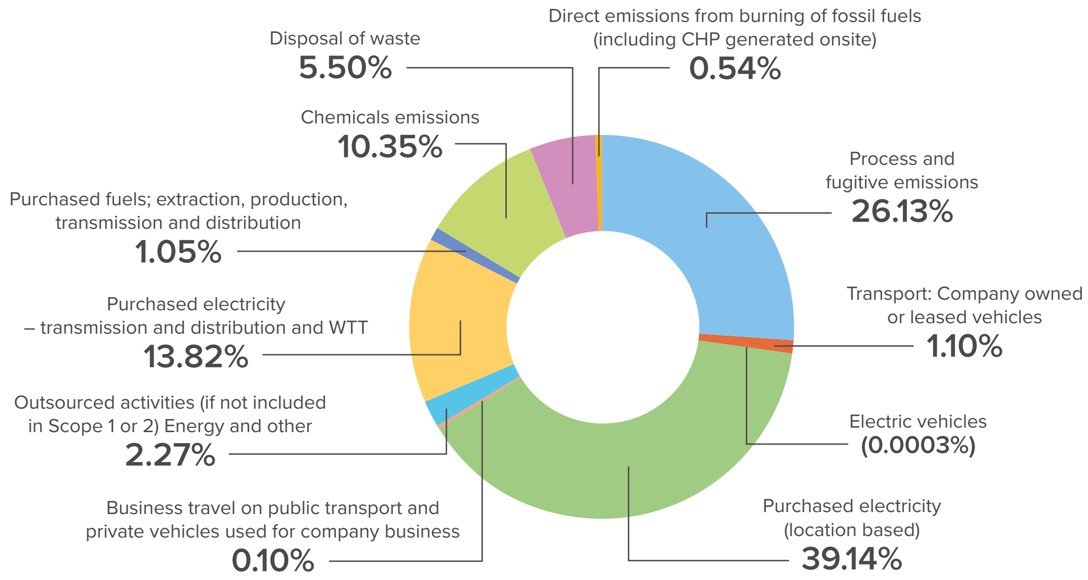
Energy use is the largest source of our reported emissions at 56.8% (location-based approach).

In 2023 Southern Water used 574,493 MWh of energy for water and wastewater operations, an increase on 2022. Wastewater is the largest user of energy, accounting for 67% of consumption. Most of this energy is used to power our pumps and blowers.

We also generated 51,095 MWh of energy in wastewater via our CHP engines, which offsets 16% of our wastewater consumption and prevents the need for this energy to be imported. Water supply accounts for the remainder of the energy needed to power our operations, with solar generation totalling 2,943 MWh, helping to ease the need for imported energy at our supply works. We currently generate 11% of our electricity from renewable sources. For details on our energy use see page 93.

Our operational performance continued

Sources of our operational carbon emissions



Process emissions:
Emissions from water and wastewater treatment formed 26.1% of our 2022–23 operational emissions. Process emissions occur primarily from our sewage and sludge treatment processes producing methane and nitrous dioxide emissions. These emissions have a significantly higher Global Warming Potential than carbon dioxide emissions.

These emissions are the biggest challenge for us and the water sector. We are working in partnership to fully understand the scale of the problem, and identify and test measurement, mitigation, and abatement solutions. Our bioresource management plans are focused on efficiencies and opportunities to upgrade our infrastructure, based on impact, cost, policy constraints and the availability of deployable solutions.

Energy emissions:
Emissions from our use of energy formed 56.8% of our 2022–23 operational emissions. Most of our energy used is electricity, but we also use gas for heating, diesel for generators and gas oil in our anaerobic digestors. While the electricity grid is decarbonising, we continue to review options to change the source of our energy; we have sourced 100% of electricity from a renewable-backed source and invested in renewable on-site electricity by installing solar panels. We continue to explore other low-carbon sources of energy, either on site or in partnership such as via a Power Purchase Agreement. We are also focused on energy efficiency.

Transport emissions:
Emissions from the use of fuel to power vehicles used for business activities formed 1.2% of our 2022–23 operational emissions. We are working to transform our LGV fleet to electric over the medium term and exploring how we convert our HGV fleet to no or low forms of carbon, such as hydrogen and biogas, in the medium to long term.

We have also launched an employee car benefit scheme for electric and plug-in hybrid cars.

For more information:

On our regulatory Streamlined Energy and Carbon Report, pages 93 to 95.

On our climate-related regulatory targets, visit: **southernwater.co.uk/our-performance/reports/annual-reporting**.

On our original 2030 net zero plan visit: **southernwater.co.uk/our-story/our-plans/net-zero-plan**.

On our sustainable bonds performance: **southernwater.co.uk/our-story/our-plans/investors**.

Next steps

We will develop our transition planning, including the reset of our decarbonisation roadmap out to 2050, and the conclusion of adaptive pathways work as part of our business planning for 2025–30. Our decarbonisation roadmap will be underpinned by four principles: further embedding a culture for decarbonisation; industry collaboration; innovation and research and development; and an adaptive approach. We will work on supporting strategies for energy and non-regulated funding.

Streamlined Energy and Carbon Report (SECR)

This section fulfils the requirements of the Companies (Directors Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2019.

Further information about our climate change activities can be found on pages 75 to 92 of this Annual Report.

Targets

To mitigate the company's climate impact, it is committed to delivering net zero by 2050, and is reviewing its interim target for net zero operational greenhouse gas (GHG) emissions, including engagement with the sector on its 2030 public interest commitment.

Energy efficiency action

Energy use is a significant source of GHG emissions, and we have continued to invest heavily in energy efficiency throughout 2022–23, in multiple areas, covering multiple technologies.

- Over £1 million investment in aeration systems to improve the efficiency of treated water process.
- Invested in real-time control, which allows us to trend our water treatment, resulting in reduced energy demands at several water treatment sites.
- Replaced pumping systems at multiple sites with new efficient pump sets.
- We have also invested in real-time control, which allows us to trend our water treatment, resulting in reduced energy demands at water treatment sites.

Quantification and reporting methodology

The methodology used to calculate operational greenhouse gas emissions for the provision of water and wastewater services follows the GHG Protocol – Corporate Reporting Standard.

The water sector employs a bespoke carbon accounting workbook, which reflects best practice and is updated every year to use the latest emission factors, derived from the UK's GHG Conversion Factors. Version 17_V4.02 of the Carbon Accounting Workbook (May 2023) has been used to prepare the GHG estimations.

Operational boundary

The reporting boundary covers all the company's operational services and aligns with our financial reporting boundary.

Assurance statement

This quantification of greenhouse gas emissions and energy usage is checked internally through a governance framework and audited by independent consultants in accordance with AA1000 v3 as part of the company's annual regulatory reporting.

Energy use

Area	2022–23 kWh	2021–22 kWh
Electricity	486,491,717	458,402,906
Imported	432,453,458	396,418,121
Self-generated	54,038,259	61,984,786
Gas	2,364,641	2,871,346
Business transport	15,303,066	13,447,058
Total incl. self-generation	**504,159,424**	**474,721,310**
Total excl. self-generation	**450,121,165**	**412,736,525**

The company's self-generated supply comes from combined heat and power (CHP), solar PV and diesel generation. In addition, the company exported excess electricity to the grid, predominantly renewable energy from the company's 16 CHP installations.

Streamlined Energy and Carbon Report (SECR)
continued

Greenhouse gas emissions

Scope	Description	Included in Scope	2022–23 ($ktCO_2e$)	2021–22 ($ktCO_2e$)
1	Direct emissions from activities that the company own or control including combustion of fuel	Gas oil use, process emissions, company transport	60.1	63.5
2	Indirect emissions from purchase of electricity (location-based)	Grid electricity	84.7	84.5
	Indirect emissions from purchase of electricity (market-based)	Grid electricity	0.0	0.0
3	Other indirect emissions*	Business travel on public transport/private vehicles, outsourced activities, grid electricity transmission and distribution, purchased chemicals, waste disposal, purchased fuels: extraction, production, transmission and distribution, embedded emissions, and purchased goods and services.	300.5	18.0
Total gross emissions (Scopes 1 & 2)	**Location-based approach****		**144.8**	**148.1**
	Market-based approach***		**60.1**	**63.5**

* In 2023 we expanded reporting of Scope 3 emissions to include the following activities: purchase of chemicals, waste disposal, purchased fuels: extraction, production, transmission and distribution, embedded emissions, and purchased goods and services. This accounts for the reported increase in Scope 3 emissions (on a like for like basis, compared to 2022, our emissions were 12.8$ktCO_2e$.

** Location-based approach uses the average grid emission factor for power from the electricity grid.

*** Market-based approach uses the carbon intensity of the energy we procure from the electricity grid.

Streamlined Energy and Carbon Report (SECR)
continued

Global greenhouse gas emissions and energy intensity metrics

Area	Unit of measurement	2022–23	2021–22
All company (location-based approach)	Tonnes of CO_2e from Scope 1 and 2 gross emissions per £100,000 turnover	18.28	18.0
All company (market-based approach)	Tonnes of CO_2e from Scope 1 and 2 gross emissions per £100,000 turnover	7.59	7.7
All company energy (incl. self-generation)	kWh/ £100,000 of turnover	63,616	57,647
All company energy (excl. self-generation)	kWh/ £100,000 of turnover	56,798	50,120
Water services	$kgCO_2e$ per megalitre (Ml) of water treated (location-based approach)	158	130
Water services	$kgCO_2e$ per megalitre (Ml) of water treated (market-based approach)	14	18
Water services (electricity incl. self-generation)	kWh/Ml	769	537
Water services (electricity excl. self-generation)	kWh/Ml	755	529
Water services (total energy incl. self-generation)	kWh/Ml	798	558
Water services (total energy excl. self-generation)	kWh/Ml	784	549
Wastewater services	$kgCO_2e$ per megalitre (Ml) of wastewater treated (location-based approach)	253	245
Wastewater services	$kgCO_2e$ per megalitre (Ml) of wastewater treated (market-based approach)	139	137
Wastewater services (electricity including self-generation)	kWh/Ml	715	662
Wastewater services (electricity excluding self-generation)	kWh/Ml	603	534
Wastewater services (total energy including self-generation)	kWh/Ml	741	685
Wastewater services (total energy excluding self-generation)	kWh/Ml	629	557

Note: Turnover 2022–23 reported as £792.5 million for use in intensity metrics. This reflects a reduction of £23.2 million due to an Ofwat regulatory settlement.

s172 Statement

In order to make **effective decisions**, the Board needs to take into account the interests of our stakeholders.

How the Board is kept informed of stakeholders' interests

Customers

- Reports from Customer Challenge Groups
- Regular reporting on customer performance metrics and performance
- Customer insight from customer panels

The Environment

- Reports from management covering: ICEG, environmental stakeholders.

Communities

- Reports of participation in local community groups
- Consultation feedback
- Meetings between our Executive and community groups
- Insights from CCG and ICEG
- Reports from ICEG.

Employees

- 'Workforce engagement' director
- Employee voice
- Speak Up (independent whistleblowing service)
- Regular reports on employee health and safety and wellbeing
- Employee engagement results
- Culture update.

Regulators

- Regular meetings between Chairman and CEO and the senior leadership of our regulators
- Reports from management
- Regulator annual reports and key correspondence
- Regulator research
- Attendance by regulators to Board meetings.

Suppliers

- Regular reports on supplier performance and matters, including health and safety performance.

s172 Statement continued

Ensuring effective stakeholder engagement

Under section 172 of the Companies Act 2006, directors need to consider the interests of the company's key stakeholders as well as the need to take into account the impact on the environment and the outcomes over the long term. The company and its Board engage with a variety of stakeholders through various mechanisms, including membership of stakeholder panels, regular meetings with stakeholders, public meetings as well as simply speaking to people and visiting operational sites.

Listening to our customers and delivering for them is one of our key priorities. In addition to regular reports from management regarding customer service performance, the Board has received updates on customer feedback and customer perceptions on the company's performance. The Board considers the impact of the company's operations on customers and receives regular updates from management, providing challenge and feedback, in the event that a significant operational event has occurred that impacts service to customers. This is in addition to an awareness of wider customer views through the C-MeX measure.

Understanding the needs of our most vulnerable customers is a focus for the Board, and management has continued to provide updates on the assistance the company provides whether through the social tariff or capping of water bills, payment breaks or the hardship fund, especially during the cost of living crisis.

Dame Gillian Guy, the former Chief Executive of Citizens Advice, who serves as an independent non-executive director, continues to provide further awareness of the needs and concerns of customers.

Our Board receive regular updates on environmental matters, including legislative changes, key areas of concern such as climate change, biodiversity and water resources. The CEO has also appeared in front of the UK Parliament's Environmental Audit Committee and gave evidence in support of the committee's investigation into water quality in rivers. Our Board also engages with our regulators to hear their views on the company's performance and plans.

A representative from our Customer Challenge Group and the Chair of our Independent Climate and Environment group attended the ESG Committee and provided insight and views of customers and stakeholders.

Mark Mathieson, a non-executive director, has the remit of engaging with the company's workforce and ensuring that their views are communicated to the Board. As reported previously, the CEO and leadership team hold regular Company Conversations with the company's workforce which address a variety of topics, including Southern Water's performance. They are also an opportunity for colleagues to express their views and ask questions. Management seeks the views of employees when developing plans, such as the introduction of the company's fourth value Working with Care and the Health and Safety Transformation Programme. These 'in-person' forms of engagement are supported by regular Gallup all-employee surveys.

Regular meetings between senior representatives of our key regulators – Ofwat, the Environment Agency and the Drinking Water Inspectorate – and our senior executives and Chairman take place, in order to discuss our performance and compliance with our statutory obligations as well as to communicate our plans for the future of Southern Water.

Since the major investment by funds managed by Macquarie Asset Management in the group, the shareholder-nominated directors ensure that the views of the company's major shareholder are communicated to the Board. In addition, the Board and executive has engaged extensively with Macquarie Asset Management, including through various 'deep-dives' into aspects of the company and in terms of developing its strategy.

s172 Statement continued

Overview

Section 172(1) of the Companies Act 2006 sets out several factors which the Southern Water Board takes into account in its activities and decisions.

Section 172 considerations key:

- Likely consequences of decisions in the long term
- The interests of the company's workforce
- The need to foster relationships with suppliers, customers and others
- Impact of operations on the community and environment
- Maintaining high standards of business conduct
- The need to act fairly between members of the company

For more information on how we take into account the interests of our employees, please refer to pages 69 to 74.

Pollutions performance

Link to Section 172 considerations

Long-term impact

Investing for the long term, with focus on the impacts of climate change.

Community and the environment

Ensuring that the company's impact on the environment is minimised to enable enjoyment of water resources and natural environment to continue into the future.

Maintaining high standards of business conduct

Minimising the number of pollution incidents, or mitigating their impact where they do occur, and acting as a good 'corporate citizen'.

Outcomes and actions:

As part of our pollution reduction programme, we invested in proactive maintenance of our sewerage network, alongside root cause analysis of pollutions.

Clean Rivers and Seas Task Force continues to upgrade our infrastructure and develop sustainable drainage solutions to cut storm overflows and actively engages with stakeholders, the UK Government and regulators on this matter.

Additional investment in our wastewater networks to improve resilience.

Link to risks:
Water; Wastewater; Compliance; Customer; Climate Change; Health and Safety; Financial; Corporate Affairs; People.

Link to strategy:
Deliver great service, protect and improve the environment and fit for the future.

Read more on page 61.

s172 Statement continued

Investing for the future

Link to Section 172 considerations

Long-term impact

Invest for the long term to ensure continued supply of essential services.

Ensure that the company remains financially and operationally resilient.

Community and the environment

The need to address climate change and population growth in the South East.

Customers and suppliers

The need to ensure that our teams and contractors continue to deliver essential services for our customers.

Shareholders

Engaging with our shareholders and obtaining their support for our investment plans.

Outcomes and actions:

During 2022–23 we made a capital investment of £213.5 million in water and £444 million in wastewater on base maintenance and enhancement of our sites and networks.

We developed a new planning process to better understand and manage the company's water quality risk and support long-term resilience at four of its critical water sites.

Work continues to progress on consultations and submissions for our Water for Life – Hampshire programme to improve water supply resilience.

We launched a full-scale review of our Health and Safety culture, embedding a fourth value – Working with Care. We began the implementation our Health and Safety Transformation Programme enabling our people to work in a safe, collaborative and inclusive workplace.

Link to risks:
People; Customer; Compliance; Water; Wastewater; Financial; Resources; Climate Change; Corporate Affairs.

Link to strategy:
Deliver great service; use water wisely; protect and improve the environment; fit for the future

Read more on pages 42 to 95.

Protecting the environment

Link to Section 172 considerations

Long-term impact

Invest in environmental improvements to create a resilient water future for our customers in the South East.

Take steps to mitigate and adapt to climate change.

Community and the environment

The need to maintain and improve water quality in rivers and beaches so that they can continue to be enjoyed.

Outcomes and actions:

Increasing the size of our leakage team and employing new tools and techniques to find and fix leaks as part of our commitment to halve leakage by 2050.

Development of our environmental programme – part of WINEP – to deliver a step change in our environmental performance to 2030 and beyond.

Consultation and submission of our Drainage and Wastewater Management Plan, which aims to improve the resilience and sustainability of our wastewater systems and water environment.

Clean Rivers and Seas Task Force continues to upgrade our infrastructure and develop sustainable drainage solutions to cut storm overflows and actively engages with stakeholders, the UK Government and regulators on this matter.

Link to risks:
Delivery; Resources; Corporate Affairs; Customer; Water; Wastewater; Health and Safety and Climate Change.

Link to strategy:
Use water wisely; protect and improve the environment; fit for the future

Read more on pages 59 to 68.

Non-financial information statement

To comply with the non-financial reporting requirements (NFR), contained in sections 414CA and 414CB of the Companies Act 2006, we are providing the details below to help stakeholders understand our position on key non-financial matters.

We have used cross referencing, as appropriate, to deliver clear, concise and transparent reporting.

Non-financial information	Page no.
Business model	22 to 32
Principal risks	127 to 132
Turnaround Plan	17, 50, 56, 64 and 72

Performance against our strategic non-financial measures is one indicator of the effectiveness and outcomes of our policies and guidance.

Across Southern Water, policies and statements of intent are in place to ensure consistent governance on a range of issues. For the purposes of the NFR requirements, these include, but are not limited to:

Our people
Our people are our business. Every day they are helping us to succeed, driving the right outcomes for our customers, business and environment. We value and seek to harness the unique skills, experiences and backgrounds of every colleague. We are committed to maintaining a safe, inclusive and great place to work, and we strive to attract and retain diverse talent, so we remain representative of our communities. Our policies support our people and are available on our company intranet – The Hub – with key policies also available on our website.

Non-financial information: External environment, pages 26 to 30; enabling and empowering our people, pages 69 to 74; gender pay, page 70; diversity of the board, pages 169 to 170; ratio of pay, page 70; operational performance, pages 42 to 95.

Policies: Code of Conduct; Health and Safety; Code of Ethics; Equality, Diversity and Inclusion; Domestic Violence and Abuse; Employee Volunteering; Grievance; Harassment; Organisational Change; Probity; Talent and Development; Supplier Code of Conduct.

The environment
We can only provide high-quality water and efficient wastewater services to our customers in the South East if we protect and improve our natural environment. As such we are committed to improving our environmental performance and, at a minimum, complying with environmental and regulatory standards. What we do, and how we do it, can have a positive and lasting impact on the environment. By going above and beyond compliance, we can create value. We are working with our customers, stakeholders, delivery partners, suppliers and regulators to do this. We have a number of policies in place to help us address our impact on the environment: **southernwater.co.uk/our-performance/key-policies**. Further information can be found in the following sections of this report:

Non-financial information: External environment, pages 26 to 30; stakeholder engagement, pages 33 to 39; operational performance, pages 42 to 74.

Policies: Environment; Biodiversity; Plastics; Carbon; Sustainable and Ethical Trading; Code of Ethics; Supplier Code of Conduct; Responsible Business.

Human rights
We operate in accordance with the United Nation's guiding principles on business and human rights. We promote human rights through our employment policies and practices and through our supply chain. We have policies and processes in place which ensure we are compliant with these requirements, and they are enforced throughout our business. Further information can be found in the following sections of this report:

Non-financial information: Enabling and empowering our people, pages 69 to 74.

Policies: Modern Slavery Statement; Privacy Notice; Information Governance; Speak Up; Sustainable and Ethical Trading; Supplier Code of Conduct; Responsible Business.

Non-financial information statement continued

Social impact

We support people, our business partners and the communities we operate in. As well as the specific policies mentioned below, we have guidance and initiatives in place to support the following:

- Age UK, Citizens Advice Bureau and debt advice bodies.
- An employee volunteering programme and community grants scheme supporting local charities and groups.
- Promotion of skills development through apprenticeships and graduate schemes as well as partnerships with universities and colleges.
- Relationships with environmental groups such as the local Wildlife and Rivers Trusts.

Further information can be found in the following sections of this report:

Non-financial information: Enabling and empowering our people; understanding and supporting our customers and communities.

Policies: Tax; Equality, Diversity and Inclusion; Responsible Business; Code of Ethics; Employee Volunteering; Sustainable and Ethical Trading; Guaranteed Standards of Service; Code of Practice; Donations and Sponsorship; Health and Safety; Environment; Social Media; Supplier Code of Conduct.

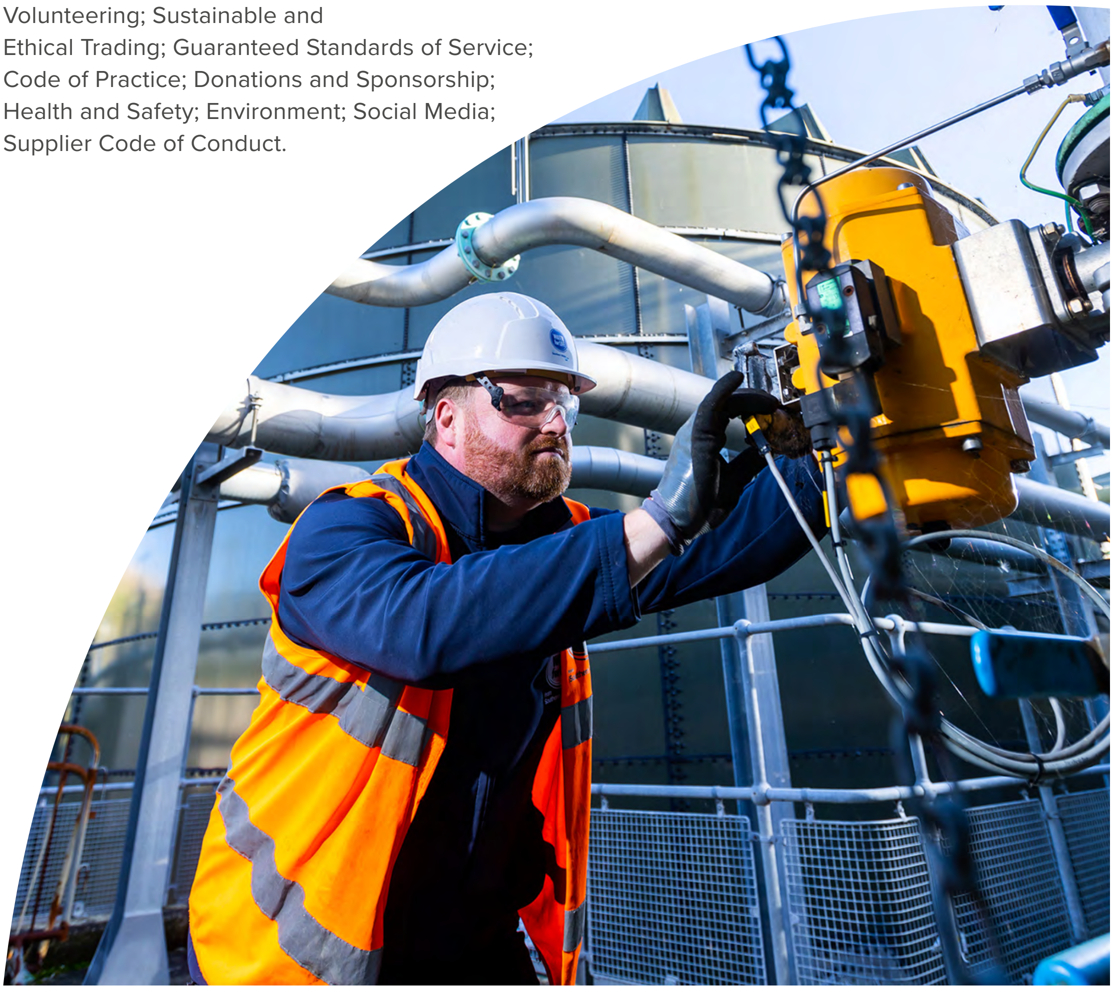
Anti-corruption and anti-bribery

We promote a culture of honesty and integrity in all our dealings, and we will not tolerate acts of fraud, dishonesty, bribery, corruption or theft of assets or data from the business. In addition to our Code of Ethics we have additional policies in place to guide our people. These are available on our company intranet. Furthermore, we have a confidential 24-hour anonymous Speak Up hotline. This is an independent whistleblowing service available for all colleagues to raise concerns.

Further information can be found in the following sections of this report:

Non-financial information: Read more about our values on pages 11, 19 and 69.

Policies: Code of Ethics; Bribery; Supplier Code of Conduct; Sustainable and Ethical Trading.



Financial performance

Chief Financial Officer's review

I joined Southern Water as Chief Financial Officer in January 2023 to work alongside Lawrence and the rest of the Southern Water team to drive the transformation of the company, and improve performance for its customers and the environment. In my first months, I have focused on understanding the challenges we face, defining and putting in place the plan that will establish the foundation we need to deliver our ambitious turnaround.

A key element of this has been the development of a revised business plan for the current regulatory period, which is designed to significantly improve our operational performance, deliver on our regulatory obligations, meet additional cost pressures, increase resilience and deliver better outcomes for customers, communities and the environment. This Turnaround Plan includes significant additional expenditure, over that agreed in our final determination for 1 April 2020 to 31 March 2025 and represents a major milestone in our turnaround journey.

To maintain momentum on our turnaround plan we have engaged with shareholders to seek an additional £550 million of new equity funds for the group. We expect this process to conclude by the end of October 2023 with £375 million of that new equity being injected into Southern Water. For further information regarding this funding and its effect on the going concern assessment, including the related material uncertainty, see page 205.

We expect to complete the first phase of our Turnaround Plan by 31 March 2025. Our business plan for the five-year regulatory period starting April 2025, will be based on the final stage of the turnaround along-side the investments required to secure long-term water supplies for our customers and address the environmental impacts of water abstraction and treatment.

As a consequence of this initial period of additional spend and investment, our credit ratings and covenant ratios will be under pressure for the remainder of this regulatory period to March 2025. On 7 July, Fitch announced its decision to downgrade our credit rating to BBB (negative outlook) which has resulted in a Trigger Event. We expect to remain in Trigger for the remainder of this regulatory period.

We are fortunate to have shareholders that have consistently supported Southern Water by approving substantial investment in the business over and above regulatory allowances, while taking no dividends and expect to take no further dividends for the remainder of this AMP. For the sixth year in succession, our external shareholders did not receive a dividend as we prioritised the critical investment we need to make in our systems and assets to improve resilience for the benefit of our customers, communities and the environment.

This support has never been so important as we face the external challenges the world has been experiencing in the last few years, with climate change, increasing energy prices and rising inflation all having an impact on our customers and our business. The impact of these cost pressures is reflected in our financial results for the financial year ended 31 March 2023 which are summarised on the next page.

Stuart Ledger
Chief Financial Officer
7 July 2023

Read more in the Financial statements on pages 209 to 257

Financial performance

The financial results have been prepared in accordance with FRS 101 and the accounting policies of the company as set out in note 1 to the financial statements.

Financial performance

Income statement	Years ended 31 March **2023** **£m**	 2022 £m
Revenue	**792.5**	823.5
Amortisation of regulatory settlement payments	**23.2**	21.0
Total revenue	**815.7**	844.5
Other operating income	**1.8**	1.8
Operating costs before court fine and costs and charge for bad and doubtful debts	**(476.8)**	(384.7)
Court fine and costs	**–**	(91.5)
Charge for bad and doubtful debts	**(12.0)**	(29.9)
Depreciation, net of amortisation	**(347.1)**	(324.1)
Operating (loss)/profit	**(18.4)**	16.1
Profit on disposal of fixed assets and other income	**6.5**	1.5
(Loss)/profit before interest and tax	**(11.9)**	17.6
Net finance costs	**(278.6)**	(196.2)
Fair value gains/(losses) on derivative financial instruments	**659.1**	(669.0)
Profit/(loss) before tax	**368.6**	(847.6)
Tax	**(83.7)**	86.1
Profit/(loss) for the financial year	**284.9**	(761.5)

Revenue

Revenue decreased to £792.5 million (2022: £823.5 million). This is principally due to £63.6 million of net penalties for Outcome Delivery Incentives (ODI), £6.6 million reduced consumption by households during the drought and £3.3 million of generally lower consumption. Partially offset by £17.0 million increased business consumption and £36.7 million inflationary increases in line with the allowances set by Ofwat.

In 2022–23 ODI penalties, relating to performance in 2020–21, were applied to our water and wastewater revenue totalling £63.6 million representing penalties of £51.6 million and an element for tax of £12.0 million. We have subsequently confirmed with Ofwat that the tax element of this adjustment was incorrectly applied to reduce our tariff and revenues in 2022–23 and we will, therefore, recover the £12.0 million through revenues in 2023–24.

Details of the other significant movements affecting our revenues are described here and shown in the diagram on the following page:

- Revenue estimation – most of our customers are billed based on metered water usage. At each period end we make an estimate for water used but not billed. In the prior year, we billed an additional £13.0 million in relation to consumption to March 2021 and in the current year we billed a net £3.1 million less than we accrued at March 2022.
- Consumption – following the return to more normal usage patterns following the pandemic, we have experienced an increase in non-household consumption in the year, which increased revenues by £17.0 million. This was partially offset by reduced household usage in response to the drought, which reduced revenues by £6.6 million.

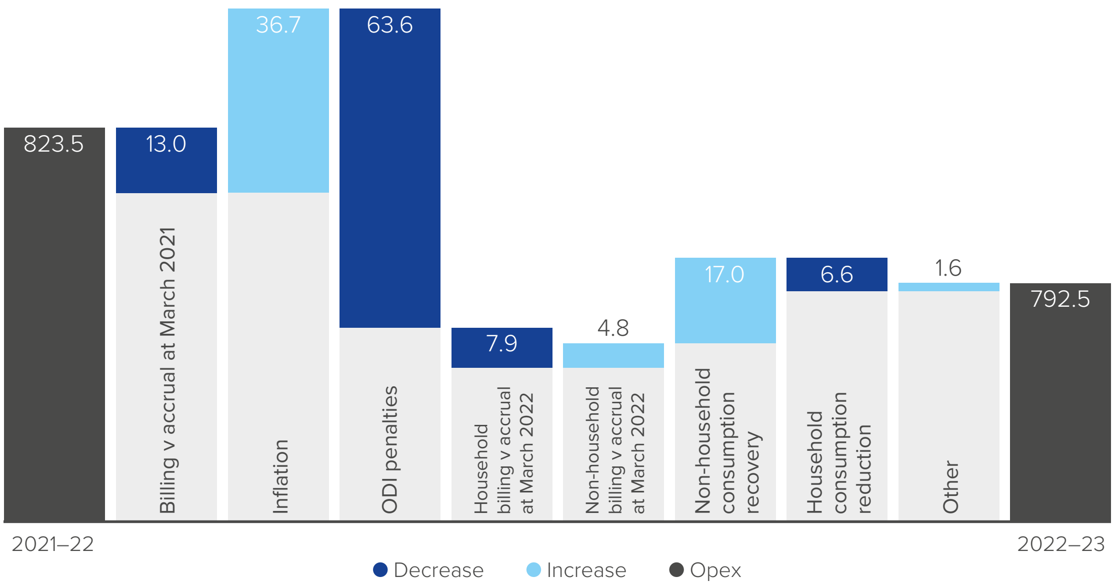
Financial performance continued

In 2018–19, we made provision for customer rebates, based on our regulatory settlement with Ofwat, to be provided to customers over the period from 2020–25. These customer rebates are now included within our tariffs and so part of the revenue reported in the income statement. The provision made in 2018–19 for these rebates is being released in line with the tariff adjustment over the same period, £23.2 million was released in 2022–23 a slight increase from the prior year, reflecting the impact of inflation on our revenues.

An analysis of revenue is provided in note 5 to the financial statements.

Read more in the Financial statements on pages 209 to 257

Movement in revenue £m



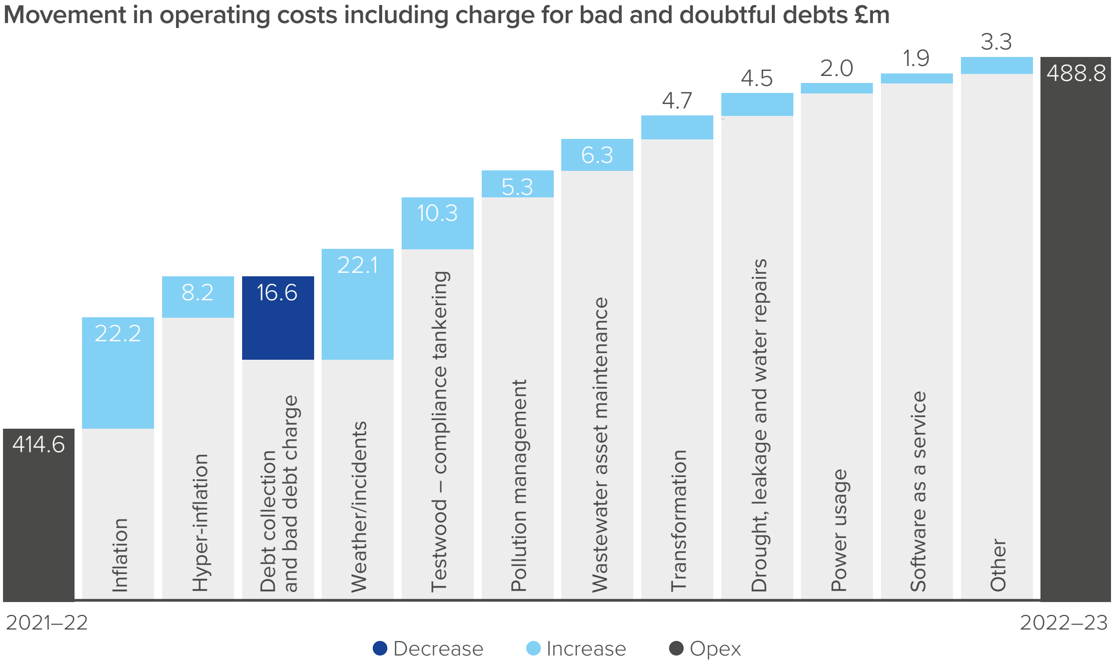
Financial performance continued

Read about our operational performance on pages 42 to 95

Operating costs and charge for bad and doubtful debts

Operating costs including the charge for bad and doubtful debts for the year increased by £74.2 million from £414.6 million to £488.8 million. This increase is explained in the chart below:

Movement in operating costs including charge for bad and doubtful debts £m



Over the course of the year the most significant cost increases were:

- **Inflation and hyper-inflation** – general inflation added a significant amount to our underlying costs, £22.2 million, with average inflation rates across most of our cost base lying between 4% and 7%. This included power costs, for which we had previously fixed prices. However, for certain chemicals and fuel we experienced inflation rates ranging from 14% to 200%, and these increased our operating costs by £8.2 million.
- **Debt collection and bad debt charge** – cash collection performance has been maintained as debt collection activities resumed post COVID–19, and with the support initiatives we have put in place to help customers facing financial difficulties in the current economic climate. As a result, our bad debt charge, which included an additional charge of £10.3 million in the prior year, for the potential impact of the economic pressure on customers, reduced by £17.9 million to £12.0 million (2022: £29.9 million). This reduction was offset by a small increase in our overall debt collection costs, resulting in a net reduction in operating costs of £16.6 million.
- **Weather/incidents** – As described in our strategic report, in 2022–23 we experienced loss of supply events in Kent and Hampshire which affected large numbers of customers. We would consider these events to be atypical due to the scale of the events which added £12.8 million to our operating costs.

  Since October 2022 we have experienced a prolonged period of extremely wet weather, with our region receiving 181% of the long-term average rainfall. Dealing with the high-ground water levels and infiltration cost a further £10.8 million. These increases were reduced in part by the costs incurred in the prior year for Storm Eunice which were not incurred in 2022–23 of £1.5 million.
- **Testwood compliance tankering** – at our Testwood Water Supply Works we have enhanced water quality performance through capital investment to replace all the chemical dosing equipment on site. Consequently, and in order to maintain compliance, this increased the amount of tankering and treatment required for the waste produced, so that it can be safely returned to the environment. This increased costs significantly by £10.3 million in the year and we are working hard to identify an alternative solution to mitigate and reduce these exceptional costs for the future.

Financial performance continued

- **Pollution management** – we increased proactive maintenance of our sewerage network by £5.3 million as part of our pollution reduction programme.
- **Transformation** – costs incurred during the year as part of our transformation programme to improve operational performance, these included the creation of a new logistics team, managing our own small fleet of water tankers as well as stores of spares for plant and equipment repairs, improvements to our control centre and alarm handling as well as production and publication of our overall transformation programme.
- **Drought, leakage and water repairs** – following the dry winter in 2021 and the hot summer water companies across the country faced the first nationwide drought for a decade, introducing a temporary usage ban for our customers in Hampshire. We incurred additional £4.5 million of operating costs in preparation for the drought and replenishing our reservoir at Bewl, along with additional leakage activity and water repairs to mitigate the effect on our overall water resources.
- **Power usage** – additional power consumption dealing with wastewater following the high levels of rainfall over the period from October 2022.
- **Software as a Service (SaaS)** – in 2021, the IFRS Interpretations Committee published its agenda decision regarding configuration and customisation costs in Cloud Computing Arrangements (SaaS). This has resulted in certain costs, that would have previously been capitalised as an intangible asset, being held on the balance sheet as a prepayment and recognised as an operating expense over the life of the contract. The impact on our operating costs is an increase of £1.9 million in 2022–23.

Court fine and costs

The company was subject to a detailed investigation by the Environment Agency (EA) regarding permit breaches at some of our wastewater treatment works during the period 2010 to 2015. On 9 July 2021, the company was sentenced and fined £90.0 million plus £2.5 million of costs for these historic offences. These costs, less the provision of £1.0 million made in 2019–20, were charged to the income statement in 2021–22.

Depreciation and amortisation

Depreciation and amortisation increased to £347.1 million (2022: £324.1 million) following the completion and commissioning of a large number of our capital investment schemes. This included a number of wastewater treatment schemes.

Operating loss/profit

As a result of the reduction in revenue and increased operating costs, we incurred an operating loss of £18.4 million (2022: profit £16.1 million).

Financing costs and profit before tax

Net finance costs increased by £82.4 million to £278.6 million (2022: £196.2 million). This increase is largely driven by higher indexation on our index-linked debt of £93.3 million, which, along with indexation form the prior year, increased the interest payable on loans by £3.9 million. These increases to our interest charge were offset by a greater level of interest capitalised during the year of £17.0 million.

The actual interest paid in cash on these loans was £176.8 million and this was offset by receipts from financial derivatives of £87.2 million.

The fair value gain on our derivative financial instruments amounted to £659.1 million reversing the loss experienced in the prior year, (2022: loss £669.0 million). The primary driver for changes in the valuation are the fluctuation in UK Government bond yields, which are used to discount the future cash flows and inflation which increases the liability associated with our index-linked instruments. As government gilt yields are constantly moving and inflation has increased significantly over the past year, the valuation of our derivative instruments is volatile. The balance sheet value represents the present value of future cash flows using financial market forecasts for inflation and interest rates. This balance sheet value does not, however, reflect the expected impact of inflation on future revenues and future Regulatory Capital Value (RCV) which is expected to more than offset the reported balance sheet value.

The profit before tax for the year amounted to £368.6 million (2022: £847.6 million loss).

Taxation

We have recognised a total tax charge to the income statement of £83.7 million (2022: £86.1 million tax credit). This differs from the charge that may be expected of £70.0 million, based on the profit before tax of £368.6 million and the current period tax rate of 19%, as described in note 10. The variance is primarily due to differences between the current and deferred tax rates.

Read about our drought response on page 57

Financial performance continued

Cash flow statement

Overall, cash and cash equivalents decreased in 2022–23 by £41.6 million (2022: £182.1 million decrease) and details of the principal movements in the cash flow are provided in the table below.

	Years ended 31 March			
	2023 £m	2022 £m	Movement £m	Explanation
Proceeds from share issues	**–**	391.3	(391.3)	In September 2021, funds managed by Macquarie Asset Management acquired a majority stake in Southern Water's ultimate parent company Greensands Holdings. As part of this investment new equity totalling £391.3 million was issued by Southern Water Services during 2021–22.
Settlement of loan to SWSG	**–**	130.0	(130.0)	As part of the investment into the group by funds managed by Macquarie Asset Management, the inter-company debtor issued to SWSG was repaid.
Net interest-related transactions	**(86.3)**	(123.0)	36.7	In total, the net cash outflow in relation to interest decreased by £36.7 million. The principal reasons were: There were no payments made in relation to accrued indexation on our index-linked loans (2022: £46.9 million). Lower interest received following the repayment of our intercompany debtor with SWSG, £8.6 million
Net movement on borrowings	**57.2**	(16.9)	74.1	During the year, we made loan and preference share repayments totalling £343.2 million (2022: £16.9 million); these were offset by the issue of a bridging loan £400.0 million (2022: nil).
Movements in short-term investments	**285.0**	(285.0)	570.0	Funds held on deposit for periods greater than three months decreased by £285.0 million in the year to support our capital investment programme.
Settlement of court fine and costs	**–**	(92.5)	92.5	Payment of the court fine and costs in 2021–22 relating to the Environment Agency prosecution.
Investment in subsidiary	**33.9**	–	33.9	In FY23 we closed our Cayman subsidiary, SWSF, resulting in the return of our investment of £29.2 million and a final dividend of £4.7 million.
Pension deficit repair	**–**	(77.3)	77.3	In FY22 we made lump sum pension deficit repair payments totalling £77.3 million which included the advance payment of £59.8 million previously scheduled to be made over the period to 31 March 2025. As a result, no further payments were made in the current year.
Other	**(331.4)**	(108.7)	(222.7)	The net cash movement from operating activities and our capital investment programme. Largely driven by the increase in our capital investment programme during the year which increased cash expenditure by £164.4 million and the increase in the cashflow associated with our higher operating costs as described above.
	(41.6)	(182.1)		

Statement of financial position

	31 March 2023 £m	31 March 2022 £m (Restated*)
Non-current assets	**7,297.8**	6,899.0
Current assets (excluding cash)	**263.8**	527.4
Cash and cash equivalents	**115.8**	157.4
Total assets	**7,677.4**	7,583.8
Current liabilities	**(530.4)**	(735.2)
Non-current liabilities	**(6,282.4)**	(6,259.6)
Total liabilities	**(6,812.8)**	(6,994.8)
Total net assets	**864.6**	589.0
Total equity	**864.6**	589.0

*The prior year has been restated following a re-analysis of prepayments from current to non-current assets

Financial performance continued

At the end of the year to 31 March 2023, we had non-current assets of £7,297.8 million (2022: £6,899.0 million), an increase of £398.8 million from March 2022. This increase largely results from our ongoing capital investment programme, which – after depreciation – increased the value of property, plant and equipment and intangible assets by £390.4 million.

Overall, during 2022–23 our capital investment in property, plant and equipment was £707.7 million (2022: £569.7 million). This step-up in expenditure was targeted at making refurbishments to our assets to improve operational performance as well as schemes to enhance the level of wastewater treatment we undertake, for example to reduce phosphorus levels.

In addition, we experienced an increase in the value of our non-current financial derivative assets of £38.3 million which was offset by a reduction in the value of investments held in subsidiaries of £29.0 million following the closure of our Cayman Islands registered subsidiary SWSF in October 2022.

Current assets decreased to £263.8 million (2022: £527.4 million). Most of this decrease resulted from the utilisation of the cash held in short-term investments at March 2022 during this financial year to finance the capital investment programme. At March 2023 there were no deposits held in short-term investments (2022: £285.0 million). This reduction was offset by increases in prepayments for interest and IT contracts of £9.2 million and a higher VAT debtor at the year-end of £7.9 million resulting from the increase in the capital investment programme.

Current liabilities decreased to £530.4 million (2022: £735.2 million). This was mainly caused by the movement on external loans due to be repaid in under one year, which decreased to £19.9 million (2022: £274.8 million), together with the repayment of an inter-company loan of £30.3 million following the closure of our Cayman Islands registered subsidiary SWSF. These reductions were offset by an increase in the level of trade and capital creditors and capital accruals of £56.8 million reflecting the increased expenditure in operating costs and the capital investment programme and an increase in deferred revenue mainly relating to payments in advance from customers of £16.3 million.

At 31 March 2023, non-current liabilities totalled £6,282.4 million (2022: £6,259.6 million). This increase of £22.8 million was principally the result of the following:

- An increase in borrowings of £485.2 million largely resulting from the issuance of a £400 million term loan facility and indexation on our inflation-linked bonds of £106.7 million offset by repayment of preference shares and loans totalling £24.1 million.
- A decrease in the derivative financial instrument liability of £533.6 million.
- An increase in the deferred tax liability of £81.5 million largely resulting from the fair value gain on derivatives recorded for the year.
- An increase in retirement benefit obligations of £13.1 million from the impact of movements in market conditions at 31 March 2023, which increased the deficit by £11.5 million, together with past service and financing costs of £1.6 million.
- The transfer of £25.6 million of the Ofwat regulatory settlement provision to short-term liabilities for rebates that will be applied through bills to customers' bills during 2023–24.
- Overall, net assets increased from £589.0 million to £864.6 million.

Financial performance continued

Dividend policy

Our dividend policy is formulated to ensure a fair balance of reward between customers and investors. To enable the successful delivery of our business plan for 2020–25, all stakeholders must share in success: customers benefiting through enhanced service and lower bills, and shareholders earning a fair return on the equity invested.

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

1. Determination of a base level of dividend, based on an equity return consistent with our most recent Final Determination and our actual level of gearing. This recognises our management of economic risks and capital employed.
2. In assessing any adjustment to the base level of dividend, we will take into account all aspects of our performance. This would reflect our overall financial performance as compared to the final business plan as agreed by Ofwat and would explicitly consider a qualitative assessment of customer service levels and how customers share in our successes.
3. We will consider our financial resilience ahead of any dividend decision and whether any financial out-performance should be reinvested to benefit customers. This consideration will include taking into account the interests of our employees, other stakeholders, and our pension schemes.

   Our dividend policy is intended to support the financial resilience and investment grade credit ratings of the business and ensure continued access to diversified sources of finance. As part of step three, we carry out an assessment of:

   a. headroom under debt covenants
   b. the impact on the company's credit rating
   c. the liquidity position and ability to fulfil licence conditions
   d. key areas of business risk.
4. We will be transparent in the payment of dividends and will clearly justify the payment in relation to the factors outlined above.
5. We will publish our dividend policy annually (in the Annual Report) and highlight any changes.

No ordinary dividends were declared or paid in 2022–23 (2022: £nil).

On 26 July 2022, having undertaken a careful consideration of the company's financial position, progress in delivery for customers, and all other relevant factors, the Board approved the redemption of 5,164 of its Class B preference shares, at nominal value plus the premium on issue, including settlement for fixed value dividends due to that date. The total amount paid was £17.5 million, comprising principal redemption of £5.2 million and dividends of £12.3 million (2022: £nil).

Dividends on the preference shares accrue like interest and from an accounting perspective they are treated as interest, even though they are called dividends. The payment made in July 2022 was our first payment since 2020. These payments are made to a SWS group company and enable the payment of external interest on loans within the group. None of this money is paid to Southern Water shareholders.

An accrual totalling £4.5 million in relation to the cumulative liability of preference share dividends to 31 March is included within the financial statements as an inter-company creditor.

Tax strategy and policies

Southern Water and all group companies adopt the tax strategy and policies outlined below.

Our approach to the management of tax affairs is driven by our core values of succeeding together, always improving, doing the right thing and working with care, alongside the corporate strategy of the company. We have a low-risk tax appetite, and this is reflected in our management of tax.

The foundation of our tax strategy is to comply fully with tax legislation and to focus upon maintaining a strong tax compliance culture and an open and transparent relationship with HMRC.

To enable this, we undertake regular compliance reviews both internally and externally to ensure our tax policies are consistently applied. Our approach to tax planning is to align to business decisions made in the best interests of customers and stakeholders, rather than use tax planning to drive or determine business decisions. The very nature of our business means we always take a long-term view on all the activities we undertake. We therefore ensure our tax strategy, and approach to tax, is sustainable, ethical, considers both social and corporate responsibilities and can stand up to external scrutiny. When faced with a decision or business case, the ongoing tax impact is always considered as part of that decision-making process.

Financial performance continued

Our approach to tax management and governance

We ensure we are fully compliant with tax laws, rules, regulations and reporting requirements in all operations. This extends to following both the letter of the law as well as the spirit of the law. A culture of doing the right thing is embedded in our core values and our approach to tax embodies this by ensuring we pay the right amount, in the right place, at the right time. We also use the expertise of professional tax advisers to ensure we maintain best practice in our approach to compliance and in circumstances when additional advice is deemed appropriate.

The management of the tax affairs of Southern Water and all companies in the group is the responsibility of the Tax team. Roles and responsibilities within the Tax team are clearly defined. The Tax team reports to the Group Treasurer, who in turn reports to the Chief Financial Officer (CFO). The CFO is the Senior Accounting Officer (SAO) and has ultimate responsibility for the tax affairs for Southern Water and the Southern Water Group companies.

Our management of tax risk

As indicated above, we adopt a conservative approach to tax risk. Our tax management focus is on compliance, systems and governance and our tax planning is always aligned with our commercial and economic activity. All companies within the group are subject to UK tax and all companies are UK tax resident, irrespective of their place of incorporation, ensuring that each company is subject to UK tax.

Tax risk primarily emanates from the evolution and complexity of the business, along with the ever-changing regulatory and legislative environment. We manage this risk by having an experienced Tax team dedicated to tax compliance and the identification and management of tax risks in our business.

Our Tax team works with the business to ensure there are processes and controls in place and determine what level of risk is acceptable. We also work with industry tax experts who provide specialist services, check what we are doing and provide guidance on compliance requirements. Our Internal Audit team also carries out assurance on the control environment relating to the transactional processes underpinning our payments to the Exchequer and our collection of taxes on behalf of the Exchequer.

Our relationship with His Majesty's Revenue and Customs (HMRC)

A key factor in our management of our tax affairs is our relationship with HMRC.

We meet all statutory and legislative requirements and we manage our tax affairs in an open and transparent way. This extends to us sharing information with HMRC, which goes beyond the normal filing of statutory returns, such as the sharing of internal audit findings so that we can be open and transparent in our approach to managing tax risk. HMRC shares our view of our low-risk approach to the management of our tax affairs with the last HMRC assessment being that we were deemed to be a 'low-risk' company, and this was reaffirmed with HMRC in December 2022.

Maintaining public trust

As previously stated, we are committed to complying fully with tax legislation, maintaining a strong culture of compliance and having open and constructive relationships with tax authorities. We do not use tax avoidance schemes or take an aggressive approach on tax planning when interpreting tax legislation.

We apply government and fiscal authority tax incentives and exemptions, where they exist. For example, the UK tax system recognises the benefit to the economy of investment in infrastructure and environmental protection through the availability of capital allowances, which reduce the corporation tax Southern Water pays. Any benefits of this are passed to our customers through reduced bills.

Southern Water and all Southern Water Group companies pay taxes in the UK and have never used offshore companies to avoid tax or levies. In October 2022 all assets and liabilities from our Cayman Islands registered subsidiary were transferred to two new UK tax registered entities (both subsidiaries of Southern Water Services Limited) and this Cayman Islands-registered entity has now been dissolved effective at the end of June 2023. It was originally set up to issue debt in the UK (see page 119 for more information). Its Cayman Island registration did not have any impact on the tax due by the group.

The full amount of the court fine and the associated costs awarded to the Environment Agency that were incurred and recorded in the accounts for 2021–22 has been fully disallowed for tax, i.e. Southern Water does not receive any tax benefit for this deduction.

Although our tax strategy is reviewed and updated each year, it is not expected to significantly change from year to year.

We regard this publication as complying with our duty as required under paragraph 16(2) of Finance Act 2016 for the financial year ended 31 March 2023.

Financial performance continued

Understanding our taxable profits and our corporation tax

Our taxable profits are generally different to our accounting profits for the following reasons:

- **Capital allowances and depreciation** – capital allowances are a way of obtaining tax relief on certain types of capital expenditure. These are treated as a business expense and so reduce our taxable profit. Depreciation represents how much of an asset's value has been used up and reduces accounting profit. Capital allowances are applied at different rates than used for depreciation. As a result, there is a difference between capital allowance deductions made against our taxable profits and depreciation made against our accounting profits. The annual variance between capital allowances and depreciation results in a difference between our taxable profit and our accounting profit. Due to the large scale of our capital expenditure programme and the level of capital allowances available and utilised, our taxable profits are significantly reduced.
- **The treatment of interest costs** – we borrow money to finance our capital expenditure programme. The interest associated with this borrowing is recognised as both an accounting and tax expense, reducing profit and the amount of tax we pay. However, there are differences between the amounts of interest recognised for accounting profits and for taxable profits. Examples are that movements on the fair value of our financial derivatives are not recognised in our taxable profits, and interest that is capitalised in our financial statements is treated as an expense when calculating our taxable profits.
- **Group relief** – Southern Water is part of the Greensands Holdings group of companies as set out on pages 116 to 119. All of these companies are taxable as UK companies and profits or losses of the companies within the group can be set off against one another in the financial year. Group relief can be claimed by Southern Water Services Ltd where the standard rate of tax for the losses claimed is paid. For 2022–23, no tax for these losses was paid, therefore there was no group relief claimed.
- **Deferred tax** – the cumulative difference between taxable profits and accounting profits, which are expected to be temporary and reverse in future years, is presented as deferred tax on the statement of financial position. Changes to the future rate of corporation tax revise the carrying value of these differences.

Our tax charge is reduced by our large capital expenditure programme and the interest we are charged on borrowings. The benefit of this is passed to our customers through reduced bills. There is no corporation tax allowance within our customer bills for the regulatory period from April 2020 to March 2025.

Details of our tax charge for the current financial year are disclosed in note 10 to the financial statements and the current year charge to the income statement is also explained further on page 210.

Financial performance continued

Our other tax contributions

Our other contributions to the Exchequer amounted to £82.1 million. These are explained below:

- Business rates of £27.7 million paid to local authorities (2022: £27.8 million) and payments to the Environment Agency of £8.5 million (2022: £8.0 million) for abstraction licences and discharge consents, which reduce profits chargeable to corporation tax.
- Employment taxes of £45.9 million (2022: £40.6 million) paid to the Exchequer under PAYE (Pay As You Earn) and National Insurance contributions.

No payments have been made to other group companies for tax losses surrendered to the company. As a result of capital allowances and interest charges, no corporation tax was paid by the company to HMRC in 2022–23.

Financial KPIs

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

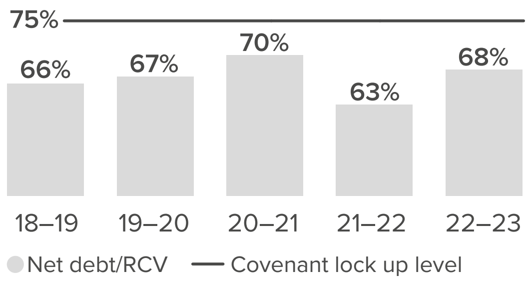
The net debt to RCV ratio is calculated as short and long-term senior borrowings less cash and short-term deposits, for the consolidated SWS group of companies, to the RCV. The RCV is set by Ofwat at each five-year review and reflects our initial market value plus subsequent capital investment and inflation. The RCV is adjusted at each periodic review for relevant changes to the level of expenditure or performance during the five-year period.

The adjusted cash interest cover is measured as the ratio of net cash inflow from operating activities less RCV depreciation to net cash interest expense for the consolidated group of SWS companies.

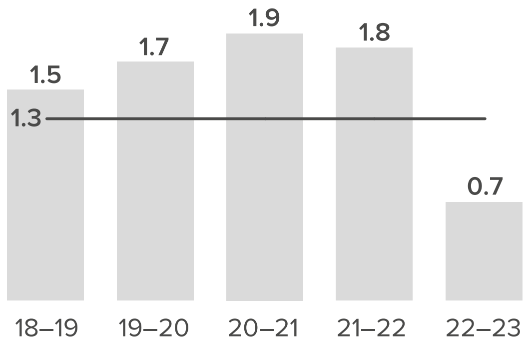
Credit ratings shown here are as at the date of publishing the accounts.

Debt covenant

Net debt/RCV



Adjusted cash interest cover ratio



The covenanted lock-up level/trigger level refers to debt covenants where payment of dividends by Southern Water is not permitted. These are structural buffers to protect against a default covenant, e.g. the covenanted default net debt to RCV level is at 95%.

Credit rating as at date of publishing the accounts

Standard & Poor's

Class A debt:

BBB+

Fitch

Class A debt:

BBB

Moody's

Class A debt:

Baa3

Notes: SWS is in a Trigger Event under our Common Terms Agreement which would restrict the payment of dividends and require the preparation of a remedial plan for our lenders. Southern Water has obtained a waiver from its lenders to continue to access permitted financial indebtedness to refinance the business in the event of a downgrade Trigger Event.

A further credit rating downgrade, or the assignment of a negative outlook, by Moody's would lead to a restriction on the payment of dividends under the terms of our Licence.

Under our Common Terms Agreement, a Trigger Event would occur if any two of the credit ratings fall to BBB (Standard & Poor's), BBB (Fitch) or Baa2 (Moody's) or below; and a Default would occur if any two of the credit ratings are less than the minimum rating required for the status of investment grade.

Capital structure

Read about our costs on pages 106 to 107

Why Southern Water raises finance

Significant capital investment has been a feature of our business since privatisation in 1989. We have invested in both maintaining our existing asset base and constructing new assets to improve the environmental quality of wastewater, improve the quality of drinking water and accommodate population growth in our area of operation.

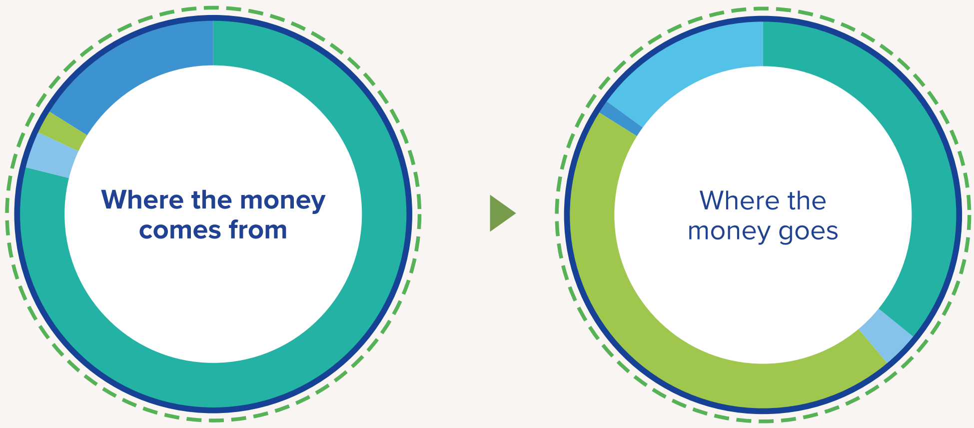
As an example, before privatisation, 350,000 cubic metres of wastewater per day was discharged into our coastal waters untreated, but the completion of our £300 million Cleaner Seas for Sussex scheme in 2013 marked the conclusion of a programme of capital investment to fully treat wastewater of the coastal towns and cities from Kent to Hampshire and the Isle of Wight. A further example is our £100 million construction project at Woolston, which has improved the quality of effluent discharged into the River Itchen and reduced odours.

We raise finance to pay for the construction of new assets and to repay loans taken out in previous years. We cannot rely wholly on raising new finance to pay for the construction of new assets. Our shareholders contribute approximately 30% of the funds we require towards this and to also provide the financial buffer we need to absorb financial risk.

Revenues from our customers are used to meet the costs of running the business (our operating expenditure), the cost of maintaining our assets, and to pay for the interest on the finance we raise and a return on the equity provided by our shareholders, to finance the capital investment programme. Our economic regulator, Ofwat, ensures that we can only charge our customers for an efficient level of cost, which is benchmarked against our peers.

The charts below illustrate the sources and uses of expected cash flows for the business plan 2020–25 and demonstrate our requirement to raise finance to fund our capital investment programme. The data is based upon the regulatory price determination for 2020–25, which sets out both our performance obligations and the limits on customer bills for this five-year price period.

Capital structure continued



Key
- Main customers 79%
- Developers 3%
- Non-price control 2%
- New borrowings 16%

Key
- Operating costs 36%
- Rates and licences 3%
- Capital investment 45%
- Working capital 1%
- Interest 15%

Where the money comes from

Main customers – income for the provision of our core water and wastewater services.

Developers – income from the provision of services to developers for the provision of infrastructure and new connections to our network.

Non-price control – income from non-appointed activities.

New borrowings – additional financing raised to support delivery of our capital investment programme.

Where the money goes

Operating costs – Day-to-day running costs include wages, power, chemicals, materials and bad debt* costs.

*Bad debt = the cost of providing for unpaid customer charges.

Capital investment – includes investment to maintain our pipework and treatment works as well as the construction of new assets to enhance treatment standards and cater for growth.

Rates and licences – business rates on buildings, wastewater treatment and water supply works and Environment Agency licences.

Working capital – the timing and growth of the difference between expenditure and receipts.

Interest – is interest on money we have borrowed to finance improvements to the business over the long term.

Capital structure continued

GSH ownership

MSCIF Wight Bidco Ltd
Funds managed by Macquarie Asset Management on behalf of long-term investors including pension funds and insurance companies.

IIF Int'l SW UK ParentCo Ltd
A constituent entity of the Infrastructure Investments Fund, a fund advised by JP Morgan Asset Management (JPMAM), a large-scale global asset manager advising institutional investors.

UBS Asset Management
Shareholding advised by UBS Asset Management, a large-scale global asset manager, offering investment capabilities across all major traditional and alternative, asset classes

Hermes Infrastructure funds
Hermes Infrastructure is part of Federal Hermes International and is a specialist infrastructure manager operating a diversified, well-established, UK-focused shared investment platform.

Other
Minor shareholdings held by infrastructure investment companies

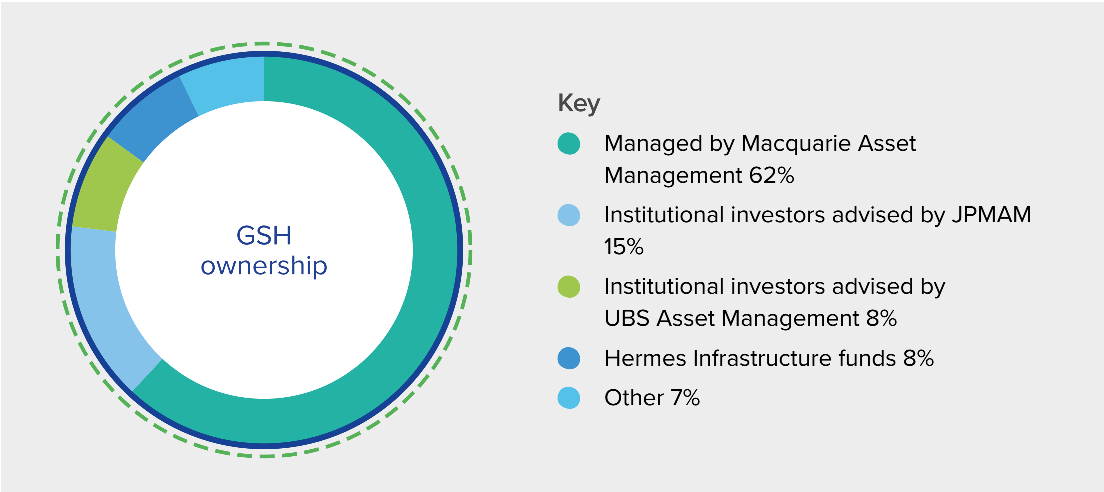
Ownership and structure

Southern Water Services Limited (SWS) is a privately owned company and is the principal subsidiary of Greensands Holdings Limited (GSH). All companies in the group are UK tax resident and liable for tax in the UK.

Ownership

GSH is owned by a consortium of long-term investors representing infrastructure investment funds, pension funds and private equity.

In September 2021, funds managed by Macquarie Asset Management (MAM) acquired a majority stake in GSH, with an investment of over £1 billion of new equity into the group. This new equity was used to recapitalise the ownership structure and improve the financial resilience of Southern Water. None of the proceeds were paid to the existing shareholders of GSH.



GSH Board

The GSH Board comprises three directors, appointed by GSH's majority shareholder.

The purpose of GSH is to act as a single-purpose entity as the ultimate holding company for Southern Water and the other companies within the group. The GSH Board complements and supports the aims of Southern Water for its long-term success. While certain matters are reserved to the GSH Board and/or shareholders in GSH, they do not impact the day-to-day operations of Southern Water and nor do they materially affect Southern Water's ability to function as a company in providing an essential public service.

Group structure

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

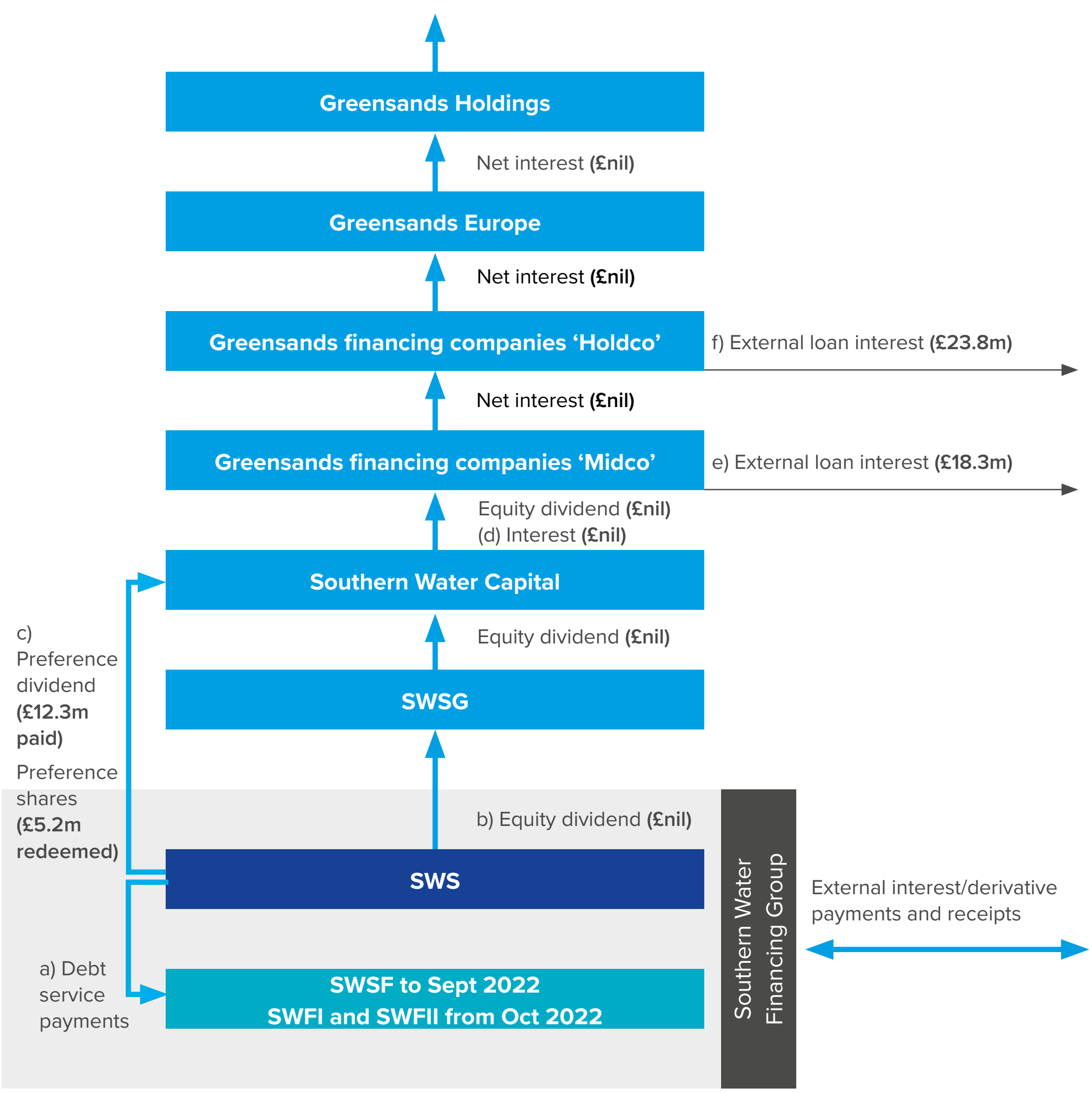
During 2018–19, additional Greensands financing companies were added to the group structure as part of a financing plan to improve financial resilience of Southern Water ahead of the five-year price review period starting April 2020.

As mentioned above, funds managed by Macquarie Asset Management acquired a majority stake in the Greensands group in September 2021. This investment was used by the group to repay external debt totalling £476.0 million and make a cash injection into Southern Water Services totalling £529.9 million from the settlement of an inter-company loan and the issue of new equity.

Capital structure continued

A summarised group structure, together with details of the interest and dividend payments between companies are shown in figure 1 below.

Fig. 1



In summary, SWS has paid £nil to internal companies. Greensands companies have paid external loan interest payments of £42.1 million.

No interest or dividends have been paid to investors in Greensands Holdings.

Footnote:

a. Interest payments from SWS to SWSF to September 2022 and SWSF I and SWSF II from October 2022 on the loans taken out by these companies on behalf of SWS.
This is then used by SWSF, SWF I and SWF II to pay the interest on these external loans.

b. There were no ordinary dividends during the year.

c. Dividend payments made on the preference shares issued by SWS of £12.3 million in relation to dividends accrued at March 2022.
In addition, preference shares totalling £5.2 million were redeemed and dividends of £4.5 million accrued for 2022–23.

d. Interest payable on inter-company loans from Southern Water Capital to Greensands Investments.

e. External interest paid by GSF Ltd, funded from interest receivable and cash held at 'Midco'.

f. External interest paid by SWGF, funded from interest receivable and cash held at 'Holdco'.

g. Dividends paid to investors.

Capital structure continued

Corporate Level	Companies	Description
Greensands Holdings	Greensands Holdings Limited (GSH)	The ultimate parent company for the group.
Greensands Europe	Greensands Europe Limited (GSE)	Intermediate holding company. Listed (Jersey) Eurobonds held by shareholders in proportion to their equity were converted to an inter-company loan with GSH in June 2021.
Greensands financing companies 'Holdco'	Greensands UK Limited (GSUK) Greensands Junior Finance Limited (GSJF) Southern Water (Greensands) Financing plc (SWGF) Greensands Senior Finance Limited (GSSF) Greensands Investments Limited (GSI)	A group of companies established to provide additional external financing for the acquisition of the Southern Water Capital group of companies in 2007 plus a further £250 million of additional finance raised in 2019, the proceeds of which were invested into SWS. The security granted to the lenders of this financing is limited to the share capital of GSH. There are no debt guarantees in place between the Greensands financing companies and the Southern Water Financing Group, with the result that SWS is fully protected, and fully isolated, from a default at any Greensands company.
Greensands financing companies 'Midco'	Greensands Finance Holdings Limited (GSFH) Greensands Finance Limited (GSF Limited) Greensands Financing plc (GSF plc)	A group of companies incorporated in 2018 as part of a financial restructuring exercise to improve the financial resilience of Southern Water. The objective of the restructuring was to reduce the total leverage within the Southern Water Financing Group. There are no debt guarantees in place between the Greensands financing companies and the Southern Water Financing Group, with the result that SWS is fully protected, and fully isolated, from a default at any Greensands company.
Southern Water Capital	Southern Water Capital Limited (SWC) Southern Water Investments Limited (SWI)	Intermediate holding companies established 2002 as part of a previous ownership structure.
Southern Water Services Group	Southern Water Services Group Limited (SWSG)	Intermediate holding company established as part of a previous ownership structure.
Southern Water Financing Group	SWS Group Holdings (SWSGH) SWS Holdings Limited (SWSH) **Southern Water Services Limited (SWS)** Southern Water Services (Finance) Limited (SWSF) SW (Finance) I plc (SWFI) SW (Finance) II Limited (SWFII)	SWS is the regulated water and wastewater company. It is the company that this Annual Report and financial statements relates to. SWSF was incorporated to raise finance on behalf of SWS and was closed in October 2022 and dissolved in June 2023. SWFI and SWFII have been incorporated to replace SWSF. The Southern Water Financing Group was established in 2003 and comprises a legal framework where each company guarantees the obligations of others within the group. Security granted to the lenders within this group is limited to the share capital of SWS Group Holdings Ltd. This structure ensures that SWS can continue to operate as a regulated water and wastewater company in the event of a default by any group company.

Capital structure continued

All companies are UK tax resident and therefore subject to UK taxes.

Most companies within the group are incorporated in the UK. The exceptions are:

- Greensands Holdings Ltd is incorporated in Jersey, but UK tax resident. The company was incorporated there because Jersey law allowed greater choice than the UK about the way distributions can be made to shareholders while treating UK and non-UK investors equally.
- Southern Water Services (Finance) Ltd was incorporated in the Cayman Islands, but was UK tax resident. SWSF was established for the express purpose of raising debt finance on behalf of SWS. Due to administrative reasons applicable at the time of forming the Southern Water Financing Group, it was necessary for SWSF to be registered in the Cayman Islands to raise debt listed on bond markets. This original requirement is no longer necessary, and in October 2022 we replaced SWSF with two new UK incorporated companies, SW (Finance) I plc and SW (Finance) II Limited and the company is now closed.

How we finance the business

In note 20 to the financial statements, we provide an analysis of our outstanding debt at 31 March 2023 and 31 March 2022. Our loans comprise: sterling bonds, issued by our financing subsidiaries SWFI and SWFII and listed on the UK Stock Exchange; other loans, including loans from US insurance companies; bank loans; and a loan from the European Investment Bank.

The regulatory framework under which revenues and the RCV are indexed exposes us to inflation risk. This risk is managed through the use of inflation-linked loans and derivatives within the overall debt portfolio. We do not intend to access future inflation-linked debt through the use of derivatives, but will instead seek such debt from natural sources, such as public and private bond markets. As a consequence, we expect the proportion of the RCV and debt that is currently linked to inflation through the use of derivatives will decrease over time. We are not restricted to issuing only sterling debt, but will ensure any other currency loans are fully hedged back to sterling. We also hedge our exposure to interest rate volatility by ensuring that at least 85% of our outstanding debt liabilities (in respect of Class A and Class B debt) is either inflation-linked or fixed rate for the current five-year regulatory period and at least 70% in the next period (on a rolling basis).

We also consider refinancing risk by ensuring that loan maturities are not concentrated in any single year or regulatory period. When issuing new loans, we test that refinancing obligations are less than 20% of RCV in any two consecutive years and 40% of RCV within any five-year regulatory period. The maturity profile of loans extends to March 2056, which ensures we comfortably meet this test. Although not formally required, we ensure that inflation-linked swap accretion payments are included within our maturity analysis.

We ensure that sufficient liquidity (cash and committed bank facilities) is in place to fund the business for at least the next 12 months (including loan and inflation-linked swap accretion maturities), which is an important consideration given that we have negative cash flow generation in the majority of years as a result of our continuing capital investment programme.

As a result of our prudent liquidity policy, we can have large cash balances at times. We reduce the risk of losing cash on deposit, from bank or fund failure, by setting maximum limits on cash deposits and minimum credit ratings for each bank or fund. Banks must have, as a minimum, a credit rating of P1 (Moody's), A1 (Standard & Poor's) or F1 (Fitch). Funds must have the most secure rating of AAA rated.

The Greensands companies also have their own loans:

- Loans issued by Greensands Finance Limited and Greensands Financing Plc, represented in the diagram above as part of the 'Midco' financing companies.
- Eurobonds issued by Greensands Europe, which were converted to an inter-company loan with GSH in June 2021.
- The Greensands financing companies also maintain liquidity facilities (£40.0 million at Greensands Midco financing companies to October 2027), which can provide a source of finance to pay interest on loans.

Risk management approach

The purpose of our approach to risk management is to **support better decisions** through an improved understanding of risk

Risk management is a core component of our governance and internal control framework, which provides the structure through which we conduct business.

Risk is inherent in our business and we face a diverse range of risk and uncertainties that cannot be completely eliminated. The purpose of our approach to risk management is to support better decisions through an improved understanding of risk. Those risks that have the potential to have a material impact on our company and our ability to deliver on our strategic objectives are our principal risks. Our risk governance model ensures that we can manage, monitor and report on our principal risks to maintain a resilient business. These risks are described on pages 127 to 130.

Managing risk

Our approach to risk management is designed to provide a clear and consistent framework for managing and reporting risks associated with our operations, to executive management and to the Board.

Our risk management framework is the totality of systems, structures, policies, processes and people that identify, measure, monitor, report and control or mitigate internal and external sources of risk.

The framework seeks to promote better decision-making, to strengthen our operational resilience and support the best outcomes and opportunities for the company and our customers through effective:

- **Risk identification and ownership**: understand the risk environment, identify the specific risks we face and assess potential exposure.
- **Risk assessment**: determine how best to manage identified risks to balance exposure.
- **Risk response**: take action to manage the risks we do not want to be exposed to, ensuring our resources are effectively and efficiently prioritised and used.
- **Risk monitoring, reporting and escalation**: report on a quarterly basis to the Executive Risk Committee, Audit Committee, and the Health and Safety and Operational Risk Committee and to the Board on a periodic basis on how significant risks are being managed, monitored, assured and the improvements that are being made.
- **Risk appetite and communication**: use our analysis to support the Board's determination of risk appetite and to monitor and report against it.

Across the company our risk management approach is embedded within the business directorates and their business processes. We have established a risk management approach that provides a consistent basis for measuring risk to:

- establish a common understanding of risks on a like-for-like basis, taking into account potential impact and likelihood,
- report risks and their management to the appropriate levels of the company,
- inform prioritisation of specific risk management activities and resource allocation.

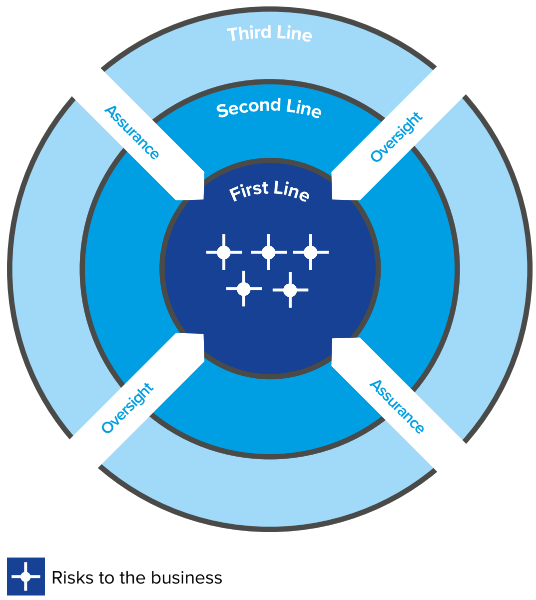
All areas of the company review significant risks and business processes to help inform and enable risk-based decision-making. As part of our annual planning process, the Executive Team and Board review the company's principal and emerging risks.

Risk management approach continued

Three lines of defence

Our approach to risk management adopts the 'three lines of defence' model in which risk ownership responsibilities are functionally independent from oversight and assurance:

- Primary responsibility for risk management lies with the business. The risk owner is the first line of defence. An important part of the role of all employees is to ensure they manage risks appropriately.
- The Risk Management function forms the second line of defence and provides independent and objective review and challenge, oversight, monitoring and reporting in relation to material risks.
- Independent External Assurance and the Internal Audit function act as the third line and provide independent assurance on the business control environment and the effectiveness of the wider system of internal control.



First line

- The functions that own and manage risk.

Second line

- The internal functions that oversee risk and regulatory compliance activities.
- Provide guidance, direction and oversight.
- Develop the related assurance frameworks.

Third line

- Provides independent assurance on the business control environment, and the effectiveness of the wider System of Internal Control.

Read more about the Board's role in mitigating risks on pages 177 to 178

The next 12 months

The coming year will see continued integration of our risk management framework and approach. This will see risk management efforts focused on maturing our activities in a number of areas, including:

- Advancing a dynamic risk-aware culture throughout the company.
- Enhanced risk reporting to the Board, Board Committees and Executive Team.
- Continued training across the company to embed our business partnering model and to develop their enterprise risk profiles and support risk-based decision-making.
- Strengthening our analytical risk management capabilities through use of our Governance, Risk and Compliance (GRC) system to utilise enhanced risk management data and insights to facilitate risk-based decision-making and deliver business intelligence reporting.

The continuous improvements that we are making with our risk management approach are setting the company up for future success. As we further embed these improvements, we will be able to demonstrate to our customers and external stakeholders that the decisions we make are considered, well thought through, and demonstrate continued commitment to our values.

Risk oversight and governance

Risk oversight and governance

To successfully embed risk management, the process is supported by a governance structure that defines roles and responsibilities at each level of the company. The Board has overall accountability for risk management but discharges this role through the Audit Committee. It oversees and advises on enterprise and corporate risks, while the Health and Safety and Operational Risk Committee oversees and advises on operational risk.

Role of the Board

The role of the Board is to promote the long-term sustainability of our company and our responsibilities to shareholders, customers, employees, and the communities in which we operate. It has overall responsibility for risk management within the company.

The Board is responsible for maintaining an effective risk culture and is committed to:

- reviewing, endorsing and monitoring our approach to risk culture and conduct
- forming a view on our risk culture and the extent to which it supports our ability to operate consistently within our risk appetite.

The Board defines our risk appetite, enabling the company, in both quantitative and qualitative terms, to judge the level of risk it is prepared to take in achieving its overall objectives.

Our risk appetite is directly aligned to our principal risks. The risk appetite for each of these underpins our governance and reporting framework and is subject to regular review by the Board. The alignment of our principal risks with risk appetite allows for an informed analysis and discussion of our risk position and provides the Board with the insight to make key-decisions.

As a company we are tolerating a level of risk which is outside our current risk appetite and is reflected in the review of our principal risks in the coming pages. This can result in more focus on short-term issues than longer-term resilience.

The Board ensures the oversight and monitoring of our risk culture, risk appetite and risk management activities through the Audit Committee.

Role of the Audit Committee

The Audit Committee is responsible for the review of the company's internal financial controls systems that identify, assess, manage and monitor financial risks, and other internal control and risk management systems. It advises the Board on the company's overall risk appetite, tolerance culture and strategy, taking into account the current and prospective regulatory, legal, political, macroeconomic and financial environment with the Board retaining overall ownership and approval.

The Audit Committee oversees and advises the Board on current risk exposure and longer-term strategic risks to determine our future risk strategy. It also has a key role in risk assessment:

- reviewing the company's overall risk assessment processes for enterprise and corporate risks that inform the Board's decision-making, ensuring qualitative and quantitative metrics are used;
- reviewing regularly and approving the parameters used in these measures and the methodology adopted; and
- setting a standard for the accurate and timely monitoring of large exposures and corporate risk types of critical importance.

In addition, the Audit Committee reviews the company's capability to identify and manage new and emerging risk types and reviews reports on any material breaches of risk limits and the adequacy of proposed action.

Role of the Health and Safety and Operational Risk Committee

The Health and Safety and Operational Risk Committee is responsible for the oversight and assessment of the overall adequacy and effectiveness, of the health, safety and wellbeing policies, strategies; processes and controls; operational risk management and compliance with relevant legal and regulatory requirements, with the Board retaining overall ownership and approval.

The Health and Safety and Operational Risk Committee has a key role in:

- reviewing the areas of significant corporate and individual health, safety, wellbeing and operational risk whether the executive is managing these risks effectively, including via the supply chain;
- reviewing the company's health, safety, security and wellbeing performance;
- reviewing operational risk and risk management of information security, information governance, water, wastewater and customer services;
- reviewing of the scope, and results, of any: health, safety, wellbeing, information security, information governance, water, wastewater and customer operational risk audits; and
- considering the findings of internal and external investigations and executives' response.

Risk oversight and governance continued

Role of the ESG Committee

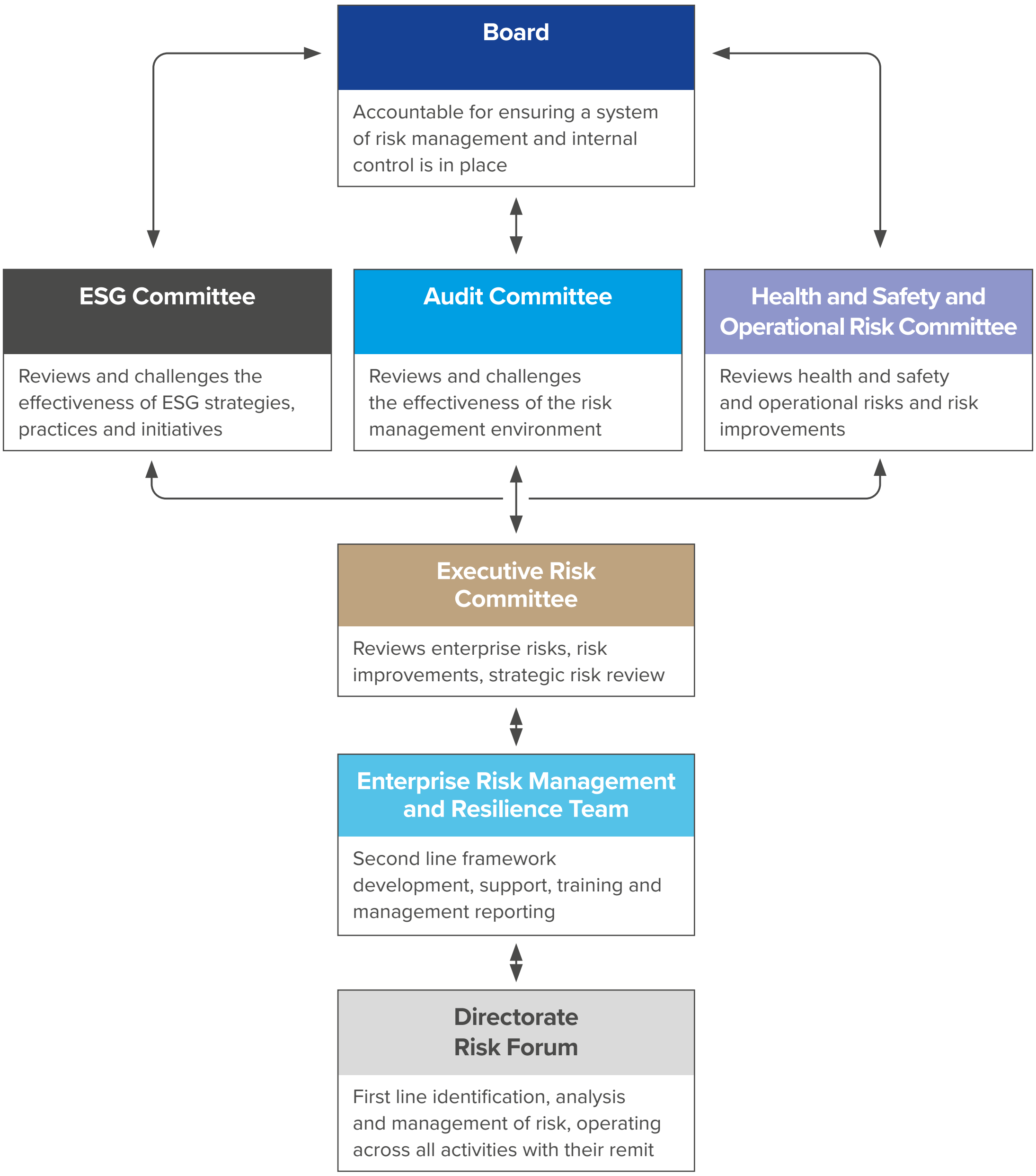
The ESG Committee was formed in 2022 to provide greater oversight and consideration of the material environmental, social and governance matters relevant to the company's activities.

ESG Committee is responsible for the review of the risks related to our environment, social, and governance practices, commitments, policies, and strategies.

The ESG Committee has a key role in:

- reviewing our progress and performance on Net Zero Plan delivery;
- ensuring the effective operation and delivery of our annual Climate Change Action Plan;
- providing oversight on the adoption and implementation of climate related disclosure regulations.

Key risk and governance responsibilities include:



Emerging and principal risks

Read more on our principal risks on pages 127 to 132

Emerging risks

We regularly consider new, changing, or emerging risks that could affect our ability to achieve long-term objectives. We define emerging risks as uncertain future events that are challenging to assess due to their unpredictable nature or lack of reliable information. We undertake regular horizon-scanning exercises to identify and monitor emerging risks. Our risk assessment process monitors available management information from a wide variety of internal and external business and environmental sources and analyses potential causes, impacts, likelihood, and the time frame over which a risk could occur. Our immediate horizon scan reviews possible emerging risks and their potential impact on the company within the next five years. These include:

Emerging risk	Description	Relevant activity
DWI enforcement regime	In early 2021, the Drinking Water Inspectorate (DWI) began work to change its method of regulatory enforcement to consider a new approach to include a punitive financial penalty regime within its regulatory framework. Southern Water is currently subject to a number of DWI notices; this could lead to a risk of additional financial penalties.	We continue to work closely with the DWI to respond and resolve our open notices in a timely manner. We are committed to reform and improve our performance related to our business operations and our provision of a sufficient supply of high-quality drinking water.
Escalating global conflicts	In 2022, war broke out in Europe between Russia and Ukraine. Tensions continue to escalate between the United States and China, Iran and Israel and in the Korean peninsula.	We are monitoring the potential expansion of global unrest to include new areas of conflict or types of conflict, resulting in new types of or expanded risk consequences, especially in relation to our supply chain and IT network.
Rainfall patterns and extreme weather	The changes in rainfall patterns and extreme weather resulting from global warming are creating a wider impact on our natural environment, including drought mitigations, flood defences and land erosion.	Associated risks are assessed and mitigated within our wider climate change strategies, our published Drought Plan and in our Drainage and Wastewater Management Plan (DWMP) to specifically address storm overflow reform and the Flood Action Plan.
Climate action failure	Climate action failure is defined by the failure by governments, corporations and businesses to take up active climate change mitigation measures and help protect ecosystems and livelihoods around the world.	We are committed to understanding the evolution and impact of climate change on our business and on the natural water supply and ecosystems. Associated risks are assessed and mitigated within our wider climate change strategies and we use our insight and knowledge to help policymakers craft their strategies and legislation to support and advance climate effective change solutions.

Emerging and principal risks continued

Principal risks

Those risks that have the potential to have a material impact on our company are our principal risks. We manage, monitor and report on the principal risks that can impact our ability to deliver our objectives. As part of our annual planning process, the Executive Team and the Board review the business's principal risks. These may be updated during the year in response to changes in internal and external circumstances.

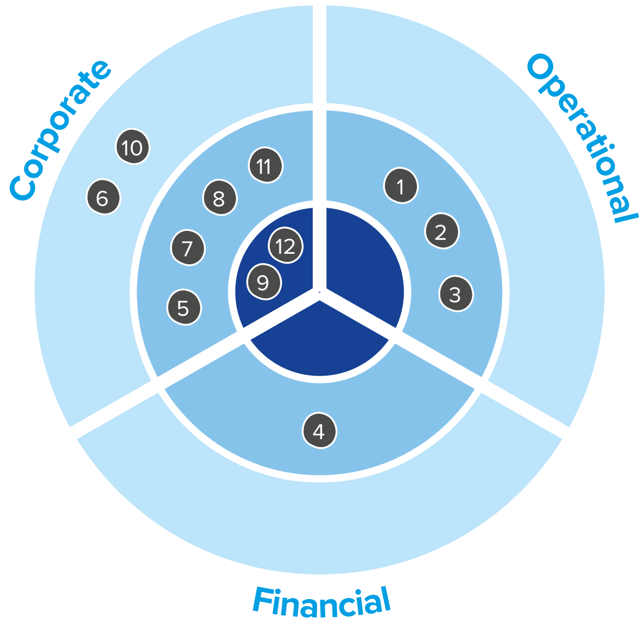
We currently have 12 principal risks. These are a key feature of our risk taxonomy and risk appetite. Our principal risks reflect our commitment to our values: doing the right thing, succeeding together, always improving and working with care. We review our principal risks and their risk components on an annual basis, ensuring emerging risks are reflected and that the current structure adequately reflects the risk context in Southern Water.

In 2022, our business was challenged by the impact of the ongoing war in Ukraine that intensified supply chain delays and failures, fuelled inflation and energy price increases, and had a deteriorating effect on our principal risks. We had to rapidly adapt to this changing operational environment to mitigate these accelerating macro-environmental influences.

Principal risks

Principal risk radar

The principal risk radar provides an indicative view of the current risk position of each of the principal risks, relative to each other.



- Improving
- Stable
- Deteriorating

Risk		Category	Risk climate	Commentary
1	Water	Operational	▶◀	We are challenged by several significant water supply disruption events on key operational sites which have resulted in an increased interruption of supply to our customers.
2	Wastewater	Operational	▶◀	We are challenged to manage an increase in capacity demand and extreme weather events while meeting our regulatory targets.
3	Customer	Operational	▶◀	We continue to support our customers through supply and service events and the challenges of the current cost of living crisis.
4	Financial	Financial	▶◀	We are working with Shareholders to bring in additional finance to the company to support long-term financial resilience, in addition to strengthening our internal financial control environment.
5	Compliance	Corporate	▶◀	We remain under continued scrutiny by our regulators as we transform and deliver on our business plan.
6	Climate Change	Corporate	▲	Planning and mitigation for climate change is embedded in our long-term strategic plans e.g. DWMP, WRMP, WINEP).
7	Delivery	Corporate	▶◀	We are challenged to deliver our capital investment delivery programme and Opex funded strategic projects due to prolonged macroeconomic conditions.
8	Information Technology (IT)	Corporate	▶◀	The global heightened cyber security threat has increased risk in this area. Our IT estate requires continual monitoring and improvement to maintain resilience.
9	Resources	Corporate	▼	Global inflationary pressures and disruption in goods or services availability has delayed supply and significantly increased our operational and capital costs.
10	Health, Safety, Security & Wellbeing	Corporate	▲	Our Health and Safety Transformation Programme is designed to improve our operations, comply with regulations and embed our Safety-First culture across the business.
11	Corporate Affairs	Corporate	▶◀	We have increased our communications in relation to service event management and recovery and work closely with our communities and regulators to support and influence the protection of our natural environment.
12	People	Corporate	▼	We are challenged to manage and develop our workforce in a competitive employment environment that has been strongly influenced by rising inflation and the current cost of living crisis.

Risk climate ▲ Improving ▶◀ Stable ▼ Deteriorating

Principal risks and uncertainties

Risk Climate Key:
▼ Deteriorating
▲ Improving
⧓ Stable

Operational risk

1 Water

We must make sure we can supply enough good quality drinking water to cater for a growing population of more than 2.7 million people across the region. Warmer summer weather and colder winters over the past two decades impact our supply/demand balance and increase our risks in relation to drought or significant water source depletion. Should we experience, water contamination, water treatment or distribution network failures, there is a risk that water may be unfit for consumption or customers may experience disruption to their water supply.

Executive accountability:

Director – Wholesale Water

Risk climate: ⧓

Following one of the driest summers on record in 2022, we have experienced a winter season that has seen higher than average rainfall which has replenished our groundwater sources, reservoirs and rivers.

Aside this, we continue to work hard at reducing leakage, which was impacted by the hot summer of 2022 and cold winter of 2022–23. We have employed digital technology to address network leakage performance, increased our field resource, continue to invest in pressure calming solutions, and have expedited speed of repair by a factor of 2.

During the year, we were challenged by several significant water supply disruption events on key operational sites which have resulted in an increased interruption of supply to our customers. We are continuously working to improve the reliability of our water supply works by putting in place new assets and improving maintenance. Our event management and operational control teams deployed immediate response and repair plans, along with establishing bottle water stations and issuing up to date communications across several media platforms to keep customers informed.

We have improved our logistics capability so we can move people and materials around faster, 24/7. This includes a new tanker fleet, storage of critical spares and an overhaul of our work management processes. We have also, improved the management and control of our sites and networks and our core systems and processes

Mitigating strategy:

- Water for Life – Hampshire, a programme of significant capital and asset improvements to provide long-term resilience.
- Water First, our improvement programme strengthening internal processes and asset performance.
- Improving the reliability of our water supply works by undertaking a complete overhaul of our four main sites, benefiting 62% of our customers.
- Investing to improve our leakage position with installation of more loggers, new data points and pressure management calming tools.
- Upgrading our logistics capability.

Cross reference:

Read more about how we are understanding and supporting our customers and communities on pages 42 to 51.

Read more about how we ensuring a supply of high-quality water for the future on pages 52 to 58.

Operational risk

2 Wastewater

We are committed to provide our customers with reliable wastewater services essential to maintain public health and protect the environment.

Periods of excessive rainfall or extreme weather may cause drainage and flooding issues. If operational wastewater treatment assets, our wastewater network or processes fail, we may discharge non-compliant sewage. These events may cause risks to the environment or public health from pollution and/or sewer flooding.

Executive accountability:

Director – Wastewater

Risk climate: ⧓

Our performance has been significantly challenged, specifically in light of increased capacity demand, fluctuations in extreme weather events and challenging regulatory targets. Improving our pollution performance is a key focus for the business and is supported by our strategic Turnaround Plans and our Pollution Incident Reduction Plans. We are building capacity and resilience at our wastewater treatment works and system networks to reach 99%+ compliance with treatment and permit standards to reduce pollution occurrences and the impact our operations might have on the environment. This means making sure our pumping stations and networks continue to operate effectively as our climate changes. We have established a dedicated Clean Rivers and Seas Task Force to enhance our network assets and reduce blockages, including an investment of £5 million to implement our Pathfinder projects to tackle the root cause of the storm overflows. We continue to work closely with our customers, the general public and stakeholders with respect to our impact on the environment; with a key focus on spills to the environment in rivers, chalk steams and bathing waters.

Mitigating strategy:

- Over £1.5 billion investment to 2025 to improve the capacity, capability and resilience of our wastewater network across the region to ensure our pumping stations and networks continue to operate effectively as our climate changes.
- Increased investment in Storm Overflow programme.
- Updated and enhanced Pollution Incident Reduction Plan.
- Updating our maintenance standards and proactive control to stop assets failing and developing an improved emergency response.
- Digitalisation of our sewer network to reduce pollutions and flooding, using industry-leading monitors, artificial intelligence for prediction and maintenance.
- Effective Event Duration Monitoring (EDM) and the expansion of EDM coverage on Beachbuoy, our online tool for information on storm release activity near coastal bathing waters.
- Improving training, development, and productivity by upskilling our front-line colleagues.

Cross reference:

Read more about how we protect and improve the environment on pages 59 to 68.

Principal risks and uncertainties continued

Risk Climate Key:
▼ Deteriorating
▲ Improving
⧓ Stable

Operational risk

3 Customer

We are committed to providing an excellent customer experience, as expected by our customers and regulators. We are prioritising our customer experience by ensuring that every colleague understands and responds to our customers and their unique needs.

When we experience interruption to services there is a risk that we are not able to deliver the standard of service expected by our customers. During these periods, we seek to address and rectify the cause of the underlying issues while also proactively managing our customers concerns in a timely manner.

Executive accountability:
Chief Customer Officer

Risk climate: ⧓

During the year, our service delivery has been challenged by a number of significant supply events that have resulted in a customer supply disruption, prolonged outage and it has negatively impacted our customers view of our performance and reputation. This was reflected in our annual customer satisfaction (C-MeX and D-MeX) performance metric measures and is a key area for our focused rebuild and improvement. In response, we enhanced our customer communications by implementing customer text messaging during incidents to keep them informed and up to date on our repairs and return to service timelines. We are also developing a new customer website which will enhance our customer service and experience.

To manage current economic pressures, household bills were increased in line with inflation. However, we continue to support our most vulnerable customers who have been most impacted by this cost of living crisis. We increased our social tariff cross-subsidy from £6.00 (for a dual service customer) to £8.50. This will allow us to increase the minimum discount offered from 20% to 45% and will support a further 21,000 customers in addition to the 107,000 who could be supported through the lower subsidy amount.

Mitigating strategy:

- Improving the digital customer experience including video assistant, a new website, improving customer journeys, data quality and complaints process.
- Enhancing our Customer Culture through customer promises and customer service training for all colleagues and partners.
- Better engagement with our communities through improved multi-channel and direct communications, education programmes and regular stakeholder forums.
- Supporting customers in vulnerable situations by improving our priority services during incidents and our social tariff offering.

Cross reference:

Read more about how we are understanding and supporting our customers and communities on pages 42 to 51.

Read more about how we ensuring a supply of high-quality water for the future on pages 52 to 58.

Financial risk

4 Financial

We are committed to managing the financial position of the company to ensure sufficient liquidity to meet our funding requirements and maintain service delivery for our customers. In the past two years we have been challenged by sustained macroeconomic volatility, leading to prolonged financially uncertain outlook. This is impactful to our ability to raise finance to fund the capital investment programme and to refinance debt maturities. Our internal cost control remains a key focus for all teams across the business.

A failure to maintain certain credit ratings could lead to an increase in interest cost, reduced availability of new capital and breach of our license conditions.

Executive accountability:
Chief Financial Officer

Risk climate: ⧓

Sustained macroeconomic volatility has increased pressure on our operating and capital budgets and created significant cost control issues. Additional cost control pressures have arisen from our response activities to our water supply outages and pollution events. This has resulted in some delays and impacted our current business plan, delivery plan and funding. We are working to strengthen our financial controls and to implement systems and processes to reduce these operational events. We are currently preparing our Business Plan 2025–30, which will outline our ambition and determine our future funding.

We have engaged with our shareholders to seek an additional £550 million of equity funding for the group, of which £375 million would be injected into the regulated entity, SWS, to allow it to invest even further above its regulatory funding for this regulatory period; we anticipate this process to conclude later in 2023.

We completed some financing activity in 2022–23 and expect to secure additional external financing in the year ahead to support our business plan ambitions and delivery. We continue to be at risk of a credit rating downgrade as a result of our poor operational performance and rapidly rising inflation. Our credit ratings are provided on page 128.

Mitigating strategy

- Liquidity testing and reporting is carried out on a regular basis, forming part of the 'going concern' assessment
- Sufficient cash and facilities are maintained to mitigate such risks as bond market closures
- Flexible dividend policy supports management of financial risk
- Detailed budgetary scrutiny of operational spend
- Improved operational performance.

Cross reference:

Read more about our financial performance on pages 102 to 119.

Principal risks and uncertainties continued

Risk Climate Key:
▼ Deteriorating
▲ Improving
⧓ Stable

Corporate risk

5 Compliance

As a regulated industry, we are committed to meeting an expected high standard of compliance with regulatory and corporate legislation.

Failure to comply can result in regulatory enforcement, fines, legal action and, in the worst case, the loss of our licence to operate as a water and wastewater company. Existing and changing legal and regulatory requirements encourage the business to operate in an agile way to ensure continued compliance with our obligations.

Executive accountability:

General Counsel

Risk climate: ⧓

We remain under continued scrutiny by our regulators. We are continuing our work to resolve a number of prior years prosecutions by the Environment Agency (EA) for wastewater permit breaches, sampling processes and governance approach. We continue to assist the EA with its ongoing investigations into these legacy issues and with their national investigations into flow compliance. The Drinking Water Inspectorate (DWI) and the EA continue to monitor our delivery of regulatory schemes (outputs) and this is likely to continue in the future.

During the year we received six Final Enforcement Orders in relation to delays in the delivery of our key capital works for the current business plan. We are working with our regulators to prioritise the delivery for those key sites, and have detailed supporting work plans in place.

Mitigating strategy:

- Delivery of key transformation and training programmes in both water and wastewater parts of the business.
- Ensuring appropriate governance through the embedding of a robust Three Lines of Defence compliance model.
- A compliance framework with internal monitoring and assurance and an ethical business framework.
- Compliance with company procedures is reviewed through our Statement of Compliance self-assessment every six months.
- Transparent communication with our various regulators.

Cross reference:

Read more about our three lines of defence on page 121.

Corporate risk

6 Climate change

We are committed to understanding the impacts of climate change and appropriately adapting our business operating model to ensure reliable continuity of service to our customers while protecting our natural environment and resources.

Failure to improve our resilience to the effects of climate change will impact our ability to deliver a sustainable supply of water to meet the growing demands of our customers and our ability to effectively manage the capacity and capability of our assets and sewer network. We must be resilient to both the physical effects, from extreme or prolonged weather events that could lead to flooding, pollution or damage to operational sites from coastal erosion or subsidence, and from transition risks including changes in policy, regulation and markets.

Executive accountability:

Chief Executive Officer

Risk climate: ▲

Extreme weather events are becoming more frequent. Severe winter storms and heavy rainfall impact our ability to effectively manage flooding and pollution events. Extended periods of dry weather greatly reduces the reliable availability of our water supply. We are challenged to balance the limitations of our stringent abstraction licences with our ability to meet customer demand while protecting our natural resources and the environment.

We are a long-term business and as such we are required to produce a number of strategic plans that include consideration of the long-term management of our water and wastewater assets to ensure that they continue to be available to provide services to customers and adapt to the changing environment we live in.

These include our published draft Water Resources Management Plan, which sets out how we will balance supply and demand for water over the next 80 years, and our first ever draft Drainage and Wastewater Management Plan, which analyses the key wastewater challenges and solutions in each of our drainage catchments over the next 25 years. We are currently in the process of producing our business plan submission for 2025–30 which will outline the investment we need to make to our assets, including mitigating and adapting to climate change risk.

Mitigating strategy:

- Annual Climate Change Adaptation Report.
- Net Zero Plan.
- Water Industry National Environment Programme (WINEP).
- 50-year Water Resources Management Plan (WRMP).
- Target 100 water efficiency programme.
- Drought Plan.
- Investment in new infrastructure.
- Drainage Wastewater Management Plans (DWMP).
- Operational resilience plans.
- Bioresources strategy.

Cross reference:

Read more about our approach to tackling climate change on pages 75 to 95.

Read our Climate Adaptation Report: **southernwater.co.uk/our-performance/reports/climate-adaptation-consultation**.

Principal risks and uncertainties continued

Risk Climate Key:
▼ Deteriorating
▲ Improving
⧓ Stable

Corporate risk

7 Delivery

We are committed to the delivery of our business plan 2020–25. We have significantly invested in upgrading our existing operational sites and sewer networks and developing our capital programme. We have also increased our investment in technology to advance our ways of working to deliver a more responsive customer experience. In the past 12 months we have developed a long-term strategy and plans for significant improvements and upgrades to our four large water treatment plants at Testwood, Otterbourne, Hardham and Burham between now and 2032. We are currently preparing our business plan (2025–30) for submission to Ofwat in October 2023.

Failure to deliver significant parts of the programme on schedule, will impact our ability to provide an excellent service to our customers, compromising or preventing us from fulfilling the commitments that we have made in our business plan and to our regulators.

Executive accountability:

Chief Operating Officer

Risk climate: ⧓

The ambition of the current capital investment delivery programme combined with the current macroeconomic environment has increased pressure on our ability to deliver on time and within budget. We have launched four key strategic plans to focus our delivery for the remainder of our current business plan around water quality and security of supply, pollutions and environment, trusted and easy customer service and health and safety. Their delivery is supported by three enablers which prioritise financing and efficiency, people and IT/digitalisation.

We are currently in the process of producing our business plan submission for 2025–30 which will be our most ambitious to date. This reflects our long-term commitment to our customers and the protection of our natural environment.

Mitigating strategy:

- We have brought significant investment capability in house including:
  - An in-house engineering and capital delivery function
  - An established long-term delivery partner supply chain.
- Risk and value are considered at each step of the investment cycle to provide best value for money to our customers
- Monitoring the delivery of our Final Determination obligations, continually assessing our financing status.
- Procurement and planning process are underway and on track to support the 2025–30 business plan delivery.

Cross reference:

Read more about our Long-Term Priorities and how they inform our five-year delivery strategy on pages 42 to 95.

Corporate risk

8 Information Technology (IT)

We are committed to providing IT services, capability and support to the business and improve our ways of working. We maintain the essential resources and processes to protect the company from external or internal attack, both physical and virtual and to protect our IT network, systems and data in accordance with our obligations under relevant regulations and legislation.

Failure to maintain the resilience of our operational and corporate IT networks and systems could have a significant impact on our business continuity, and the resilience and capability of our operational assets.

Additionally, we hold and process personal and payment data about our customers and employees. Failure to properly protect the data we hold could lead to reputational damage and loss of confidence from our customers, as well as significant fines under Data Protection (GDPR) and the Network and Information Systems (NIS) Directive.

Executive accountability:

Chief Information Officer

Risk climate: ⧓

The sustained conflict between Russia and the Ukraine has increased the disruptive and destructive attacks on global organisations IT networks and systems by cyber hacktivists. This has escalated risks associated cyber security across all businesses. We have adopted the National Cyber Security Centre's (NCSC) Cyber Assessment Framework (CAF) to achieve and demonstrate an appropriate level of cyber resilience. We are continually reviewing and adapting the resilience of our approach to cyber security to ensure we are adequately protected from potential cyber threats.

As a mature company, our IT estate requires continual maintenance and improvement to deliver the required capability across the business. We are also challenged to manage the volume of demand from across the company for IT solutions and expertise for digital technologies to advance our various projects and programmes, and to meet customer and regulatory expectations.

Mitigating strategy:

- Business continuity processes reducing impact on IT systems.
- Active programme for migration of services off legacy infrastructure and onto new fully-managed infrastructure.
- Migration of existing critical and core service applications into the new data centres.
- Enhanced suite of IT general controls identified following alignment to the Network and Information System (NIS) – Cyber Assessment Framework.
- Continued investment in cyber threat mitigation strategies in response to the ever-changing risk landscape.

Principal risks and uncertainties continued

Risk Climate Key:
▼ Deteriorating
▲ Improving
⧓ Stable

Corporate risk

9 Resources

We are committed to establishing a sustainable, resilient, outcome-based supply chain for the provision of essential goods and services to support the delivery of our business plan that can adapt to market shocks. These include the supply of Engineering, Construction and Asset Management Advice to support our capital delivery programme and repair & maintenance services, chemicals, fuel, and spare parts to ensure continuity of service across our network and operational sites, as well as the energy required to power our operational equipment on a continuous basis, at a commercially viable price. We use long-term contracts for the provision of critical goods, services and works, as well as outsourced activities. In the past year, global inflationary pressures and disruption in goods or services availability has continued to delay supply of some commodities and services, and increased our operational and capital costs.

Failure to appropriately protect the resilience of our supply chain could lead to significant business interruption and result in an inability to deliver our commitments to our customers and stakeholders.

Executive accountability:

Chief Financial Officer

Risk climate: ▼

During the year we have continued to be challenged by the rising costs of goods and services due to rapid inflation and delays or failures in the global supply chain. This has caused a significant impact on both our operational costs as well as the ability to deliver on our capital programmes and projects within scope and budget. In response, we have commenced a significant review of our operational supply contracts and have focused on establishing new supply chain frameworks for a wide variety of operational site services, using category spend management to drive opportunities, mitigate risk, benchmark prices, and achieve savings and efficiencies. We have also implemented an improvement in our contract management system and processes, and are looking at how we simplify our contracting approach to create the right conditions for improved supplier relationships that better position us as an 'attractive client' to secure best rates, resources and innovation. While our operating model employs several mitigation strategies to hedge the effect of these type of market events, it has not been possible to completely mitigate the current unprecedented economic conditions.

Recent macroeconomic influences have impacted capacity throughout our supply chain. This significantly impacts our external third party suppliers ability to deliver timely and cost effective goods and services and has created many challenges with managing performance, quality and consistency.

As part of our Business Plan submission for 2025–30, the procurement process for key contractors and suppliers for our capital delivery programme and network maintenance is underway. We have established a balanced scorecard to better align our supply chain to our strategic themes, this will be a core part of our supplier selection, tender evaluation, and supplier performance management. A Market Engagement Event was held on 7 February 2023 to outline the vision and strategy to the market.

Mitigating strategy:

- Hedging strategy is in place for energy cost fluctuations/increases to manage impact to end customers.
- An enhanced Contract Management framework was implemented to effectively work with suppliers.

Corporate risk

10 Health and safety

We are committed to ensuring that the health, safety, security and wellbeing of our employees and the public is of the highest priority. The nature of our work requires that our employees and contractors undertake activities or use equipment which, if uncontrolled, have the potential to cause significant harm. Failure to comply with our Health and Safety Management System and associated procedures could result in death, serious injury or adverse health effects.

Executive accountability:

Chief Executive Officer

Risk climate: ▲

The safety of our communities, colleagues, and supply chain partners remains our highest priority. Our recently launched Health and Safety Transformation Programme includes our new corporate value, Working with Care. Together they are designed to improve safety standards, establish a robust system of operational process reviews and inspections, comply with governing regulations and legislation and support our colleagues and contractors in their day-to-day work to embed our Safety First culture across the business. The results of this are already being seen in the 20% reduction in our Lost Time Incident Accident Frequency Rate experienced in the financial year 2022–23.

Mitigating strategy:

- A review and update of all our safety policies and procedures, including a new policy statement and the issuing of CEO empowerment cards to encourage adherence and challenge in the business.
- The rollout of a new, app-based, online Safety Reporting System to improve information flow, awareness and the management of hazards and incidents.
- Upgrading the capacity (by 50%) and capability of the H&S team to enhance investigations and deliver better support to frontline teams.
- Improving the safety of our colleagues when conducting physical work through the introduction of a new mobile AI based risk safety app.
- The allocation of ring-fenced monies to repair hazards identified by the workforce.
- Delivery of a behavioural change project, including an immersive actor led away day, a revised site audit and inspection plan, enhanced manager health and safety training and a mandated Senior Leadership Visit programme.
- Enhanced communications, including the launch of the fourth Corporate Value, Working With Care, our "Stop, Think, Act" campaign and target local initiatives.
- A new induction strategy, to update our existing training requirements and expand their application to cover our supply chain workforce to ensure that all personnel are aware of the potential dangers specific to each operational site.
- A continued focus at Board level with a Health and Safety and Operational Risk Committee.
- The integration of SafetyFirst in every meeting or activity, including at the Executive Safety Committee which has been expanded by 33% to cater for the growth in reporting.
- Enforce suppliers and delivery partner safety standards.
- Strategic Reviews of Security and Wellbeing.
- Managing our compliance through new systems, inspections and assurance.

Principal risks and uncertainties continued

Risk Climate Key:
▼ Deteriorating
▲ Improving
⧓ Stable

Corporate risk

11 Corporate affairs

We are committed to engaging in regular and transparent communication with our customers and stakeholders. We appropriately monitor and adapt to any changes in our political and regulatory frameworks, or take a lead role to advocate and influence positive change to the political or regulatory landscape impacting both our industry and our natural environment.

Failure to do this may impact our relationships and reputation with our customers and stakeholders and may result in business disruption or regulatory fines.

Executive accountability:

Director of Corporate Relations

Risk climate: ⧓

Our relationships with customers and stakeholders is strongly connected to our operational performance. During the year we were challenged by several significant service disruption events and noncompliant spills, which have resulted in an increase in customer complaints and negative media coverage. We understand that increased monitoring is essential to improve our wider environmental performance and to achieve a significant reduction in the use of storm overflows. We continue to invest in improvements to the timeliness and accuracy of our data. We have engaged in open conversations with our customers, community leaders and regulator and provide timely reporting of events to share causes, impacts and future mitigation to prevent re-occurrence. We are committed to improving our performance and accountability to rebuild our trust and connection with our communities.

Mitigating strategy:

- Work with our customers to understand their service delivery needs and expectations.
- Monitor developments in the requirements from all of our regulators on key issues.
- Maintain close dialogue with Government, Ofwat and other regulators on key issues.
- Continue to engage constructively with all of our regulators in regards to the water scarcity challenges.
- Investment Pathfinder projects to improve CSO performance.
- Investment in Event Duration Monitoring (EDM) and the expansion of EDM coverage on Beachbuoy, our online tool for information on storm release activity near coastal bathing waters.
- Work with our regulators on how we better understand and address our customers' needs to enable successful outcomes in the next business plan period 2025–30.

Cross reference:

Read more about our Long-Term Priorities and five-year delivery strategy on pages 42 to 95.

Corporate risk

12 People

We are committed to attract, retain, and establish succession planning to maintain a workforce of the right people, with the right skills for the role. This is a central part of our long-term strategy and our ability to ensure the company is agile and adaptable to change.

We have designed our people risk framework to support a diverse and inclusive culture that promotes employee engagement and demonstrates the desired conduct and behaviours that align with our values. It includes building and retaining an industry-leading workforce and managing our people to upskill and develop our talent. This means we can ensure that we have the right resources to support our operations while implementing HR processes and procedures that support, protect and manage our people, and provide a fair and transparent reward and recognition programme.

Failure to develop our workforce and implement a successful succession planning programme across the business can significantly impact our service delivery and result in business interruption and our ability to meet our customer and regulatory commitments.

Executive accountability:

Chief People Officer

Risk climate: ▼

We continue to manage challenges in relation to talent attraction and retainment especially in the Technical and STEM roles. Our recruitment efforts are also impacted in part by our geographic location. In the past year, the already competitive employment environment has been strongly influenced by rising inflation and the current cost of living crisis. We have established industry relationships with specialty recruitment partners to help us manage our talent attraction strategy. We are committed to supporting an empowering and collaborative work environment that recognises performance and facilitates career progression and development.

Mitigating strategy:

- Ongoing workforce planning analysis and high-level strategic talent reviews take place across the business to assess capability and capacity needs
- Development of a Talent Acquisition Strategy
- Our internal INSPIRE Academy supports in-role development and career progression
- Our recruitment strategy streamlines our best route to market
- Our annual engagement surveys assess our employee satisfaction with remedial action plans developed by teams
- Strong inclusion and diversity culture.

Cross reference:

Read more on our people on pages 69 to 74.

Viability Statement

Southern Water Services (SWS) is a regulated utility which is characterised by a long-term investment horizon, over multiple-price control periods with stable revenues. Ofwat sets price controls for five-year periods, which reduces the potential for variability in revenues from the regulated business. The company benefits from a rolling 25-year operating licence.

Ofwat regulates the water industry in England and Wales and has a statutory obligation to ensure that water and wastewater companies can finance their functions. In addition, the regulator has a primary duty (under the Water Act 2014) to ensure that water and waste companies have the long-term resilience to meet the needs of customers.

In preparing the long-term viability statement (LTVS), SWS has included an expected equity receipt of £375 million (£550 million into the group). The proceeds are expected to be received by the end of October 2023, and to be used to invest in the operational turnaround plan of SWS. The equity was not committed at the date of signing the accounts and therefore considered to be a material uncertainty for the going concern statement (see page 205). This expected equity receipt is in addition to the £529.9 million received by SWS in September 2021.

SWS has conducted an assessment covering the period up to March 2030, which aligns to the price control cycle and covers the current and next cycle. The analysis has taken into account current performance, planned performance improvements, funding of the defined benefit pension scheme and the principal risks that affect the business as documented in the Strategic Report on pages 120 to 132. Scenarios were developed with reference to a quantification of financial effects of specific risks incorporated in the principal risks faced by the business, as well as consideration of the gearing sharing mechanism relating to gearing in the current five years period to 2025, and the recovery in the next five years period of additional expenditure incurred during the current five years period. These risk scenarios were then tested both individually and in combined scenarios. An overview of this analysis is provided on page 134. Mitigating actions and the effectiveness of these actions were also considered.

The analysis has also considered the long-term financing needs of the business, including the maturity profile of existing debt, which extends to 2056. Future financing plans assumed for the long-term viability statement includes £825 million of new finance to be raised by March 2025, £400 million of which is to repay existing debt; plus £4.5 billion of projected new finance used for the capital investment programme and the repayment of £2.2 billion of debt maturities and inflation-linked accretion repayments during the period 2025 to 2030.

Assessment period

For the LTVS, the Board continues with a forward-looking term up to 31 March 2030:

- SWS has accepted the commitments and customer promises in the Final Determination for 2020–25 and the SWS Board has agreed a business plan for the period to March 2025, albeit there is a material uncertainty regarding the expected equity receipt of £375 million by the end of October 2023.
- The Board notes that analysis of financial resilience over the period 2025 to 2030 is uncertain given a plan for this period will not be agreed with Ofwat, our regulator, until at least February 2025. SWS will, however, be producing a plan for the period from 2025–30 as part of the business plan submission to Ofwat in October 2023, following which there will be a period of review by Ofwat, leading to a final determination in December 2024. SWS will have the right to appeal the final determination which will extend the period of uncertainty into 2025. A preliminary view of the SWS plan submission has been used for the long-term viability assessment. However, cost allowances, performance challenges and returns are yet to be set, implying a wide range of potential outcomes, which have been taken into account in the stress tests below.
- It is not considered practicable to extend the period beyond 2030 given the inherent uncertainties already present in the forecasts used to 2030.

Viability statement continued

Stress tests

The ‘principal risks’ identified (pages 120 to 132) are recognised as the key risks facing SWS and those that will have the potential greatest impact on the business. These are regularly reviewed by the Board. Based on the principal risks, the following risk factors are considered to have the potential for a negative impact on the financial position of SWS.

- **Outcome Delivery Incentive (ODI) penalties:** These may materialise as a result of under-performing on performance commitment targets set by Ofwat, which are significantly more challenging compared to the previous price control.
- **Increased expenditure:** Increased expenditure has been considered in light of the challenging cost allowances set in the PR19 Final Determination as well as unexpected costs arising from high energy prices, high inflation, operational incidents, and maintaining service during periods of severe weather.
- **Outturn inflation is different to forecast:** SWS’s financial projections are sensitive to inflation scenarios given the index-linked nature of business cash flows and a number of credit metrics which include inflation adjustments (SWS uses inflation forecasts published by HM Treasury). SWS has in place inflation linked debt and derivatives to mitigate some of this risk.
- The likely financial impact of these risks has been estimated and used in the construction of severe, but plausible, downside scenarios. In developing these scenarios, we have considered combinations of risk factors and the potential correlations between risk factors.

Stress test	Link to principal risks	Specification of stress test
ODI penalty	Operational risks	ODI penalties resulting from failing to deliver on performance commitments due to operational failures. (RORE -2.0% to 2025 and -0.4% to 2030).
Increased expenditure	Operational risks Corporate risks	Increased expenditure resulting from the principal risks (see pages 120 to 132) over and above the costs already in the plan which are £1.2 billion more than the PR19 Final Determination). (Sensitivity +3.7% of each year to 2030).
Macroeconomic shock – low inflation	Financial	Inflation forecasts to 2030 -1%.
Macroeconomic shock – high inflation	Financial	Inflation forecasts to 2030 +1%.
Combined operational scenario	Operational risks Corporate risks	+4.3% overspend to 2030 combined with the ODI penalties, and high inflation.
Combined operational scenario	Operational risks Corporate risks	+4.3% overspend to 2030 combined with the ODI penalties, and low inflation.

Viability statement continued

Assessment of results and mitigating actions

There is limited financial flexibility within the assessment period to 2030. Primarily the result of a significant level of planned expenditure to improve resilience of SWS assets, to accommodate population growth in the Southeast, and to reduce the impact on the environment from the treatment and processing of water and wastewater.

For the period to March 2025 SWS is planning to spend an additional £1.2 billion to improve asset resilience whilst also incurring unexpected costs arising from high energy prices, high inflation, operational incidents, and maintaining service during periods of severe weather. Should a severe weather event occur (or a greater number of severe events in close succession), management believes that the costs of this can therefore be accommodated, although it (or any other significant one-off cash cost) may require rephasing of borrowing and spending plans. ODI penalties incurred during the period and customer reparation to 2025 also reduce customer receipts. Significant resource has been invested in a turnaround plan for SWS, which is expected to achieve demonstrable improvement in performance by the end of current five-year period to 2025

The additional investment to 2025 is expected to improve operational resilience for the period 2025 to 2030. The demand for further investment will, however, result in limited financial flexibility as the 2025 to 2030 investment plan is expected to be around 50% larger than the plan determined for the period to 2025.

A consequence of the significant increase to planned spend is that dividends are retained in SWS to finance enhancement expenditure, in addition to the expected receipt by October 2023 of £375 million of new equity. Restricting dividends is, therefore, not available as a mitigation to increased expenditure.

SWS is in a credit rating Trigger Event as a result of current credit ratings. There is a risk of a further credit rating downgrade if SWS is unable to deliver its planned improvement to operational performance and business efficiency for the remainder of the current regulatory period to March 2025. SWS also expects be in a debt covenant Trigger Event for the remainder of the current period to 2025 as a result of the impact on financial ratios of significant additional expenditure.

Credit ratings are expected to recover during the period from 2025 to 2030 as a result of improved operational performance from the significant additional expenditure in the period to 2025, plus the natural reset associated with a new five-year regulatory period, including the cessation of customer reparation in 2025.

Therefore, SWS is expected to be out of Trigger for the period 2025 to 2030. There is, however, a risk of a Trigger Event during the period 2025 to 2030 if operational performance does not adequately recover by 2025 and if increased expenditure cannot be effectively mitigated within planned expenditure to 2030.

A Trigger Event (see page 113 for further explanation) would result in restrictions on the payment of dividends and for SWS to prepare a plan, for the Security Trustee, of how it plans to recover from Trigger. Southern Water obtained a waiver from its lenders in 2021 to permit continued access to financial indebtedness, and to also continue to finance the business in a credit rating downgrade Trigger Event or the breach of interest cover ratio to March 2025. A further waiver to extend this period to March 2035 is expected to be secured as part of the planned new equity process.

A Default Event (see page 113 for further explanation) is considered unlikely and did not materialise in any of the scenarios tested. Financial forecasts include an expected equity receipt of £375 million by the end of October 2023. This is a material uncertainty for the going concern assessment (see page 205).

For each of the scenarios tested, we have identified appropriate mitigating actions if stress tests would result in projected metrics deteriorating materially. These mitigating actions are set out in the table on the following page.

Viability statement continued

Description of risk	Scenario	Potential mitigating actions
Costs incurred are higher than planned	Increased expenditure	Utilise contingency in AMP7. Re-prioritisation of expenditure, increase expenditure within debt covenants.
Underperformance on ODIs and totex	Combined operational scenario	Re-prioritisation of expenditure, increase expenditure within debt covenants.
Combined event – totex overspend, ODI penalty and high inflation	Combined scenario (high inflation)	Re-prioritisation of expenditure, increase expenditure within debt covenants.
Combined event – totex overspend, ODI penalty and low inflation	Combined scenario (low inflation)	This is the most severe scenario. Re-prioritisation of expenditure, increase expenditure within debt covenants. Risk of Trigger Event by 2030.

Viability

The Board has assessed the viability of SWS to the period March 2030. In doing so, it has considered SWS's current position, the principal risks facing the company and resulting stress tests, and the impact of mitigating actions.

The other companies in the wider Greensands group are principally in place to support the viability of the regulated business. The Board has taken into consideration the activities of other group companies (pages 116 to 119) as well as the overall group structure and is satisfied that it poses no additional risk to the financial flexibility of SWS.

In making their assessment, the directors have assumed that the planned equity injection will be successful, and capital markets will be available to provide funding for the significant ongoing capital investment programme as well as for the refinancing of debt, credit facilities and financial derivative maturities when they fall due. The directors anticipate the ability to efficiently raise new finance and a stable and supportive regulatory environment, but recognise that there is a material uncertainty relating to the £375 million equity raise not committed at the date of signing the financial statements that may cast significant doubt on the company's ability to continue as a going concern as detailed on page 205.

The Board is satisfied that it has sufficient information to judge the viability of the company and has a reasonable expectation, based on the assumption that it will be possible to raise additional debt and, subject to the material uncertainty as noted above, that the company will be able to continue to operate and meet its obligations over the period to March 2030.

Governance and assurance

The Board has reviewed the medium-term plan and reviews the company's principal risks from a strategic perspective, which form the basis of the stress tests modelled.

The Audit Committee supports the Board in reviewing the results of the analysis as part of its normal procedures. To support the Board in its assessment, a third-party assurance was obtained over the calculations applied to the financial projections for the LTVS in 2021.

The Strategic Report, including the directors' Section 172(1) Statement on pages 15 to 136, was approved by the Board of Directors and signed on its behalf by:

Richard Manning
General Counsel and Company Secretary
7 July 2023

Corporate governance

Chair's overview

"Over the past year, public scrutiny of the water industry and Southern Water has been intense, focusing on the impact of our activities on our customers and the environment."

Keith Lough
Chair

As I reported last year, 2021–22 was a year of major events and changes for Southern Water. We were given a significant fine as a result of charges brought by the Environment Agency; we received a major investment from funds managed by Macquarie Asset Management (which led to changes in the composition of our Board); and both our CEO and CFO announced that they would step down. We invested in strengthening the culture and ethics of the company and renewed our commitment to deliver for the environment, with supporting investments.

I am pleased to report that 2022–23 has seen us continue to make progress. We have made significant steps to address our performance and laid the ground for immediate and longer-term investments to assure the current and future delivery of our customer and environmental commitments. This includes strengthening the financial resilience of the company.

However, we know that our performance is still not good enough. We also, quite rightly, remain subject to public and regulatory scrutiny. It has been our duty as a Board to lead from the front, working with a strengthened executive team, to address the issues we continue to face in the short term while making plans for the longer term.

This report demonstrates how we, as a strong and active Board, have in place the corporate governance arrangements needed to continue to take the company forward. Rightly, we measure the Board and our governance against best standards in this field, and against the Ofwat Board leadership, transparency and governance principles. But in these times especially, we need to show that it does more than satisfy an assessment framework. As a Board we are the upholders of the company's overriding public service mission. Over the past year we have sharpened the role of the Board to ensure focus, and in particular we have aimed to:

- challenge and seek remedy in areas of poor performance to address short-term issues. The focus of our work here has been in developing the Turnaround Plan. The CEO, with the Executive team, has driven the creation of this plan, and it is strongly supported by the Board. Key features of this plan are explained by Lawrence in his report on pages 16 to 19. We are already beginning to see the benefits of the focus provided by the plan.
- give relentless focus to developing our business plan for 2025–30 with underpinning projects and programmes to secure our long-term future. This will be submitted to Ofwat in October 2023 and will chart the way for the medium to longer term. It includes major and innovative investment proposals.

We also see it as core to the company's long-term future that as a Board we should continue to:

- work closely with our investors and give them the confidence to provide the investment needed to secure the long-term success and prosperity of the company;
- work with government and regulators to build confidence that we are on track to turn round our performance;
- create an environment in which our own people are led and motivated to deliver on our important mission. An environment in which they can work safely and securely in the knowledge of the importance of what they do. We maintain a robust focus on being a company whose performance turnaround is underpinned by values and ethics.

As Chair, I have engaged with, and heard directly from key stakeholders, to ensure that we, as a Board, understand the issues and priorities of others.

A separate and more detailed report of the main areas on which the Board has focused during the year is on page 165.

Under the terms of our licence, Southern Water is required to meet the objectives set out in Ofwat's Board leadership, transparency and governance principles (the 'Ofwat Principles'). We set out our assessment of our compliance with the Ofwat Principles on pages 181 and 183.

In addition, the Board has further sought to embed more consistently its consideration of section 172(1) factors in its decision making. Our section 172(1) Statement can be found on pages 96 to 99.

K G Lough

Keith Lough
Chair
7 July 2023

Board of directors

Keith Lough
Chair

Non-Executive
Independent: On appointment

Committee membership:
N RE (until 31 July 2023)

Date of appointment:
01/08/2019

Experience:

Keith has extensive experience in the natural resources and energy sectors in both finance and leadership roles, including as finance director for British Energy plc between 2001 and 2004 during a period of major restructuring.

In addition, Keith served as non-executive chairman of Gulf Keystone Petroleum plc following a successful debt restructuring. Immediately prior to his appointment to the Board of Southern Water, Keith was a non-executive member of the Gas and Electricity Markets Authority (Ofgem), where he was chairman of the Audit and Risk Assurance Committee, having served on the board since 2012.

Keith holds an MA in economics and MSc in finance and is a Fellow of the Association of Chartered Certified Accountants.

External appointments:

Keith holds non-executive directorships in a number of oil and gas companies, including at Rockhopper Exploration plc as non-executive Chairman, and at Hunting plc as Senior Independent Director.

Lawrence Gosden
Chief Executive Officer

Executive
Independent: No

Committee membership: N/A

Date of appointment:
01/07/2022

Experience:

Lawrence joined Southern Water in May 2020 and was appointed to the Board on 1 July 2022 when he was appointed CEO.

Lawrence brings significant experience to the Board having worked in the water sector for over 30 years. He has a track record for successful operational and capital programme delivery and a wealth of experience delivering major infrastructure programmes, asset management, customer service and operational transformation alongside the provision of impactful and inclusive strategic leadership.

Prior to his return to Southern Water, Lawrence spent 12 years at Thames Water in a variety of senior executive and leadership positions. Notably he was managing director for wastewater and subsequently chief operating officer.

Lawrence gained a first-class honours degree in engineering before starting his career as a graduate at Southern Water.

External appointments:

Lawrence is a non-executive director at National Highways where, among other things, he chairs their health and safety committee.

Committee membership key

A Audit Committee
N Nomination Committee
RE Remuneration Committee
E ESG Committee
RI H&S and Operational Risk Committee
Committee Chair

Board of directors continued

Stuart Ledger
Chief Financial Officer

Executive
Independent: No

Committee membership: N/A

Date of appointment:
03/01/2023

Experience:

Stuart joined Southern Water as CFO on 3 January 2023.

He has held senior positions both inside and outside the water sector. Stuart was previously the CEO at Affinity Water and the CFO for Affinity for the four years prior to that. Stuart's extensive experience in the industry also includes nine years at Thames Water as the CFO of the Retail business and as group financial controller. Prior to this, he was financial controller at Wolseley, following almost eight years at EDF Energy.

External appointments:

Stuart is a director of Landlord Tap Limited, a website that provides water companies with details of who is responsible for paying water or wastewater charges in tenanted properties. He is also a trustee of Rett UK, a charity supporting sufferers of Rett Syndrome, as well as their families and carers.

Mike Putnam
Independent Non-Executive Director

Non-Executive
Independent: Yes

Committee membership:
RI RE

Date of appointment:
26/09/2017

Experience:

Mike has over 25 years' experience leading and managing multiple businesses across development and construction. He has since transitioned to a plural career with a portfolio of non-executive directorships.

Mike was president and CEO of Skanska UK between 2009 and 2017, responsible for a business with circa £1.8 billion revenues and 6,000 employees. Prior to this, he was executive vice president and main board director from 2001, as well as working across the group as a non-executive director on some of the international boards.

He was a member of the Construction Leadership Council and Chair of the Green Construction Board, both of which were partnerships between government and industry developing the industry change and sustainability agendas. He was also a non-executive director of the Association of Consulting Engineers.

Mike is a Chartered Engineer and a Fellow of both the Institution of Civil Engineers and Royal Institution of Chartered Surveyors.

External appointments:

Mike currently serves on the boards of Network Rail, The Programme Board of Transpennine Route Upgrade, Arcadis NV and Bazalgette (Tideway) Tunnel Ltd.

Board of directors continued

Dame Gillian Guy DBE
Senior Independent Non-Executive Director

Non-Executive
Independent: Yes

Committee membership:
E N

Date of appointment:
12/11/2018

Experience:

Gillian joined the Board in November 2018.

Gillian is a lawyer and spent 11 years as chief executive officer of the London Borough of Ealing before becoming chief executive officer of Victim Support. Following this she became chief executive of Citizens Advice.

Gillian has previously served as a non-executive board member and chair of the Audit Committee of the National Audit Office, as a non-judicial member of the Sentencing Council for England and Wales, as chair of the UK Finance Consumer Advisory Group and as a member of the Banking Standards Board.

Gillian was awarded a CBE in the New Year's Honours List in 2015 and was awarded a Damehood in the 2020 New Year's Honours List for services to public and voluntary sectors.

External appointments:

Gillian is Independent Assessor to the Financial Ombudsman Service.

Malcolm Cooper
Independent Non-Executive Director

Non-Executive
Independent: Yes

Committee membership:
A RE RI

Date of appointment:
23/12/2019

Experience:

Malcolm joined the Board in December 2019 and was appointed as Chair of the Audit Committee.

Malcolm has extensive experience in the regulated utility sector, having worked for around 30 years at National Grid plc, British Gas plc and other companies. He was a member of the board of both National Grid Gas plc and National Grid Electricity Transmission plc.

Malcolm was previously a non-executive director of St William. He is also a past president of the Association of Corporate Treasurers and was a member of the Listing Authority Advisory Panel of the FCA.

Malcolm has a degree in Pure Mathematics and is both a Fellow of the Association of Chartered Certified Accountants and the Association of Corporate Treasurers.

External appointments:

Malcolm is a non-executive director at: Morgan Sindall plc where he chairs the Audit Committee and the Responsible Business Committee; MORhomes plc where he is Senior Independent Director and chairs the credit committee; and the Custodian Property Income REIT plc where he chairs the Audit Committee. He is a non-executive director and chair of the Audit Committee of Local Pensions Partnership Ltd.

Committee membership key

- A Audit Committee
- N Nomination Committee
- RE Remuneration Committee
- E ESG Committee
- RI H&S and Operational Risk Committee
- Committee Chair

Board of directors continued

Christèle Delbé
Independent Non-Executive Director

Non-Executive
Independent: Yes

Committee membership:
E RE

Date of appointment:
31/05/2023

Experience:
Christèle Delbé is a sustainable business director with more than 18 years pioneering strategic initiatives and shifting behaviour to unlock tangible commercial benefits across food, consumer goods, technology and non-profit sectors. She is an issues expert on responsible supply chains and consumption, carbon, waste, packaging and human rights.

Christèle was head of innovation and partnerships for Bonsucro, the global sustainability standard for sugarcane, where she shaped and secured £1.5 million in funding for seven multi-stakeholder impact programmes. She has also advised organisations including UNICEF, Solidaridad, RNIB, Producers Direct on developing strategic partnerships with the corporate sector. As Supply Chain Solutions Director at KSAPA, she is currently co-creating innovative solutions for smallholder led agriculture value chains with organisations including GPSNR, Reckitt Benckiser and Coca-Cola.

Previously, as head of sustainable innovation for the Vodafone Group, Christèle pioneered a £5 million B2B programme that sparked the creation of four mobile products for Unilever, Nestlé, Danone, Anglo American to address supply chain, community and water challenges across Africa and Asia. As group head of sustainability at Orange Group, Christèle spent seven years embedding global sustainability strategy, ethics and reporting frameworks into seven countries.

External appointments:
None

Kerensa Jennings
Independent Non-Executive Director

Non-Executive
Independent: Yes

Committee membership:
E A

Date of appointment:
31/05/2023

Experience:
Kerensa Jennings is an award-winning digital leader and adviser who has held senior leadership positions in the private, public and charitable sectors. Selected by Computer Weekly among the most influential tech leaders in the UK, she has served on a range of boards including commercial companies, social enterprises, charities and government committees.

A former director at the Royal Household where she was CEO of a Royal social enterprise based at Buckingham Palace, she was previously the BBC's Head of Strategic Delivery. Her remit as BT Group Director of Data Platforms is helping BT transform from Telco to Techco. Kerensa is also a professionally qualified executive coach and a bestselling author.

External appointments:
Her current portfolio includes chair at the Centre for the Acceleration of Social Technology (CAST) helping the social sector with digital, data and design; Trustee at Sir John Soane’s Museum; chair at techUK Local Digital Capital Index Working Group; visiting professor of Media, Strategy and Communications at University of Huddersfield; Fellow at RSA; and Advisory Board member at Digital Leaders and at Digital Boost.

Board of directors continued

Steve Fraser
Non-Executive Director

Non-Executive
Independent: No

Committee membership: N/A

Date of appointment:
01/05/2022

Experience:

Steve has over 20 years' experience of managing and transforming infrastructure businesses, latterly as COO and a main board director of the FTSE100 water and wastewater company United Utilities.

He has a degree in management studies and a Master's in engineering management from UMIST and also holds a diploma in advanced management from Harvard University.

After leaving education, Steve trained in utilities operations working across water, electricity, and latterly high-pressure gas pipelines.

He became a director of Bethell Group, where he worked to establish them as a leading player in the energy services sector. This was prior to joining United Utilities in 2005 to run the global outsourcing division Energy and Contracting Services working across the UK, Europe and the Middle East.

External appointments:

Steve is the CEO at Cadent Gas, accountable for serving circa 11 million customers, across four gas distribution networks, as well as running the National Gas Emergency Number on behalf of all distribution networks.

Will Price
Non-Executive Director

Non-Executive
Independent: No

Committee membership:
A RE N

Date of appointment:
08/09/2021

Experience:

Will joined the Board in September 2021.

Will joined Macquarie in 2007, and now heads the European Utilities team for Macquarie Asset Management.

Will has a Bachelor of Science in Economics and Politics from the University of Bristol in the UK. He also holds a Master of Finance from INSEAD business school in France.

External appointments:

Will currently serves as a non-executive director on the boards (and various wholly-owned subsidiaries) of National Gas in the UK, and EP Infrastructure and Czech Grid Holding in the Czech Republic.

Committee membership key

A Audit Committee
N Nomination Committee
RE Remuneration Committee
E ESG Committee
RI Health and Safety and Operational Risk Committee
Committee Chair

Board of directors continued

Mark Mathieson

Non-Executive Director

Executive
Independent: No

Committee membership:
RI E

Date of appointment:
08/09/2021

Experience:

Mark joined the Board in September 2021.

A Chartered Engineer, and a Fellow of the Institution of Engineering and Technology, he has 33 years of experience in the energy utility sector.

Mark joined Macquarie in 2018.

Previously Mark was CEO at Green Highlands Renewables, and prior to that he spent 26 years at the North of Scotland Hydro Electric Board, subsequently part of SSE plc, where he was the MD responsible for electricity networks business.

He was also a non-executive director at the Smart DCC company, and is a past chair of both the Energy Networks Association, the trade association and EA Technology.

Mark has a Bachelor of Engineering in Electrical and Electronic Engineering from Heriot-Watt University, Edinburgh.

External appointments:

Mark sits on the Boards of Cadent Gas Networks, Nortegas Energia Grupo, and Distributie Energie Oltenia SA, an electricity distribution network in Romania.

Phil Swift

Non-Executive Director

Non-Executive
Independent: No

Committee membership: RI

Date of appointment:
31/05/2023

Experience:

Former President, National Grid Electricity Distribution (NGED)/CEO Western Power Distribution (WPD).

Phil joined WPD (then SWEB) in 1992 after graduating as an engineer and following an apprenticeship in the aerospace industry.

In July 2013, Phil was appointed to the Board of WPD as Operations Director. In this role, he was responsible for the business' network services, design, logistics and safety and training activities. In November 2018, Phil was appointed as Chief Executive.

In July 2020 Phil supported the sale process of WPD. This completed successfully in June 2021 with the acquisition by National Grid plc. WPD was renamed and rebranded in mid 2022.

Phil left NGED at the end of March 2023.

External appointments:

Elenia Oy, Finland

Richard Manning

General Counsel and Company Secretary. Secretary to all committees

Committee membership:
Secretary to all committees

Date of appointment:
24/07/2018

Experience:

Richard joined Southern Water in July 2018 as General Counsel and Company Secretary and now has overall responsibility for leading the Risk and Compliance directorate alongside his legal and governance roles. He is a member of the Executive Committee and the Executive Leadership Team.

He has held similar roles in a number of listed and private companies including GCap Media plc, JJB Sports plc and Waterstones, and brings a wide experience of legal and governance matters.

Richard holds a law degree and an MBA and is a qualified solicitor.

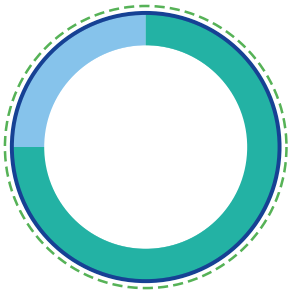
External appointments:

None.

Board of directors continued

Our Board's composition as at 7 July 2023

Board gender profile



- Male (9)
- Female (3)

Board independence

- Executive (2)
- Independent on appointment (1)
- Independent (5)
- Shareholder nominated (4)

Executive and non-executive directors

- Executive (2)
- Non-executive (10)

Board tenure

	Number of Board members				
	1	2	3	4	5
<One year					
One to three years					
Three to six years					
Six to nine years					

Governance at a glance

The year has seen **significant events** for the company and its Board.

What was on the Board's agenda this year

Operational performance

To deliver the next phase of the company's transformation plan and support the turnaround strategy.

Water quality

To deliver improved water quality and resilience at four key sites.

The environment

Developing solutions to reduce reliance on storm overflows.

Long-term plan submissions.

To deliver resilience through our Water for Life – Hampshire Programme, Water Resource Management Plans, Drainage and Wastewater Management Plans and Water Industry National Environment Programme.

Succession planning

Strengthening the Board with new members.

Price review 24

Planning for the next five-year business plan between 2025–30.

Committee highlights

Nomination Committee

Areas of focus this year:

- Recruitment of two new independent non-executive directors.
- Selecting candidates to replace the Chief Executive Officer and Chief Financial Officer.

Priorities for 2023–24

- Continued focus on Board succession planning.
- Board diversity.

Audit Committee

Areas of focus this year:

- Annual and interim financial statements.
- Assurance of regulatory submissions.

Priorities for 2023–24

- Assurance of our business plan for 2025–30.
- IT and internal financial controls.

Health and Safety and Operational Risk Committee

Areas of focus this year:

- Development of Health and Safety Transformation Programme.
- Safety as a fourth value.

Priorities for 2023–24

- Employee wellbeing.
- Measuring progress against the Health and Safety Transformation Programme.

Remuneration Committee

Areas of focus this year:

- Setting and reviewing executive remuneration, objectives and KPIs.
- Benchmarking executive pay.

Priorities for 2023–24

- Ensuring executive remuneration meets environmental and customer objectives.
- Incentivise executives to achieve the Turnaround Plan.

ESG Committee

Areas of focus this year:

- Defining our ESG priorities and outcomes against the company's overall strategy.
- ED&I and culture.
- Development of net zero plans.

Priorities for 2023–24

- Tracking progress against our gender action plan.

Corporate governance report

1

Competence and independence

Boards and their committees are competent, well run, and have sufficient independent membership, ensuring they can make high-quality decisions that address diverse customer and stakeholder needs.

"Effective Boards must be comprised of individuals with diverse skillsets and experience, who exhibit independence of thought and judgment."

Keith Lough
7 July 2023

Overview of the Board's responsibilities

The Board's role is to:

- establish the company's purpose, strategy and values
- develop and promote the company's purpose in consultation with a wide range of stakeholders
- determine overall strategic aims and direction consistent with the company's purpose
- monitor and assess the company's values and culture to ensure that behaviour throughout the business is aligned with the company's purpose
- have full responsibility for all aspects of the company's regulated business in the long term
- ensure that the company's obligations to, and interests of, all its stakeholders, including customers, employees, key partners, contractors and regulators, are known and met appropriately
- provide effective leadership and collective responsibility for the long-term success of the company for the benefit of its members, taking into account the interests of a wide range of stakeholders, including customers, local communities, employees, suppliers and the company's impact on the environment
- ensure that sufficient resources are available to the Chief Executive Officer and his team to operate, manage and develop the business appropriately to provide an essential public service to our customers
- ensure that appropriate and effective processes and controls are in place to assess and manage risk.

Greensands Holdings Board

The Shareholders' Agreement of our parent company, Greensands Holdings Limited, reserves certain matters by exception to the board and shareholders of that company. This includes the company's dividend policy, which can be found on page 110. While the policy governing dividends is subject to shareholder approval, the decision whether or not to recommend payment of a dividend from Southern Water Services Limited sits with the Southern Water Board. A schedule of those matters reserved to Greensands Holdings Limited is published at **southernwater.co.uk/greensands-ownership-of-southern-water**.

During the year 2022–23 a number of matters required the approval of the Board, the majority shareholder or shareholder of Greensands. These included approval of the company's execution plan, financing – including that necessary to carry out the removal of the Cayman Islands entity – the investment for the four water quality strategic plans and the approvals required as a result of the major investment by funds managed by Macquarie Asset Management.

Corporate governance report continued

Shareholders

Greensands Holdings Limited Board of Directors

Certain key matters are reserved to the board of Greensands Holdings Limited and/or the shareholders.

Southern Water Services Limited Board of Directors

The Board of Southern Water is ultimately responsible for the company.

Executive Committee (ExCom)

Comprising the Chief Executive Officer, Chief Financial Officer, General Counsel and Company Secretary, Chief Operating Officer, Chief Customer Officer, Chief Information Officer, Chief People Officer and Director of Corporate Relations, it meets to agree areas of strategy and other matters critical to the company.

Executive Committees

The ExCom, alongside members of the company's senior leadership team, support the CEO in driving the implementation of strategy in the company. Comprised of the senior leaders of the functions and operational units, the executive committees meet regularly to:

- Consider performance and make decisions on operational matters;
- Oversee the company's transformation programme; and
- Consider health, safety, security and wellbeing, risk and compliance.

Corporate governance report continued

1. Competence and independence continued

The Board

The Board comprises the non-executive Chairman, two executives – the Chief Executive Officer and Chief Financial Officer – and nine non-executive directors, five of whom, making up the single largest group, are independent. It routinely determines the following matters:

- Business and financing strategy
- Business plans
- Approval of annual budgets
- Fixing of principal charges and schemes
- Approval of financial statements
- Key regulatory submissions
- Key customer and stakeholder publications
- Entering into significant contracts or commitments
- Approval of dividends
- Commencing new businesses
- Appointment or removal of the auditor, directors and company secretary
- Remuneration of independent non-executive directors.

During the year, the Board's agenda covered:

- The execution plan to deliver the company's business plan for 2020–25.
- Preparation and planning for the next five-year business plan for 2025–30.
- The development and approval of the water quality strategic plans.
- Strategic action plans to improve the company's resilience and performance and to support the turnaround strategy.
- Monitoring the company's environmental impact and the further development of the company's storm overflow reduction programme.
- Continuing to develop measures for monitoring of the company's culture, including the introduction of a new value, Working with Care.
- Reviewing and monitoring the company's progress against the undertakings given to Ofwat following the settlement in 2019–20.
- Risk appetite and risk monitoring.
- Development and approval of key regulatory submissions including the company's draft Water Resources Management Plan (WRMP), Water Industry National Environment Programme (WINEP), Drainage and Wastewater Management Plan (DWMP), Water for Life – Hampshire (WfLH).
- Health and Safety Transformation Programme.
- Cost of living crisis and impact on customers.
- Water resources and the introduction of Temporary Use Bans.

Board committees

In line with both the Board leadership, transparency and governance principles published by Ofwat and the UK Corporate Governance Code as well as best practice, the Board has established a number of standing committees with specific responsibilities. These committees are:

Audit
Health and Safety and Operational Risk
ESG
Nomination
Remuneration

The committees assist the Board by monitoring and reviewing performance and issues within their respective scopes. Specific responsibilities have been delegated to these committees.

Each committee has written terms of reference, which are published at: **southernwater.co.uk/board-committee-terms-of-reference**. These terms of reference are reviewed at least annually.

In addition to the established committees, the Board constituted a Committee to oversee the Price Review 2024 (PR24) and other regulatory submissions, including our water resource and drainage and wastewater management plans.

Other committees are constituted if and when required for specific matters.

Formation of our ESG Committee

As reported last year, In February 2021, the Board approved the formation of an Environment, Social and Governance Committee to provide greater oversight and consideration of the material environmental, social and governance matters relevant to the company's activities, including environmental performance programmes and plans; social performance programmes, including employee engagement, equality, diversity and inclusion and community engagement; and governance matters relating to ethical and transparent business practice. The committee met for the first time in the reporting year.

Corporate governance report continued

1. Competence and independence continued

The Board

- Has full responsibility for the company's business over the long term.
- Establishes the company's purpose, values and culture and sets its strategy.

Read more on pages 140 to 145

Audit Committee

- Monitors the integrity of the company's financial statements by challenging the basis of preparation and the judgments made.
- Monitors the integrity of non-financial information reported by the company.
- Keeps under review the company's internal controls and risk management systems.
- Reviews the company's overall risk appetite, tolerance and strategy and level of resilience.
- Oversees Internal Audit and the relationship with the external auditor.

Read more on pages 172 to 176.

Health and Safety and Operational Risk Committee

- Monitors and advises on health, safety, security and wellbeing and makes appropriate recommendations to the Board.
- Reviews and monitors operational risks and related risk management systems.

Read more on pages 177 to 178.

ESG Committee

- Reviews and provides oversight and consideration of the material environmental, social and governance matters relating to the company's activities.
- Monitors the company's culture including employee engagement, equality, diversity and inclusion and community engagement.
- Reviews governance matters relating to ethical and transparent business practice.
- Overseas the company's environmental plans.

Read more on pages 179 to 180.

Nomination Committee

- Reviews the size, structure and composition of the Board.
- Evaluates the balance of independence, skills, experience and diversity on the Board.
- Leads the process for identifying and nominating candidates for approval by the Board.

Read more on pages 168 to 170.

Remuneration Committee

- Sets remuneration policy for all executive directors and the Chair.
- Recommends and monitors remuneration for senior leaders.
- Approves the design of, and determines targets for, any performance-related pay schemes.
- Reviews the design of all long-term incentive plans.
- Oversees major changes to employee benefit structures.

Read more on pages 184 to 201.

Corporate governance report continued

1. Competence and independence continued

Board meetings and attendance

A total of eight Board meetings were scheduled to take place during the year.

The attendance at scheduled Board meetings during the year was as follows:

Member	Attendance
Keith Lough	8/8
Ian McAulay[1]	2/2
Sebastiaan Boelen[2]	3/3
Lawrence Gosden[3]	6/6
Nadim Ahmad[4]	2/2
Stuart Ledger[5]	3/3
Paul Sheffield	7/7
Rosemary Boot	6/7
Mike Putnam[6]	7/8[6]
Gillian Guy	6/8
Kevin McCullough[7]	3/3
Malcolm Cooper	8/8
Mark Mathieson	8/8
Will Price	8/8
Martin Bradley[8]	0/0
Steve Fraser[9]	7/8

[1] Ian McAulay resigned as a director on 30 June 2022.

[2] Sebastiaan Boelen resigned as a director on 31 July 2022.

[3] Lawrence Gosden was appointed a director on 1 July 2022.

[4] Nadim Ahmad was appointed a director on 31 July 2022 and resigned as a director on 3 January 2023.

[5] Stuart Ledger was appointed a director on 3 January 2023.

[6] Due to a date change for a Board meeting, Mike Putnam was unable to attend.

[7] Kevin McCullough resigned as a director on 31 July 2022.

[8] Martin Bradley resigned as a director on 1 May 2022. He remains a director of the company's ultimate holding company, Greensands Holdings Limited.

[9] Steve Fraser was appointed a director on 1 May 2022.

The agenda and papers are sent to Board members in advance of each meeting. A monthly performance report is distributed for the months when there is no scheduled meeting.

The Board usually holds its meetings at the company's head office in Worthing. The Board also endeavours to hold some meetings at an operational site during the year. In addition to the scheduled meetings, the Board holds a strategy day each year in order to provide an opportunity to discuss the company's future strategy and plans.

Where a director has a concern over any unresolved matter, they are entitled to require the Company Secretary to record that concern in the minutes of a meeting. Should the director later resign over the issue, the Chair would bring it to the attention of the Board.

All members of the Board were and are able to allocate the necessary time to the company in order to be able to discharge their responsibilities effectively.

Board composition

There have been a number of changes in the composition of the Board during the year. As reported last year, the then Chief Executive Officer (Ian McAulay) and Chief Financial Officer (Sebastiaan Boelen) announced their intention to retire in 2022–23. Nadim Ahmad served as interim Chief Financial Officer until the arrival of Stuart Ledger in January 2023. Kevin McCullough resigned as a director in July 2022, with Mark Mathieson assuming his role as workforce non-executive director. Lawrence Gosden was appointed CEO in July 2022.

Keith Lough has served as Chairman since 1 August 2019. Mark Mathieson and Will Price are also directors of the company's ultimate parent company, Greensands Holdings Limited.

As at 31 March 2023, women made up 18% of the Board (two out of 11 directors). During the year, the company's Nominations Committee has overseen the recruitment of two new independent non-executive directors. As at 7 July 2023, women made up 25% of the Board (three out of 12 directors). The company is committed to having a diverse workforce that reflects the communities it operates in. The company publishes a Gender Pay Gap Report. Our report showed that the median pay gap remains in favour of female employees at -3.32%. In terms of the bonus gap, we have seen a further reduction from 16.1% to 14.95% in favour of male employees.

We are committed to supporting the aspirations of our talented female workforce and have implemented plans to address the gender pay gap. Read the full report at: **southernwater.co.uk/gender-pay-gap**.

In accordance with good governance practice, the roles of the Chair and Chief Executive Officer are separate.

Corporate governance report continued

1. Competence and independence continued

Board composition continued

Chair

The role of the Chair is to lead the Board in its shared responsibilities, to encourage and facilitate the contributions of its members and to ensure adherence to the governance principles and processes of the Board. Keith Lough has served as the company's Chair since 2019. In line with the Ofwat Board leadership, transparency and governance principles as well as the UK Corporate Governance Code, Keith was viewed as independent on appointment.

The Chair discusses and agrees Board meeting agendas with the Chief Executive Officer and Company Secretary, although any director may sponsor an item to be included on the agenda. The Chair has authority to act and speak for the Board between its meetings, which includes engaging with the Chief Executive Officer. The Chair reports to the Board, chairs of its committees and individual directors as appropriate on decisions and actions taken between Board meetings. The Chair also meets with the non-executive directors, without the executive directors present, to consider the performance of the executive directors and to provide feedback.

The Chair is not a member of the Greensands Holdings Limited (the company's ultimate parent company) board.

Chief Executive Officer

The Chief Executive Officer is a member of the Board and has all the responsibilities of a director of the company. Lawrence Gosden has served as the company's Chief Executive Officer since July 2022. In his executive role, responsibility has been delegated to him to deliver the company's strategy. He is empowered to take all decisions and actions that further the company's strategy and which, in his judgment, are reasonable within the Chief Executive Officer's limits set out in the company's internal controls and matters reserved to the Board. The non-executive directors, led by the Chair, appraise his performance annually.

Chief Financial Officer

The Chief Financial Officer is a member of the Board with all the responsibilities of a director of the company. Stuart Ledger was appointed as the company's Chief Financial Officer in January 2023. In his executive role and reporting to Lawrence Gosden, he has the responsibility for managing the company's financial affairs and assisting the Chief Executive Officer in the delivery of the company's strategy. His performance is reviewed annually by the Chief Executive Officer.

Senior independent non-executive officer

Paul Sheffield was the senior independent non-executive director for the reporting period. Paul chaired the Remuneration Committee and was also a member of the Nomination Committee.

As senior independent non-executive director, ordinarily Paul would chair Board meetings in the event that the Chair was unable to do so for any reason. In the capacity of senior independent non-executive director, he was available to discuss matters or concerns with investors as required.

Paul announced his intention to step down from the Board and he resigned as a director on 31 March 2023 and was replaced by Gillian Guy.

Corporate governance report continued

1. Competence and independence continued





Independent non-executive directors

The largest single group on the Board are the independent non-executive directors in accordance with the Ofwat Principles and as a matter of good governance practice. The number of independent non-executive directors is also in accordance with the company's licence conditions, which require at least three independent non-executive directors on the Board.

They provide independent advice and perspectives and review and challenge decisions and reporting on behalf of all stakeholders, including customers and the workforce. The independent non-executive directors have been appointed for their individual external expertise and experience in specific areas, such as customer service, the environment, operations, procurement, capital project delivery, regulation, transformation and for the range of their experience of general corporate management.

The non-executive directors also appraise the Chair's performance.

The standard terms and conditions for the appointments of independent non-executive directors can be viewed at: **southernwater.co.uk/corporate-governance**.




Shareholder representative non-executive directors

Under the terms of the Shareholders' Agreement, certain investors have a right to nominate for appointment non-executive directors to the Board of Southern Water. As a statutory director, such an individual has all the duties, obligations and rights of a director of Southern Water. As such, they act in accordance with the directors' duties set out in the Companies Act 2006, including those set out in section 172 to promote the success of the company for the benefit of its members as a whole, having regard to the long term and the interests of the company's stakeholders.

The funds managed by Macquarie Asset Management have nominated four directors – Mark Mathieson, Will Price, Steve Fraser (from 1 May 2022 when he replaced Martin Bradley) and, from 31 May 2023, Phil Swift – to act as shareholder representative non-executive directors. Please refer to pages 144 to 145 for details of the background and experience of the shareholder representative non-executive directors.

Neither Will Price nor Mark Mathieson receive any remuneration from Southern Water. In May 2023, Phil Swift was nominated to act as a shareholder representative non-executive director, with the intention that Mark Mathieson will leave the Board later in the year.

Company Secretary

All directors have access to the advice and services of the Company Secretary, Richard Manning, and the Company Secretariat team. The Company Secretary is responsible for ensuring that the Board operates in accordance with the adopted governance framework and that there are good information flows to the Board and its committees and between senior executives and the non-executive directors. The appointment and removal of the Company Secretary is a matter reserved to the Board.

Directors are also able to obtain appropriate independent professional advice in connection with the performance of their duties.

Corporate governance report continued

1. Competence and independence continued

Board independence

In accordance with the Board leadership, transparency and governance principles published by Ofwat, the majority of non-executive directors have been independent and independent non-executive directors were the largest single group on the Board throughout the year.

Following listed company best practice, the Board takes into account those matters listed in Provision 10 of the UK Corporate Governance Code, as well as any other relevant circumstances or considerations in forming its assessment of the independence of directors.

The Board considers that the independent non-executive directors were throughout the year, and continue to be, independent in character and judgment and persons of standing with relevant experience, collectively having connections with, and knowledge of, the company's area and understanding of the interests of our customers, communities, workforce, suppliers and the environment and how these can be respected and protected.

Conflicts or potential conflicts are governed by the Companies Act 2006. The Board does not have power to authorise conflicts under the company's Articles of Association. If a conflict should arise, the conflicted director takes no part in discussions and may not vote on that issue. During 2022–23, no director declared a material interest at any time during the year in any contract of significance with the company.

Balance of skills and experience of the Board (as at 7 July 2023)

The Board, as a whole, has an appropriate balance of skills, experience, independence and knowledge of the company, and the Board provides independent support and advice as well as new ideas and healthy challenge. The number of directors with significant and/or material skills, knowledge and experience related to the key areas necessary to deliver the company's strategy is summarised below. Details of the individual Board members' experience are on pages 140 to 145.

	1	2	3	4	5	6	7
Capital programmes							
Operations							
Customer							
Environment							
Governance							
Regulation							
Financing							
Transformation							
Utilities sector							
Digital and technology							

Moving towards creating a resilient water future for our customers

In order to be able to deliver for our customers and the communities we serve, the Board requires a diverse range of skills and experience. The table above shows the current Board members in terms of their primary skills and experience.

Corporate governance report continued

1. Competence and independence continued

Board Report

Introduction

The Board takes full responsibility for setting the company's strategy and holding the executive to account for performance. Specifically the Board's role is to:

- establish the company's purpose, strategy and values
- develop and promote the company's purpose in consultation with a wide range of stakeholders
- determine overall strategic aims and direction consistent with the company's purpose
- monitor and assess the company's values and culture to ensure that behaviour throughout the business is aligned with its purpose
- have full responsibility for all aspects of the company's regulated business in the long term
- ensure obligations to, and interests of, all company stakeholders are known and met appropriately
- provide effective leadership and collective responsibility for the long-term success of the company for the benefit of its members, taking into account the interests of a wide range of stakeholders, including customers, local communities, employees, suppliers and the company's impact on the environment
- ensure that sufficient resources are available to the CEO and his team to operate, manage and develop the business appropriately
- ensure that appropriate and effective processes and controls are in place to assess and appropriately manage risk.

The Board plays a critical role in setting the tone of the company and acting as an interface with key stakeholders – the company's customers and shareholders, communities, government, regulators.

The Board works through and with its committees to ensure proper oversight of the company's business. The role of committees is described on page 151. Each committee makes its own report setting out its responsibilities and the key areas it has addressed during the year. This report of the Board's activities sets out the areas where the Board has focused during the year.

Setting long-term strategy

A key focus for the Board in 2022–23 has been the development of the company's investment plan for the next Price Review period 2025–30. The Board met in February 2023 for a day dedicated to the company's strategic objectives, outcomes and priorities, informed by what is important to customers and stakeholders as well as taking account of current and future trends.

Aligning purpose, values and culture

The Board reaffirmed the company's purpose and vision, which remain:

Our purpose: To provide water for life to enhance health and wellbeing, protect and improve the environment and sustain the economy.

Our vision: To create a resilient water future for customers in the South East.

Last year's annual report set out in detail the steps the Board had taken to ensure that the company's values, culture and ethics were aligned with its purpose. The Board felt then – and continues to feel – that a robust and ethical culture is critical to avoiding negative behaviours of the past and is a crucial underpinning to the delivery of the company's purpose and vision. The Board has given its strong endorsement to the company's Code of Ethics. The Board continues to monitor key indicators of culture, whether directly or through its committees. A nominated Board member takes a specific interest in workforce engagement and reports to the Board on these matters.

During the year, management considered the company's existing company values and, in taking steps to improve the safety culture of the business, the company identified an absence of a specified safety core value. The Board was pleased to support and approve a fourth value: Working with Care. It supports the company's commitment to ensuring that everyone returns home safely and healthy at the end of the working day.

Corporate governance report continued

1. Competence and independence continued

Addressing performance issues

The Board has maintained focus on the company's performance, overseeing and supporting the development of programmes and plans to continue improvements to both short-term and long-term performance.

In March 2022, the Board welcomed Marcus Rink, Chief Inspector at the Drinking Water Inspectorate (DWI). Subsequent to an internal review, management developed a new planning process to better understand and manage the company's water quality risk and support long-term resilience at four of its critical water sites. The Board oversaw, supported, and approved submissions to the DWI, having previously approved the additional investment to deliver the improved performance required. The Board will continue to track performance against the plans to ensure timely delivery.

Throughout the year there has been increased scrutiny on all water companies on the operation of their storm overflows and management of discharges to the environment. The Board has ensured that it has received updates on the company's performance and endorsed and supported management's plans to continue to deliver performance improvements.

Within the reporting year, several significant operational incidents have occurred, impacting the supply of water to some of our customers. The Board ensures that it is kept up to date during these events, challenging and supporting management to ensure that key learnings are identified and acted upon, including the support provided to customers both during and after the event. Read more about the company's operational performance on pages 42 to 95.

Turnaround Plan

In April 2023, the company published its two-year delivery plan to rapidly improve performance. The Board has supported its development. It contains stretching performance targets that underpin business priorities to improve our service to customers and the environment. Alongside the plans, the CEO has strengthened his leadership team to maintain focus on driving delivery against the performance targets and building on improvements.

Long-term resilience

In addition to the company's plans for the next five-year investment period, the Board has overseen the company's water resource management planning (WRMP), including the significant Water for Life – Hampshire programme (WfLH). The Board is committed to the development of water resource plans that include innovative solutions to continue to provide a resilient water supply to its customers while protecting the important river habitats within its region.

As well as overseeing significant programmes for water, the Board oversaw and approved the Drainage and Wastewater Management Plan (DWMP), the company's strategic long-term plan for the next 25 years that sets out the investment needs to manage and reduce risks, arising from the performance of our wastewater systems, to our customers and the environment.

Holding the company to account for performance

The Board dedicates considerable time to the monitoring of performance, keeping under review activities within its remit, as will be seen from individual committee reports. The Board carries out its monitoring and oversight role as follows:

- Each committee chair reports matters considered by the committee at Board meetings.
- At each meeting the Executive team presents a reporting suite, including the CEO and CFO reports, an operational performance report of key KPIs, and a report on health and safety.
- In addition to its core meetings, the Board conducts deep dives into specific topics, with matters considered in the year including – cyber security risk, water quality and public health, the cost of living crisis and the impact on customers, the company's Health and Safety Transformation Programme and pollutions.
- The Board conducts periodic site visits to enable it to get a first-hand feel for issues and to hear the views of Southern Water colleagues.

Where performance falls below levels expected the Board will always interrogate the facts and background to the issue and will seek to give firm support to the Executive team in ensuring appropriate remedies.

Sustainability

With the formation of the ESG Committee, the Board is ensuring that it is enhancing its oversight of sustainability and that it is a key component

Corporate governance report continued

1. Competence and independence continued

within the company's vision and purpose. In addition to the matters brought to the ESG Committee, see pages 179 to 180, the Board receives regular updates on ESG matters.

Other key matters considered during the year

- Environmental Performance, as measured through the Environment Agency's Environmental Performance Assessment.
- Deep dives on water quality and public health, cost of living crisis (customer), Health and Safety Transformation Programme, non-financial regulatory performance commitments, pollutions, storm spills.
- Leakage performance.
- Customer charges, including the enhancement of the company's social tariff offering.
- Section 19 compliance and monitoring report.
- Water quality (CRI) and delivery of Final Enforcement Orders (FEOs).
- Customer service improvement plan.
- Risk management.
- Code of Ethics review.

Board evaluation

The full results of the external evaluation, carried out by Korn Ferry, were received at the end of the 2021–22 year. The focus of the Board in 2022–23 has been on embedding the changes recommended by that review. Within the reporting year, the Chair and Board have undertaken an informal review, linked to the recruitment of new appointments to the Board.

Corporate governance report continued

2. Purpose, value and culture continued

2

Purpose, values and culture

The company Board establishes the company's purpose, strategy and values, and is satisfied that these and its culture reflect the needs of all those it serves.

"The company's purpose is why it exists. Its purpose should influence all of the company's actions and the company's strategy must fulfil its purpose."

Keith Lough
7 July 2023

Our purpose:

To provide water for life to enhance health and wellbeing, protect and improve the environment and sustain the economy.

Our vision:

To create a resilient water future for customers in the South East.

Establishing Southern Water's purpose

The Board is responsible for establishing Southern Water's purpose and for ensuring that its decisions in respect of its strategy enable it to deliver this purpose. The Board and the company must stay informed and take into account the interests of a wide array of stakeholders. It must ensure that its activities, which affect matters such as support for the vulnerable, infrastructure investment, measures to protect the environment and engagement with the public to reduce water consumption, support the company's purpose.

Alignment of Southern Water's purpose with values and culture

Values dictate how a company acts when delivering its purpose. The company's culture should align with those actions in order to deliver on its purpose.

One of the key expressions of the company's values is its Code of Ethics. The code sets out the behavioural expectations for colleagues and partners, as well as showing the values guiding how Southern Water conducts its business.

The Board plays a key role in setting the tone for the business, and has consistently supported the commitment to embedding ethical business practice throughout the organisation. All Board members have signed up to the Code of Ethics, and it has been personally endorsed by the Chair and Chief Executive Officer.

The Board has continued to monitor the company's culture, building on the steps taken to ensure that the unacceptable behaviours never happen again.

Corporate governance report continued

2. Purpose, value and culture continued

A key area of focus for the Board is to monitor culture

Monitoring and assessing our culture

As reported last year, a core component of the company's cultural change programme was the development of appropriate and informative measures. These can be used to inform the Board about the culture within the organisation and the progress made in terms of the attempts to change culture for the better.

Building on the company's cultural change programme, the development of the company's Turnaround Plan supports ethical working and the alignment of culture to business outcomes.

As the company's approach has matured, the measurement of culture has continued to evolve, to enable the Board to better understand the extent to which ethical business practices have been embedded within the organisation. This includes the monitoring of the company's and individuals' behaviours, compliance and enterprise risk actions and controls.

3.89
Gallup survey score out of 5

These results provide valuable insight for the Board.

Culture Change Group

The Culture Change Group continued to meet throughout the reporting period, sharing ideas and best practice and monitoring progress against the culture measures and action plans, to further embed ethical business practice across the business.

Corporate governance report continued

2. Purpose, value and culture continued

The Board has continued to monitor the company's culture and the effectiveness of the company's **values to support ethical business practice** across the organisation

How the Board continued to monitor culture over the past year

Regular reports on Speak Up	Link to culture
The Audit Committee receives regular reports on the company's Speak Up policy, including information in respect of the number and seriousness of the reports.	By monitoring concerns raised, often anonymously, the Board is afforded insight into the potential ethical culture within the business and can take steps accordingly.
Reviewing the results of employee engagement surveys	**Link to culture**
Both the all-employee GALLUP and targeted 'pulse' surveys provide valuable insight into the attitudes within the company.	By reviewing the high-level results, the Board is informed about the level of engagement across the business. Engagement, values and ethics have a positive correlation.
Reviewing progress against the company's ED&I action plan	**Link to culture**
A series of activities has been developed to drive the company towards a leader-led organisation.	By reviewing progress against defined measures, the Board is able to fulfil its role in leading, enabling and governing inclusion in the organisation.

The Board has continued to review metrics to effectively monitor culture including:

- Employee engagement scores
- Gender hourly pay and bonus pay and gender distribution
- Near misses and employee sickness
- Pollution incidents and compliance
- Water Quality compliance
- Customer satisfaction (C-MeX) and complaints
- Speak Up (whistleblowing) reports.

Corporate governance report continued

2. Purpose, value and culture continued

Examples of ways that the Board monitors and assesses culture

Board member/group	Examples
Audit Committee	The committee receives regular reports on the company's Speak Up policy, including information in respect of the number and seriousness of the reports.
Health and Safety and Operational Risk Committee	The committee receives regular reports on health and safety matters, including the number of incidents/accidents and the culture of health and safety in the company, in particular trends with regard to 'near-miss' and hazard reporting.
ESG Committee	The committee receives regular reports on people and culture, including ED&I, employee engagement and development.
Workforce engagement non-executive director	The director meets regularly with employee forums and the company's HR team to enable him to understand the views within the organisation.

Stakeholder engagement

Throughout the year, the Board has been kept informed of the views of the company's stakeholders, including its regulators, suppliers, investors and government. The company's Chair and Chief Executive Officer regularly attend meetings with government bodies such as Ofwat, the Department for Environment, Food and Rural Affairs, the Environment Agency and Drinking Water Inspectorate.

The CEO also regularly attends meetings and other events with Water UK in respect of matters relevant to the water sector as a whole.

Further information about stakeholder engagement can be found on pages 33 to 41 and as part of the company's section 172(1) Statement on pages 96 to 99.

Employee engagement

In accordance with the UK Corporate Governance Code and in support of the Board's duty under section 172(1) to consider the interests of the company's workforce as well as part of the Board's role in its monitoring and assessing of culture, Mark Mathieson succeeded Kevin McCullough as the appointed non-executive Director with the remit of communicating the views of the company's workforce (as defined in the UK Corporate Governance Code) to the Board.

The scope of this role includes:

- Obtaining and communicating to the Board the views of the company's workforce in respect of matters, including pay and conditions; health, safety and wellbeing; working environment and culture. This enables the Board to give appropriate consideration of the interests of the workforce. Communication methods include: regular meetings with the company's workforce representatives, the HR Director, the Director of Corporate Relations and the Head of Health, Safety, Security and Wellbeing; attendance at workforce events; and visits to operational sites and offices.
- Providing regular reports to the Board.
- At least annually, meeting with the chair of the Remuneration Committee to enable the committee to take into account the conditions of the workforce when setting executive remuneration policy (in accordance with the UK Corporate Governance Code).

Following on from their success during 2022–23, during the year the Chief Executive Officer also carried out bi-monthly meetings via tele- and video-conferencing facilities with all employees invited to attend and ask any questions.

Corporate governance report continued

2. Purpose, value and culture continued

Board listening approach

Board listening channels	What this channel brings
Non-executive director for workforce engagement	This provides an opportunity for the Board to obtain information about the views of the workforce directly as opposed to via management.
Company Conversations	These provide an opportunity for all employees to directly ask questions of and communicate their concerns to the CEO.
All-employee surveys	The all-employee surveys give the Board an insight into the engagement and satisfaction levels of employees as well as insight into the culture and ethics of the organisation.

A letter from Mark Mathieson

Mark Mathieson
Non-executive Director

"Since the changes introduced by the UK Corporate Governance Code in 2018, one of the suggested methods for the Board to obtain a clearer understanding of the concerns of the workforce is to assign a non-executive director with the remit of engaging with the workforce and reporting to the Board. In 2022, I succeeded Kevin McCullough to the role to provide an important, potentially, alternative route for employees to raise concerns as well as provide a perspective on employee concerns and engagement, independent of management.

"As such, during the year, I have attended meetings with the company's human resources management and the workforce representative groups. I am pleased to see that various matters brought to the Board are discussed and tested with our Employee Voice group and other employee forum, for example the fourth value, Working with Care, and the development of the Health and Safety Transformation Programme.

"My understanding of employee engagement and concerns reinforces my work on the Health and Safety and Operational Risk Committee, and the ESG Committee."

Mark Mathieson
7 July 2023

Read more about employee engagement on pages 69 to 74.

Corporate governance report continued

2. Purpose, value and culture continued

Board activities

During the year, the Board reviewed and considered a number of key matters as part of implementing the company's strategy.

Area	What was reviewed and considered?	Link to our strategy
Business strategy The company's plan to deliver over the 2020–25 period and beyond.	The Board considered the impact of changes to the company's design and delivery of capital projects to improve the resilience of its assets as well as a move toward more proactive maintenance. In addition, the Board has approved a Turnaround Plan to deliver the company's business objectives.	Protect and improve the environment; Use water wisely; Fit for the future
The environment The company's impact on the environment.	The Board oversaw the launch of the company's storm overflow reduction programme.	Protect and improve the environment
Our customers The company's delivery for our customers.	The Board reviewed and monitored the steps taken by the company in response to the cost of living crisis, including customers in financial difficulty as well as those who are vulnerable. The company increased the minimum discount for eligible households on its social tariff from 20% to 45%.	Deliver great service; Fit for the future
Our finances The company's ability to continue to operate as a going concern and deliver its strategy.	The Board reviews the company's performance and its finances at every Board meeting. In the face of significant cost pressures over the last 18 months, including above inflation increases for energy, costs for the maintenance and upgrade of its network, as well as higher funding costs, to maintain its turnaround momentum, Southern Water has engaged with its shareholders to seek an additional £550 million of equity funding into the group. This process is expected to complete later in 2023.	Protect and improve the environment; Use water wisely; Fit for the future
Our people The health and safety and wellbeing of our workforce.	The Board reviewed the company's Health, and Safety Transformation Programme, which seeks to further embed a health and safety culture within the organisation. The Board approved the company's fourth value, Working with Care.	Deliver great service

Key:

- Deliver great service
- Use water wisely
- Protect and improve the environment
- Fit for the future

Corporate governance report continued

3. Effectiveness

3

Effectiveness

The regulated company has an effective board with full responsibility for all aspects of the regulated company's business for the long term.

"A Board must be effective if the company is to deliver its strategy and plans. In assessing its effectiveness, the Board must take steps to address areas identified for improvement."

Keith Lough
7 July 2023

An evaluation should consider the balance of skills, experience, independence and knowledge, and diversity.

Board evaluation

In line with the UK Corporate Governance Code and the Ofwat Principles, there is an annual evaluation of the Board in terms of its performance and effectiveness. Due to the major changes on the Board following the investment by funds managed by Macquarie Asset Management in 2021, it was agreed that a second successive annual external evaluation, facilitated by Korn Ferry, would take place at the beginning of 2022, notwithstanding that there was an external evaluation during 2020–21.

Typically, in accordance with listed company best practice, Southern Water conducts an externally-facilitated Board evaluation once every three years.

2020–21	External evaluation
2021–22	External evaluation
2022–23	Internal evaluation

Progress against last year's evaluation

The Board evaluation during 2022–23 was undertaken internally, and built on the external evaluation that took place in 2022.

Good progress has been made in all areas identified by the Board evaluation conducted in early 2022.

Corporate governance report continued

3. Effectiveness continued

Evaluation of the Board

The internal evaluation was based on a number of key areas to be assessed, which were defined in conjunction with senior management, and were addressed during interviews with each of the directors. These areas included: alignment with strategy and direction of the group; alignment on Board responsibilities; Board composition; directors' contributions; quality of discussions; delivery; quality of secretariat support; and effectiveness of Board committees.

Following the completion of the evaluation, the outcomes and suggested actions were presented to the Board by the Chair.

The Board also conducted an evaluation of the Chair, led by the senior independent non-executive director. The feedback from the review by the senior independent non-executive director and from the non-executive directors consulted as part of this process was positive.

Board development and training

The Board also has access to professional development provided by external bodies and by the company's professional advisers.
In the Chair's annual appraisal of the non-executive directors, he considered any specific training and development needs for the non-executive directors. The Board members individually also carry out their own training and development, such as by attending relevant seminars and workshops to ensure that their knowledge is kept up to date.

Corporate governance report continued

3. Effectiveness continued

Nomination Committee Report

Message from the Chair

It has been another full year for the Nomination Committee. There have been planned Board changes relating to the retirements of two long standing directors, Rosemary Boot and Paul Sheffield, whose terms came to an end.

The committee has been actively recruiting two new independent non-executive directors. This is in addition to the appointment of a new CEO and CFO, following the retirement of the incumbents. I reported last year that a priority of the Board for 2022–23 was to improve diversity and I am delighted that Kerensa Jennings and Christèle Delbé joined us in May 2023, alongside Phil Swift, a shareholder nominated non-executive director. All bring fresh perspectives and diversity of opinion and thought.

We have supported Lawrence Gosden in his continuing strengthening of the executive team, welcoming a new Chief People Officer, Usha Baidya, and Deborah Binks Moore as Interim Director of Corporate Relations in May 2023.

As I reported last year, an independent third-party effectiveness evaluation was undertaken towards the end of 2021–22 and we have focused on implementing the recommendations. As part of our recruitment processes, we have undertaken an informal review to ensure that the Board remains effective, while strengthening it in key areas. I have led that review, supported by Paul Sheffield as senior independent non-executive director.

Keith Lough
Chair of the Nomination Committee
7 July 2023

Committee membership

Keith Lough
Chair

Attendance 2/2

Paul Sheffield
Committee member

Attendance 2/2

Will Price
Committee member

Attendance 2/2

Note: Following the retirement of Paul Sheffield on 31 March 2023, Gillian Guy was appointed to the Nomination Committee.

Areas of focus this year:

- Selection process and appointment of new Chief Financial Officer and Chief Executive.
- Board diversity.
- Implementing the recommendations of the externally facilitated Board review.
- Selection process for two new independent non-executive directors.

Priorities for 2022–23:

- Continued focus on Board succession planning.
- Supporting the continuing drive for diversity on the Board, and within the company.
- Supporting the strengthening of the Executive team.

Corporate governance report continued

3. Effectiveness continued

Our role is to ensure an effective Board

Introduction

The Nomination Committee is responsible for reviewing the structure, size and composition of the Board and, based on the results of this review, for assessing the balance in terms of independence, skills, experience, expertise and diversity on the Board and making appropriate recommendations based on this assessment. The committee leads the process for identifying and nominating candidates to fill independent non-executive director vacancies.

Board appointment process

The Nomination Committee leads the appointment process for a new independent non-executive director based on criteria for skills, experience and knowledge, determined as a result of the committee's review of the Board's composition. The committee, typically supported by an external search firm with no connection to the business, produces a role specification and then leads the search for appropriate candidates. The preferred candidate is selected through a series of meetings between Board members and the candidate(s).

When the committee is satisfied with its preferred choice, it then recommends the appointment to the Board for approval. The candidate is also required to meet with Ofwat under the provisions of the Board leadership, transparency and governance principles. Once the candidate has met with Ofwat and, subject to receipt of approvals by the Southern Water Board and under the terms of the Shareholders' Agreement between investors in Greensands Holdings Limited, the individual is appointed as a director according to the terms published at: **southernwater.co.uk/our-story/our-governance/appointment-of-non-executive-directors**.

The Board, as a whole, supported by the Nomination Committee, appoints those individuals nominated by investors under the terms of the Shareholders' Agreement. These candidates are, as with the independent non-executive directors, required to meet with Ofwat prior to appointment.

The current Chair would not chair the committee if it was considering his succession.

Director induction

On appointment to the Board, induction coverage is agreed with each appointee and then an appropriate comprehensive and individualised induction is provided. This will include access to, and time with members of the executive and other key staff, information on the company structure, the regulatory framework of our business, customer service and the operation of assets, strategic plans, financial reports, business plans and our governance framework and holding group structure. In addition, the appointee will meet with the company's external advisers as appropriate. The appointee will also be afforded the opportunity to visit the company's sites.

Board diversity

Diversity of views and opinions in a decision-making body ensure that proposals face sufficient scrutiny and challenge, and that decisions are made based on a broad range of perspectives.

Diversity and different perspectives facilitate innovation, which is of great importance for any business. Therefore, the composition of the Board is made up of individuals from a diverse range of backgrounds, industries and professions to encourage a diverse range of perspectives. Furthermore, a Board must also reflect the communities and other stakeholders served by that business and there should be representation of different genders and of different ages, ethnic and social groups.

The Board continues to be supportive of greater representation of those historically underrepresented in senior leadership positions and seeks to, as a minimum, aim to meet the expectation applicable to listed companies that at least 25% of Board members are female. Women made up 18% of the Board (two out of 11 directors) as at 31 March 2023, and 25% of the Board (three out of 12 directors) as at 7 July 2023.

Corporate governance report continued

3. Effectiveness continued

Approach to succession planning

A considered and thorough assessment of the skills and expertise on the Board and what will be required in the future is of great importance for the long-term resilience of an organisation. The Board, assisted by the Nomination Committee, has reviewed its current array of skills and expertise as well as what is required in order to ensure that the Board continues to be effective.

Conflicts of interest and time commitments

As a matter of law as well as being able to function effectively, directors must be free of conflicts between the interests of the company and their own interests, or, where such conflicts are unavoidable, appropriate mitigations must be in place. Directors are required to declare any external interests that they or persons closely connected to them might have which could, reasonably, conflict with the interests of Southern Water. Under its Articles of Association, the Board of Southern Water is not permitted to authorise conflicts of interest.

The Board is aware of the potential for conflicts of interest in respect of the directors nominated by the investors and closely monitors this. As statutory directors, these individuals must manage any conflicts arising from their position in accordance with the provisions of the Companies Act 2006.

It is accepted that most directors will also have appointments on other boards (or similar bodies) or, in the case of non-executives, potentially also have full-time executive positions in other companies.

This is viewed positively, as it allows for a breadth of experience and enables Southern Water to take advantage of perspectives and expertise from other industries and sectors. However, the director must be able to devote sufficient time to their role at Southern Water and be able to discharge their duties effectively. Therefore, the number of external appointments of each director is kept under review. Under their terms of appointment, independent non-executive directors are expected to devote at least 24 days per year to their role.

The Board is satisfied that all directors were able to devote sufficient time and attention to their role at Southern Water throughout the year.

Corporate governance report continued

4. Transparency and accountability

4

Transparency and accountability

The Board's leadership and approach to transparency and governance engenders trust in the regulated company and ensures accountability for their actions.

"The role of the Board is to ensure the transparency and accuracy of all information published by the company. This is vital in order to build trust and confidence."

Malcolm Cooper
7 July 2023

The Board is there to make sure that the company reports transparently about its performance to markets and key stakeholders such as its regulators and customers.

The publication of financial statements and other documents is a core element of ensuring transparency and accountability on the part of the company. These disclosures must be correct and accurate, otherwise they cannot be relied upon by their respective audiences. The Audit Committee plays a key role in this process.

The committee is supported in its work by both internal and external auditors who can give independent assurance of the information presented by management.

Companies must also be transparent about the market and environment in which they operate, including the risks faced and what risks the company is willing to accept as well as its strategies for mitigation of these. Accordingly, companies need to clearly understand the risk landscape in which they operate and the Board needs to agree what level and type of risk is acceptable.

Corporate governance report continued

4. Transparency and accountability continued

Audit Committee Report

Message from the Chair

The Audit Committee has had a full agenda this year. In addition to focusing on both financial and non-financial reporting for the annual and interim financial statements, the committee has overseen the assurance for key regulatory submissions throughout the year.

The committee has continued to monitor the company's culture programme through regular updates on the Speak Up service, as well as progress against the obligations, commitments and undertakings of the company to its regulators.

Management reported the status of its IT and internal financial controls to the committee, identifying actions to address identified areas for improvement.

Malcolm Cooper
Chair of the Audit Committee
7 July 2023

Committee membership

Malcolm Cooper
Chair

Attendance 4/4

Rosemary Boot
Committee member

Attendance 3/4

Will Price
Committee member

Attendance 4/4

Note: Following the retirement of Rosemary Boot, Kerensa Jennings was appointed to the Audit Committee on 31 May 2023.

Areas of focus this year:

- Annual and interim financial statements.
- Non-financial assurance.
- Progress on undertakings and commitments given to our regulators.
- Assurance for the Price Review 2024, our Drainage and Wastewater Management Plan, Water Resource Management Plan, our submission to the Water Industry National Environment Programme and our Water for Life – Hampshire programme.
- Compliance and controls.
- Ongoing investigations and the associated accounting treatment.

Priorities for 2023–24:

- Assurance of our business plan for the period 2025–30.
- IT and internal financial controls.

Corporate governance report continued

4. Transparency and accountability continued

Introduction

The Audit Committee focuses on the monitoring and review of the company's internal controls in respect of its financial and non-financial data, as well as the controls put in place to address risk within the business in areas such as legal and regulatory compliance, and information governance and information security. The committee also oversees the relationship with the company's external auditors and oversees the work of the company's internal audit function. As reported last year, responsibility for monitoring and reviewing risk appetite and 'strategic' risks moved to the Audit Committee from the then Risk Committee. The Health and Safety and Operational Risk Committee continues to have responsibility for the monitoring of operational risk.

A primary area of focus is the company's annual and interim financial statements, including reviewing, assessing and recommending to the Board related areas including any relevant judgments and accounting treatments, going concern and long-term viability statement and 'fair, balanced and understandable' assessments, as well as reviewing and assessing the company's non-financial reports such as the Annual Performance Report.

Throughout 2022–23, the committee received regular reports from the Head of Group Accounts, Group Treasurer, Head of Internal Audit and the company's external financial and non-financial assurers and auditors. The Chief Executive Officer, Chief Financial Officer, and the company's external financial and non-financial audit partners are all regular attendees at meetings of the Audit Committee. The committee also has access, as appropriate, to external professional advisers.

The committee is comprised of a majority of independent non-executive directors. No executive directors or the Chairman of the Board may be members of the committee, and at least one member of the committee must have recent and relevant financial experience, and at least one member must also have competence in accounting and/or auditing. The Chair of the Audit Committee is also a member of the Health and Safety and Operational Risk Committee.

Work of the Audit Committee during the year

Throughout the year, the committee received regular updates on financial reporting, risk, internal audit and the company's regulatory framework.

An area of focus continues to be the company's performance in improving its internal controls and reporting in respect of non-financial information.

During the year the work of the Audit Committee focused on the following key areas:

- The company's annual and interim financial statements and going concern and viability statements.
- Non-financial regulatory reporting and improvements in processes and controls, including oversight of external assurance.
- Internal controls – including financial and IT.
- Corporate governance matters.
- Condition P.
- Annual review of Licence.
- Internal audit reports and plans.
- Oversight of internal and external audit, including an assessment of the effectiveness of the external auditor.
- Compliance with the company's legal and regulatory obligations in relation to financial and non-financial reporting.
- Water and wastewater regulatory compliance.
- Speak Up.
- The undertakings given to Ofwat as part of the regulatory settlement.
- The assurance for regulatory submissions.
- The ongoing investigations by the Environment Agency and Ofwat and the associated accounting considerations.
- The level of non-audit fees paid to the external audit firm.

Financial statements

The Audit Committee received and reviewed the financial statements, including the key areas of judgment and estimation uncertainty set out in note 2, and the external audit report from Deloitte regarding the year-end financial statements, considering any items of significant judgment that have been made and comments on the control environment. There were no significant issues raised by Deloitte. The company continues to take steps to address the matters, including the fact that Deloitte were unable to rely on IT controls, raised by Deloitte's audit and the committee will monitor progress.

Corporate governance report continued

4. Transparency and accountability continued

Unbilled revenue

There were no changes to treatment of revenue recognition in the year, nor to the underlying system for estimating the measured income accrual.

How this issue was addressed

Non-household revenues recovered further during the year, which was expected following the lifting of COVID-19 restrictions in the prior year. In total, actual billing was £7.9 million lower than the accrual made at March 2022 reflecting the fact that customer usage patterns have been harder to predict following the pandemic.

Impairment of trade receivables

The company's policy for providing for bad debt based on customer segments and the age of outstanding debt has not changed in the year and the methodology used last year was applied, on a consistent basis, to calculate the base underlying provision charge for the full year accounts.

How this issue was addressed

At March 2022, an additional provision charge of £10.3 million recognised as a judgment for the impact of the pressure on household finances from high inflation and the wider economy.

Across 2022–23 we did not experience a significant change to customer payment behaviour. However, given that the pressure on household finances is continuing the Committee agreed with managements decision to retain an amount for this issue within the provision.

We applied a consistent approach to the prior year to estimate the value for the provision to carry for this, ranking our customer segments as high, medium or low risk and generating a provision based on this. This is a significant judgment for these accounts and has resulted in a provision charge of £9.6 million being retained at March 2023.

Provisions and contingent liabilities

The investigation by the Environment Agency (EA) into wastewater sampling compliance and the separate industry wide investigations by Ofwat and the EA wastewater treatment works are ongoing.

How this issue was addressed

The Audit Committee has considered the status of these investigations along with advice from internal and external legal advisors in order to assess whether it would be appropriate to make a provision or disclose the matters as a contingent liability. Given the status of the investigations, the Committee concluded that it was appropriate to disclose them as a contingent liability, see note 33 to these accounts.

Going concern

The committee considered the going concern assessment for the company with specific consideration of whether the company should disclose a material uncertainty in its going concern statement.

How this issue was addressed

The committee reviewed the current financial projections of the company for the going concern period and the progress made and likely timing of new equity. It noted that the company only has sufficient liquidity to support its plans for part of the year and is reliant on the injection of new equity to fully support its financial projections. As a result, the committee concluded that it would be appropriate to disclose a material uncertainty in the going concern statement.

Viability statement

We have continued to use the period through to 2030 for the viability assessment.

How this issue was addressed

The committee reviewed the company's viability assessment and agreed for this to be made for the period to 2030 for this year. Please see pages 133 to 136 for our statement.

Corporate governance report continued

4. Transparency and accountability continued

Our Ofwat performance commitments

The company has an external non-financial assurer to independently assure its non-financial reporting to Ofwat and that there is a robust system of internal controls in place for non-financial regulatory reporting, such that information in the Annual Performance Report fairly represents the company's progress and delivery of its promises. The assurer attends meetings of the Audit Committee and reports formally the results of its assurance.

Section 19 Undertakings

As part of the regulatory settlement reached with Ofwat in 2019–20, the company agreed to certain undertakings to implement improvements in the business in areas such as culture and robustness of non-financial reporting, as well as to recompense current and former customers. The Audit Committee is responsible for monitoring and reviewing the controls and assurance put in place by management in respect of these undertakings and receives regular reports from management about the progress against the agreed action plans and from the company's external assurers in respect of such progress.

Internal controls

The committee keeps under review the internal financial controls systems of the company that identify, assess, manage and monitor financial risks along with other internal control and risk management systems and, accordingly, receives regular reports from both Internal Audit, external audit and any external assurers appointed by the company to review any particular areas of concern.

The committee receives a regular report of any incidents of fraud or bribery, including the actions taken to investigate and respond to the incidents and information on potential incidents of wrongdoing under investigation.

The committee is provided with updates on matters identified via the company's Speak Up policy. There were no material incidents reported via Speak Up during the year.

The committee is also aware of the need to ensure that the group complies with sanctions placed on individuals and organisations in Belarus and Russia following the invasion of Ukraine.

Oversight of internal audit and external audit

The Audit Committee is responsible for overseeing both the work of the Internal Audit function and for the management of the relationship with the external auditor and external non-financial assurer. The committee reviews the performance of external auditors on an annual basis to ensure that they remain effective.

In accordance with best practice, the committee held discussions with both the internal and external auditors and the external non-financial assurers in the absence of management and the Audit Committee will continue this practice.

Internal audit

The Lead Audit Manager and the team report on a day-to-day basis to management on the effectiveness of the company's systems of internal controls and the adequacy of these systems to manage business risk and to safeguard the company's assets and resources.

The committee received regular reports throughout the year from Internal Audit in respect of its work during the year in accordance with the internal audit plan agreed with the committee at the beginning of the year. The reports from Internal Audit are a material element of the assurance received by the committee on the company's controls. If changes are required to internal audit action dates for medium and high actions, the action owners are required to attend the committee and explain why such changes are required and to seek the committee's approval.

The committee reviews, at least annually, the level of resources and the budget of the Internal Audit function. The Head of Internal Audit is able to raise any issues with the committee or its Chair at any time during the year.

Corporate governance report continued

4. Transparency and accountability continued

Fair, balanced and understandable

At the request of the Board, the committee has considered whether, in its opinion, this Annual Report and Financial Statements, taken as a whole, is fair, balanced and understandable and whether it provides the information necessary for shareholders to assess the company's position, performance, business model and strategy.

Step 1 – Developing key themes

The initial themes and structure for the Annual Report are developed, taking into account feedback from Ofwat and other stakeholders as well as a 'best practice' review.

Step 2 – Drafting content

Subject matter experts are identified to provide the detailed information used to draft the content for each section of the Annual Report.

Step 3 – Review

The draft content is reviewed by the subject matter experts, the project team, legal team and members of the Executive team.

Step 4 – Assessment

The content of the report is reviewed to determine which statements are 'positive' and which are 'negative'. These are then extracted and provided to the Audit Committee organised by section and/or subject for it to review the key areas of the report for fairness, balance and understandability.

Step 5 – Decision

Based on the content provided to it as well as their own reading of the draft Annual Report, the Audit Committee members make their decision whether or not to advise the Board that the Annual Report, taken as a whole, is fair, balanced and understandable.

Risk

During the year, the Audit Committee was responsible for supporting the Health and Safety and Operational Risk Committee's work in overseeing and challenging the effectiveness of Southern Water's approach to risk management. This included responsibility for monitoring the effectiveness of the company's systems of internal controls and for endorsing an internal audit plan that is informed by principal risk exposures, including overseeing targeted reviews of key risk and control areas. Following the changes to the committee remit in February 2022, the Audit Committee is now responsible for monitoring and reviewing the company's risk appetite and tolerance and for more 'strategic' risks.

The committee is also responsible for maintaining an assurance landscape that has integrity, independence and reliability.

External auditor

As reported last year, a tendering exercise was carried out in 2020–21 with Deloitte LLP being re-appointed as the external auditor. During 2022–23 the audit partner, Delyth Jones, was replaced by Lucy Openshaw.

The Audit Committee reviews the external auditor's effectiveness each year, seeking views from the committee and management via a questionnaire, and would report to the Board any concerns over the continuation of the appointment.

The committee undertakes an annual review of the external auditor's independence and objectivity within the context of the applicable regulatory requirements and professional standards. This includes an assessment of the impact of any non-audit work carried out by the audit firm on the auditor's independence and objectivity. In the committee's view the external auditor met these criteria. The committee also monitored the ratio of audit fees to non-audit fees and approved non-audit services and fees paid to Deloitte during 2022–23.

Details of the amounts paid to Deloitte for these services are provided in note 6 to the financial statements.

In accordance with listed company practice, the external audit contract will be put to tender at least every 10 years. A tender process would also be initiated if there were any concerns about the quality of the audit or the independence and objectivity of the auditor. There are no contractual obligations that act to restrict the Board's choice of external auditor, although the Board is mindful of non-audit services currently being undertaken by other potential external audit providers.

Corporate governance report continued

4. Transparency and accountability continued

Health and Safety and Operational Risk Committee Report

A key area of focus for the Health and Safety and Operational Risk Committee (HS&ORC) has been oversight of the development of the company's Health and Safety Transformation Programme, together with tracking progress throughout the year.

The committee regularly received updates on accelerating and emerging risks as well as key risks impacting business performance. The committee reviewed the company's principal risks.

A number of deep dives were also performed into areas of the business, including water resources and drought, water quality and pollutions, winter readiness and cyber security.

Management presented its business readiness for the 2022–23 winter, with mitigation actions drawn from the impact of the storms of 2018 (Beast from the East) and 2022 (Storm Eunice).

Mike Putnam
Chair of the Health and Safety and Operational Risk Committee
7 July 2023

Committee membership

Mike Putnam
Chair

Attendance 4/4

Kevin McCullough
Committee member

Attendance 1/1

Malcolm Cooper
Committee member

Attendance 1/2

Mark Mathieson
Committee member

Attendance 4/4

Note: Kevin McCullough resigned from the Board and the committee on 31 July 2022. Phil Swift was appointed to the committee on 31 May 2023.

Areas of focus this year:

- Development of the company's Health and Safety Transformation Programme
- The company's plans for winter readiness
- Cyber security
- Water quality risk pollutions.

Priorities for 2023–24:

- Progress against the Health and Safety Transformation Programme
- Health and Safety Culture.

Corporate governance report continued

4. Transparency and accountability continued

Introduction

The Health and Safety and Operational Risk Committee has responsibility for monitoring and advising on day to day operational risks, together with reviewing and monitoring health, safety, security and wellbeing, and continuing to provide appropriate advice and recommendations to the Board in this area. The Chief Executive Officer, Chief Operating Officer, Director of Health, Safety, Security and Wellbeing and Head of Risk and Assurance are all regular attendees at meetings of the committee. The committee also has access, as appropriate to external professional advisers.

The committee is comprised of a majority of independent non-executive directors. The Chair of the Audit Committee is also a member of the Health and Safety and Operational Risk Committee to ensure there are no gaps in the remits of the two committees.

Health, safety, security and wellbeing

In addition to receiving updates on the company's health and safety performance, the committee oversaw the development of the company's Health and Safety Transformation Programme. This programme was developed by management having regard to the findings of the review undertaken by a third-party advisory firm and the outcome of an Ambition Workshop held with 40 colleagues from across the organisation. The committee received regular updates on progress of the programme.

The committee received an update on the company's Gold, Silver and Bronze award scheme to set and raise site standards and celebrate success, together with a demonstration of software to support point of work risk assessments.

In taking steps to improve the safety culture of the business, the company identified an absence of a specified safety core value. A fourth value, Working with Care, was developed to support the company's commitment to ensuring that everyone returns home safe and healthy at the end of the working day. The new value was piloted through the company's Employee Voice group and presented to the committee for their consideration before approval was sought from the Board.

Operational Risk

During the year the committee received reports from management to enable it to monitor and review the company's operational risks and relevant risk management systems. Updates included winter preparedness, water quality risk, IT controls, security and cyber security. A risk management update is presented at each meeting, providing the committee with details of the company's Enterprise Risk Management (ERM) framework and practice within Southern Water. The committee received updates on the enterprise risk profile, and the current risk position and emerging risk. The Full Enterprise Risk Report is provided to the Audit Committee.

Operational risk deep dives on key areas were presented to the committee, including the deep dives on water quality, flow and pollutions.

Corporate governance report continued

4. Transparency and accountability continued

ESG Committee Report

Message from the Chair

As reported last year, the Board approved the formation of an Environmental, Social and Governance Committee, tasked with supporting the Board in defining the company's strategy and reviewing priorities and initiatives relating to ESG matters.

The committee met for the first time within the reporting year, chaired by Rosemary Boot. With Rosemary's resignation from the Board, I am pleased to present, as both a member and now Chair of the committee, this report.

Throughout the year, the committee has reviewed and challenged the effectiveness of the company's ESG strategies, priorities and initiatives. An assessment of ESG confirmed management's view that the company is at differing levels of maturity and ambition across the ESG universe. Management is focused on prioritising ESG strategic ambitions and tactical activities and to develop maturity in aspects most closely aligned with the company's long-term goals and stakeholders' expectations.

The committee received updates from management, including on the company's progress against its Equality, Diversity and Inclusion (ED&I) action plan, covering the development of a gender action plan to improve both recruitment and retention of women across the organisation.

The committee was pleased to hear from the Chair of the company's Independent Climate and Environment Group (ICEG) and a representative of the Customer Challenge Group, sharing viewpoints from the company's customers and stakeholders.

Gillian Guy
Chair of the ESG Committee
7 July 2023

Committee membership

Rosemary Boot
Chair

Attendance 4/4

Gillian Guy
Committee member

Attendance 1/4*

Mark Mathieson
Committee member

Attendance 4/4

Note: Following Rosemary Boot's retirement from the Board and the committee on 31 March 2023, Gillian Guy was appointed chair.
On 31 May 2023 Christèle Delbé and Kerensa Jennings were appointed to the committee.

* Meeting schedule clashed with previously agreed commitments.

Areas of focus this year:

- Development of the ESG strategy.
- Net zero plans.
- Diversity targets and gender action plan.

Priorities for 2023–24:

- Climate-related risks and opportunities.
- Monitoring diversity and inclusion activities and outcomes.
- Review of ESG-related reporting.

Corporate governance report continued

4. Transparency and accountability continued

Introduction

In its first year, the ESG Committee has received updates on a broad spectrum of ESG-related topics, challenging and supporting management on the development of the company's plans. The committee received an update on the status of the company's published ESG policies and ESG-related reports.

Environment

The committee received updates on the work of the Environment Steering Group and the company's climate change action plan, and heard directly from the Chair of the Independent Climate and Environment Group. It also reviewed the company's net zero plans and considered strategy in this area. Read more about the company's approach to climate change on pages 75 to 95.

Culture

Building on the work of the Board in prioritising the monitoring of culture across the organisation, the Committee received an update on the results of the annual employee engagement survey. Overall satisfaction returned to the 2021 level, with 'My manger cares about my wellbeing' seeing the strongest result.

Plans to address the gender imbalance at senior management levels have been developed and a deep dive on the company's ED&I vision and ambition was presented to the committee. Progress against the company's People plan, which is an enabler to the overall turnaround plan, is reported to the committee.

Customer

Hearing the views of our customers and the impact the company's operations have on them is important to the committee. A representative of the company's Customer Challenge Group attended the committee to provide insight into customer and stakeholder views. In addition, an update on customer insights was presented, explaining how the company ensures it understands the views of its customers, communities and key stakeholders.

The committee received an update from management on operational incidents that had impacted customers in the year, including customer feedback and the company's response and recommendations for improvement.

The committee heard about the approach to engaging customers and communities when commencing large capital projects, including understand the impact such schemes have.

Our approach to governance

Ofwat principles

In 2019 Ofwat published its Board leadership, transparency and governance principles and, subsequently, in July 2019, amended the licences of water and wastewater companies to require such companies to meet the objectives set out in the Ofwat Principles.

The Ofwat Principles represented a major update of the previous principles published in 2014 and include many of the principles and provisions of the Financial Reporting Council's (FRC) UK Corporate Governance Code. Accordingly, Southern Water seeks to apply both the Ofwat Principles and the relevant principles and provisions of the UK Corporate Governance Code in terms of its approach to corporate governance.

The Ofwat Principles are based around four objectives (set out below), each of which is supported by a number of provisions designed to assist companies in demonstrating that they are meeting the relevant objective.

1 Competence and independence

Boards and their committees are competent, well run, and have sufficient independent membership, ensuring they can make high-quality decisions that address diverse customer and stakeholder needs.

	Objective/provision	Compliant	Page(s)
	Boards and their committees are competent, well run, and have sufficient independent membership, ensuring they can make high-quality decisions addressing stakeholder needs.	Yes	140, 146, 148-153, 156
i.	i. Boards and board committees have the appropriate balance of skills, experience, independence and knowledge of the company. Boards identify what customer and stakeholder expertise is needed in the boardroom and how this need is addressed.	Yes	140-145, 154-155, 168-170
ii.	Independent non-executive directors are the largest single group on the board.	Yes	146, 156
iii.	The chair is independent of managers and investors on appointment and demonstrates objective judgment throughout their tenure. There is an explicit division of responsibilities between running the board and executive responsibility for running the business.	Yes	149, 153-155
iv.	There is an annual evaluation of the performance of the board. This considers the balance of skills, experience, independence and knowledge, its diversity, how stakeholder needs are addressed and how the overarching objectives are met. The approach is reported in the annual report and any weaknesses are acted on and explained.	Yes	166, 168-170
v.	There is a formal, rigorous and transparent procedure for new appointments which is led by the Nomination Committee and supports the overarching objective.	Yes	168-170
vi.	To ensure there is a clear understanding of the responsibilities attached to being a non-executive director in this sector, companies arrange for the proposed, final candidate for new non-executive appointments to the regulated company board to meet Ofwat ahead of a formal appointment being made.	Yes	169
vii.	There is a majority of independent members on the Audit, Nomination and Remuneration Committees and the Audit and Remuneration Committees are independently led.	Yes[1]	168, 172, 186

[1] The membership of the Nomination and Remuneration committees is: the Chair, one independent non-executive director and one non-executive director. The Chair, while not independent under the UK Corporate Governance Code is independent of management and the shareholders, and was independent on appointment.

Our approach to governance continued

2 Purpose, values and culture

The regulated company board establishes the company's purpose, strategy and values, and is satisfied that these and its culture reflect the needs of all those it serves.

Objective/provision	Compliant	Page(s)
The regulated company board establishes the company's purpose, strategy and values, and is satisfied that these and its culture reflect the needs of all those it serves.	Yes	162-165
i. The board develops and promotes the company's purpose in consultation with a wide range of stakeholders and reflecting its role as a provider of an essential public service.	Yes	162-163
ii. The board makes sure that the company's strategy, values and culture are consistent with its purpose.	Yes	162-165, 178-180
iii. The board monitors and assesses values and culture to satisfy itself that behaviour throughout the business is aligned with the company's purpose. Where it finds misalignment it takes corrective action.	Yes	160-165, 179-180
iv. Companies' annual reporting explains the board's activities and any corrective action taken. It also includes an annual statement from the board focusing on how the company has set its aspirations and performed for all those it serves.	Yes	138-139, 148, 160-161, 165

3 Effectiveness

The regulated company has an effective board with full responsibility for all aspects of the regulated company's business for the long term.

Objective/provision	Compliant	Page(s)
The regulated company has an effective board with full responsibility for all aspects of the regulated company's business for the long term.	Yes	140-146, 148-159, 166-167, 168-170
i. The regulated company sets out any matters that are reserved for shareholders or parent companies (where applicable), and explains how these are consistent with the board of the regulated company having full responsibility for all aspects of the regulated company's business, including the freedom to set, and accountability for, all aspects of the company's strategy.	Yes	116, 148-149
ii. Board committees, including but not limited to Audit, Remuneration and Nomination Committees, report into the board of the regulated company, with final decisions made at the level of the regulated company.	Yes	151, 158
iii. The board of the regulated company is fully focused on the activities of the regulated company; takes action to identify and manage conflicts of interest, including those resulting from significant shareholdings; and ensures that the influence of third parties does not compromise or override independent judgment.	Yes	148-150, 156, 169-170

Our approach to governance continued

4 Transparency and accountability

The board's leadership and approach to transparency and governance engenders trust in the regulated company and ensures accountability for their actions.

Objective/provision	Compliant	Page(s)
The board's leadership and approach to transparency and governance engenders trust in the regulated company and ensures accountability for their actions.	Yes	148, 171-176
Regulated companies publish the following information in a form and level of detail that is accessible and clear for customers and stakeholders:		
i. An explanation of group structure;	Yes	116-119
ii. An explanation of dividend policies and dividends paid, and how these take account of delivery for customers and other obligations (including to employees);	Yes	110
iii. An explanation of the principal risks to the future success of the business, and how these risks have been considered and addressed;	Yes	120-132
iv. The annual report includes details of board and committee membership, number of times met, attendance at each meeting and where relevant, the outcome of votes cast; and	Yes	140-145, 168, 172, 177, 179, 186
v. An explanation of the company's executive pay policy and how the criteria for awarding short and long-term performance-related elements are substantially linked to stretching delivery for customers and are rigorously applied. Where directors' responsibilities are substantially focused on the regulated company and they receive remuneration for these responsibilities from elsewhere in the group, policies relating to this pay are fully disclosed at the regulated company level.	Yes	186-201

Find more information at **ofwat.gov.uk**

Directors' Remuneration Report

Remuneration Committee Report

Chair's Annual Statement

I am pleased to present the Remuneration Committee's report for the year to 31 March 2023.

I was appointed to the Committee on 1 May 2023 and, although not a member of the Remuneration Committee during the reporting year, I make this statement having reviewed all relevant matters of the committee members in post during that time.

I would like to thank Paul Sheffield, who retired from the Board and the Remuneration Committee on 31 March 2023, for his stewardship of remuneration matters as Chair of the Remuneration Committee. Paul has supported the committee in handing over his knowledge to me. I also welcome Mike Putnam and Christèle Delbé to the committee, joining, respectively, 1 May 2023 and 31 May 2023. Keith Lough will step down from the committee on 31 July 2023. I intend to support the committee as chair for the next year or so, before handing over to the new chair.

One of the purposes of the Remuneration Committee is to put in place the incentive and retention structures that allow Southern Water to drive performance delivery and improvement across a broad and balanced set of outcomes. These outcomes are shaped to deliver benefits for our customers, the environment and our shareholders, while encouraging our employees to align with the high ethical values of the company of 'doing the right thing'. In delivering this purpose, the company takes advice on an ad-hoc basis where necessary and is supported by the Company Secretary. It also takes account of guidance and regulation from, among others, Ofwat. In addition to its broader purpose, the main focus of the Remuneration Committee is to set remuneration for the company's executives, always aligned to the broader purpose.

Summary of the year

2022–23 has seen further significant challenge for the company during a period of transition. Ian McAulay was replaced as CEO by Lawrence Gosden on 1 July 2022; Nadim Ahmad replaced Sebastiaan Boelen as Interim CFO and was in place from 31 July 2022 to 3 January 2023. Stuart Ledger was appointed as CFO with effect from 3 January 2023. All of these changes and the respective implications on reported remuneration are set out in this report.

The company's turnaround, led by Lawrence Gosden, will take time to deliver the ambitious targets that have been set. Those ambitious targets were embodied in stretching remuneration KPIs, with customers, the environment and shareholders at their heart. As noted below, for 2022–23 the remuneration outcomes for the executives and for the company as a whole have reflected the challenges in meeting the targets, although the Board and the Remuneration Committee recognises the significant effort that everyone in the company makes.

Throughout the year, and within this context, the Remuneration Committee reviewed the remuneration policy, committee terms of reference and base and variable pay arrangements and satisfied itself on their application.

In setting bonus arrangements for the coming years, the Remuneration Committee has followed Ofwat guidance and best practice. In addition to the continuing Annual Bonus Plan, the committee has finalised a longer-term incentive plan for key executives to deliver outcomes to the end of the asset management period.

Remuneration outcomes for 2022–23

The metrics agreed for the 2022–23 year were designed to deliver operational performance and better outcomes for customers, the environment and shareholders alike. They embodied ESG principles and were compliant with the undertakings given by the company to Ofwat in October 2019.

In a year where targets were not met, the Remuneration Committee is satisfied that the remuneration KPIs have tracked

Directors' Remuneration Report continued

Remuneration Committee Report continued

business performance and that with two exceptions, no bonus has been earned under the remuneration KPIs. CRI has reduced significantly year on year and there was a small reward based on the target. Of particular note, the Remuneration Committee determined that the company's health and safety transformation has been judged to have made good progress and that this produces a reward for everyone in the company.

The detailed bonus outturn and how this translates to outcomes for the executive directors is set out in the detailed report. As has been announced previously, both Lawrence Gosden and Stuart Ledger have declined the bonus that had been earned under the terms of the Annual Bonus Plan for 2022–23 on the basis that customer and environmental outcomes have not been met. Additionally, Lawrence Gosden has declined the 6% cost of living salary increase, which otherwise he would have been eligible to receive.

As has been reported in previous years, bonus awards relating to years prior to the reporting year, under the previous bonus scheme applicable to the executive directors, the Incentive and Retention Plan, had been deferred into a bonus pool with the balance being paid to each executive in July 2023, subject to the rules of the scheme. Details of payments to the executive directors are set out in the report. The Remuneration Committee exercised its discretion under the rules of the scheme to withhold 100% of payments to Ian McAulay and Sebastiaan Boelen that otherwise would have been due to be paid.

Malcolm Cooper
Chair of the Remuneration Committee

7 July 2022

Directors’ Remuneration Report continued

Remuneration Committee Report continued

Introduction

This report details the activities of the Remuneration Committee for the period to 31 March 2023. It sets out the remuneration policy and remuneration details for the executive and non-executive directors of the company. It has been prepared in accordance with the Corporate Governance Code, the Ofwat Board, Leadership, Transparency and Governance Objectives and Principles, the guidance issued by Ofwat in Regulatory Accounting Guidance (RAG 3.14) and, where relevant for a non-listed company, has taken into account the requirements of the Companies Act 2006 and the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.

The Remuneration Committee of Southern Water

The Remuneration Committee has the responsibility for setting the remuneration policy and structure of the executive directors and senior executives. It is also responsible for setting the remuneration of the Chair. The committee has defined terms of reference, which are published at **southernwater.co.uk/board-committee-terms-of-reference**. These have been reviewed and revised during the year.

We recognise that the independent non-executive directors have an important role to play in determining and challenging remuneration policy and practice. In order to reflect this, the independent non-executive directors are a majority on the committee. The Chair of the company is considered independent for these purposes; he will step down from the committee on 31 July 2023.

Only committee members are entitled to attend meetings, with the Chief Executive Officer and Chief Financial Officer attending by invitation. The Company Secretary acts as secretary to the committee.

No attendee participates in discussions regarding their own remuneration.

Committee membership during the period 1 April 2022 to 31 March 2023

Paul Sheffield
Chair
Attendance 4/4

Keith Lough
Committee member
Attendance 4/4

Will Price
Committee member
Attendance 4/4

Note: Following Paul Sheffield's retirement from the Board and the committee, Malcolm Cooper and Christèle Delbé were appointed to the committee on 1 May 2023 and 31 May 2023 respectively, Malcolm as chair.

Directors' Remuneration Report continued

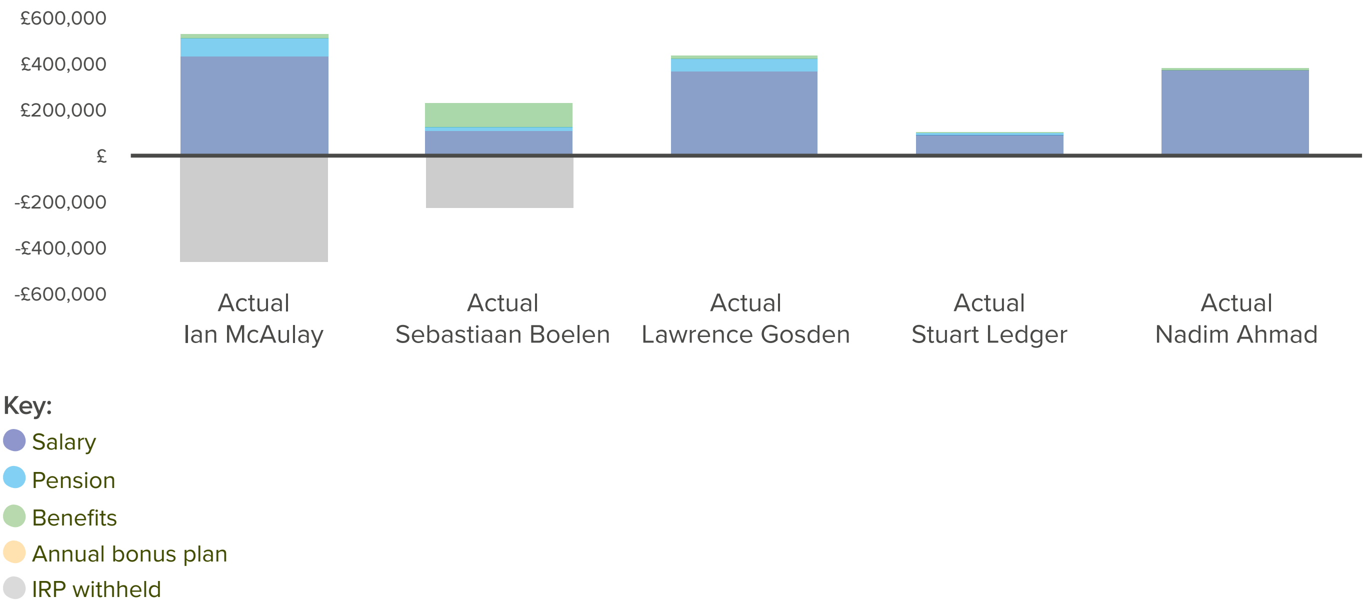
Remuneration Committee Report continued

Remuneration at a glance

Key objectives

Providing transparent alignment between performance-related pay and quality, customer and environmental outcomes	Governance, risk management and rigorous application	Applying stretching targets linked to customer and environmental outcomes

Single total figure of remuneration for executive directors for year ended 31 March 2023



Note: The chart presented above includes the impact of the Remuneration Committee's decision to exercise its discretion to withhold payments to Ian McAulay and Sebastiaan Boelen previously awarded under the Incentive and Retention Plan.

Executive directors' remuneration policy

Elements of executive directors' pay

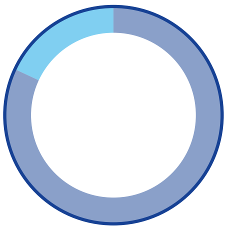
Element	Aspects
Base salary	Attracts and retains executives of the quality required to deliver our strategy.
Annual Bonus Plan	Drives and rewards performance against stretching financial, customer and operational KPIs, which are directly linked to business strategy.
Pension	Defined contribution scheme.
Other benefits	Provides market competitive benefits.
Release of historic balances in Incentive and Retention Plan	Former bonus plan, now closed.

Directors' Remuneration Report continued

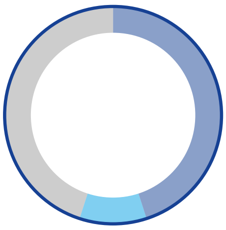
Remuneration Committee Report continued

Ian McAulay

2022–23



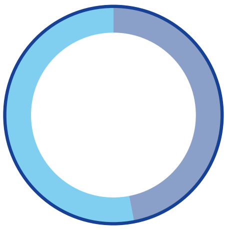
2021–22



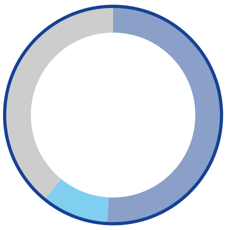
	2022–23	2021–22
Fixed	**100%**	**55%**
Base Salary	82%	45%
Pension and other benefits	18%	10%
Performance linked	**0%**	**45%**
Annual bonus	0%	45%

Sebastiaan Boelen

2022–23



2021–22

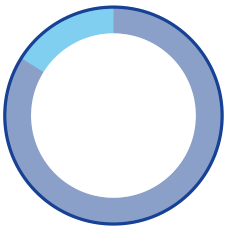


	2022–23	2021–22
Fixed	**100%**	**61%**
Base Salary	47%	51%
Pension and other benefits	53%	10%
Performance-linked	**0%**	**39%**
Annual bonus	0%	39%

Note: the charts above for Ian McAulay and Sebastiaan Boelen exclude the impact of the Remuneration Committees decision to withhold payments previously awarded under the IRP.

Lawrence Gosden

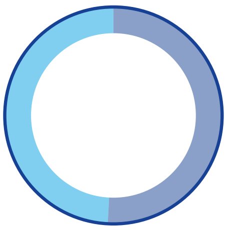
2022–23



	2022–23
Fixed	**100%**
Base Salary	84%
Pension and other benefits	16%
Performance-linked	**0%**
Annual bonus	0%

Stuart Ledger

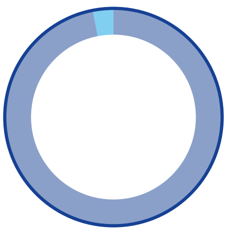
2022–23



	2022–23
Fixed	**100%**
Base Salary	51%
Pension and other benefits	49%
Performance-linked	**0%**
Annual bonus	0%

Nadim Ahmad

2022–23



	2022–23
Fixed	**100%**
Base Salary	97%
Pension and other benefits	3%
Performance-linked	**0%**
Annual bonus	0%

Directors' Remuneration Report continued

Remuneration policy applicable in year (unaudited)

Purpose

This remuneration policy applies to all Southern Water employees. The Board of Directors has adopted the remuneration policy at the recommendation of the Remuneration Committee. This policy applies to remuneration earned from 1 April 2022 to 31 March 2025. This was reviewed during the reporting period and will be reviewed again during the current period.

Providing transparent alignment between performance-related pay and quality customer outcomes

The policy reflects the Board's commitment to being open and transparent in respect of executive pay and to follow Ofwat and other relevant guidance. The Board has also committed during the year to ensuring that performance-related executive pay has a clear alignment to delivering stretching performance improvement, which is in the interests of customers as well as providing sustained and long-term value creation for shareholders and other stakeholders by:

- setting stretching performance targets that are based on the performance ambitions set out in our business plan
- ensuring that targets and metrics have a substantial and demonstrable link to stretching performance delivery and quality outcomes that align with the interests of customers and the environment
- transparently reporting how performance-related executive pay is linked to the underlying performance of the company
- embedding behavioural competence built around company values to underpin the cultural change and instil a way of working that will increase employee engagement and therefore productivity
- ensuring employees feel encouraged to create sustainable results and that a clear link exists between customers, shareholders and employees' interests
- ensuring that performance payments do not compromise employees' compliance with the Ofwat Section 19 requirements
- aligning pay to the market-median position, recognising the need, from time to time, to implement specific arrangements for certain individuals
- ensuring employees are offered a competitive and market median-aligned remuneration package, which balances the fixed and variable remuneration components according to job role
- ensuring that Southern Water is able to attract, develop and retain high-performing and motivated employees in a competitive market.

The table on page 191 summarises the elements of our executive directors' remuneration package and our policy for each item.

Governance, risk management and rigorous application

The Board applies sound and effective risk management principles to ensure that the policy is rigorously monitored and applied through:

- the application of good corporate governance by taking into account regulatory requirements and, among others, the UK Corporate Governance Code and any corporate governance principles issued by its regulator, Ofwat, from time to time
- a stringent governance structure for setting relevant and stretching goals, which are aligned to customer outcomes, and communicating these goals to employees
- clear alignment with our business strategy, company values, priorities and long-term goals
- during the year, the Remuneration Committee consisted of two independent non-executive directors and one non-executive director and no executive directors. The Remuneration Committee now consists of four independent non-executive directors (one of whom, Keith Lough, will step down on 31 July 2023) and one non-executive director. This avoids any conflicts of interest and aligns the principle of protection of customers, the environment and investors.
- a commitment to the transparent reporting of executive pay within our Annual Report and Financial Statements, and any other channels as appropriate in accordance with legal and regulatory requirements, including the Ofwat Board leadership, transparency and governance principles
- a commitment to transparently report any changes to the policy, including the underlying reasons, within the Annual Report and Financial Statements, and any other channels as appropriate
- an annual review of the constitution and terms of reference of the Remuneration Committee to maintain its operational effectiveness and publishing these on our website for transparency
- ensuring the ongoing effectiveness of the Board and its committees through regular external and independent evaluation.

Directors' Remuneration Report continued

Remuneration policy applicable in year (unaudited) continued

Applying stretching targets linked to customer outcomes

The Board sets stretching bonus targets linked to outcomes for customers and the environment that require equivalent stretching performance. The Board is committed to setting more than 50% of bonus targets that are linked to customer outcomes, which have additional benefits to the environment. For 2022–23 these included five ODI performance commitment outcomes (pollution incidents, internal flooding incidents, leakage, C-MeX and water quality compliance).

Customers would also have benefited from performance against the financial metric, designed to drive financial efficiency.

The Health and Safety Transformation Programme, which is a key element of focus, was subject to stretching targets to ensure appropriate focus.

All of the targets were subject to adjustment factors to reflect the company's focus on operational performance.

All metrics were used throughout the organisation so that all company employees are incentivised to achieve stretching levels of customer service. Additionally, senior executives had stretching personal objectives, which influence remuneration outcomes.

Executive remuneration components

Executive remuneration comprises both fixed and variable elements with the four remuneration components detailed as follows:

- Fixed remuneration (including fixed supplements)
- Performance-based remuneration (variable percentage of salary)
- Pension schemes, where applicable
- Other benefits in kind (e.g. car allowance and private medical cover).

The fixed remuneration is determined on the basis of the role and position of the individual employee, including professional experience, responsibility, job complexity and local market conditions and is benchmarked against industry peer groups.

The performance-based remuneration motivates and rewards those employees who significantly contribute to sustainable results, perform according to set expectations for the individual in question, strengthen long-term delivery of quality outcomes for customers and generate income and shareholder value.

The Board of Directors has determined a maximum percentage of performance-based remuneration relative to the fixed salary remuneration for the executive management positions. The table below shows the maximum limit on variable remuneration (excluding any pension allowance) for the CEO and CFO for 2022–23.

	CEO	CFO
Total range of variable remuneration	0% – 150%	0% – 150%

Performance-based remuneration is disbursed as a cash bonus. For 2022–23, the Annual Bonus Plan was introduced, with any resulting payment being made in July 2023. Both the CEO and the CFO have declined to accept an annual bonus in respect of the 2022–23 financial year.

Note that for 2023–24, a new long-term incentive plan for senior executives is being introduced – see page 201.

Executive directors are covered by an insured four times salary 'death in service' lump sum benefit and a contribution to a personal pension arrangement. The CEO currently receives a 15% of base salary contribution rate and the CFO receives 11%. Where retirement savings have exceeded the Lifetime Allowance (as defined by HMRC for their circumstances) the employer contribution may instead be taken as a pay supplement, subject to the relevant tax and National Insurance deductions.

The policy is that remuneration should be market-competitive relative to other comparable companies, with a significant proportion being performance-related. The performance-related element is only paid out if stretching targets are achieved that benefit both customers and shareholders. In setting the remuneration policy for executive directors, the committee takes into account the remuneration practices found in other UK companies of a similar size or operating in the same sector. It also ensures that the remuneration arrangements for the executive directors are appropriate when compared with those for other senior executives and the wider workforce. Attracting and retaining first class leadership is vital to the long-term success of the company.

Directors' Remuneration Report continued

Remuneration policy applicable in year (unaudited) continued

In particular, the committee is kept informed on a regular basis of the following, which it uses to set executive remuneration policy:

- The level of salary increase for the general employee population
- Benefit provision and any proposed changes
- Overall spend on management bonus
- The gender pay gap across the company.

An investor representative non-executive director sits on the committee and as such is involved in setting remuneration levels, monitoring the performance of the executive directors, agreeing payments and approving any changes to executive reward packages. This involvement ensures that shareholders play a key part in shaping remuneration policy and decisions. Along with the independent non-executive directors they ensure that the link between pay and performance is closely managed.

To ensure that our remuneration practices remain competitive, the committee periodically calls upon experienced specialist consultants.

Remuneration components

Element of remuneration	Purpose and link to strategy	Policy and approach	Maximum opportunity 2022–23
Base salary	Takes into account experience and personal contribution to our strategy and performance. Attracts and retains executives of the quality required to deliver our strategy.	• Reviewed annually with changes effective from 1 July, if applicable (1 April with effect from 2023–24 reporting year). • Consideration given to individual and company performance. • General pay increases to all employees taken into consideration. • Aim to pay within a mid-market range, but may pay higher salaries to attract and retain executives of the right calibre or for out-performance by the individual or company. • Referenced against UK companies of a similar size, utility companies and other water companies.	Base salary increases are applied in line with the annual review.
Annual Bonus Plan	Drives and rewards performance against stretching financial, customer and operational KPIs, which are directly linked to business strategy.	• Details of the operation of the plan are shown on page 192. • Performance metrics and targets are established annually by the committee, making sure they are sufficiently stretching, while also recognising the nature and risk profile of the company. • Where applicable, 25% of the opportunity available for each measure is created for achieving a threshold target. 100% is awarded for achieving the actual target, with stretch targets creating 120% for achieving outstanding performance. • The committee has discretion to amend or withdraw payments based on the consideration of other factors which could significantly affect business performance. • Plan awards are disclosed on pages 194 to 195.	150% of salary for the CEO and CFO
Pension	Defined contribution scheme minimises the risk to the company associated with defined benefit pension plans.	• A company contribution into a defined contribution scheme, and/or • A cash allowance in lieu of pension.	CEO 15% of salary CFO 11% of salary

Directors' Remuneration Report continued

Remuneration policy applicable in year (unaudited) continued

Element of remuneration	Purpose and link to strategy	Policy and approach	Maximum opportunity 2022–23
Other benefits	Provides market competitive benefits.	May consist of: • Car allowance • Health cover • Disturbance or relocation allowances.	Based on individual circumstances.

Notes to the policy table

Directors' pay

Executive directors who served during the 2022–23 year are shown below:

Lawrence Gosden	Chief Executive Officer (appointed 1 July 2022)
Ian McAulay	Chief Executive Officer (resigned 30 June 2022)
Stuart Ledger	Chief Financial Officer (appointed 3 January 2023)
Nadim Ahmad	Interim Chief Financial Officer (appointed 31 July 2022, resigned 3 January 2023)
Sebastiaan Boelen	Chief Financial Officer (resigned 31 July 2022)

Details are given on page 194 of the amounts paid to them in the year ended 31 March 2023.

Operation of the Annual Bonus Plan

Under the Annual Bonus Plan, participants have had the opportunity to earn an annual bonus based on both performance against targets pre-determined by the Board and on achievement of personal objectives. Any resulting award is paid out to participants in cash in July 2023. Both the CEO and the CFO have declined to accept an annual bonus in respect of the 2022–23 financial year.

Measures used in the Annual Bonus Plan

During the year, the Remuneration Committee identified and operated performance measures that support customer and environmental performance as well as transforming our plan to keep our employees safe and healthy at work and also for delivering financial performance for the company, such as:

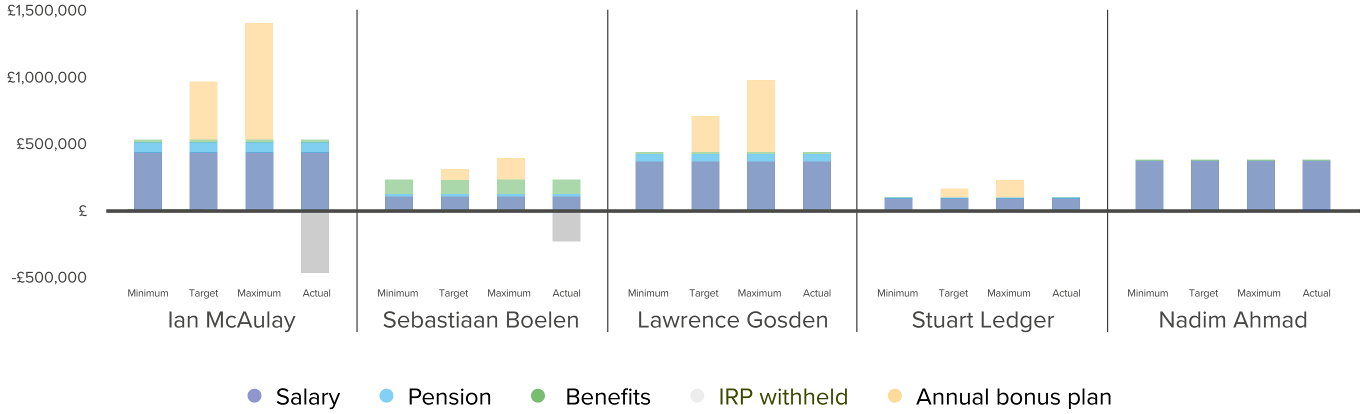
- Pollution incidents
- Internal sewer flooding incidents
- Leakage
- Water quality compliance
- Customer satisfaction, as measured by our C-MeX performance
- Delivery against our Health and Safety Transformation Programme
- Delivery of certain financial performance measures.

Directors' Remuneration Report continued

Remuneration policy applicable in year (unaudited) continued

Remuneration scenarios for 2022–23

The following chart sets out the remuneration scenarios for each of the executive directors for various levels of performance as well as the actual remuneration for 2022–23.



Notes: 'Target' performance is the level of performance required for the annual bonus plan to pay out at 50% of maximum.
The chart presented above includes the impact of the Remuneration Committee's decision to exercise its discretion to withhold payments to Ian McAulay and Sebastiaan Boelen previously awarded under the Incentive and Retention Plan.

Notice periods

The table below sets out the contractual notice periods for the executive directors. If the notice period is worked, no termination payment is payable, otherwise a payment up to a maximum equivalent to the notice period of basic salary, pension and car allowance is payable.

	Notice period
Lawrence Gosden, CEO	12 months by either party
Stuart Ledger, CFO	12 months by either party

Directors' Remuneration Report

Annual remuneration report

Single figure of remuneration for 2022–23 (audited)

Details of the remuneration received by the executive directors are shown below. The figures shown are the amounts paid or awarded for each of these financial years. Base salary is generally reviewed in July each year and so the amounts reported for base salary reflect a part-year effect of any pay award granted.

£'000		Base salary paid	Benefits	Annual Bonus Plan[1]	Incentive and Retention Plan[2]	Incentive and Retention Plan withheld[2]	Investment transaction incentive[3]	Total	Pension related benefit	Total including pension
Lawrence Gosden[4]	**2022–23**	**360.0**	**13.7**	–	**–**	**–**	**–**	**373.7**	**54.0**	**427.7**
	2021–22	–	–	–	–	–	–	–	–	–
Stuart Ledger[5]	**2022–23**	**87.5**	**73.0**	–	**–**	**–**	**–**	**160.5**	**9.6**	**170.1**
	2021–22	–	–	–	–	–	–	–	–	–
Ian McAulay[6]	**2022–23**	**435.0**	**18.9**	–	**–**	**(474.3)**	**–**	**(20.4)**	**78.3**	**57.9**
	2021–22	435.0	18.5	–	435.0	–	435.0	1,323.5	78.3	1,401.8
Sebastiaan Boelen[7]	**2022–23**	**106.7**	**104.8**	–	**–**	**(229.4)**	**–**	**(17.9)**	**16.0**	**(1.9)**
	2021–22	302.3	14.6	–	234.8	–	300.0	851.7	45.3	897.0
Nadim Ahmad[8]	**2022–23**	**371.3**	**10.0**	**–**	**–**	**–**	**–**	**381.3**	**-**	**381.3**
	2021–22	–	–	–	–	–	–	–	–	–

1 Southern Water makes a performance related bonus based on the delivery of specific targets set out within the scheme. In line with the scheme, the Remuneration Committee assessed performance for the Annual Bonus Plan for 2022–23 and made an award of £97,638 to Lawrence Gosden and £19,307 to Stuart Ledger for those targets that were met as set out on page 196. In recognition of environmental and customer expectations Lawrence Gosden and Stuart Ledger have declined the awards made to them for 2022–23.

2 Under the Incentive and Retention Plan, any amount earned was added to the bonus pool for the year and payments are then made out of the bonus pool. As noted in the committee chair's introduction, the Remuneration Committee exercised its discretion under the rules of the scheme to withhold 100% of payments to Ian McAulay and Sebastiaan Boelen for bonuses awarded in prior years under the scheme that otherwise would have been due to be paid in July 2023, as set out in the table. This scheme has now been closed.

3 In 2021–22, the executive directors were incentivised to support a successful outcome to the investment transaction whereby funds managed by Macquarie Asset Management invested £530 million to recapitalise the company. These payments were not paid for by customers.

4 Salary, benefits, pension and bonus figures for Lawrence Gosden reflect part-year earnings and are for the period from 1 July 2022 when he was first appointed to the Board. As noted above, Lawrence Gosden has not accepted a bonus in respect of the period 2022–23.

5 Salary, benefits, pension and bonus figures for Stuart Ledger reflect part-year earnings and are for the period from 3 January 2023 when he was first appointed to the Board. His benefits include an amount of £65,446 as compensation for loss of vested LTIP benefit from his previous employer in respect of periods prior to 1 April 2022. A further equivalent payment of £39,989 is due in July 2024. As noted above, Stuart Ledger has not accepted a bonus in respect of the period 2022–23.

6 Ian McAulay resigned as an executive director on 30 June 2022 but continued to receive salary and benefits up to the end of his required notice period being 31 March 2023.

7 Sebastiaan Boelen resigned as an executive director on 31 July 2022. His benefits for 2022–23 are pro-rated to this date. Benefits include a payment of £100,000 agreed as compensation for extending his contract while a successor was appointed. Payments for loss of office are shown in the table below and include an amount of £159,833 for pay in lieu of notice.

£'000		Base salary paid	Benefits	Pay in lieu of notice	Total	Pension related benefit	Total including pension
Sebastiaan Boelen[7]	**2022–23**	**–**	**43.9**	**159.8**	**203.7**	**24.0**	**227.7**

8 Nadim Ahmad served as an executive director for the period from 31 July 2022 to 3 January 2023 and his benefits for 2022–23 are pro-rated for this period. He was appointed on an interim basis.

Directors’ Remuneration Report continued

Notes to the single figure of remuneration (unaudited)

Annual Bonus Plan

The performance measures agreed by the Committee for 2022–23 were:

- Pollution incidents
- Internal sewer flooding incidents
- Leakage
- C-MeX – measuring customer experience
- Water quality compliance
- Health, Safety, Security and Wellbeing – ensuring our employees are kept safe and healthy at work
- Controllable Opex
- Role specific personal objectives.

The following adjustment factors apply:

Additional award/penalty for pollution incidents:

- For every quarter with 2 or more Category 2 pollution incidents a -2.5% Annual Bonus Plan penalty applies, with a maximum -10% penalty for the year
- For every quarter with 1 or more Category 1 pollution incidents a -5% Annual Bonus Plan penalty applies, with a maximum -20% penalty for the year
- If there are no Category 1 or 2 incidents during the year, an extra +20% Annual Bonus Plan bonus applies.

In the event that C-MeX target is met but there is no improvement on 16th ranking, a 50% penalty on that individual KPI outturn applies.

If, at the financial year end, the 12-month rolling average Lost-Time Accident Frequency Rate is above 0.39, a 2.5% Annual Bonus Plan penalty applies. If it is above 0.45, the Annual Bonus Plan penalty increases to 5%. If it falls below 0.31, the company will make a charitable donation. Starting position at 1 April 2022 was 0.39.

If there is an employee or contractor fatality, the Remuneration Committee has discretion to reduce Annual Bonus Plan award to zero.

All targets are considered to be compliant with the company’s section 19 Undertakings given to Ofwat in October 2019 and to drive positive compliance with environmental permits and performance more generally.

These KPIs apply to all employees throughout the company in relation to different bonus schemes.

The performance for 2022–23 was assessed by the committee in May 2023. Details of the maximum bonus achievable, targets and outturn percentage for each executive director are shown in the tables below. Both Lawrence Gosden and Stuart Ledger have declined to take the bonus awards for 2022–23.

CEO and CFO	Maximum bonus achievable	Outturn %	Outturn as a % of salary
Annual Bonus Plan performance outturn	150%	14.71%[1]	22.07%

Directors' Remuneration Report continued

Annual Bonus Plan 2022–23	2022–23	Threshold performance level (25%)	Target performance level (100%)	Stretch performance level (120%)	Performance[1]	Weighting (% of salary)	Outturn (% of salary)
Pollution Incidents	Performance	265	189	151	358	15.0%	0.0%
Internal Sewer Flooding	Performance	428	315	252	496	15.0%	0.0%
Leakage	Performance	95	94.3	88	98.9	15.0%	0.0%
C-MeX	Performance	72.5	73.5	77	69.77	7.5%	0.0%
Water Quality Compliance	Performance	6.0	4.0	2.0	6.38	22.5%	0.0%
Health & Safety	Performance	Satisfactory	Good	Excellent	Good	15.0%	15.0%
Controllable Opex	Performance	£491.3m	£457.0m	£422.7m	£559.8m	37.5%	0.0%
Personal objectives	Performance	Satisfactory	Good	Excellent	7.5%[2]	22.5%	11.25%
Total						150.0%	**26.25%**
Adjustments[3]							-4.18%
Total awarded							**22.07%**

1 Where the performance has been based on the latest forecast position available at the time, any subsequent changes to the final outcome position will be adjusted for in the following performance year and in accordance with the Annual Bonus Plan scheme rules. In particular, the Pollution Incidents figure of 358 is subject to review.

2 The outcome was adjudged by the committee as between satisfactory and good, 95% performance.

3 There was a positive adjustment of +7.07% in the outturn in respect of Water Quality Compliance, where an in-year change in DWI methodology, which came into effect in May 2022, resulted in a 0.55 adjustment to the year-end outturn from 6.38 to 5.83. There was also a negative adjustment of -11.25% in the outturn due to there being one quarter where there were two Category 1 pollution incidents and two quarters where there were two Category 2 pollution incidents. See the notes above as to these adjustments.

The threshold, target and stretch bonus percentages shown reflect the level of bonus award for achievement of the threshold, target and stretch performance levels for each metric.

Both the CEO and the CFO have declined to accept an annual bonus in respect of the 2022–23 financial year.

Incentive and Retention Plan closure

As has been reported in previous years, bonus awards under the previous bonus scheme applicable to executives, the Incentive and Retention Plan, had been deferred into a bonus pool with the balance being paid to each executive in July 2023, subject to the rules of the scheme.

As noted in the Committee Chairman's introduction, the Remuneration Committee exercised its discretion under the rules of the scheme to withhold 100% of payments to Ian McAulay and Sebastiaan Boelen that otherwise would have been due to be paid. The amounts were, respectively, £474,300 and £229,400.

Directors' Remuneration Report continued

Pension contributions

The pension contribution for the executive directors, for the period they served on the Board, is set out in the table below:

Pension	Salary received (£'000)	Pension contribution as a % of base salary	Cash allowance in lieu of pension (£'000)	Pension contribution to scheme (£'000)	Total Pension related benefit (£'000)
Lawrence Gosden	360.0	15%	54.0	–	54.0
Stuart Ledger	87.5	11%	9.6	–	9.6
Ian McAulay	108.8	18%	18.6	1.0	19.6
Sebastiaan Boelen	106.7	15%	12.0	4.0	16.0

Following the closure of the company's defined benefit pension scheme to future accrual and the introduction of a new defined contribution scheme for the company's workforce, the Remuneration Committee reviewed the pension contribution payable to the executives. In doing so, it also considered the expectation in Provision 38 of the UK Corporate Governance Code that the pension contributions payable to the executive directors are aligned to that of the workforce. Accordingly, it was agreed that from 1 April 2020, the employer pension contributions offering for new executive director appointments would be aligned to the 'all employee' rate of 11%. Lawrence Gosden's pension contribution is based on the previous executive director level, which was applicable at the time of his recruitment into the business in a different role and is therefore treated as a continuous term and condition of employment.

Directors' Remuneration Report continued

Non-executive director fees for the year (audited)

The Chair and the non-executive directors each receive a fee and do not participate in any performance-related incentive arrangements. The investor-nominated non-executive director does not receive any remuneration from the company.

The Board as a whole is responsible for setting the level of non-executive director fees and in doing so receives input from the Remuneration Committee.

Details of the emoluments received by the Chair and non-executive directors are shown below:

	2022–23			2021–22		
£'000	Fees	Other	Total	Fees	Other	Total
Keith Lough (Chair)	**286.3**	**10.1**	**296.4**	275.0	3.9	278.9
Paul Sheffield (Senior independent non-executive director) (Retired 31 March 2023)	**73.8**	**2.1**	**75.9**	70.0	0.6	70.6
Rosemary Boot (Independent non-executive director) (Retired 31 March 2023)	**62.9**	**1.4**	**64.3**	50.0	1.1	51.1
Mike Putnam (Independent non-executive director)	**63.8**	**2.1**	**65.9**	60.0	0.6	60.6
Dame Gillian Guy DBE (Independent non-executive director)	**53.8**	**2.2**	**56.0**	50.0	0.3	50.3
Kevin McCullough (Independent non-executive director) (Retired 31 July 2022)	**22.1**	**0.3**	**22.4**	65.0	0.7	65.7
Malcolm Cooper (Independent non-executive director)	**68.8**	**0.6**	**69.4**	65.0	0.7	65.7
Steve Fraser (Investor-nominated non-executive director) (from 1 May 2022)	**49.6**	**3.8**	**53.4**	n/a	n/a	n/a
Marykay Fuller (Greensands Board-nominated non-executive director) (to 8 September 2021)	n/a	n/a	n/a	26.3	0.1	26.4
Martin Bradley (Investor-nominated non-executive director) (from 8 September 2021 to 1 May 2022)	–	–	–	–	–	–
Will Price (Investor-nominated non-executive director) (from 8 September 2021)	–	–	–	–	–	–
Mark Mathieson (Investor-nominated non-executive director) (from 8 September 2021)	–	–	–	–	–	–
Sara Sulaiman (Investor-nominated non-executive director) (to 8 September 2021)	n/a	n/a	n/a	–	–	–

The base fees for the non-executive directors are £55,000.

In May 2022, the Remuneration Committee reviewed the fees paid to the Chair and independent non-executive directors, comparing the fee data between 2014–15 and 2020–21 of a number of other companies in the sector. Following this review, the Remuneration Committee agreed to increase the Chair's fees from £275,000 to £290,000 with effect from 1 July 2022.

The same data was subsequently presented to the Board at its May 2022 meeting, at which it was agreed to increase the base fees of non-executive directors from £50,000 to £55,000 per annum with effect from 1 July 2022, noting that there had been no increase since 2014. The Board also agreed that a responsibility supplement should be paid to the Chair of the newly-formed ESG Committee, Rosemary Boot, with effect from 1 May 2022.

Directors' Remuneration Report continued

The table below provides details of applicable responsibility payments for 2022–23.

	Chair and date of appointment	Responsibility supplement	Comments on supplement
Audit Committee Chair	Malcolm Cooper 23 December 2019	£15,000	
Health, Safety and Operational Risk Committee Chair	Mike Putnam 1 July 2019	£10,000	
Remuneration Committee Chair	Paul Sheffield 1 April 2015	£10,000	
ESG Committee Chair	Rosemary Boot 1 May 2022	£10,000	Introduced with effect from 1 May 2022
Senior independent non-executive director	Paul Sheffield 1 April 2015	£10,000	

The other amounts payable to the non-executive directors include taxable expenses incurred in connection with attendance at Board meetings and shareholder events.

None of the directors who held office during the financial year had any disclosable interests in the shares of Southern Water or the group; there are no share options in place and no payments were made to them by any other group companies.

Gender pay (unaudited)

Creating an environment to enable a diverse and inclusive workforce will have a positive effect on our organisation and this is a key part of Southern Water's People Strategy.

Our median pay gap is -3.32%, meaning that it is in favour of women. The median gives a strong indicator of 'average' earnings as it is not skewed by a few individuals earning at high or low levels, which can be true of the mean.

Our mean hourly pay gap has decreased by 2.22% to 2.58%. In 2021 the hourly pay gap had increased by approximately two percentage points from the previous year so this has now been reversed. The underlying reason for this is the movement in the gender balance in senior roles. There is a higher proportion of females in Upper and Upper Middle quartiles than in previous years.

The company will continue to focus on increasing the diversity of our workforce through our recruitment and attraction approach, inclusive development programmes and ensuring that all of our people have an opportunity to grow and develop their career with us.

For more information, see the report on our gender pay gap at **southernwater.co.uk/gender-pay-gap**.

Creating a workplace where all of our people feel they belong

We have deliberately designed our diversity and inclusion approach and outcomes to be understandable, actionable and deliverable. We have created a clear vision that communicates our intent to consciously recognise and value our differences, ensuring that all of our people feel they belong and that we succeed together. So far we have made significant progress against our action plan and have welcomed external recognition through our position as an Inclusive Top 50 UK employer for the third year in a row. We are currently ranked 44 out of 50 which is an increase on the previous year. In terms of pay, we are committed to ensuring that we have a fair pay structure and that we have processes in place to make sure we have a consistent and fair approach. We recognise that while we do not have all the answers, we are keen to learn and grow, valuing the different experiences and perspectives that our people bring.

Directors' Remuneration Report continued

Executive pay gap reporting

From 2020 onwards, the Companies (Miscellaneous Reporting) Regulations 2018 require all publicly-listed companies with more than 250 UK employees to publish the ratio between their CEOs full time equivalent remuneration and that of employees at the 25th, 50th and 75th percentile when total remuneration is calculated and ranked from lowest to highest.

Although not a listed company, Southern Water has chosen to publish this information in line with our commitment to providing information about pay diversity and fairness within our organisation.

The regulations set out three options for calculating the pay ratio.

- Option A – takes into account all forms of remuneration and payments (pension etc)
- Option B – uses the gender pay calculation figures
- Option C – uses some other method

Our ratio has been calculated using 'Option A' as this takes into account full remuneration and is therefore the most comprehensive comparison.

Year	Method	25th Percentile Ratio	50th Percentile Ratio	75th Percentile Ratio
2022	A	**23:1**	**18:1**	**14.1:1**
2021	A	43.4:1	34.3:1	26.6:1

The calculation is based on total remuneration between April 2022 and March 2023, our current CEO has been in post since 1 July 2022, this will have impacted the reduction in ratio as a comparison against 2020–21. The 2021–22 measure spiked because of a special bonus made on completion of the Macquarie Acquisition to some of our senior managers, including our CEO.

An internal Remuneration Committee exists, made up predominantly of non-executive directors, which is responsible for setting and agreeing salary arrangements for the Executive Leadership Team and ensuring that arrangements for this group are in line with the strategic direction of the organisation and managed fairly in the context of the organisation.

Executive remuneration within Southern Water is in line with the structure of remuneration for the wider population. The main elements of remuneration are salary, bonus and pension contributions. Other taxable benefits are included i.e. health benefits and car benefits.

Salary is benchmarked with the external market for all roles, including members of the Executive Team. Salary increases in the Executive leadership are made in line with the budget and principles applied in other areas of the organisation subject to approval by the Remuneration Committee.

Implementation of policy for 2023–24 (unaudited)

Base salary

The base salaries for each executive director are as follows:

Base salary	Base salary for 2022–23 (£'000)	Base salary increase (%)	Base salary from 1 April 2023 (£'000)
Lawrence Gosden	480.0	0%	480.0
Stuart Ledger	350.0	6%	371.0

Note: Lawrence Gosden has declined the 6% cost of living salary increase which otherwise he would have been eligible to receive.

Directors' Remuneration Report continued

Annual Bonus Plan and Long-Term Incentive Plan

The Annual Bonus Plan (ABP) is based on performance conditions designed to focus the executive directors on the areas of key strategic importance for the company. As such, the performance conditions will be strongly aligned with delivering customer and environmental outcomes and associated appropriate behaviours, while ensuring that the company continues to strengthen its financial position in the interests of customers and stakeholders alike.

We have fully committed to comply with Ofwat's code of practice for executive remuneration for 2020–25 and our Remuneration Policy sets out:

- our policy to provide transparent alignment between executive performance-related pay and stretching outcomes for all our stakeholders and, substantially, for our customers
- our policy to apply stretching targets linked to customer outcomes
- our policy to apply rigorous application of incentive scheme rules and provide independent governance of remuneration decisions, while taking into consideration risk management principles
- our policy to defer an element of bonus so that performance can be measured over the medium to long term.

Our performance measures for 2023–24 will focus on positive outcomes for our customers and other stakeholders

In determining the performance measures for 2023–24, the Remuneration Committee considered the expectation under the Ofwat Principles that the company's performance-related elements should be linked to stretching delivery for customers, as well as the steps needed to further embed the Ofwat code of practice for executive remuneration. It was agreed that the following measures will be used to assess our performance:

Annual Bonus Plan objectives

- Five Ofwat PR19 ODI performance commitments (Pollution incidents; Internal sewer flooding incidents; Leakage; CSS score from C-MeX and Water quality compliance – notice delivery)
- Health and Safety Transformation Programme
- Cash spend

Scheme adjustment factors

Additional award/penalty for pollution incidents:

- For every quarter with two or more Category 2 pollution incidents a -2.5% ABP penalty applies, with a maximum -10% penalty for the year
- For every quarter with one or more Category 1 pollution incidents a -5% ABP penalty applies, with a maximum -20% penalty for the year
- If there are no Category 1 or 2 incidents during the year, an extra 20% ABP bonus applies.

If, at the financial year end, the 12-month rolling average Lost-Time Accident Frequency Rate is above **0.27**, there is a 2.5% ABP penalty. If it is above **0.35**, the ABP penalty increases to 5%. If it falls below **0.25**, the company will make a charitable donation. Starting position at 1 April 2023 was **0.27**.

If there is an employee or contractor fatality, the Remuneration Committee has discretion to reduce the ABP award to zero.

All targets are considered to be compliant with the company's section 19 Undertakings given to Ofwat in October 2019 and to drive positive compliance with environmental permits and performance more generally.

The above targets will apply to the whole company. Further adjustments are reserved to the committee for executives within its remit relating to individual and financial performance.

LTIP and objectives applicable from 1 April 2023 to 31 March 2025

The introduction of the new Long-Term Incentive Plan for executives within the committee's remit was delayed by one year to allow the new Turnaround Plan to be finalised and to ensure KPIs are aligned with that plan. The applicable objectives are focused as follows:

- EPA
- CRI
- C-MeX
- Financial
- PR24 Final Determination.

Awards, weightings, targets and adjustment factors along with actual performance, will be fully disclosed in the 2023–24 Remuneration Report.

Directors' report

for the year ended 31 March 2023

The Directors of Southern Water Services Limited (registered no. 02366670) present their report and the audited financial statements for the year ended 31 March 2023.

Principal activities

The principal activities of Southern Water Services Limited, herein after referred to as 'the company', also referred to as SWS, are the provision of water supply and wastewater services in the South East of England. The company is regulated by the Water Services Regulation Authority (Ofwat) and supplies water to over 2.7 million people and provides wastewater services to over 4.7 million people.

Strategic Report

The information that fulfils the requirement of the Strategic Report can be found in our Annual Report on pages 15 to 136 including the Section 172 (1) Statement on pages 96 to 99.

Future developments

The information regarding future developments of the company can be found in our Annual Report on pages 17, 50, 56, 64 and 72.

Post balance sheet events

On 7 July 2023 Fitch announced its decision to downgrade the Class A Unwrapped Debt of the Company to BBB (negative outlook) from BBB+ (negative outlook). As a consequence of the Fitch credit rating action, a credit rating downgrade Trigger Event has occurred. Further details regarding the implications of a Trigger Event can be found on page 113.

Results and dividends

The income statement on page 210 shows the company's results and loss for the year. Further details are also available in the Annual Report on pages 104 to 109.

No ordinary interim dividends were paid during the year (2022: £nil). No final dividend has been declared or paid for the year ended 31 March 2023.

Directors and their interests

Directors during the year ended 31 March 2023 and up to the date of signing the financial statements, were as follows (details on pages 140 to 145):

Keith Lough
Chair

Lawrence Gosden
(Executive director – Chief Executive Officer)
(Appointed 1 July 2022)

Ian McAulay
(Executive director – Chief Executive Officer)
(Resigned 30 June 2022)

Stuart Ledger
(Executive director – Chief Financial Officer)
(Appointed 3 January 2023)

Nadim Ahmad
(Executive director – Interim Chief Financial Officer)
(Appointed 31 July 2022, Resigned 3 January 2023)

Sebastiaan Boelen
(Executive director – Chief Financial Officer)
(Resigned 31 July 2022)

Paul Sheffield
(Senior independent non-executive director)
(Resigned 31 March 2023)

Rosemary Boot
(Independent non-executive director)
(Resigned 31 March 2023)

Malcolm Cooper
(Independent non-executive director)

Gillian Guy
(Independent non-executive director)

Kevin McCullough
(Independent non-executive director)
(Resigned 31 July 2022)

Michael Putnam
(Independent non-executive director)

Christèle Delbé
(Independent non-executive director)
(Appointed 31 May 2023)

Kerensa Jennings
(Independent non-executive director)
(Appointed 31 May 2023)

Phil Swift
(Independent non-executive director)
(Appointed 31 May 2023)

Directors' report

for the year ended 31 March 2023 continued

Martin Bradley
(Investor-nominated non-executive director)
(Appointed 8 September 2021,
resigned 1 May 2022)

Will Price
(Investor-nominated non-executive director)
(Appointed 8 September 2021)

Mark Mathieson
(Investor-nominated non-executive director)
(Appointed 8 September 2021)

Stephen Fraser
(Investor-nominated non-executive director)
(Appointed 1 May 2022)

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

Research and development

Improvement of existing services and processes, together with the identification and development of new technology and solutions, are important aspects of the company's strategy to enhance the quality of service to customers and improve ways of working. Research and development expenditure charged to the income statement for the year amounted to £0.6 million (2022: £0.8 million).

Financial risk management

The Financial Risk Management Policy is included in the Strategic Report which can be found in the Annual Report on page 128.

Corporate governance

A description of the company's corporate governance arrangements for the purposes of Part 8 of Schedule 7 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 as introduced by regulation 14 of the Companies (Miscellaneous Reporting) Regulations 2018 can be found in the Annual Report on pages 147 to 183.

Employees

The company recognises the importance of its employees and is committed to effective two-way communication and consultation.

The company re-established an Employee Voice group during 2020–21 to facilitate meaningful consultation between company management and employees through elected employee representatives. The group meets regularly at both a functional and company-wide level.

In 2017, the company introduced the Gallup employee survey, which has continued to be undertaken every six months to help develop management action plans and provide insight into the views of employees. The company also conducts further surveys throughout the year on specific matters, the results of which are reported to management and/or the Board as appropriate.

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

General information is posted on the company intranet and regular team briefing sessions are also held. The information in these publications and briefings covers a wide range of subjects that affect the business, including progress on business and capital projects, the impact of regulatory issues and wider financial and economic issues.

The company's Executive directors and Executive Committee members as well as, occasionally, individual non-executive directors hold monthly 'Company Conversations', using video conferencing, to inform and engage with the company's employees about the company's priorities, purpose and values. These sessions afford employees an opportunity to put questions to the executive directors and senior leadership about anything regarding the business.

In line with the UK Corporate Governance Code, one of the company's independent non-executive directors, Mark Mathieson, has been given the remit of communicating the views of the company's workforce to the Board.

Further details of the company's employees and the company's engagement activities, as well as how the directors have had regard to employee interests, can be found in the Strategic Report on pages 69 to 74.

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

Directors' report

for the year ended 31 March 2023 continued

Health, safety, security and wellbeing: The health, safety, security and wellbeing of our people is our priority and colleagues are encouraged to challenge anything they believe may be wrong or potentially dangerous. Empowerment forms a crucial part of our safety strategy as does making safety the first thing we consider when conducting any activity. Our June 2023 Policy Statement reaffirms our position and provides clear direction from the CEO on how we approach health, safety, security and wellbeing within the business.

Our focus on prioritising safety is linked to the delivery of our Health and Safety Transformation Programme, progress against which is discussed at monthly Safety Executive Committees and with members of the Executive at monthly programme boards. This seeks to deliver a step change in our approach by embedding cultural, behavioural, process and system improvements. We are on track to deliver in 2023 and regularly review our position, ambitions and initiatives through quarterly external audits.

We continue to ensure that every employee receives training, instruction and supervision to deliver their role, proportionate to the specific level of risk. These requirements are frequently reviewed with the delivery of accredited NEBOSH and IOSH Health and Safety training, and the development of modern site safety instructions and supply chain training courses are recent examples of this.

Our well-established forums, including Employee Voice and our Speak Up line, are used to share safety information and we distribute regular safety cascades and immediate safety alerts to ensure our colleagues are appraised of incidents and mitigations. We are moving to an online Safety Reporting System in 2023 that should make this passage of information even better.

The company provides an internal occupational health service for employees, including the provision of physiotherapy and support through the Employee Assistance line. In 2023, we will deliver strategic review of Wellbeing and security to ensure our people remain well supported.

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

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

Engagement with customers, suppliers and others

The company recognises the importance of its suppliers to ensure the company's ability to continue to deliver an essential public service. Further details of the company's engagement with its suppliers during the year can be found on pages 69 to 74.

Due to the nature of its business and the regulatory framework in which the company operates, engagement with its customers is of key importance. The company undertakes extensive customer engagement activities throughout the year. Further details can be found on pages 33 to 39.

As a private limited company, Southern Water Services Limited is not required to hold an annual general meeting.

The company, its senior executives and Board regularly engage with the company's regulators, with local and national government as well as with relevant industry groups through meetings and other events.

The company's statement explaining how the directors have had regard to the matters set out in section 172(1)(a) to (f) of the Companies Act 2006, and which provides further detail in respect of how the directors have taken into account the interests of the company's employees, suppliers, customers and others during the year, can be found on pages 96 to 99.

Environmental issues

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

The company is subject to ongoing investigations by the Environment Agency regarding wastewater performance and further details are disclosed in note 33 to the accounts.

Directors' report

for the year ended 31 March 2023 continued

The company's environmental performance for 2022–23 is reported on pages 59 to 68. The company recognises its responsibility to operate within a framework that supports sustainable development and has established, where possible, indicator targets which are measurable. Performance against these targets is monitored and reported regularly.

Streamlined Energy and Carbon Report (SECR)

The Streamlined Energy and Carbon Report is included within the TCFD section of the Strategic Report on pages 93 to 95.

Political donations

No political donations were made.

Land and buildings

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

Going concern

The directors believe, after due and careful enquiry, that it is appropriate to adopt the going concern basis in preparing the financial statements to 31 March 2023 notwithstanding the material uncertainty discussed below.

The company incurred an operating loss of £18.4 million (2022: profit of £16.1 million) in 2023. As of 31 March 2023, it had cash on hand of £115.8 million (31 March 2022: £157.4 million) and undrawn bank facilities of £435.0 million (2022: £375.0 million). The company also has borrowings totalling £4,221.0 million (31 March 2022: £4,017.7 million), for which the earliest repayment is £400 million in March 2025. In 2022–23 borrowings attracted a total monthly cash interest charge of circa £6.1 million.

The borrowings are subject to financial ratio covenants measured annually in March, as well as the covenants relating to credit rating of debt issued by the company and its subsidiaries. A breach of these covenants can result in either a Trigger Event or a Default Event.

A Trigger Event is a structural buffer intended to protect the company and its finance creditors from a Default Event. If a Default Event were to occur, all lenders' claims are frozen, and they have the right to exercise their security of a charge over the share capital of the parent company of SWS (see how the company is financed on page 119).; The main consequence of a Trigger Event is that the company is prevented from making distributions. It is also required to prepare a plan to recover from a Trigger Event.

Should a Default Event occur, the business enters a 'standstill period'. Committed and undrawn reserves of £190 million are available to finance the business during this period, but there would however be restrictions on the company's operations, including the cessation of capital investment expenditure.

In assessing the going concern position of the company, the directors considered the forecast cash flows over the 12 months to July 2024, and the capital structure of the company and financing needs for the period. The directors have considered a base case and various sensitivities in establishing that in order to meet the company's commitments over and above its obligations under PR19 price determination, it is necessary to raise additional capital as set out below.

Base case – forecast cash flows

The company has a significant level of planned expenditure over at least the next twelve months to continue to enhance its assets and improve operational performance. The company is also facing the effect of high inflation, particularly on costs such as energy, chemicals, and materials. As a result, the company has forecast net cash outflows for every month throughout the going concern assessment period of 12 months to July 2024.

In preparing the forecasts, management has considered:

- The company's business activities, together with the factors likely to affect its future development, performance, and position. In particular, the company has considered the significant level of expenditure we have committed to in addition to that allowed at the PR19 price determination.
- The financial position of the company, its forecast monthly cash flows, liquidity position, covenants and borrowing facilities.
- The effects of the operational incidents in 2022–23 (see page 106) on the ongoing cost base of the company.
- The effects of current high levels of inflation on costs such as energy, chemicals, and materials.

Directors' report

for the year ended 31 March 2023 continued

- Investment needed to improve operational performance and reduce the impact on the environment from the treatment and processing of water and wastewater, and mitigate the effects of climate change.
- The company operates in an industry that is largely subject to economic regulation rather than market competition. Ofwat, the economic regulator, has a statutory obligation to set price limits that it believes will enable the water companies to finance their activities.

Base case – financing needs

In planning for the future financing needs of the company, the directors have also considered the following information:

- The committed undrawn revolving credit facility was increased from £330 million to £350 million on 31 October 2022 and renewed for a further five years. This facility is expected to be partially utilised for part of 2023–24.
- Borrowings are generally at fixed interest rates but include certain inflation-linked loans and derivatives. The inflation-linked instruments are subject to inflation risk which is expected to be offset by inflation movement of the RCV and revenues (see note 22).

To assist in financing of the planned expenditure the company expects to receive £375 million of new equity ("the Equity Raise"), with cash expected to be received by the end of October 2023. The directors anticipate receiving the equity, based on a history of successful fundraising in the past (most recently £529.9 million received from the shareholders in 2021) and on discussions with the major shareholder, who has indicated their support for the company. We understand that the shareholders are at an advanced stage of the equity raising process, but the equity has not been committed at the date of signing the accounts.

Base case – covenant compliance

- The company's credit rating as at 31 March 2023 was Baa3/BBB+/BBB+, and in July 2023 has been downgraded to Baa3/BBB+/BBB as a result of pressure on financial ratios from the planned level of expenditure, plus operational performance challenges which are being addressed by the company turnaround plan. This has resulted in a credit rating Trigger Event, as well as being expected to adversely affect the cost of the additional finance planned to be raised, albeit the company still retains three investment-grade credit ratings.
- The adjusted interest cover ratio is expected to have negative headroom until at least March 2025 and therefore the company is expected to continue to be in a Trigger Event to at least that date.
- The company obtained a waiver from its lenders in February 2021 which allows full use of available borrowing facilities, plus the raising of new finance, during a Trigger Event related to either a credit rating downgrade or a breach of a financial ratio. This waiver is in place to March 2025, and the company anticipates being able to extend the waiver as part of the new equity process to extend the period of permitting full use of available liquidity to 2035 and increasing the associated debt/RCV limit to 75% while in a Trigger Event.

There is positive financial headroom across all Default debt covenant ratios for the going concern period in the base case, although there is limited financial headroom against the post maintenance interest cover ratio for 2023–24, and the debt/RCV ratio of 74%. A breach of this ratio will occur if any further financial indebtedness is incurred; as noted above, management expects to vary this covenant as part of the equity raise process.

Sensitivities

- **Liquidity:** Downside sensitivities to the cash flows to check that the company can operate within its current facilities and covenants, which have identified that there is limited liquidity headroom to accommodate any overspend or one-off costs. If total expenditure is 12% over plan, the company will not have sufficient liquidity for the going concern period.
- **Financing:** Should the equity raise not succeed and £375 million not be received, the company will not have sufficient liquidity for the going concern period, with headroom reduced to nil in February 2024.
- **Covenants:** The post maintenance interest cover ratio covenant would be breached if net cash flow from operating activities less capital maintenance expenditure were to exceed plan by £41 million; the consequences of this would be Default Event.

Additional financing

Following the equity raise, additional new debt finance of £825 million is planned for the current financial year to 31 March 2024. This is not included in the base case as it is not committed and the timing is uncertain. Proceeds from the new debt finance will be used to repay the £400 million debt due in March 2025 and further finance the planned expenditure in the period beyond the going concern period. The directors anticipate receiving the additional debt financing based on the company's history of being able to do so in the past.

Conclusion

If the £375 million Equity Raise is successful, then the Directors believe that the company will have sufficient liquidity over the going concern period to execute its business plan, to finance the significant level of expenditure in addition to that allowed at the PR19 price determination, and to meet its regulatory obligations and financial commitments as they fall due.

If the £375 million Equity Raise does not proceed by the end of October 2023, the company will need to develop a new plan and will not be able to finance the full amount of planned expenditure in addition to that allowed at the PR19 price determination.

The Directors are of the opinion that the Equity Raise will be received but given it has not been committed at the date of the financial statements and its commitment is not within the Directors' control, believe that the risk that the equity is not received constitutes a material uncertainty that may cast significant doubt about the company's ability to continue as a going concern such that it may be unable to realise its assets and discharge its liabilities in the normal course of business.

Long-term viability statement

In accordance with Provision 31 of the UK Code and Ofwat's Information Notice IN 19/07, the Board has assessed the prospects of the company over a longer period than the 12 months required by the 'Going Concern' provision. Details of its assessment and the associated viability statement can be found on pages 133 to 136 of this report.

Qualifying third party indemnity

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

Directors' responsibilities statement

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

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law), including FRS101 'Reduced Disclosure Framework'. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently
- make judgments and accounting estimates that are reasonable and prudent
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Responsibility statement

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with the relevant financial reporting framework, give a true and fair view of the assets, liabilities, financial position and profit or loss of the company
- the Strategic Report includes a fair review of the development and performance of the business and the position of the company, together with a description of the principal risks and uncertainties that it faces.

Statement of disclosure of information to auditor

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

1. so far as the director is aware, there is no relevant audit information of which the company's auditor is unaware
2. they have taken all the steps that they ought to have taken as a director in order to make themselves aware of any relevant audit information and to establish that the company's auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of Section 418 of the Companies Act 2006.

Auditor

Deloitte LLP has indicated its willingness to continue in office.

Approved by the Board of Directors and signed by order of the Board.

Richard Manning
General Counsel and Company Secretary
7 July 2023

Financial statements

2022–23

Income statement

For the year ended 31 March 2023

	Note	**2023** £m	2022 £m
Continuing operations			
Revenue	5	**792.5**	823.5
Amortisation of regulatory settlement	5	**23.2**	21.0
Total revenue		**815.7**	844.5
Other operating income	5	**1.8**	1.8
Operating costs			
– before court fine and costs, charge for bad and doubtful debts, depreciation and amortisation		**(476.8)**	(384.7)
– court fine and costs		**–**	(91.5)
– charge for bad and doubtful debts		**(12.0)**	(29.9)
Operating costs before depreciation and amortisation		**(488.8)**	(506.1)
Depreciation and amortisation	6	**(347.1)**	(324.1)
Total operating costs		**(835.9)**	(830.2)
Operating (loss)/profit	6	**(18.4)**	16.1
Operating loss before regulatory settlement		**(41.6)**	(4.9)
Amortisation of regulatory settlement		**23.2**	21.0
Operating (loss)/profit		**(18.4)**	16.1
Other income	5	**4.8**	–
Profit on disposal of fixed assets	6	**1.7**	1.5
Finance income	5, 9	**4.3**	4.8
Finance costs	9	**(282.9)**	(201.0)
Fair value gains/(losses) on derivative financial instruments	9	**659.1**	(669.0)
Net finance income/(costs)	9	**380.5**	(865.2)
Profit/(loss) before taxation		**368.6**	(847.6)
Taxation	10	**(83.7)**	86.1
Profit/(loss) for the financial year		**284.9**	(761.5)

The notes on pages 215 to 257 form part of these financial statements.

Statement of other comprehensive income

For the year ended 31 March 2023

	Note	2023 £m	2022 £m
Profit/(loss) for the financial year		**284.9**	(761.5)
Other comprehensive (expense)/income:			
Items that cannot be reclassified to profit or loss:			
Actuarial loss on pension scheme	24	**(11.5)**	(18.4)
Movement on deferred tax relating to retirement benefit obligations	23	**2.2**	13.3
Total other comprehensive expense for the year, net of tax		**(9.3)**	(5.1)
Total comprehensive income/(expense) for the year attributable to the owner of the company		**275.6**	(766.6)

Statement of financial position

As at 31 March 2023

	Note	2023 £m	2022 £m (Restated)*
Non-current assets			
Intangible assets	12	**110.0**	100.0
Property, plant and equipment	13	**7,092.8**	6,712.4
Investments	14	**0.2**	29.2
Derivative financial instruments	22	**83.9**	45.6
Other non-current assets	15	**10.9**	11.8*
		7,297.8	6,899.0*
Current assets			
Inventories	16	**10.4**	10.2
Trade and other receivables	17	**253.4**	232.2*
Investments	32	**–**	285.0
Cash and cash equivalents	32	**115.8**	157.4
		379.6	684.8*
Total assets		**7,677.4**	7,583.8
Current liabilities			
Trade and other payables	18	**(477.6)**	(400.7)
Borrowings	19, 20	**(19.2)**	(304.4)
Lease liabilities	21	**(4.0)**	(3.6)
Regulatory settlement liability	25	**(27.4)**	(25.0)
Provision for liabilities	26	**(2.2)**	(1.5)
		(530.4)	(735.2)
Non-current liabilities			
Borrowings	20	**(4,165.3)**	(3,680.1)
Lease liabilities	21	**(32.5)**	(29.6)
Derivative financial instruments	22	**(1,655.3)**	(2,188.9)
Deferred tax liabilities	23	**(284.5)**	(203.0)
Retirement benefit obligations	24	**(73.0)**	(59.9)
Regulatory settlement liability	25	**(28.2)**	(53.8)
Provision for liabilities	26	**(3.3)**	(5.0)
Other non-current liabilities	27	**(40.3)**	(39.3)
		(6,282.4)	(6,259.6)
Total liabilities		**(6,812.8)**	(6,994.8)
Net assets		**864.6**	589.0
Equity			
Called up share capital	28	**0.1**	0.1
Share premium account	29	**437.5**	437.5
Non-distributable reserve	30	**94.6**	85.1
Retained earnings	31	**332.4**	66.3
Total equity		**864.6**	589.0

* The prior year has been restated following a re-analysis of prepayments from current to non-current (see note 15 and note 17 for more detail).

The financial statements of Southern Water Services Limited (Registered no. 02366670) on pages 209 to 257 were approved by the Board and authorised for issue on 7 July 2023. They were signed on its behalf by:

Stuart Ledger
Chief Financial Officer

Statement of changes in equity

For the year ended 31 March 2023

	Note	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 2021		**0.1**	**46.3**	**76.9**	**841.1**	**964.4**
Profit/(loss) for the financial year		–	–	9.9	(771.4)	(761.5)
Other comprehensive (expense)/income for the year:						
Actuarial loss on pension scheme	24	–	–	–	(18.4)	(18.4)
Movement on deferred tax relating to retirement benefit obligations	23	–	–	–	13.3	13.3
Total comprehensive income/(expense) for the year		**–**	**–**	**9.9**	**(776.5)**	**(766.6)**
Issue of shares		–	391.2	–	–	391.2
Reserves transfer*		–	–	(1.7)	1.7	–
Equity dividends paid	11	–	–	–	–	–
Balance at 31 March 2022		**0.1**	**437.5**	**85.1**	**66.3**	**589.0**
Profit for the financial year		–	–	11.4	273.5	284.9
Other comprehensive (expense)/income for the year:						
Actuarial loss on pension scheme	24	–	–	–	(11.5)	(11.5)
Movement on deferred tax relating to retirement benefit obligations	23	–	–	–	2.2	2.2
Total comprehensive income for the year		–	–	**11.4**	**264.2**	**275.6**
Reserves transfer*		–	–	(1.9)	1.9	–
Equity dividends paid	11	–	–	–	–	–
Balance at 31 March 2023		**0.1**	**437.5**	**94.6**	**332.4**	**864.6**

* 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 2023

	Note	2023 £m	2022 £m
Cash from operations	32	**348.3**	235.2
Tax paid		**–**	–
Net cash from operating activities		**348.3**	235.2
Investing activities			
Interest received		**3.3**	8.9
Purchase of property, plant and equipment		**(635.1)**	(478.4)
Purchase of intangible assets		**(41.8)**	(34.1)
Proceeds on disposal of property, plant and equipment		**1.4**	1.2
Acquisition of short-term investments		**(90.0)**	(590.0)
Maturity of short-term investments		**375.0**	305.0
Dividends received from subsidiary		**4.8**	–
Return of investment in subsidiary		**29.2**	–
Acquisition of shares in subsidiaries		**(0.1)**	–
Repayments of inter-company loan receivables		**–**	130.0
Net cash used in investing activities		**(353.3)**	(657.4)
Financing activities			
Equity dividends paid		**–**	–
Interest paid		**(176.8)**	(177.6)
Net settlements on derivative financial instruments		**87.2**	45.7
Repayment of borrowings		**(343.2)**	(16.9)
Repayments of principle on leases		**(4.2)**	(2.4)
Proceeds of new loans		**400.4**	–
Proceeds from share issue		**–**	391.3
Net cash (used in)/generated from financing activities		**(36.6)**	240.1
Net decrease in cash and cash equivalents		**(41.6)**	(182.1)
Cash and cash equivalents at beginning of the year		**157.4**	339.5
Cash and cash equivalents at end of the year		**115.8**	157.4

Notes to the financial statements

For the year ended 31 March 2023

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 (SWS) 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 the inside front cover of this report. The nature of the company's operations and its principal activities are set out in the Strategic Report on pages 15 to 136.

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 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/our-story/our-plans/investors**.

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, 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.

Separate line items on face of income statement

When assessing whether an event should be presented separately on the face of the income statement, management considers the nature, frequency, materiality and the facts and circumstances of each event. It considers whether there is any precedent, and ensures consistent treatment for both favourable and unfavourable transactions. The fine imposed by the court in the prior year in relation to the Environment Agency prosecution is material due to size and incidents, and has been separately disclosed.

Notes to the financial statements continued

For the year ended 31 March 2023

1 Accounting policies (continued)

Adoption of new and revised accounting and financial reporting standards

There are no new major standards applicable for the year ended 31 March 2023. A number of amendments, however, are effective for periods beginning from 1 January 2022. These changes had no material impact on the company's financial statements.

Prior year restatements

Prepayments of £11.8 million previously disclosed as current as at 31 March 2022 have been restated to non-current, representing the value of prepaid expenditure for goods or services not due to be received within 12 months of the balance sheet date.

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 on pages 15 to 136.

The directors have undertaken a detailed review of the company's liquidity requirements compared with the cash and facilities available, which includes cash on hand, cash on deposit and committed undrawn bank facilities totalling £550.8 million at 31 March 2023, the financial covenant position including projections based on future forecasts, the current credit ratings and financial risk.

When determining whether it is appropriate to adopt the going concern basis, the directors also consider whether there is a material uncertainty regarding whether the company has sufficient resources for its present requirements.

The company has a significant level of planned expenditure, over at least the next twelve months and will continue to March 2025 to improve operational performance, the resilience of its assets, and reduce the impact on the environment from the treatment and processing of water and wastewater. The company is also facing the effect of high inflation, particularly on costs such as energy, chemicals, and materials.

To assist in financing the planned expenditure the company expects to receive £375 million of new equity in the coming months. The ultimate shareholders of the company have indicated their support for the company and are believed to be at an advanced stage of the equity process, but the receipt has not been committed at the date of signing these financial statements.

The directors are of the opinion that that the equity will be received but given it has not been committed at the date of the financial statements and its commitment is not within the directors' control, believe that the risk that the equity is not received constitutes a material uncertainty that may cast significant doubt about the company's ability to continue as a going concern such that it may be unable to realise its assets and discharge its liabilities in the normal course of business.

However, notwithstanding the material uncertainty above, on the basis of their assessment of the company's overall financial position, and the board approved latest cash flow forecast, 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. This assessment includes the company's ability to raise new finance to repay existing debt and the management of operational cash flows along with the availability of committed and undrawn facilities. 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 202 to 208. The financial statements do not include the adjustments that would result if the company were unable to continue as a going concern.

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 executive leadership team is considered to be the company's chief operating decision maker. The executive leadership 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.

1 Accounting policies (continued)

Revenue recognition (continued)

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 current customers attract a provision rate of 100%, i.e. assessed as not generating economic benefit, revenue would not be recognised. In 2022–23 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.

Water and wastewater services also include the treatment of cesspool and trade effluent waste as well as the provision of bulk water supplies to other water companies.

Services to developers and third parties

Grants and contributions are also received from developers and third parties in relation to the provision of new infrastructure and/or new connections to the water and/or sewerage network. These 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. The significant components of grants and contributions, and their treatment, are as follows:

New connections

The company considers that the developer requesting the new connection is the customer and, that 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.

Income received in advance of the new connection being made is held on the statement of financial position as a receipt in advance.

Infrastructure charges

Infrastructure charges are a developer's contribution to fund future general network reinforcement resulting from the incremental growth in the number of customers served. These charges must be paid by the developer at the point of connection and do not relate to any specific network reinforcement activity.

The company considers that the developer requesting the new connection associated with the infrastructure charge is the customer and that 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 infrastructure charges are recognised at this point.

Requisitions

The company receives contributions from developers towards requisitions of new 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. The contribution receivable is held on the statement of financial position as deferred revenue and subsequently recognised in full as revenue on completion of the requisition works.

Diversions

The company receives contributions from third parties to divert existing water mains and public sewers.

The company considers the requesting party to be the customer in these contracts and the contribution received towards the cost of undertaking the diversion is held on the statement of financial position as deferred revenue and subsequently recognised as revenue on completion of the performance commitment in the contract, in this case on completion of the diversion of the water main or sewer.

Notes to the financial statements continued

For the year ended 31 March 2023

1 Accounting policies (continued)

Revenue recognition (continued)

Fair value of assets adopted

Infrastructure assets, constructed by a developer, which are contributed to the company for £nil consideration, in exchange for relieving the developer of any future liability, are recognised at fair value of the asset upon adoption. The fair value is based on a valuation provided on the vesting certificate when the asset is transferred into the company's ownership. At the point of legal transfer of the asset, the company has concluded that the performance obligation to the developer, adopting the asset, has been satisfied and the fair value of the asset is recognised as a contribution through revenue at this point.

These 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.

Other contributions

Grants and contributions receivable in respect of other non-current assets where the performance commitment is also delivered over the life of the asset, are treated as deferred income and released to other operating income over the useful economic life of those fixed assets.

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.

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

Taxation

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 net 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 comprise:

i. Assets in development, generally implementation of IT software.

ii. Other assets – comprising software and development projects.

Intangible assets are measured at cost less subsequent amortisation and any impairment.

1 Accounting policies (continued)

Intangible assets (continued)

Cost

Software acquired separately, or internally generated where a separate resource that is controlled by the company is created, are capitalised at cost.

Capitalised development costs are for plant installed on sites or work undertaken by suppliers to test new processes for performance data and scalability. The data is used to identify innovative and efficient future assets and processes to meet higher environmental or quality standards. Development costs can relate to projects or can be more general such as network modelling or catchment management. General development costs that are capitalised are amortised over five years. Where a development project concludes that there is insufficient chance of success of the related investment, it is amortised in full in the same year.

Costs in respect of development costs are capitalised as an intangible asset where the following criteria are met:

- It is technically feasible to create and make the asset available for use or safe;
- There are adequate resources available to complete the development and to use or sell the asset;
- There is the intention and ability to use or sell the asset;
- It is probable that the asset created will generate future economic benefits; and
- The development costs can be measured reliably.

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

Finite life intangible assets are reviewed for impairment where indicators of impairment exist.

Useful economic lives

Amortisation of intangible assets is calculated on a straight-line basis over the estimated useful lives. 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.

Assets in development are not amortised and are transferred to other intangible assets at the point at which they are operational.

Software is amortised over the length of the licence, generally three to five years.

Development costs relating to specific projects are amortised over the life of the related scheme.

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 – prior to completion/commissioning, all capital investment projects are classified as 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.

Notes to the financial statements continued

For the year ended 31 March 2023

1 Accounting policies (continued)

Property, plant and equipment (continued)

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.

1 Accounting policies (continued)

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.

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

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

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

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

The 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.

Right-of-use assets are presented separately from other assets in the notes to the financial statements and 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. Depreciation starts at the commencement date of the lease.

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.

Notes to the financial statements continued

For the year ended 31 March 2023

1 Accounting policies (continued)

Cash and cash equivalents

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

Current asset investments

Current asset investments comprise cash on deposit with a maturity of more than three months from the date of acquisition.

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.

Executory contracts

Executory contracts are contracts under which neither party has performed any of its obligations, or both parties have partially performed their obligations to an equal extent. Provisions are not recognised for executory contracts unless they are onerous.

Retirement benefits

SWS operated a defined benefit pension scheme which closed to future accrual 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 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 charged and actually paid are shown as either accruals or prepayments in the statement of financial position.

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 the company's historical experience of trade receivable write-offs, and forward-looking macro-economic events to the extent that the past response of customers to changes in the economy is built into the expected future cash collection performance for each customer segment.

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

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

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.

Notes to the financial statements continued

For the year ended 31 March 2023

1 Accounting policies (continued)

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.

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.

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

Critical accounting judgments

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

Revenue recognition in relation to new connections, infrastructure charges, requisitions, diversions and adoptions

As described in Note 1 Accounting Policies, the company receives income from developers and third parties for new connections, infrastructure charges, requisitions, diversions and adoptions either in cash or, for adoptions, in the form of infrastructure assets.

In selecting its accounting policy for the recognition of revenue from these services, the company uses judgment to determine:

- the customer of each contract;
- the performance obligation; and
- whether the service is distinct from the ongoing provision of water and wastewater services.

The company considers that these services are contracts with the developer and not the future occupiers of the property and as such the developer is considered the customer for these services.

The promise to undertake the activity is separately identifiable from any other services that may be being provided to the developer as there is a separate application process and contract for each of these items and once they have been provided the obligation to the developer is complete. The performance obligation is therefore considered to be the completion of the new connection, requisition, diversion or adoption.

As the future network services are readily available to the occupiers of the property, without the need for them to have made the earlier connection-related transactions, the revenue for these services is deemed to be distinct from revenue from the ongoing provision of water and wastewater services and is therefore recognised on completion of the connection-related service.

The future provision of water services are separate contracts with the owner/occupiers of the property at a later date, and the income for these is recognised as that service is consumed.

During the period, the company recognised income from adoptions of infrastructure assets with a fair value of £11.4 million (2022: £9.9 million), new connections amounting to £4.5 million (2022: £4.1 million), infrastructure charges amounting to £4.4 million (2022: £5.2 million) and requisitions and diversions amounting to £1.2 million (2022: £2.5 million).

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 2020–25, as part of a regulatory settlement agreed with Ofwat following its investigation into wastewater treatment compliance.

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, which is reassessed annually to provide for fluctuations in the future estimates of inflation. See note 25 for more detail.

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 are judged to be either 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.

For all the matters set out in note 33, management judge that it is either not possible to measure reliably the outflow of economic benefit or that settlement is not probable

Notes to the financial statements continued

For the year ended 31 March 2023

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

Critical accounting judgments (continued)

Right to receive water from 1 April 2029 from Portsmouth Water

In February 2021 the company entered into a contractual arrangement with Portsmouth Water Limited ('Portsmouth Water'), under which Portsmouth Water will obtain planning permission, design, build, finance, and operate a reservoir in Havant (the Havant reservoir). Once the construction is complete, and Southern Water has laid a pipe, Portsmouth Water will supply, on the request of Southern Water Services Limited, up to 21 million litres of treated water per day from 1 April 2029. Following a detailed review of the complex contractual arrangement, and with a better understanding of the contractual terms of the agreement, which require both parties to complete certain activities to enable the water to be provided, the company has formed the judgment that this contract should be accounted for as an executory contract until such time that both parties have fulfilled their obligations and the right to water can be met. The contract runs for the period from 2021 to 2100 and comprises fixed capacity charge payments as well as volumetric charges for the water to be supplied. The fixed contractual payments over the period from 2021 to 2100 total £658 million and the volumetric charge will be recognised as water is supplied, from 1 April 2029. An annual review of the performance obligations of both parties will be performed to assess whether the contract is an executory contract.

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 capitalises 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:

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. The value of derivatives is highly sensitive to assumptions of inflation and interest rates, and the following scenarios indicate the impact of a 1% movement in the respective rate structures on the fair value of the derivatives portfolio as at 31 March 2023. These values have been obtained by recalculating the entire portfolio value by shifting the interest rate curve and the inflation curve by +-1%.

	+1% increase (£m	-1% increase (£m)
Event		
Interest rates	324.5	(421.6)
Inflation rates	(917.5)	761.2

Multiple inflation linked derivatives contain an inflation floor optionality. These floors take effect in the event of a deflation (e.g. less than 0% inflation) over periods specified on a derivative level.

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 2023 was £5.5 million (2022: £6.5 million) based on an agreed schedule of works required. The company estimates that actual costs could vary up to +/- 10% due to fluctuations in prices.

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

Key sources of estimation uncertainty (continued)

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.

Sensitivity analysis shows that the measured accrual would vary by £2.0 million and £6.0 million if consumption estimates were between 1% and 3% above or below those predicted. The sensitivities of 1% and 3% illustrate the impact expected to be seen from a change in the level of consumption.

Measured accrual sensitivity analysis	31 March 2023	Sensitivity			
		1%	3%	–1%	–3%
Measured accrual balance (£m)	223.5	2.0	6.0	–2.0	–6.0

The value of household billings raised in the year ended 31 March 2023 for consumption in prior years was £225.6 million. The value of these billings was lower than the accrual made at 31 March 2022 of £233.6 million. The estimation difference was £7.9 million (3.4%) and this has been recognised in the current year's turnover. This difference is slightly higher than normally expected, with customer usage patterns remaining particularly difficult to predict since COVID-19.

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

In March 2022, an additional charge of £10.3 million was recognised to reflect the expected impact that the cost of living would have on the macro-economic environment. At March 2023, a provision of £9.6 million has been maintained due to continued high inflation and falling household incomes. This is a significant judgment as the overall impact of the pressure of the rising cost of living is continuing to evolve.

The assessment of the future impact of these economic factors was based on the Ofwat Cost of living survey, published in December 2022. The findings of the survey showed an increase in the proportion of customers expecting to struggle to pay household bills.

The value of the provision for doubtful debts as at 31 March 2023 was £260.1 million (2022: £283.9 million). The actual level of receivables collected may differ from the estimated levels of recovery, which could impact future operating results positively or negatively.

Sensitivity analysis shows that the impairment provision would vary by £2.5 million and £7.6 million if cash collections estimates were between 1% and 3% above or below those predicted.

The sensitivities of 1% and 3% illustrate the impact expected to be seen from a change in the level of cash collection. The company's experience is that cash collection in general could vary by 3.5% from expectations.

Impairment provision sensitivity analysis	31 March 2023	Sensitivity			
		–1%	–3%	1%	3%
Impairment provision estimate (£m)	260.1	2.5	7.6	–2.5	–7.6

Notes to the financial statements continued

For the year ended 31 March 2023

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

Key sources of estimation uncertainty (continued)

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 £11.5 million (2022: loss of £18.4 million).

The pension cost and liabilities under IAS 19 are assessed in accordance with directors' best estimates using the advice of an independent qualified actuary and assumptions in the latest actuarial valuation. The assumptions are based on member data supplied to the actuary and market observations for interest rates and inflation, supplemented by discussions between the actuary and management. The mortality assumption uses a scheme-specific calculation based on the CMI 2021 model with a smoothing factor of 7.0 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.

Climate change

Climate change is a one of our principal risks, and the company is continually developing its assessment of the impact this risk has on the assets and liabilities presented in the financial statements.

As set out in the Strategic Report, which includes the risk section on pages 120 to 132 and the protecting and improving the environment section on pages 59 to 68, the natural environment in which the company operates is constantly changing and this influences how water and wastewater services will be delivered in the future and our long-term strategy is focussed on identifying, managing and mitigating climate related risks.

In preparing the financial statements, the directors have considered the impact of climate change, in the context of the risks identified in the Strategic Report and the sustainability disclosures as referenced above. There has been no material impact identified on the financial reporting judgments and estimates. In particular, the directors considered the impact of climate change in the following areas:

- the carrying value and useful economic life of property, plant and equipment
- the value of inventory held
- provisions and liabilities.

The estimated useful lives of property, plant and equipment and the depreciation charged are reviewed at the end of each reporting period, for assets impacted by climate change, environmental legislation or changes in operational strategy. This may result in the acceleration of depreciation for any assets deemed to have shorter useful economic lives than originally planned. No material changes to asset lives and depreciation were made in the current financial year. The company does not view the uncertainty around the potential future impact of climate change to indicate that the current useful life policy needs revising.

The company is exposed to potential asset write-downs as a result of extreme weather events, most notably through flooding or subsidence. In these circumstances, any assets identified as having been damaged beyond repair would be fully written down. No such charges were required in the current year.

Climate change, and the environment in general, are heavily embedded in the planning stage of asset construction to mitigate future risk. This planning process considers the scenarios as described in the TCFD disclosures in the Strategic Report. It is expected that any impact identified through these processes would materialise over a longer period of time, rather than a single year, no impact from this was identified in the current year.

3 Changes in significant accounting policies

There are no new major standards applicable for the year ended 31 March 2023. A number of amendments however are effective for periods beginning from 1 January 2022. These changes had no material impact on the company's accounting policies.

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 Executive Committee is considered to be the company's chief operating decision maker. The Executive Committee review all internal management information on a single segment basis and accordingly no segmental information is provided in this report.

5 Income

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

	2023 £m	2022 £m
Water and sewerage services:		
Household – measured	**492.7**	542.5
Household – unmeasured	**109.9**	113.8
Non-household – measured	**131.8**	110.2
Non-household – unmeasured	**4.3**	4.0
Total water and sewerage services	**738.7**	770.5
Bulk supplies	**6.2**	5.4
Infrastructure charge receipts	**4.4**	5.2
Trade effluent	**7.4**	7.6
Cesspools	**6.2**	5.8
New connections	**4.5**	4.1
Adoptions (see note (a) below)	**11.4**	9.9
Other services	**13.7**	15.0
Total revenue before amortisation of regulatory settlement	**792.5**	823.5
Amortisation of regulatory settlement (see note (b) below)	**23.2**	21.0
Total revenue	**815.7**	844.5
Other operating income (see note (c) below)	**1.8**	1.8
Other income (see note (d) below)	**4.8**	–
Profit on disposal of fixed assets	**1.7**	1.5
Interest receivable (note 9)	**4.3**	0.8
Interest revenue from Southern Water Services Group Limited	**–**	4.0
Total income	**828.3**	852.6

(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) The company co-operated with Ofwat in relation to its investigation into the management, operation and performance of its wastewater treatment works.

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 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.

Amortisation of £25.0 million in the year ended 31 March 2023 is shown net of changes for future inflation estimates of £1.8 million.

(c) Other operating income in the current year relates to 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.

(d) Other income relates to distributions from Southern Water Services (Finance) Limited, as part of the activities associated with the removal of this company from the company's financing structure. (See note 14 for further detail).

Notes to the financial statements continued

For the year ended 31 March 2023

6 Profit/(loss) for the year

Profit/(loss) for the year has been arrived at after charging/(crediting):	**2023 £m**	2022 £m
Depreciation on:		
– Owned assets	**323.1**	299.0
– Leased assets	**4.2**	3.7
	327.3	302.7
Amortisation of intangible assets	**19.8**	21.4
Depreciation and amortisation	**347.1**	324.1
Profit on disposal of fixed assets	**(1.7)**	(1.5)
Research and development expenditure	**0.6**	0.8
Rentals under operating leases (see note (a) below):		
– Properties	**0.1**	0.2
– Vehicles	**3.9**	2.9
Employee costs (note 7)	**83.0**	74.8
Amortisation of grants and contributions (see note 27)	**(1.7)**	(1.7)
Fees payable to the company's auditor in respect of:		
– statutory audit of the company's financial statements	**0.8**	0.5
– other services pursuant to legislation (see note (b) below)	**0.1**	0.1
– all other services	**0.2**	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.

7 Employee information

(a) Employee costs (including directors' emoluments):		**2023 £m**	2022 £m
Wages and salaries		**120.1**	107.6
Social security costs		**13.8**	12.3
Pension costs	– Defined contribution	**15.1**	13.2
	– Defined benefit	**–**	–
Total employee costs		**149.0**	133.1
Less: charged as capital expenditure		**(66.0)**	(58.3)
Charged to the income statement		**83.0**	74.8

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 number of persons (including executive directors) employed by the company during the year was:

	2023 Number	2022 Number
Operations	**1,338**	1,279
Customer services	**45**	35
Corporate centre	**1,097**	902
	2,480	2,216

8 Directors' emoluments

	2023 £000	2022 £000
Aggregate emoluments (including benefits in kind)	1,966	2,968

No retirement benefits accrued to directors (2022: nil) under a Southern Water Services Limited defined benefit scheme. Retirement benefits of £8,000 accrued to directors (2022: £18,250) under a Southern Water Services Limited defined contribution scheme.

Further details can be found in the Directors' Remuneration Report on pages 184 to 201.
Details of emoluments and benefits for the highest paid director:

	2023 £000	2022 £000
Highest paid director's aggregate emoluments and benefits	428	1,402

During the year the company made contributions of £nil (2022: £4,000) to a money purchase pension scheme in respect of the highest paid director's qualifying services.

9 Net finance income/(costs)

	2023 £m	2022 £m
Finance income		
Interest revenue from Southern Water Services Group Limited	–	4.0
Deposit income on short-term bank deposits	4.3	0.8
	4.3	4.8
Finance costs		
Interest payable on other loans	(4.6)	(2.1)
Interest paid on loans from subsidiary companies	(163.5)	(159.6)
Indexation of index-linked debt	(139.8)	(46.5)
Amortisation of issue costs	(1.5)	(1.5)
Amortisation of gilt lock proceeds	0.1	0.1
Amortisation of bond premium	0.7	0.7
Interest on lease liabilities	(1.0)	(0.8)
Other finance expense (note 24)	(1.6)	(2.3)
Dividends on preference shares – see note (a) below	(4.6)	(4.9)
	(315.8)	(216.9)
Amounts capitalised on qualifying assets	32.9	15.9
	(282.9)	(201.0)
Fair value losses on derivative financial instruments		
Movements on derivative financial instruments (note 22)	659.1	(669.0)
Net finance income/(costs)	380.5	(865.2)

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 5.10% to expenditure on such assets (2022: 2.10%)

Dividends on preference shares

(a) Dividends due to Class B preference shareholders of £70 per share totalled £4.6 million (2022: £4.9 million). Of this amount £0.1 was paid during the year (2022: £nil) with £4.5 million accrued at 31 March 2023 (2022: £4.9 million). The cumulative balance sheet liability for unpaid preference share dividends at 31 March 2023 was £4.5 million (2022: £12.2 million).

Notes to the financial statements continued

For the year ended 31 March 2023

10 Taxation

	2023 £m	2022 £m
Current tax:		
Current year	–	–
Adjustments in respect of prior years	–	–
Total current tax charge	–	–
Deferred tax:		
Origination and reversal of timing differences	82.7	(145.4)
Adjustment in respect of prior years	1.0	0.1
Effect of corporation tax rate change	–	59.2
Total deferred tax charge/(credit)	83.7	(86.1)
Total tax charge/(credit)	83.7	(86.1)

The total deferred tax charge of £83.7 million includes £8.7 million relating to super deductions.

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

	2023 £m	2022 £m
Profit/(loss) before tax	368.6	(847.6)
Tax at the UK corporation tax rate of 19% (2022: 19%)	70.0	(161.1)
Permanent differences	1.2	20.7
Differences between current and deferred tax rates	11.5	(5.0)
Impact of tax rate changes	–	59.2
Adjustment in respect of prior years:		
Current tax	–	–
Deferred tax	1.0	0.1
Total tax charge/(credit) for year	83.7	(86.1)

Factors that may affect future tax charges:

The Spring Finance Bill 2023 confirmed that the main rate of corporation tax increased to 25% from 1 April 2023 (from 19%). All of our deferred assets and liabilities will reverse after 1st April 2023 and therefore this has been calculated at 25% rate.

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:

	2023 £m	2022 £m
Deferred tax		
Arising on income and expenses recognised in other comprehensive income:		
Tax credit relating to retirement benefit obligations	(2.2)	(3.5)
Deferred tax movement due to rate change	–	(9.8)
Total deferred tax credit recognised in other comprehensive income	(2.2)	(13.3)

11 Dividends

	2023 £m	2022 £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 (2022: £nil per share)	–	–
	–	–

No additional interim or final dividend has been declared for the year ended 31 March 2023 (2022: Interim additional - £nil, final - £nil).

12 Intangible assets

	Externally generated		
	Assets in development £m	Other £m	Total £m
Cost			
At 1 April 2022	45.9	185.2	**231.1**
Additions	29.8	–	**29.8**
Transfers	(35.2)	35.2	**–**
Disposals	–	(0.9)	**(0.9)**
At 31 March 2023	40.9	219.5	**260.0**
Amortisation			
At 1 April 2022	–	131.1	**131.1**
Charge for the year	–	19.8	**19.8**
Disposals	–	(0.9)	**(0.9)**
At 31 March 2023	–	150.0	**150.0**
Net book amount			
At 31 March 2023	40.5	69.5	**110.0**
At 31 March 2022	45.9	54.1	**100.0**

Intangible assets, which generally relate to the implementation of computer software, are transferred from assets under development to other intangible assets at the point at which they are deemed operational.

Other intangible assets consists of IT software with a net book value of £68.7 million (2022: £51.4 million), and development projects with a net book value of £0.8 million (2022: £2.7 million).

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

Included within additions above is £0.1 million (2022: £2.9 million) of interest that has been capitalised on qualifying assets in accordance with IAS 23 'Borrowing Costs'. The cumulative net book value of the borrowing costs capitalised amount to £3.7 million (2022: £3.7 million).

Notes to the financial statements continued

For the year ended 31 March 2023

13 Property, plant and equipment

	Land & buildings £m	Plant & machinery £m	Infrastructure assets £m	Assets under construction £m	Other £m	Total £m
Cost						
At 1 April 2022	1,599.6	4,116.9	3,069.9	681.1	750.8	**10,218.3**
Additions	–	–	–	707.7	–	**707.7**
Transfers	1.8	383.4	176.8	(623.0)	61.0	**–**
Disposals	–	(8.4)	(0.5)	–	(18.3)	**(27.2)**
At 31 March 2023	1,601.4	4,491.9	3,246.2	765.8	793.5	**10,898.8**
Depreciation						
At 1 April 2022	887.2	1,812.0	243.3	–	563.4	**3,505.9**
Charge for the year	41.8	186.5	37.2	–	61.8	**327.3**
Disposals	–	(8.4)	(0.5)	–	(18.3)	**(27.2)**
At 31 March 2023	929.0	1,990.1	280.0	–	606.9	**3,806.0**
Net book amount						
At 31 March 2023	**672.4**	**2,501.8**	**2,966.2**	**765.8**	**186.6**	**7,092.8**
At 31 March 2022	712.4	2,304.9	2,826.6	681.1	187.4	6,712.4

Freehold land is stated at a cost of £51.7 million at 31 March 2023 and 31 March 2022 and is not depreciated.

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

Other property, plant and equipment consists of vehicles with a net book value of £10.0 million (2022: £7.8 million), and computer hardware and IT infrastructure with a net book value of £176.6 million (2022: £179.6 million).

Included within additions above is £32.8 million (2022: £13.0 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 £274.7 million (2022: £241.9 million).

Leased assets

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

	Land & buildings £m	Infrastructure assets £m	Other £m	Total £m
Net book amount at 31 March 2022	14.2	11.3	7.8	33.3
Remeasurement due to change in lease payments	0.5	2.4	–	2.9
Additions	–	–	4.6	4.6
Depreciation charge for the year	(1.7)	(0.2)	(2.3)	(4.2)
Net book amount at 31 March 2023	**13.0**	**13.5**	**10.1**	**36.6**

14 Investments

Shares in subsidiaries	2023 £m	2022 £m
At 1 April	**29.2**	29.2
Additions	**0.2**	–
Disposals	**(29.2)**	–
At 31 March	**0.2**	29.2

The company has the following direct investments in subsidiary undertakings at 31 March 2023:

	Registered Office	Class of share capital	Activity
SW (Finance) I Plc	Southern House, Yeoman Road, Worthing	Ordinary (100%)	To raise debt finance
SW (Finance) II Limited	Southern House, Yeoman Road, Worthing	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

The directors are satisfied that the carrying value of investments is supported by the underlying assets and activities of the subsidiaries.

On 13 October 2021, two entities, SW (Finance) I Plc and SW (Finance) II Limited, were incorporated as part of the process to remove the Cayman Islands-registered entity, Southern Water Services (Finance) Limited (SWSF). Both of the new companies are wholly-owned by Southern Water Services Limited.

On 4 October 2022, the company completed the process of substituting SW (Finance) I Plc and SW (Finance) II Limited as Issuer/Borrower of the Bonds and Artesian loans currently held by SWSF, and transferred ownership of SWSF to Southern Water (NR) Holdings Limited prior to its intended liquidation.

15 Other non-current assets

Non-current receivables	2023 £m	2022 £m (Restated)*
Prepayments	**10.9**	11.8

* The prior year has been restated following a re-analysis of prepayments previously disclosed as current. The figure of £11.8 million represents the value of prepayments where the goods or services paid for were not due to be received within 12 months of the balance sheet date. See note 17 for further detail.

Non-current prepayments includes a balance of £6.5 million (2022: £6.5 million) in relation to capacity charge payments made to Portsmouth Water Limited in respect of the Havant Thicket reservoir as described in note 1 – accounting policies, note 2 – critical judgments and note 34 – financial commitments.

16 Inventories

	2023 £m	2022 £m
Raw materials	**7.2**	6.0
Work in progress	**3.2**	4.2
	10.4	10.2

Notes to the financial statements continued

For the year ended 31 March 2023

17 Trade and other receivables

	2023 £m	2022 £m (Restated)*
Trade receivables	**347.1**	361.3
Provision for impairment	**(256.1)**	(278.0)
Net trade receivables	**91.0**	83.3
Loan to subsidiary	**30.1**	35.0
Other amounts owed by other group undertakings	**9.4**	10.5
VAT recoverable	**20.9**	13.0
Other amounts receivable	**4.0**	3.6
Net accrued income	**76.2**	75.1
Prepayments	**21.8**	11.7*
	253.4	232.2

* The prior year has been restated following a re-analysis of prepayments of £23.5 million previously disclosed as current. £11.8 million has been reclassified from current to non-current (see note 15) and the amount of £11.7 million now stated in the table above reflects the value of prepayments where the goods or services paid for were due to be received within 12 months of the balance sheet date.

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.

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:

	2023 £m	2022 £m
At 1 April	**(283.9)**	(253.9)
Net impairment charge	**(12.0)**	(29.9)
Net amounts written back during the year	**35.8**	(0.1)
At 31 March	**(260.1)**	(283.9)

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

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

	2023 £m	2022 £m
Current	**–**	–
1–2 years	**–**	–
2–3 years	**–**	0.1
3–4 years	**0.1**	0.2
More than 4 years	**11.8**	20.8
	11.9	21.1

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.

17 Trade and other receivables (continued)

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

	2023 £m	2022 £m
Current	**79.9**	80.0
1–2 years	**45.5**	42.1
2–3 years	**34.7**	38.1
3–4 years	**32.4**	32.8
More than 4 years	**120.3**	122.0
	312.8	315.0

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

At 31 March 2023	**Gross £m**	**Provision £m**	**Net £m**
Accrued income – not due	**80.2**	**(4.0)**	**76.2**
Trade receivables			
Not due	**22.3**	**–**	**22.3**
Overdue and not specifically provided	**312.8**	**(244.2)**	**68.6**
Overdue and specifically provided	**11.9**	**(11.9)**	**–**
	427.2	**(260.1)**	**167.1**

At 31 March 2022	Gross £m	Provision £m	Net £m
Accrued income – not due	81.0	(5.9)	75.1
Trade receivables			
Not due	25.2	–	25.2
Overdue and not specifically provided	315.0	(256.9)	58.1
Overdue and specifically provided	21.1	(21.1)	–
	442.3	(283.9)	158.4

18 Trade and other payables

	2023 £m	2022 £m
Trade payables	**74.8**	26.8
Amounts owed to group undertakings	**43.6**	57.0
Capital creditors and capital accruals	**198.0**	189.1
Taxation and social security	**4.8**	3.1
Accruals	**107.1**	91.7
Deferred revenue	**49.3**	33.0
	477.6	400.7

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 £2.9 million (2022: £2.0 million).

Notes to the financial statements continued

For the year ended 31 March 2023

19 Current borrowings

	Note	**2023 £m**	2022 £m
Class A £150m – 3.826% index linked 2023	20(ii)	**–**	257.1
Unamortised debt issuance costs	20(iii)	**(1.5)**	(1.5)
Bond premium deferred		**0.7**	0.7
Deferred gilt lock proceeds	20(iv)	**0.1**	0.1
Other loans from subsidiary Southern Water Services (Finance) Limited	20(v)	**–**	30.3
Class A £60m – 0.000% index linked 2025	20(vi)	**12.1**	10.7
Class A £40m – 0.000% index linked 2026	20(vi)	**7.8**	7.0
Current borrowings excluding lease liabilities		**19.2**	304.4
Lease liabilities		**4.0**	3.6
Total current borrowings including lease liabilities		**23.2**	308.0

20 Total borrowings

	Note	2023 £m	2022 £m
Loans from subsidiaries:	20(i)		
Class A £350m – 6.192% (2022: 6.202%) fixed rate 2029	20(ii)	**349.0**	348.9
Class A £150m – 3.706 (2022: 3.716%) index linked 2034	20(ii)	**288.9**	257.2
Class A £35m – 3.706 (2022: 3.716%) index linked 2034	20(ii)	**61.1**	60.0
Class A £350m – 6.640% (2022: 6.650%) fixed rate 2026	20(ii)	**349.4**	349.3
Class A £150m – 3.816% (2022: 3.826%) index linked 2023	20(ii)	**–**	257.1
Class A £150m – 5.000% (2022: 5.010%) fixed rate 2041	20(ii)	**147.4**	147.3
Class A £200m – 4.500% (2022: 4.510%) fixed rate 2052	20(ii)	**197.4**	197.3
Class A £300m – 5.125% (2022: 5.135%) fixed rate 2056	20(ii)	**292.9**	292.8
Class A £375m – 2.375% (2022: 2.385%) fixed rate 2028	20(ii)	**371.5**	370.8
Class A £450m – 3.000% (2022: 3.010%) fixed rate 2037	20(ii)	**444.2**	443.8
Class A £300m – 1.625% (2022: 1.626%) fixed rate 2027	20(ii)	**296.3**	295.3
Class A £175m – 2.780% (2022: 2.790%) fixed rate 2031	20(ii)	**174.3**	174.2
Class A £75m – 2.960% (2022: 2.970%) fixed rate 2036	20(ii)	**74.6**	74.6
Artesian £165m – 4.076% (2022: 4.086%) index linked 2033	20(ii)	**317.9**	283.0
Artesian £156.5m – 3.635% (2022: 3.645%) index linked 2032	20(ii)	**294.2**	261.9
Total Class A debt from subsidiaries		**3,659.1**	3,813.5
Unamortised debt issuance costs	20(iii)	**(6.9)**	(8.4)
Bond premium deferred		**6.2**	6.9
Deferred gilt lock proceeds	20(iv)	**4.3**	4.4
Other loans from Southern Water Services (Finance) Limited	20(v)	**–**	30.3
Total loans and other borrowings from subsidiaries		**3,662.7**	3,846.7
Class A £60m – 0.000% index linked 2025	20(vi)	**29.6**	36.6
Class A £40m – 0.000% index linked 2026	20(vi)	**27.5**	31.4
Class B Preference shares	20(vii)	**64.7**	69.8
Term Loan Facility Agreement – SONIA + margin	20(viii)	**400.0**	–
Lease liabilities	21	**36.5**	33.2
Total borrowings		**4,221.0**	4,017.7
Included in:			
Current liabilities			
Borrowings	19	**19.2**	304.4
Lease liabilities	21	**4.0**	3.6
		23.2	308.0
Non-current liabilities			
Borrowings		**4,165.3**	3,680.1
Lease liabilities	21	**32.5**	29.6
		4,197.8	3,709.7

On 4 October 2022, as part of the process to remove the company's Cayman Island registered subsidiary, Southern Water Services (Finance) Limited, from its financing structure, SW (Finance) I Plc was substituted as lender of the Class A bonds, and SW (Finance) II Limited as lender of the Artesian bonds, and the intercompany lending margin reduced to nil (see note 20 (i)).

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, SW (Finance) I Plc, SW (Finance) II Limited, 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 to the financial statements continued

For the year ended 31 March 2023

20 Total borrowings (continued)

Notes in respect of the specific instruments on the previous page:

(i) Under the loan agreements between SWS and Southern Water Services (Finance) Limited (SWSF), SWSF advanced an amount equal to each bond or other debt raised at the same interest rate plus a margin of 0.01% or 0.001%. Following the substitution of SW (Finance) I Plc and SW (Finance) II Limited as lender, this margin was reduced to nil and replaced with an annual fee of £10,000 and £5,000 to each lender respectively.

(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 £139.8 million (2022: £46.5 million) has been taken to the income statement as part of finance costs.

(iii) Unamortised debt issuance costs represent issue fees paid 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 2023 unamortised debt issuance costs amounted to £6.9 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) The loan from SWSF was repaid on 30 September 2022.

(vi) 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.
Amounts for scheduled repayments due in the year to 31 March 2024 have been shown as current borrowings in the year to 31 March 2023 (note 19).

(vii) The Class B preference shares are redeemable at the option of SWS at any time. At the date of signing these accounts, no plans have been made to redeem these shares.

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 26 July 2022, the company redeemed 5,164 of the Class B preference shares at nominal value plus premium, amounting to £5.2 million plus settlement of fixed dividends due to that date of £12.3 million which included accrued unpaid dividends to 31 March 2022 of £12.2 million. The total amount paid was £17.5 million.

No further dividends were paid to the shareholders in the year and at 31 March 2023 the cumulative accrual for unpaid dividends due was £4.5 million (2022: £12.2 million).

(viii) The Term Loan Facility of £400.0 million was utilised on 2 March 2023. Interest is calculated on a daily basis for the period of utilisation at SONIA plus a margin between 70 bps and 290 bps determined by the period of utilisation and lower of the highest two ratings ascribed to the Class A Unwrapped Bonds by the Rating agencies on the first day of each interest period.

20 Total borrowings (continued)

The maturity profile of borrowings disclosed within this note is given below:	2023 £m	2022 £m
Borrowings excluding leases:		
Between one and two years	**419.2**	17.0
Between two and five years	**660.7**	674.9
After five years	**3,085.4**	2,988.2
	4,165.3	3,680.1
On demand or within one year	**19.2**	304.4
	4,184.5	3,984.5
Leases:		
Between one and two years	**3.7**	3.0
Between two and five years	**8.2**	7.0
After five years	**20.6**	19.6
	32.5	29.6
On demand or within one year	**4.0**	3.6
	36.5	33.2
Borrowings including leases:		
Between one and two years	**422.9**	20.0
Between two and five years	**668.9**	681.9
After five years	**3,106.0**	3,007.8
	4,197.8	3,709.7
On demand or within one year	**23.2**	308.0
	4,221.0	4,017.7

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 include 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.

Notes to the financial statements continued

For the year ended 31 March 2023

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:

	2023 £m	2022 £m
Right of use assets within property, plant and equipment:		
Buildings	13.0	14.2
Infrastructure	13.5	11.3
Other	10.1	7.8
	36.6	33.3
Lease liabilities		
Current	4.0	3.6
Non-current	32.5	29.6
	36.5	33.2

Additions to right-of-use assets during the financial year to 31 March 2023 were £4.6 million (2022: £6.8 million).

(ii) Amounts recognised in the income statement

The income statement shows the following amounts relating to leases:

	31 March 2023 £m	31 March 2022 £m
Depreciation charge of right-of-use assets		
Buildings and infrastructure	(1.9)	(1.7)
Other	(2.3)	(2.0)
	(4.2)	(3.7)
Interest expense (included in finance costs)	(1.0)	(0.8)
Expense relating to short-term leases (included in operating costs)	(4.0)	(3.1)

(iii) Amounts recognised in the statement of cash flows

	31 March 2023 £m	31 March 2022 £m
Repayments of principal	4.2	2.4
Interest element included in interest paid	1.0	0.8
Total cash outflow for leases	5.2	3.2

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; and
- 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 2032 and the lease expires on 31 March 2096.

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

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

Right-of-use assets are generally depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis. If the 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.

Notes to the financial statements continued

For the year ended 31 March 2023

22 Derivative financial instruments

Categories of financial instruments at fair value

	2023 £m	2022 £m
Derivative assets carried at fair value through profit or loss (FVTPL):		
Inflation swaps – not hedge accounted	**83.9**	45.6
Total derivative financial assets	**83.9**	45.6
Derivative liabilities carried at fair value through profit or loss (FVTPL):		
Inflation swaps – not hedge accounted	**(1,655.3)**	(2,188.9)
Total derivative financial liabilities	**(1,655.3)**	(2,188.9)

There are no liabilities offset against assets and no assets offset against liabilities where there is no legal right to do so.

Changes in value of financial instruments at fair value	2023 £m	2022 £m
Movements on derivative financial assets at FVTPL	**38.3**	(22.6)
Movements on derivative financial liabilities at FVTPL	**533.6**	(688.3)
Total movements on derivative financial instruments at FVTPL	**571.9**	(710.9)
Realised movements on derivative financial liabilities in the period	**87.2**	41.9
Total movements on derivative financial instruments	**659.1**	(669.0)

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

Under inflation 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 mitigation of inflation risk on issued fixed rate debt held.

The nominal value of the interest rate swaps held at 31 March 2023 are shown in the table below:

	Notional £m	Start date	Maturing in	Mandatory break
Lloyds Bank	99.3	2016	2037	–
ING Bank	77.8	2016	2037	–
SMBC Nikko	75.0	2016	2037	–
UBS	75.0	2016	2037	–
Bank of America	50.0	2016	2037	–
National Australia Bank	44.1	2016	2037	–
Banco Santander	20.0	2016	2037	–
JP Morgan	50.0	2017	2056	2029
National Australia Bank	92.1	2017	2039	2025
Banco Santander	13.2	2017	2039	2025
SMBC Nikko	70.2	2017	2039	2025
Lloyds Bank	150.0	2016	2041	–
Alum Bay & NatWest SPV*	89.4	2016	2041	–
Lloyds Bank	50.0	2016	2031	–
NatWest SPV*	9.5	2016	2031	–
BNP Paribas	200.0	2016	2051	–
Alum Bay & NatWest SPV*	185.4	2016	2051	–
Morgan Stanley	250.0	2015	2055	–
Morgan Stanley ILCA	250.0	2015	2055	2025
Alum Bay & NatWest SPV*	206.0	2015	2055	–
Bank of America	150.0	2041	2046	–
Alum Bay & NatWest SPV*	31.9	2041	2046	–
Bank of America	50.0	2031	2046	–
Alum Bay & NatWest SPV*	37.7	2031	2046	–
JP Morgan	441.2	2037	2046	–
Alum Bay & NatWest SPV*	185.1	2037	2046	–

* Series of future inflation payments have been stripped from the bank swaps with the result that nominal to real cash flows occur between company and bank, and the residual inflation cash flows are paid to the SPV. Investors into the SPV are established pension and insurance companies.

None of the interest rate swaps are due to be repaid in the next 12 months.

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 2021	**591.6**	**(261.8)**	**(22.8)**	**(4.6)**	**302.4**
Charge/(credit) to income statement	(34.2)	(118.2)	6.6	0.4	**(145.4)**
Prior year adjustment:					
– Charge/(credit) to income statement	0.1	–	–	–	**0.1**
Credit to other comprehensive income	–	–	(3.5)	–	**(3.5)**
Effect of change in tax rate:					
– Charge/(credit) to income statement	176.2	(120.0)	4.5	(1.5)	**59.2**
Credit to other comprehensive income	–	–	(9.8)	–	**(9.8)**
At 1 April 2022	**733.7**	**(500.0)**	**(25.0)**	**(5.7)**	**203.0**
Charge/(credit) to income statement	(11.8)	91.4	1.7	1.4	**82.7**
Prior year adjustment:					
– Charge/(credit) to income statement	7.2	–	–	(6.2)	**1.0**
Credit to other comprehensive income	–	–	(2.2)	–	**(2.2)**
At 31 March 2023	**729.1**	**(408.6)**	**(25.5)**	**(10.5)**	**284.5**

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:

	2023 £m	2022 £m
Deferred tax liabilities	**729.1**	733.7
Deferred tax assets	**(444.6)**	(530.7)
	284.5	203.0

24 Retirement benefit obligations

The deficit associated with retirement benefit obligations has increased to £73.0 million (2022: £59.9 million). The decrease in the deficit over the year is principally due to the significant increase in AA corporate bond yields, which leads to a higher discount rate and therefore a lower value of liabilities. This has been offset to some extent by high short term price inflation increasing benefits. There has also been a significant decrease in the assets primarily as a result of the negative impact on the LDI funds of increasing yields.

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 one professional Trustee. 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 Trustee is 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.

Notes to the financial statements continued

For the year ended 31 March 2023

24 Retirement benefit obligations (continued)

As part of the company's interactions with both the Trustee 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 Trustee, 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 2023 amounted to £13.9 million (2022: £13.2 million). At the balance sheet date, £1.3 million of contributions were outstanding for payment and were paid on 4 April 2023 (2022: £nil).

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 2022 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:

	2022 % per annum
Discount rate	Fixed interest gilts curve + 65 bps
Pension increases on the excess over guaranteed minimum pensions (where capped at 5% per annum)	In line with RPI assumption (uncapped), with an allowance for the impact of the floor calculated using the Black formula and assuming an inflation volatility of 2% per annum

24 Retirement benefit obligations (continued)

The assets of the scheme had a market value of £779.8 million at 31 March 2022. This was sufficient to cover 78.9% of the scheme's benefits. The weighted average duration of the scheme liabilities is 13 years.

As there were insufficient assets to cover the scheme liabilities at the valuation date, the Trustee and the company are required to agree a recovery plan. The Trustee and company have agreed that this shortfall should be removed by the payment of a series of deficit contributions. The timing and quantum of future contributions in relation to the deficit were agreed with the Trustee and Pensions Regulator, and updated on 14 March 2023.

The first payment was made in November 2018 and payments up to 1 April 2021 totalled £69.1 million. On 31 March 2022 the company made an additional one-off lump sum deficit contribution of £59.6 million into the Southern Water Pension Scheme covering the 1 April 2022 contribution under the previous Schedule of Contributions of £20.6 million plus a further prepayment of £39.0 million in relation to deficit contributions due in future years under a) and b) below.

Updated future deficit contributions have been agreed as follows:

a) From 2023 to 2029 (annual contributions): £21.0 million per annum increased to the relevant payment year in line with the actual increase in RPI between December 2022 and the December immediately prior to the relevant payment year.
b) Plus, an additional £500,000 per annum from 2023 to 2028 (inclusive), which, together with the equivalent amounts paid since 2018, is recognised as an advance on part of the deficit contribution due in 2029. Accordingly, the deficit contribution payable in 2029 will be reduced by £5.5m from the amount otherwise calculated under a) above.

The base deficit contributions (before adjustment for RPI) outlined in a) and b) above, and offset where relevant by the £39.0 million prepayment also described above, are payable by 1 April of the relevant year and total £105.3 million.

If the assumptions documented in the Scheme's Statement of Funding Principles dated 14 March 2023 are borne out in practice, the deficit will be removed by 1 April 2029.

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:

	2023 % per annum	2022 % per annum
Price inflation (RPI)	**3.25**	3.50
Price inflation (CPI)		
– RPI less 1% per annum up to 2030	**2.25**	2.50
– Equal to RPI after 2030	**3.25**	3.50
Rate of increase of pensions in payment:		
– MIS* members only***	**2.25**	2.50
– Old section** members only***	**3.25**	3.50
– New section and ex Final Salary LifePlan (FSLP) (RPI max 5%)***	**3.15**	3.35
– Post-5 April 1988 Guaranteed Minimum Pension (GMP) (CPI max 3%)***	**2.00**	2.15
– All sections post-31 March 2013 service (RPI max 2.5%)***	**2.20**	2.25
Rate of increase for deferred pensions:		
– MIS* members only***	**2.25**	2.50
– Old section** members only***	**3.25**	3.50
– New section and ex Final Salary LifePlan (FSLP) (RPI max 5%)***	**3.15**	3.35
– Post-5 April 1988 Guaranteed Minimum Pension (GMP) (CPI max 3%)***	**2.00**	2.15
– All sections post-31 March 2013 service (RPI max 2.5%)***	**2.20**	2.25
Discount rate	**4.65**	2.75

* 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).

Notes to the financial statements continued

For the year ended 31 March 2023

24 Retirement benefit obligations (continued)

Assumptions regarding future mortality experience are set based on advice, published statistics and experience.

The base mortality tables have been updated from 2022 to reflect the best estimate basis from the Trustees' 2022 Actuarial Funding Valuation. Improvements rates have been updated to use the most recently available CMI model (CMI 2021), using a smoothing factor of 7.0 (2022: 7.5) and long-term improvement rate of 1.25% (2022: 1.25%). The smoothing factor applied to the CMI model has been updated to be in line with the parameter used for the Trustees' 2022 Actuarial Funding Valuation.

Assumed future life expectancy at age 65	2023 Years	2022 Years
Currently aged 45:		
Male	23.9	24.3
Female	26.1	26.4
Currently aged 65:		
Male	22.6	23.0
Female	24.7	24.9

The assets and liabilities in the scheme and the expected rates of return at 31 March 2023 and 31 March 2022 were:

	Value at 2023 £m	Value at 2022 £m
Equities	79.7	200.5
Government bonds	203.8	151.3
Non-government bonds	260.7	348.0
Cash	68.6	79.6
Total market value of plan assets	612.8	779.4
Total value of plan liabilities	(685.8)	(839.3)
Accrued deficit in the plan	(73.0)	(59.9)
Related deferred tax asset	13.9	25.0
Net retirement benefit obligations	(59.1)	(34.9)

The equity investments and bonds which are held in plan assets are quoted and are valued at the current bid price. The equity holding quoted includes a number of small holdings in other return seeking assets (such as hedge funds, DGF etc). The government bond and cash allocation set out above includes £214.6 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	2023 £m	2022 £m
At 1 April	839.3	888.0
Past service cost	–	–
Interest expense	22.5	18.6
Experience loss on liabilities	108.3	22.7
Actuarial gain on liabilities:		
– due to changes in demographic assumptions	(6.5)	(0.8)
– due to changes in financial assumptions	(233.9)	(48.0)
Benefits paid	(43.9)	(41.2)
Scheme liabilities at 31 March	685.8	839.3

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.	(8.6)
	-0.1% p.a.	8.8
Price inflation (RPI measure)*	+0.1% p.a.	7.0
	-0.1% p.a.	(6.9)
Mortality	+1 year	30.0
	-1 year	(28.7)

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

The above sensitivity analysis illustrates the impact expected to be seen from 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	2023 £m	2022 £m
At 1 April	**779.4**	771.5
Interest income	**20.9**	16.3
Return on assets less than discount rate	**(143.6)**	(44.5)
Employer contributions	**–**	77.3*
Benefits paid	**(43.9)**	(41.2)
Bid value of scheme assets at 31 March	**612.8**	779.4

The net return on scheme assets was a loss of £122.7 million (2022: loss of £28.2 million)

* On 31 March 2022 the company made an additional one-off lump sum deficit contribution of £59.6 million into the Southern Water Pension Scheme.

Total cost recognised as an expense	2023 £m	2022 £m
Past service cost	**–**	–
Net interest cost	**1.6**	2.3
Total income statement expense before deduction for tax	**1.6**	2.3

Analysis of the amounts recognised in other comprehensive income	2023 £m	2022 £m
Loss due to liability experience	**108.3**	22.7
Gain due to changes in demographic assumptions	**(6.5)**	(0.8)
Gain due to changes in financial assumptions	**(233.9)**	(48.0)
Return on plan assets greater than discount rate	**143.6**	44.5
Total loss recognised in OCI before adjustment for tax	**11.5**	18.4

The cumulative amount of actuarial losses recognised in other comprehensive income is £267.6 million (2022: £256.1 million).

Analysis of the movement in the scheme deficit during the year	2023 £m	2022 £m
Deficit in the scheme at 1 April	**(59.9)**	(116.5)
Employer's contributions	**–**	77.3
Employer's past service cost	**–**	–
Financing charge	**(1.6)**	(2.3)
Actuarial loss	**(11.5)**	(18.4)
Deficit in the scheme at end of year	**(73.0)**	(59.9)

Notes to the financial statements continued

For the year ended 31 March 2023

25 Regulatory settlement liability

	2023 £m	2022 £m
At 1 April	**78.8**	99.8
Settlements in year	**(25.0)**	(23.9)
Reassessment of provision for changes in future inflation estimates	**1.8**	2.9
At 31 March	**55.6**	78.8

Included in:	2023 £m	2022 £m
Current liabilities	**27.4**	25.0
Non-current liabilities	**28.2**	53.8
	55.6	78.8

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 agreed to make direct customer rebates totalling £122.9 million in 2017–18 prices over the period 2020–25 reflecting the seriousness of the breaches identified in the investigation. These amounts have been provided for in the financial statements at outturn prices and are reassessed each year to account for the impact of inflation. After reassessment at 31 March 2023, the profile for release of the provision is as follows:

Year Ending:	2020–21	2021–22	2022–23	2023–24	2024–25	Total
AMP6 Bill Rebate (2017/18 CPI real)	33.54	22.33	22.33	22.33	22.33	122.86
Inflation	2.21	1.60	2.70	5.05	5.90	17.46
Provision (Nominal)	35.75	23.93	25.03	27.38	28.23	140.32

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.

26 Provisions for liabilities

	Environmental obligations £m	Other £m	Total £m
Balance 1 April 2021	5.7	2.5	**8.2**
Utilised in year	(1.0)	(2.5)	**(3.5)**
Increase in year	1.8	–	**1.8**
Balance 1 April 2022	6.5	–	**6.5**
Utilised in year	(1.3)	–	**(1.3)**
Increase in year	0.3	–	**0.3**
Balance at 31 March 2023	**5.5**	**–**	**5.5**

Included in:	**2023 £m**	2022 £m
Current liabilities	**2.2**	1.5
Non-current liabilities	**3.3**	5.0
	5.5	6.5

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 at 31 March 2021 included £1.5 million relating to the payment of compensation for missed appointments under the Guaranteed Standards of Service Scheme. All payments have now been made and the provision fully released as at 31 March 2022.

Also included in other provisions at 31 March 2021 was £1.0 million relating to the Environment Agency investigation (further explanation below) which has now been paid.

Environment Agency

The company has been subject to a detailed investigation regarding permit breaches at some of its wastewater treatment works during the period 2010–15.

On 9 July 2021, the company was sentenced and fined £90.0 million plus £2.5 million of costs for these historic offences against the previous provision of £1.0 million made in the year to 31 March 2020, giving rise to a charge to the income statement in the year to 31 March 2022 of £91.5 million. As a result, provisions for liabilities relating to this Environment Agency investigation are now £nil (2022: £nil).

The company is seeking to work proactively with the Environment Agency to resolve its separate investigation into sampling compliance and reporting issues for the period 2013 to 2017 (inclusive). The Board has concluded that it is not yet possible to make a reliable estimate of the financial obligation that will arise from this separate investigation and further details are provided in note 33 Contingent liabilities, to these accounts.

Notes to the financial statements continued

For the year ended 31 March 2023

27 Other non-current liabilities

	Grants and contributions £m	Deferred Revenue £m	Total £m
Balance at 1 April 2022	26.9	12.4	**39.3**
Increase in year	3.1	–	**3.1**
Released to income statement	(1.7)	(0.4)	**(2.1)**
Balance at 31 March 2023	**28.3**	**12.0**	**40.3**

Grants and contributions relate to property, plant and equipment.

Deferred revenue of £12.0 million (2022: £12.4 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.

28 Called up share capital

Equity shares	2023 £000	2022 £000
Authorised: 46,050,000 ordinary shares of £1 each	**46,050**	46,050
Allotted and fully paid: Ordinary shares of £1 each		
At 1 April	**112**	56
Issued for cash	**–**	56
At 31 March	**112**	112

Non-equity shares	2023 £000	2022 £000
Issued: Preference shares		
64,655 (2022: 69,829) Class B shares of £1 each	**65**	70

On 8 September 2021 as part of the investment by a fund managed by Macquarie Asset Management into the group, 56,000 ordinary shares with aggregate nominal value of £56,000 were issued at £6,987.18 each to SWS Holdings Limited. The premium arising on issue amounts to £391.2 million and is shown in note 29.

The redeemable preference shares are presented as a liability (see note 20) at an amount of £64.7 million (2022: £69.8 million) including share premium of £64.6 million (2022: £69.7 million) and accordingly are excluded from called up share capital in the balance sheet. The total statutory company share premium of £502.1 million (2022: £507.2 million) includes ordinary share premium of £437.5 million (2022: £437.5 million).

29 Share premium account

	2023 £m	2022 £m
Equity share premium		
At 1 April	**437.5**	46.3
Issued for cash	**–**	391.2
Balance at 31 March	**437.5**	437.5

On 8 September 2021 as part of the investment by a fund managed by Macquarie Asset Management into the group, 56,000 ordinary shares with aggregate nominal value of £56,000 were issued at £6,987.18 each to SWS Holdings Limited. The premium arising on issue amounted to £391.2 million.

30 Non-distributable reserve

	£m
Balance at 1 April 2021	76.9
Profit for the financial year	9.9
Transfer to retained earnings	(1.7)
Balance at 1 April 2022	85.1
Profit for the financial year	11.4
Transfer to retained earnings	(1.9)
Balance at 31 March 2023	**94.6**

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 2021	841.1
Equity dividends paid	–
Loss for the financial year	(771.4)
Other comprehensive loss for the year	(5.1)
Transfer from non-distributable reserve	1.7
Balance at 1 April 2022	66.3
Equity dividends paid	–
Profit for the financial year	273.5
Other comprehensive loss for the year	(9.3)
Transfer from non-distributable reserve	1.9
Balance at 31 March 2023	**332.4**

Notes to the financial statements continued

For the year ended 31 March 2023

32 Notes to the statement of cash flows

	2023 £m	2022 £m
Operating (loss)/profit	**(18.4)**	16.1
Adjustments for:		
Fair value of sewer adoptions	**(11.4)**	(9.9)
Depreciation of property, plant and equipment	**327.3**	302.7
Amortisation of intangible assets	**19.8**	21.4
Difference between pension charge and cash contributions	**–**	(77.3)
Receipt of grants and contributions	**3.1**	6.6
Amortisation of grants and contributions	**(1.7)**	(1.7)
Operating cash flows before movements in working capital	**318.7**	257.9
Increase in inventories	**(0.3)**	(3.9)
Increase in receivables	**(20.1)**	(13.1)
Increase in payables	**74.1**	17.0
Decrease in regulatory settlement liability	**(23.2)**	(21.0)
Decrease in provisions	**(0.9)**	(1.7)
Cash from operations	**348.3**	235.2
Tax paid	**–**	–
Net cash from operating activities	**348.3**	235.2

On 31 March 2022 the company made an additional one-off lump sum deficit contribution of £59.6 million into the Southern Water Pension Scheme covering the 1 April 2022 contribution under the previous Schedule of Contributions of £20.6 million plus a further prepayment of £39.0 million in relation to deficit contributions due in future years.

Cash and cash equivalents	2023 £m	2022 £m
Cash and short-term bank deposits	**115.8**	157.4

Cash and cash equivalents (which are presented as a single class of assets on the face of the Statement of Financial Position) 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 2022 £m	Cash flow changes £m	Fair value adjustments £m	New leases £m	Other non-cash changes £m	At 31 March 2023 £m
Cash and cash equivalents	157.4	(41.6)	–	–	–	**115.8**
Net liabilities from financing activities:						
Term facilities/index linked loans (note 20)	(68.0)	(381.2)	(7.9)	–	–	**(457.1)**
Loans from subsidiary (note 20)	(3,846.7)	318.8	(134.1)	–	(0.7)	**(3,662.7)**
Lease liabilities (note 20, 21)	(33.2)	4.2	–	(7.5)	–	**(36.5)**
Redeemable preference shares (note 20)	(69.8)	5.1	–	–	–	**(64.7)**
Net interest rate swaps (note 22)	(2,143.3)	(87.2)	659.1	–	–	**(1,571.4)**
Total liabilities from financing activities	(6,161.0)	(140.3)	517.1	(7.5)	(0.7)	**(5,792.4)**
Net debt	(6,003.6)	(181.9)	517.1	(7.5)	(0.7)	**(5,676.6)**

Other non-cash changes to loans from subsidiary of £0.7 million relate to the amortisation of loan issue costs, bond premium, and gilt-lock proceeds.

32 Notes to the statement of cash flows (continued)

Balances at 31 March 2023 comprise:	Non-current assets £m	Current assets £m	Current liabilities £m	Non-current liabilities £m	Total £m
Cash and cash equivalents	–	115.8	–	–	**115.8**
Derivative financial instruments	83.9	–	–	(1,655.3)	**(1,571.4)**
Unamortised debt issuance costs	–	–	1.5	5.4	**6.9**
Gilt-lock proceeds	–	–	(0.1)	(4.2)	**(4.3)**
Borrowings due within one year	–	–	(20.6)	–	**(20.6)**
Borrowings due after one year	–	–	–	(4,166.5)	**(4,166.5)**
Leases	–	–	(4.0)	(32.5)	**(36.5)**
Net debt	83.9	115.8	(23.2)	(5,853.1)	**(5,676.6)**

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).

Cash and cash equivalents (which are presented as a single class of assets on the face of the statement of financial position) comprise cash at bank and other short-term highly liquid investments with a maturity of three months or less, and excludes cash on deposit with a maturity of more than three months from the date of acquisition which are shown as current asset investments in the statement of financial position.

33 Contingent liabilities

There are currently two significant ongoing investigations being conducted by the Environment Agency (EA) of which one is also being considered by Ofwat.

As has been reported previously, we continue to assist the EA in its investigation into legacy issues relating to wastewater sampling compliance for the period 2013 to 2017. This investigation is ongoing and there have not been any significant developments during the year. We do not know when the investigation stage will be concluded, and we do not know if or when any charges against the company are likely, nor how many charges may be brought, nor how any specific charges might be framed. As the investigation is ongoing, and as the EA has not stated what its intentions are so far as the next steps in the investigation are concerned, the Board has concluded that it is not yet possible to make a reliable estimate of any financial obligation that may arise from this investigation, nor its timing (which could be several months or years), but will keep the situation under review.

In November 2021 the Environment Agency and Ofwat launched an investigation into sewage treatment works belonging to all water and wastewater companies in England and Wales. As we reported in our Annual Report at March 2022, Ofwat has opened enforcement cases into six water companies (not Southern Water). However, all water and wastewater companies in England and Wales remain subject to their ongoing investigation as they continue to review the information they have gathered. As the investigations are ongoing, and as neither the EA nor Ofwat have stated what their intentions are so far as the next steps in the investigations are concerned, the Board has concluded that it is not yet possible to make a reliable estimate of any financial obligation that may arise from these investigations, or its timing (which could be several months or years), but will keep the situation under review.

The Board monitors and supports the work of the Risk and Compliance teams, 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.

As well as the ongoing EA and Ofwat investigations, companies of the size and scale of Southern Water Services Limited are sometimes subject to civil claims, disputes and potential litigation. 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.

Notes to the financial statements continued

For the year ended 31 March 2023

33 Contingent liabilities (continued)

There is an ongoing claim in respect of property search income going back six years. A number of property search companies claim the return of amounts paid in respect of CON29DW water and drainage search reports, which they allege should have been provided to them either free of charge or for a nominal fee in accordance with the Environmental Information Regulations. It is a highly complex group action against multiple Defendants across the sector, with many legal, factual, and evidential issues to be resolved. It is proceeding in phases, with the stage 1 trial expected in late 2023, and it is not anticipated to be concluded for several years. The Board has concluded that it is not yet possible to make a reliable estimate of any financial obligation that may arise from this claim, or its timing, but will keep the situation under review.

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 period end (2022: £nil).

34 Financial commitments

(a) Capital commitments are as follows:

	2023 £m	2022 £m
Contracted for but not provided for in respect of contracts placed in respect of property, plant and equipment	**682.5**	1,179.0
Contracted for but not provided for in respect of contracts placed in respect of intangible assets	**18.4**	22.3
Right to receive water from Portsmouth Water Limited[1]	**700.9**	658.0

[1] In February 2021 the company entered into a contractual arrangement with Portsmouth Water Limited ('Portsmouth Water'), under which after constructing the reservoir, and Southern Water have laid a pipe, Portsmouth Water will supply Southern Water with 21 million litres of water a day from 1 April 2029 as part of the development of the Havant Thicket Reservoir in Portsmouth Water's supply area. The contract runs for the period from 2021 to 2100 and comprises fixed capacity charge payments as well as volumetric charges for the water to be supplied. The present value of the fixed contractual payments, which total £658 million over the period to 2100, using a discount rate of 4.98%, being the nominal return on capital allowed per the PR19 final determination, is £137.3 million at 31 March 2023 (2022: £130.8 million). The volumetric charge will be recognised as water is supplied, from 1 April 2029.

(b) The company as lessee

	2023 £m	2022 £m
Lease payments under operating leases recognised as an expense in the year	**4.0**	3.1

As at 31 March 2023 and 2022, 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.

Macquarie Asset Management, as the major shareholder in the consortium of investors owning GSH, is considered to be a related party of the company as they have the ability to influence the financial and operating policies of both the company and the group. Other related parties comprise key management personnel.

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

On 7 July 2023 Fitch announced its decision to downgrade the Class A Unwrapped Debt of the Company to BBB (negative outlook) from BBB+ (negative outlook). As a consequence of the Fitch credit rating action, a credit rating downgrade Trigger Event has occurred. Further details regarding the implications of a Trigger Event can be found on page 113.

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 2023 and of its profit 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 statemwwents 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.

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. Material uncertainty relating to going concern

We draw attention to note 1 in the financial statements, which indicates that the planned equity raise of £375 million required to have sufficient liquidity over the going concern period has not been committed at the date of signing the financial statements. As stated in note 1, these events or conditions, along with the other matters as set forth in note 1, indicate that a material uncertainty exists that may cast significant doubt on the company's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

- 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. In evaluating the directors' assessment of the company's ability to continue to adopt the going concern basis of accounting we:
- Obtained an understanding of relevant controls related to the directors' assessment of going concern;
- Obtained third party bank confirmations for the group's bank accounts, which confirmed cash balances and borrowings, inspected facility agreements and compared to the facilities assumed in the forecasts;
- Obtained the directors' going concern assessment, including cashflow forecast, liquidity requirements and forecast covenant calculations for the going concern period and have performed integrity checks including testing the mathematical accuracy;
- Assessed the forecasts used for the going concern assessment period for reasonableness and reconciled the data with information from other areas of the audit. We have evaluated the appropriateness of key revenue and expenditure assumptions in the forecasts, considering consistency with the PR19 price determination and other commitments made by directors and considered the historical accuracy of forecasting;
- Recalculated debt covenants and assessed compliance over the forecast period, including consideration the most recent available credit ratings of the company to determine the impact this has on covenant compliance;
- Evaluated and challenged management's stress test modelling to understand the impact on the company's liquidity and covenant ratios;

3. Material uncertainty relating to going concern continued

- Worked with our debt advisory specialists to evaluate the company's ability to raise additional equity as well as debt finance;
- Held discussions with the majority shareholder and obtained supporting evidence to understand shareholders' intentions and plans for a £375m equity injection in the company to support the going concern assessment; and
- Assessed the appropriateness of the disclosures within the financial statements as disclosed in note 1 relating to the material uncertainty on going concern.

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

4. Summary of our audit approach

Key audit matters	The key audit matters that we identified in the current year were: • Going concern (see material uncertainty relating to going concern in section 3 above); • Expected credit loss provision for bad and doubtful debts; • Revenue recognition – valuation of unbilled water accrual; • Classification of expenditure and valuation of capitalised overheads; and • Valuation of derivative financial instruments. Within this report, key audit matters are identified as follows: Newly identified Increased level of risk Similar level of risk Decreased level of risk
Materiality	The materiality that we used in the current year was £12.0 million which was determined on the basis of 3.6% of Earnings before interest, tax, depreciation and amortisation ('EBITDA').
Significant changes in our approach	We have classified going concern as key audit matter as a consequence of material uncertainty around going concern.

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. In addition to the matter described in the material uncertainty related to going concern section, we have determined the matters described below to be the key audit matters to be communicated in our report.

5.1. Expected credit loss provision for bad and doubtful debts

Key audit matter description	The company has a significant domestic customer base and due to regulation it 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 an area of judgement and is based on assumptions made regarding the forecast collectability of debts across both invoiced amounts and accrued revenues. Due to the level of judgement and estimation involved in the determination of the expected credit loss provision we consider it to be a key audit matter.

Independent Auditor's report continued

to the members of Southern Water Services Limited

Key audit matter description

At 31 March 2023, the company held a bad debt provision of £260.1 million (2022: £283.8 million) and recognised a further bad debt charge during the year of £12.0 million (2022: £29.9 million). Management estimates the provision based on historic collection performance data, which is considered to be representative of collection risk on the whole population of household debtors at the balance sheet date. Also included within the provision is an "affordability overlay" of £9.6 million (2022: £10.3 million) to take account of the impact of external economic factors on customers' ability to pay which is not reflected in the historic data used to determine the value of the overall credit loss provision.

The bad debt provision represents 71%, (68.4% excluding the affordability overlay), of the gross receivables amount (2022: 70.6%, or 68.0% excluding the affordability overlay).

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

- 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 macroeconomic environment on customers' ability to pay.

We have identified a potential risk of fraud in relation to this audit matter due to the level of estimation uncertainty and its influence on key metrics which management utilise to monitor and report business performance. The procedures responsive to the potential fraud risk are included in next section below.

Further details are included within the Audit Committee report on page 174, the 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 relevant controls around bad debt provisioning;
- used data analytics to recalculate, using the data inputs, the provision computed by the provisioning model;
- tested the completeness and accuracy of the data used in the provisioning model;
- evaluated the completeness and valuation of the non-model based provision balance through assessing the reasonableness of the provisioning rates using historical trends and checking for consistency with FY22;
- used the cash collection performance in the year against current year billing, prior year and budgets to evaluate the completeness of the provision;
- verified a sample of cash collections to third party evidence;
- challenged management on the basis of the affordability overlay adjustment and data sources used for its calculation, particularly considering correlation between macroeconomic factors with historic bad debt trends and cash collection trends in the current and comparative periods;
- assessed the overall bad debt provision and overlay adjustment by benchmarking against peer companies and reviewing post year end cash collection performance; and
- assessed the disclosures provided regarding the key sources of estimation uncertainty, and sensitivities disclosed.

Key observations

We are satisfied that management's methodology for assessing the expected credit losses of trade receivables and related disclosures is reasonable and have been applied appropriately in accordance with IFRS 9 - Financial Instruments.

5.2. Revenue recognition – valuation of unbilled water accrual

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 unbilled income accrual (before off-setting payments on account) for the year to 31 March 2023, incluc ding manual adjustments of £12.3 million, is £241.0 million (2022: £246.0 million). The most judgemental area of the estimation of unbilled revenue relates 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 of fraud 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 page 174, 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 the relevant controls around valuation of unbilled water accrual; • used data analytics to recalculate the accrual based on the billing and consumption patterns over the last three years derived from meter readings and historical billing; • verified the estimated consumption data to third party evidence for a sample of customers; • for a sample of customers where payments have been received in advance, tested the payment received to bank statement; • performed a retrospective review of historical accuracy of the estimate; • obtained an understanding of and tested the manual adjustments applied by management to the period end accrued income amount such as those adjusting for nullifications and high value bills and historical overestimation; and • evaluated completeness of the provision by tracing a sample of customers from third party meter reading reports during the period to the current year accrual.
Key observations	We are satisfied that management's estimates in relation to the recognition of unbilled revenue are appropriate.

5.3. Classification of expenditure and valuation of capitalised overheads

Key audit matter description	The company continues to invest significantly in infrastructure renewal and replacement in the third year of AMP7 agreed with Ofwat, with property, plant and equipment additions, of £707.0 million (2022: £582.2 million) in the year that includes £77.9 million (2022: £61.4 million) 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 has resulted in identification of a key audit matter as follows: – judgement in determining whether expenditure is capital or operational; and – estimation in determining the value of overheads that is directly attributable to relevant capital projects. Further details are included within the critical accounting estimates and judgements (note 2) and in note 13 to the financial statements.

Independent Auditor's report continued

to the members of Southern Water Services Limited

5.4. Valuation of derivative financial instruments

Key audit matter description	The company has both fixed interest rate and floating interest rate debt and the overarching aim of the inflation-linked derivative financial instruments (interest rate swaps) is to manage its exposure to inflation risk. Due to the significance of the balance and material fluctuations in current year due to external market factors we consider the valuation of financial instruments to be a key audit matter. The company measures the derivative financial instruments at fair value through profit and loss, and the fair value is determined based on quoted prices adjusted for credit risk. Credit risk is computed in line with market practice. The fair value of the derivative liabilities was £1,655.3 million (2022: £2,188.9 million) and the fair value of the derivative asset was £83.9 million (2022: £45.6 million). We have identified a potential risk for material misstatement in the valuation of the financial instruments as the valuation requires management's judgement. Valuation of derivative financial instruments is assessed as an area involving key sources of estimation uncertainty by management and is disclosed as such in note 2 to the financial statements. Further details are included in note 22 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 around valuation of financial instruments; • involved internal financial instruments specialist to recalculate the risk-free valuation of the derivative financial instruments; • challenged the credit risk adjustment through determining an independent range for the credit risk adjustment and assessing whether management's adjustment is within a reasonable range; • obtained independent counterparty confirmations to assess the completeness of financial instruments; and • assessed the appropriateness of the disclosures in accordance with the requirements of IFRS 9: Financial Instruments, IFRS 17: Financial Instruments: Disclosures and IFRS 13: Fair Value Measurement.
Key observations	We are satisfied that management's valuation of derivative financial instruments is appropriate.

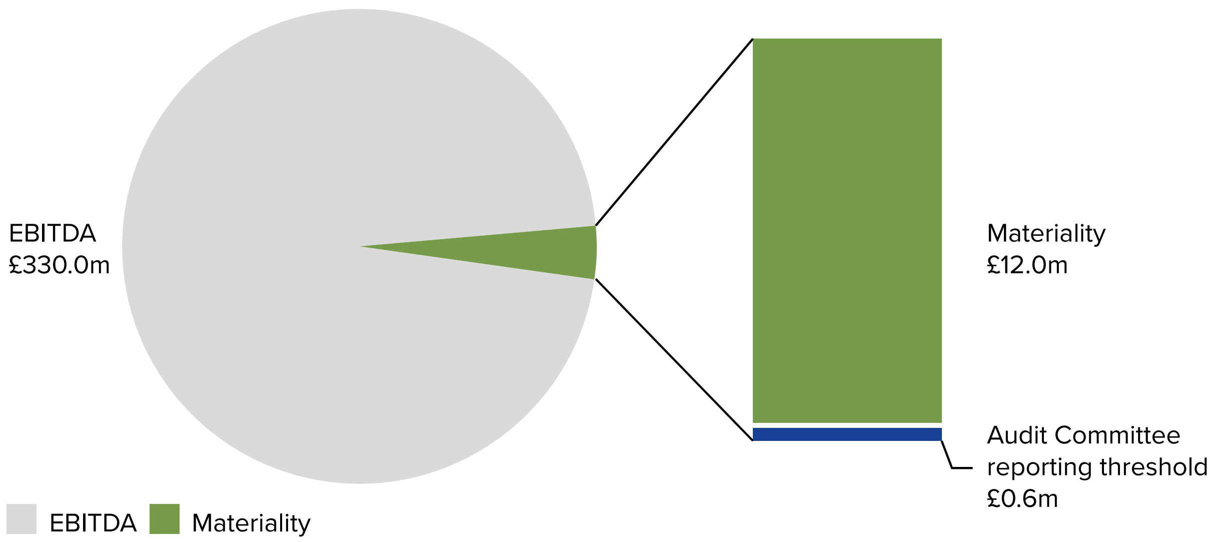
6. Our application of materiality

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	£12.0 million (2022: £11.6 million)
Basis for determining materiality	3.6% of earnings before interest, tax, depreciation and amortization (2022: 3% of EBITDA adjusted for EA fine).
Rationale for the benchmark applied	EBITDA is used as a basis for determining materiality as this excludes the volatility of a significant one-off item and focuses on underlying operational performance. EBITDA is aligned with cash flows, which is a key metric in the company's covenant calculation.



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 2023 audit (2022: 60%). In determining performance materiality, we considered factors including the impact of our ability to rely on general IT controls, history of prior year errors, 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 £0.60 million (2022: £0.58 million), 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.

7.2 Our consideration of the control environment

The company uses SAP, a financial accounting software platform. With the involvement of our Information Technology specialists, we obtained an understanding of relevant General Information Technology Controls ('GITCs') within the company's financial accounting software platform, including access controls, change management controls and controls around segregation of duties.

Additionally, we have obtained an understanding of manual key controls relevant to the audit as documented in the key audit matters section 5 above. Our audit for the period identified a number of control deficiencies, including access controls, precision of management review controls and controls around posting of manual journals. As described in the Corporate Governance section on page 173, the Board has commenced a review of the company's internal controls and asked management to remediate the deficiencies.

As a result of the deficiencies in IT controls and the business process controls summarised above, we extended the scope of our substantive audit procedures in response to the identified deficiencies and performed our audit placing no reliance on controls.

Independent Auditor's report continued

to the members of Southern Water Services Limited

7.3 Our consideration of climate-related risks

Management prepared a climate change business risk assessment demonstrating that the company is exposed to the climate change in various areas including business disruption, brand and reputation and legal and regulatory. We reviewed management's climate change risk assessment and evaluated the completeness of the identified risks and impact on the financial statements, including relevant disclosures – see note 2 of the financial statements. We also considered climate change within our audit risk assessment process in conjunction with our assessment of the balances and did not identify any additional risks of material misstatement.

As part of our procedures, we obtained an understanding of the processes and controls around the climate change related risks identified and additionally with the involvement of our Environmental, Social and Governance ("ESG") specialists, we evaluated financial statements disclosures to assess whether climate change assumptions underpinning specific account balances were appropriately disclosed.

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 within 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 this regard.

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: **frc.org.uk/auditorsresponsibilities**. This description forms part of our auditor's report.

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, including those that are specific to the company's sector;
- 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, financial instruments, valuation, 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 relation to revenue recognition - valuation of unbilled water accrual and expected credit loss provision for bad and doubtful debts. 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. These includes the license conditions imposed by The Water Services Regulation Authority (Ofwat).

Independent Auditor's report continued

to the members of Southern Water Services Limited

11.2 Audit response to risks identified

As a result of performing the above, we identified 'expected credit loss provision for bad and doubtful debts' and 'revenue recognition – valuation of unbilled water accrual' as key audit matters 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, in-house 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, the audit committee, reviewing internal audit reports and reviewing correspondence with Ofwat, HMRC and other regulatory authorities; 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. Opinions 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.

13. Opinion on other matter prescribed by our engagement letter

In our opinion the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the provisions of the Companies Act 2006 that would have applied were the company a quoted company.

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

14.1. 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.

14.2. 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.

15. Use of our report

This report is made solely to the company's member, 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 member 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 member as a body, for our audit work, for this report, or for the opinions we have formed.

Lucy Openshaw FCA (Senior statutory auditor)
For and on behalf of Deloitte LLP
Statutory Auditor
London, United Kingdom
07 July 2023

WATER for LIFE®

from Southern Water®