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.

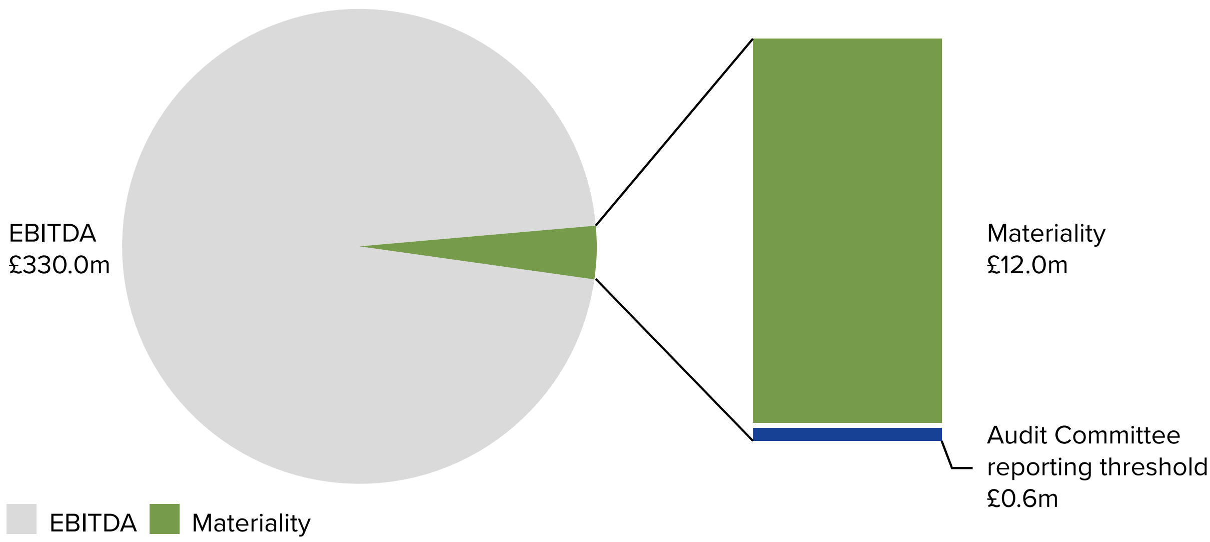
6. Our application of materiality

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

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