Affinity Water

Annual Report and Financial Statements

For the year ended 31 March 2019

Affinity Water Limited
(Registered Number 02546950)

Contents

Winner of the 'Best Customer Insight Initiative'

Gold award for 'Best Use of Insight and Feedback'

Winner of the 'Best Online Customer Experience'

Awarded the Fair Tax Mark

Important information

Terms used in this report

The 'company' or 'Affinity Water' means Affinity Water Limited; the 'regulated business' or 'regulated activities' means the licensed water activities undertaken by Affinity Water Limited in the South East of England.

Cautionary statement

The annual report and financial statements contain certain statements that are forward-looking. Although the company believes that the expectations reflected in these forward-looking statements are reasonable, it can give no assurance that these expectations will prove to be correct. Because these statements involve risks and uncertainties, actual results may differ materially from those expressed or implied by these forward-looking statements. The company undertakes no obligation to update any forward-looking statements whether as a result of new information, future events or otherwise.

Integrated report

We aim to continually develop our reporting in order to improve our communication with customers and stakeholders. This annual report and financial statements has been prepared using the principles of the International Integrated Reporting Framework.

Our Registered Office

Tamblin Way
Hatfield
Hertfordshire
AL10 9EZ

affinitywater.co.uk

Affinity Water at a glance

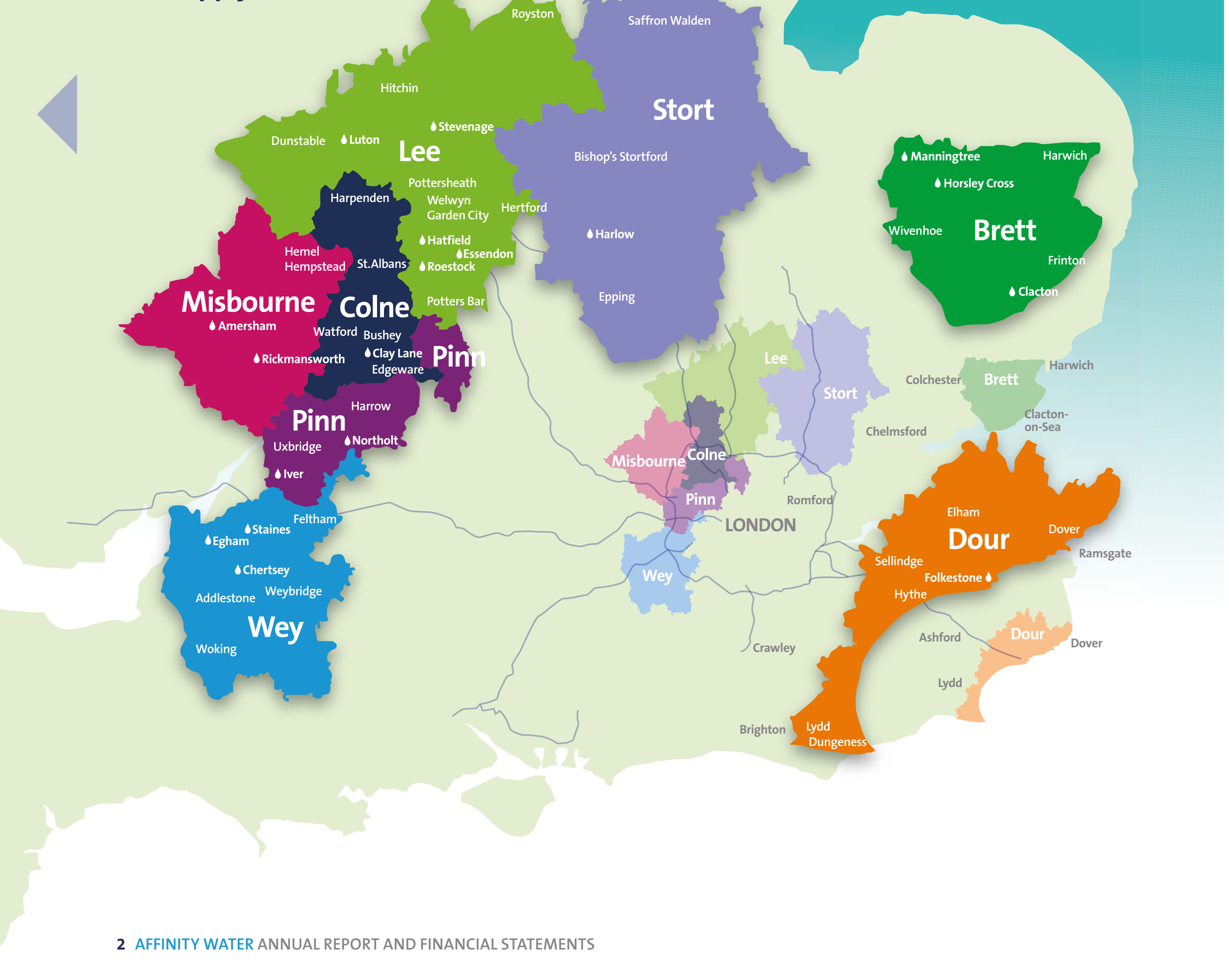
Where we operate

Affinity Water Limited is the largest water only supply company in the United Kingdom, owning and managing the water assets and network in an area of approximately 4,515km² split over three supply regions in the South East of England.

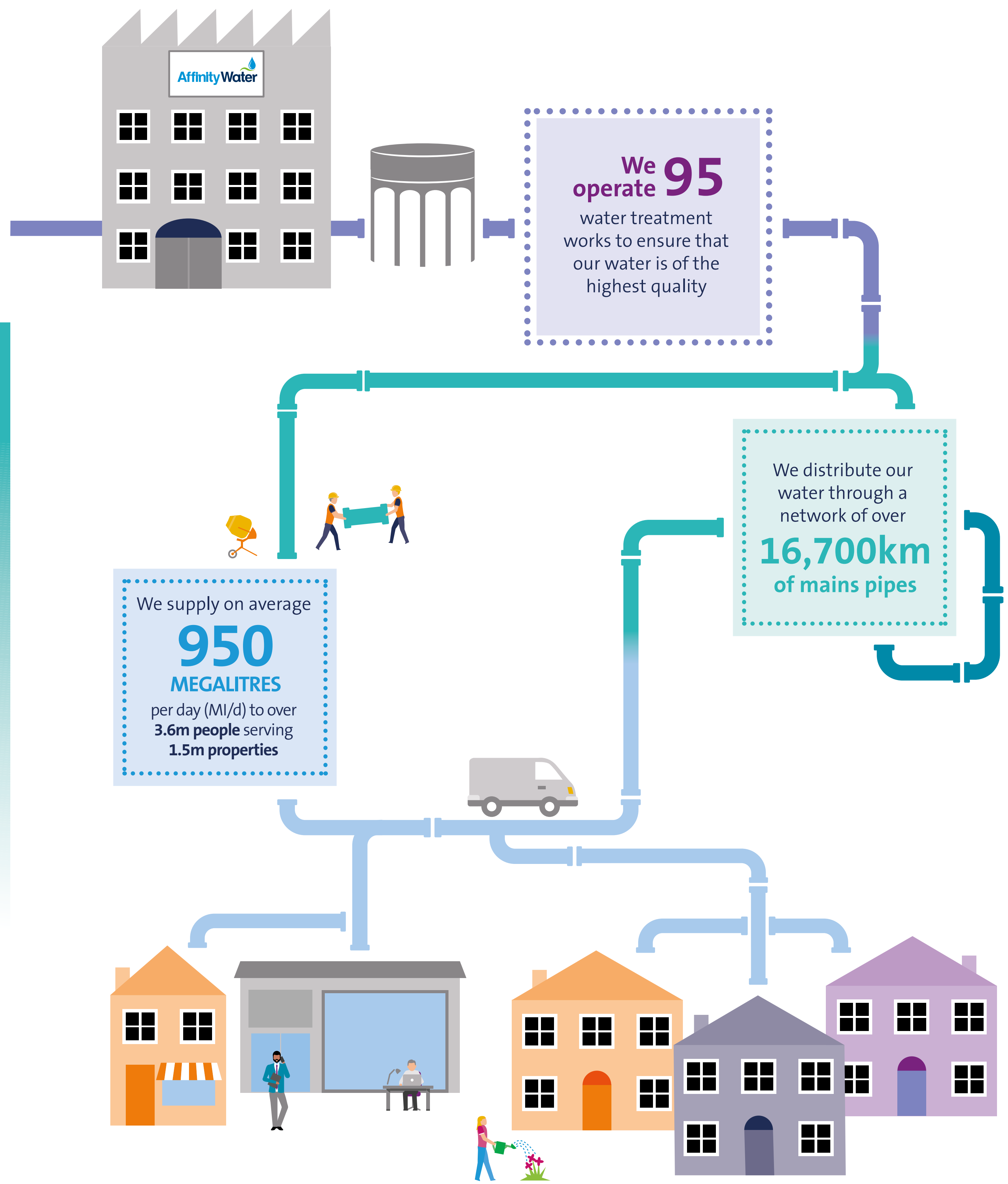
Our vision is to be the UK's leading community-focused water company. It reflects the importance we place on our people working within and for the communities of customers we serve. By understanding and responding to the needs of different community groups, we are accountable to them at a local level for how well we provide our services.

We divide our supply area into eight different communities, based on our existing water resource zones and each named after a local river, allowing us to tailor a high quality service to customers at a local level.

Our supply area



What we do



Affinity Water at a glance continued

Our highlights

Operating profit:
£58.6m
2017/18: £72.3m
Our operating profit for 2018/19 was lower than the prior year mainly due to £18.0m higher operating costs partially offset by £3.6m higher revenue

Net cash inflow before tax and financing[1]:
£42.3m
Target: £48.8m; 2017/18: £56.3m
Our net cash inflow was lower than the prior year, primarily due to receiving £27.0m proceeds on disposal of the non-household retail business in the prior year, as well as £20.0m lower cash generated from operations in 2018/19 offset by £33.0m lower net capital expenditure

The latest actuarial valuation of our Pension Plan was completed in the year and concluded that it was fully funded on a
self-sufficiency basis
as at 31 December 2017

Post tax return on regulated capital value:
3.9%
2017/18: 6.1%
Our post tax return on regulated capital value was lower than the prior year due to profit from the sale of the non-household retail business included within our return in the prior year

Gearing:
78.3%
31 March 2018: 78.6%
Our gearing at 31 March 2019 was slightly lower than the prior year, and remained below our internal threshold of 80.0% of regulatory capital value at 31 March 2019 and throughout the financial year. This allows sufficient headroom within our financial covenants

Credit rating:
Baa1
2017/18: Baa1
During the year, we continued to maintain an investment grade corporate family credit rating in line with our peers in the water sector, being two notches above investment grade

Leaving more water in the environment
We have failed to meet our leakage targets for 2017/18 and 2018/19, but are taking action to ensure we meet the industry's largest leakage percentage reduction target for 2015-20. Since 2015 we have reduced our abstraction of water from environmentally sensitive sites by
42.1Ml/d

Supplying high quality drinking water
Mean zonal compliance ('MZC')[1] of
99.96%
for the 2018 calendar year, compared to a target of 99.95% and actual performance in 2017 of 99.96%

Since 2014/15 we have revised our strategy and improvement plan to focus on a number of safety and health initiatives.
In 2018/19, recoreded
0.23
lost time injuries per
100,000
hours worked,
compared to actual performance of 1.02 in 2014/15

Minimising disruption to our customers
We experienced
309
unplanned interruptions over 12 hours
compared to a target of 320 and actual performance of 7,890 in 2017/18

We experienced
2,530
bursts
compared to our target of 3,100 and actual performance in 2017/18 of 2,923

Providing a value for money service
Improvements have been seen in our customer service metrics, including a
22% reduction in complaints and a **41% reduction** in escalated complaints

[1] This "non-GAAP" measure is calculated as the total of the following line items per the statement of cash flows **(refer to page 135)**: cash generated from operations; purchases of property, plant and equipment; capital contributions; proceeds on disposal of property, plant and equipment; and purchase of intangible assets.

[1] MZC is the average of the 'mean zonal compliance' performance of 39 water quality parameters and is an important measure of the quality of the water supplied to customers. It is measured over a calendar year. The individual results for each parameter are taken from the company's compliance sampling programme and are reported to the Drinking Water Inspectorate ('DWI').

Affinity Water at a glance continued

Our year at a glance

April

In April 2018 we published our first Gender Pay Report for April 2017, which showed a mean gender pay gap of 24.8%. For April 2018, this gap had reduced to 22.5%. We have introduced gender monitoring so that we can identify and respond to any trends in the proportion of males and females applying for roles, being recruited, leaving the organisation and their reasons for leaving. For more information on gender pay and what we are doing to close our gender pay gap please refer to **page 34**.

May

Pauline Walsh joined as Chief Executive Officer and was appointed to the Board on 1 May 2018. Please refer to **page 12** for her reflections on her first year.

The General Data Protection Regulation ('GDPR') came into effect on 25 May 2018 with all employees being required to complete training on this new legislation.

June

The rollout of our fieldwork management system, Maximo, was completed in June 2018. All of our operational engineers have access to Maximo on Toughbook devices which means better access to the right information so we can respond quicker and ensure we get things right first time, whilst keeping our customers informed.

July

We had a period of exceptionally hot, dry weather over the summer months and resultantly had 36 consecutive days where demand exceeded 1,000 Ml/d and 12 days where demand exceeded 1,100 Ml/d, challenging our production plants and our network. Our average for 2018/19 was 953 Ml/d. By carefully managing the network and working with other water companies to share water, we were able to maintain supply to our customers during the period without the need to introduce temporary usage restrictions.

August

We transacted our first ever Retail Price Index ('RPI') linked inflation swap in August 2018. It had the effect of moving £135.0m of our bonds from fixed to be index-linked. This was entered into to mitigate our interest rate exposure and increase the headroom against our covenant limits in view of planned expenditure for the 2020-25 price control period (Asset Management Plan 7, 'AMP7').

September

On 3 September 2018, we submitted our AMP7 Business Plan to our economic regulator, Ofwat.

We had a large burst on the high pressure raw water main feeding into one of our key water treatment works. Our Emergency Reponse Team was mobilised to maintain the supply of high quality water while the 42 inch pipe was repaired with a bespoke fitting. There was minimal customer impact throughout this incident.

October

On 28 October 2018, we hosted our 35th annual Ricky Road Run, a 10 mile road race around Chorleywood and Rickmansworth in our Misbourne community. 46 of our employees volunteered at the event this year which raised more than £21,000 for WaterAid, KitAid and Herts Young Homeless.

We were re-certfied for Cyber Essentials Plus, a UK government-backed scheme, which helps guard against common cyber threats and demonstrates our continued commitment to information security.

November

In November 2018 we were announced as the winner of the Best Customer Insight Initiative Award at the European Contact Centre and Customer Service Awards and we won the Best Online Customer Experience at the 2018 Engage Awards.

We identified a large burst on the outlet pipe of one of our key water treatment works. The burst was isolated and put back into service during the year. However this leak contributed to a deterioration in our leakage performance for the year and, because we found that the burst started in 2017/18, has resulted in us restating our leakage figure for 2017/18 and failing our target for that year.

December

In December 2018 we launched our 'Beat the Chill' campaign, providing our customers with top tips to get their home ready for winter. We also offered free pipe lagging kits to help our customers protect their pipes and outside taps from cold weather which increases the risk of frozen pipes, bursts and flooding during the winter months.

January

On 22 January 2019, we completed the substitution of our Cayman Islands financing entity with a UK entity as part of simplifying our group structure.

On 31 January 2019, we received Ofwat's initial assessment of our AMP7 Business Plan ('IAP'), disappointingly placing us in the bottom category of 'significant scrutiny'.

February

In February 2019 we achieved Competent Operator accreditation from the DWI, which recognises that the team members who operate our water treatment works are competent and compliant to ensure the highest standards of drinking water supplies are met and maintained.

Our community engagement fund for 2019 opened in February. The programme is designed to give local community groups, charities, and clubs an opportunity to apply for up to £3,000 funding for specific projects.

March

In March 2019 we were awarded the Fair Tax Mark, becoming only the 50th company to receive this certification, which recognises that we pay the right amount of corporation tax, at the right time and in the right place.

On 31 March 2019, we re-submitted our revised AMP7 Business Plan to Ofwat, responding to all actions from Ofwat in their IAP report and committing to do more for less by reducing the average annual customer bill over the 15-year period to 31 March 2030 from £183.50 to £164.50 (expressed in real terms) and increasing our leakage reduction target for AMP7 from 15.0% to 18.5%.

Affinity Water at a glance continued

Chairman's welcome

I am delighted to present Affinity Water's annual report and financial statements for the year ended 31 March 2019.

We have just completed the fourth year of our five-year Business Plan (the 2015-20 price control period, Asset Management Plan 'AMP6'), which includes a number of stretching performance commitments. Ofwat acknowledged the level of ambition in that plan and I am pleased to say that we are achieving most of our targets and are taking mitigating action in those few cases where we have fallen behind – please see the review from Pauline Walsh on **page 12** and our operational performance on **pages 44 to 46**.

Since 2015 we have worked hard to improve the interaction we have with our key stakeholders, building partnerships in the process, specifically within the local communities we serve. We have insourced some of our key services and focused on the training and development of our people, in order to strengthen our delivery capability and our ability to respond to unplanned incidents at short notice. We continue to enhance our community approach, as we strive to deliver on our ambition to be the UK's leading community-focused water company.

We were both surprised and disappointed by Ofwat's initial assessment of our AMP7 Business Plan for the 2020-25 price control period and their rating of our information quality in their 2018 Company Monitoring Framework assessment, and we have subsequently worked with Ofwat to address their concerns, submitting our revised plan on 31 March 2019.

Our AMP7 Business Plan addresses continuity of supply to all our customers, minimising the impact our activities have on the environment and maintaining and developing our assets and sites so that they are fit for purpose, as well as financial and corporate aspects. This ensures that we continue to provide customers with the service they expect, high quality water at an affordable price. We commissioned an independent assessment of our 'Resilience in the Round' and used it to inform our AMP7 Business Plan, building on our strengths whilst identifying areas where we can continually improve. We are committed to ensuring we have a strong approach to risk management and handling physical and operational resilience issues, and also to sound financial viability resilient to stress tests.

Our business strategy has innovation at its core; putting new ideas into action and delivering enhanced business performance – put simply: doing things better to improve customer service, reduce costs, enhance our ability to respond to unforeseen circumstances and to improve efficiency. We consider innovation to be essential in an ever-changing world as we strive to deliver more for less, and make progress against our stretching performance commitments. We are continuing to shift our working practices to be more agile and responsive, enabling us to be easier to do business with, thus transforming the customer experience and minimising the impact of our activities on the environment in the process.

We plan to invest £1.37bn in our wholesale business during AMP7, whilst reducing the average annual customer bill over the 15-year period to 31 March 2030 from £183.50 to £164.50 (before inflation). Our investment will be key to enabling us to continue to deliver and to improving the quality of the service we provide to our customers, whilst delivering sustainability reductions requiring our assets to work harder. New access to water, improved demand management and increased flexibility in the movement of water are all essential. We have led work with other water companies in the South East of England to encourage best use of existing resources through the introduction of new transfers of water.

We submitted our final Water Resources Management Plan ('WRMP') to the Secretary of State on 7 June 2019, which sets out how we will meet our long-term water supply challenges **(see page 28 for details)**. We expect to publish our final plan in late 2019.

REGULATORY ENVIRONMENT

We operate in an increasingly fast paced and changing environment where global trends including climate change, environmental degradation, economic and social change, technological transformation, population growth and demographic shifts are shaping business and society worldwide. Many of these trends are fundamental in shaping the service that the water industry will need to deliver in the future.

Our customers expect us to be able to supply water in the long-term, for their children and grandchildren, and are increasingly aware of some of the challenges we face, not least climate change and population growth. It is important that our Business Plan reflects what our customers consider should be our priorities.

The government, the Environment Agency and Ofwat have set a clear commitment to protect and enhance the environment for the next generations, including how we use water. In April 2018, the National Infrastructure Commission published its report on preparing for a drier future, which recommended that plans are put in place to deliver additional water supply and demand reduction. This was followed in May 2018 by the Environment Agency's report on 'The State of Water Resources', concluding that action must continue to reduce demand, increase supply and minimise the wasting of water.

We welcome these challenges and recognise the need to focus on the physical resilience of our infrastructure, particularly in the context of population growth and climate change including weather shocks. We are in the frontline against mitigating the impacts of climate change and protecting and enhancing the environment.

We are proud of the ongoing morphological work we are undertaking to nurture and improve the precious water resources in the communities we serve. We are focused on ensuring that we can continue to deliver clean, safe water reliably and cost-effectively for future generations to come.

We recognise the importance of ensuring that our customers and communities can trust the service we provide, and we must ensure that they are confident that we are operating in a way which is responsible, accountable and transparent. We agree that water companies must be financially resilient in the round, given the vital importance of the industry to society and the need to plan and invest for the long-term.

The debate over water companies' regulation and governance, and their long-term requirements continued during the year, with nationalisation of the industry remaining a key topic. We are happy to contribute evidence and do so where it is useful to help the public policy debate on this and other matters.

OUR GOVERNANCE

As a Board, we spend a significant amount of time aligning our company plans to the interests of customers, employees and wider stakeholders, discussing at length how we can make our infrastructure and company more resilient.

During the year we strengthened our Board, carefully selecting individuals with relevant skills and experiences to challenge and support the business. In May 2018, Pauline Walsh was appointed as Chief Executive Officer. In July 2018, we welcomed Anthony Roper to the Board replacing Gareth Craig who resigned from his role as non-executive director and in January 2019 Chris Newsome was appointed as an independent non-executive director, bringing with him significant experience of the industry. Please refer to **page 64** for more information on our governance and changes during the year.

Our Customer Challenge Group ('CCG'), which consists of individuals with experience of representing household customers and special interest groups, holds us to account on how we are performing against our AMP6 commitments. Our AMP7 Business Plan was shaped with the help of our CCG as they challenged us on how we researched our plans and engaged with stakeholders. We welcome feedback from the CCG to ensure that we continue to put customers at the heart of everything we do.

Our vision to be the UK's leading community-focused water company reflects the importance of the way we work with and for customers and the communities we serve, understanding and responding to their needs and acting as the steward of a very precious resource in the process.

Tony Cocker,

Chairman

Strategic Report

CONTENTS

Lemsford Springs was one of the local projects to benefit from our Community Engagement Fund

Structure of our strategic report – providing a clear line of sight

The Chief Executive Officer's introduction and Chief Financial Officer's review provide an introduction to our vision and how we create value for our customers and stakeholders, summarising progress made in the year in terms of both our operational and financial performance.

The subsequent sections set out the external environment in which we operate before explaining in detail how we create long-term value for our customers and stakeholders, drawing upon our five capitals (our customers and communities, our environment, our people, our assets and sites and our finances) as inputs for our business and transforming them through our operating activities into our four customer outcomes (making sure our customers have enough water, whilst leaving more water in the environment; supplying high quality water you can trust; minimising disruption to you and your community; and providing a value for money service).

We measure our success in relation to each of our customer outcomes through a series of operational KPIs and targets aligned to the performance commitments made in our AMP6 Business Plan. Details of our performance against these targets in the year is discussed in the operational performance section.

Risks and uncertainties identified as potentially having a material adverse effect on our ability to achieve our vision and create value are described in the principal risks and uncertainties section, and are again linked to our business model through our four customer outcomes.

An assessment of the company's financial viability over the ten-year period to 31 March 2029 is presented in the viability statement, which includes how each of our principal risks and uncertainties have been taken into account in this assessment.

Strategic Report

Chief Executive Officer's introduction

I am delighted to introduce our strategic report as I reflect on my first year since joining Affinity Water in May 2018, at an exciting and challenging time for both the company and the industry as a whole.

Firstly, on behalf of the Executive Management Team and the Board, I would like to thank all my Affinity Water colleagues and our partners for their hard work, dedication and achievements over the past year, although we still have plenty left to do as we move towards the end of the current AMP6 price control period and as we prepare for AMP7.

Whilst we have performed well in some areas in AMP6, we need to improve in others. We are fundamentally reviewing how we work and that includes: driving a major transformation programme to improve productivity and service levels; undertaking a large operational expenditure efficiency programme to deliver the lean and efficient structure that we need ahead of tackling the very stretching targets in the next AMP; clarifying accountabilities and strengthening our senior leadership team, bringing in new skills and increasing our pace of change.

We are increasing the quality of management information: bringing in systems which provide better granularity and transparency of performance information; increasing the visibility of performance data at all levels of the business; and improving the robustness of our data management as well as audit and compliance systems. We are also giving our teams more of a voice to share their expertise, ideas and concerns to drive higher performance. As part of this, we are developing clearer lines of communication from the front line to the Board and back. Board members and our leadership team are sponsoring community areas, which helps to ensure they are visible and accessible to customers and stakeholders in our communities.

Having instigated these reforms in other sectors, I am focusing on putting solid foundations in place to respond to the challenges and opportunities that lie ahead. We have started on that journey so that we can aim to achieve upper quartile performance in the next AMP.

Pauline Walsh

Chief Executive Officer

OUR VISION AND VALUE CREATION

At Affinity Water, we understand that we provide an essential service to customers across the communities we serve, and it is this that drives our vision to become the UK's leading community-focused water company.

For us today, community-focused means making sure we understand the needs and requirements of our customers in the different locations in which they live and work, keeping them informed about our activities and giving them a real opportunity to give us their thoughts on how we are performing. We are helping customers to understand the value of water, which encourages them to reduce consumption and thereby allows us to reduce water abstraction from precious rivers and streams in our operating area, where scientific evidence shows that it will protect the environment.

We operate in a region of environmental importance, featuring rare chalk streams which support a unique ecology. We continue to work collaboratively with partner organisations in our communities to protect our environment for future generations.

By performing efficiently and helping to maintain our local environment, working with our local communities and supporting our local economies, we can create value for our customers, the business and our communities as a whole. We are transforming our operating activities to deliver the standards of service that our customers expect and to meet the performance commitments in our AMP6 Business Plan. For more information on our commitments, please refer to **pages 22 to 23**.

Customers and our other stakeholders must have confidence that we are operating in a responsible and accountable way. To achieve this, we publish how we have performed broken down by the communities we serve, so our customers can see how we are performing in their local area. Please refer to our stakeholder website:

stakeholder.affinitywater.co.uk/company-performance.aspx

SUPPLYING HIGH QUALITY DRINKING WATER

Customers continued to benefit from high quality drinking water during the year. Our MZC was 99.96%, outperforming our regulatory target, however we had a small number of water quality incidents in the year. Whilst there was no risk to customers, we have worked to understand the causes as we are committed to improving our performance going forward. We have a programme to further reduce this risk involving making improvements to our asset resilience; completing planned investments such as pesticide removal schemes at our water treatment works; replacing lead pipes; and coaching and developing our people.

In February 2019, we achieved Competent Operator accreditation from the Energy & Utility Skills Register ('EUSR'), and endorsed by Water UK, which recognises that the team members who operate our water treatment works are competent and compliant to ensure the highest standards of drinking water supplies are met and maintained.

LEAVING MORE WATER IN THE ENVIRONMENT

During the current regulatory period, we are focused on enhancing the environment in which we operate and the fact that we have reduced our abstraction of water from environmentally sensitive sites by 42.1 Ml/d since 2015 supports this ambition.

We have committed to reducing leakage on our network by 14% over AMP6. In November 2018, we identified a large burst on the outlet pipe of one of our key water treatment works. The burst was isolated and put back into service during the year. However this leak contributed to a deterioration in our leakage performance for the year and has resulted in us restating our leakage figure for 2017/18 and failing our target for that year.

We are very disappointed to have failed our targets for 2017/18 and 2018/19. We understand the causes and have taken steps to address these. We are progressing actions to achieve our target for 2019/20 and AMP6.

Strategic Report continued

Chief Executive Officer's introduction (continued)

We had a period of exceptionally hot, dry weather over the 2018 summer months and as a result had 36 consecutive days where demand exceeded 1,000 Ml/d including 12 days where demand exceeded 1,100 Ml/d, challenging our production plants and our network. This has also had an impact on our leakage performance with increased bursts and pressure issues caused by the high demand. Our ability to target leakage was further complicated by the high night use seen.

The 2018 summer's unusually warm and dry weather further impacted on per capita consumption (the average water use per person, 'PCC'). However our climate-adjusted PCC decreased by 1.8 litres per person per day ('l/p/d') from 151.0 l/p/d in 2017/18 to 149.2 l/p/d for 2018/19. The large burst on the outlet pipe of one of our key water treatment works has resulted in a restatement of our 2017/18 PCC performance, previously reported as 151.7 l/p/d. We have a target PCC of 147.0 l/p/d by the end of this AMP and we remain focused on achieving it.

PROVIDING A VALUE FOR MONEY SERVICE

Customer satisfaction is of utmost importance to us. In 2018/19, we experienced a 22% reduction in complaints and a 41% reduction in escalated complaints. We narrowly missed our service incentive mechanism ('SIM') target for the current year despite making significant reductions in unwanted calls, complaints and escalations. Unfortunately our SIM score remains below the industry average.

Many of our customers live in some of the most economically thriving parts of our country, yet we know that some struggle to pay for basic necessities. We are proud of our record in keeping bills down and of the help we provide through our inclusive services, supporting more than 50,000 customers through our social tariffs. Our challenge remains to keep bills as low as possible whilst delivering against stretching targets for the AMP7 2020 to 2025 price control period.

MINIMISING DISRUPTION TO OUR CUSTOMERS

This year we have focused on reducing our unplanned interruptions to supply over 12 hours, recognising that we had underperformed in this area for the first three years of AMP6.

We have launched new initiatives and ways of working, focusing on innovative solutions to restoring supplies to customers by alternative means when repair of a main is likely to be difficult and protracted. We achieved our target of fewer than 320 properties experiencing unplanned interruptions to supply of more than 12 hours this year, a marked improvement on the previous three years.

For the second year running, the number of bursts on our network stayed below our target of 3,100 bursts. We continue to monitor and look for ways to reduce bursts and their effects on customers, understanding that it is important we are able to demonstrate that we are playing our part by managing our assets and providing clean, safe drinking water for customers, at a time when we are asking customers to save water.

OUR PEOPLE

The safety and health of our people are of utmost importance. During the year we experienced 0.23 lost time injuries per 100,000 hours worked compared to a target of 0.22 and actual performance of 0.29 in 2017/18. We reviewed and updated our strategy and improvement plan during the year and aim to reduce lost time injuries further going forwards.

We are committed to building a more inclusive culture to ensure that our company and its values best reflect the communities we serve and allow us to be world class in what we do. For more information refer to our introduction to our Governance section on **page 64**.

I am keen to recognise the huge effort from different teams across the business and from our partners that have delivered improved levels of performance to help us meet the commitments we have made to customers. However, I recognise that we need to improve our performance going forward if we are to deliver on all our performance commitments for the last year of AMP6 and going forward into AMP7. For more information on our operational performance, including our KPIs, please refer to **pages 44 to 46**.

Chief Financial Officer's review

This year has been a challenging year both operationally and financially. In particular the increased demand during summer 2018's hot, dry weather led to additional expenditure being incurred to ensure a continuous supply of high quality water to our customers was maintained. We continued to invest in our assets during the year to improve the resilience of our network and reduce leakage.

The physical and financial resilience of the sector continued to be the subject of much public discussion during the year. Given the capital-intensive nature of the water industry, coupled with the need for new investment, and its importance for our customers and communities, we strongly agree that companies in our sector should be financially resilient in the round, and able to withstand shocks.

In order to be regarded as being fully transparent, we substituted our Cayman Islands financing subsidiary, Affinity Water Programme Finance Limited with a new UK based entity, Affinity Water Finance PLC during the year. The liquidation of Affinity Water Programme Finance Limited is expected to be completed within the 2019/20 financial year.

We also entered into our first ever RPI linked inflation swap, with a nominal value of £135.0m, as this was the most efficient way to switch to a higher proportion of index linked debt. This will lead to a net interest receivable cashflow over the life of the swap, which is expected to increase the headroom above our covenant limits, offset by an accretion payment on maturity.

2018/19 FINANCIAL PERFORMANCE

Our financial results are prepared in accordance with Financial Reporting Standard 101: 'Reduced disclosure framework' ('FRS 101') and are summarised in the table below. For more information refer to the basis of preparation of our statutory financial statements on **page 136**.

	2019 £m	2018 £m
Revenue	**311.6**	308.0
Operating costs	**(270.9)**	(253.1)
Other income	**17.9**	17.4
Operating profit	**58.6**	72.3
Profit on disposal of non-household retail business	**–**	10.9
Net finance costs	**(44.9)**	(47.3)
Profit before tax	**13.7**	35.9
Taxation	**(3.1)**	(6.3)
Profit for the year	**10.6**	29.6

Revenue for 2018/19 was £311.6m, being a £3.6m (1.2%) increase on the prior year (2018: £308.0m). The increase is primarily due to higher summer consumption and higher new connections activity, partially offset by lower household prices.

Operating costs for the year increased by £17.8m (7.0%) to £270.9m (2018: £253.1m), as explained in the graph on the following page:

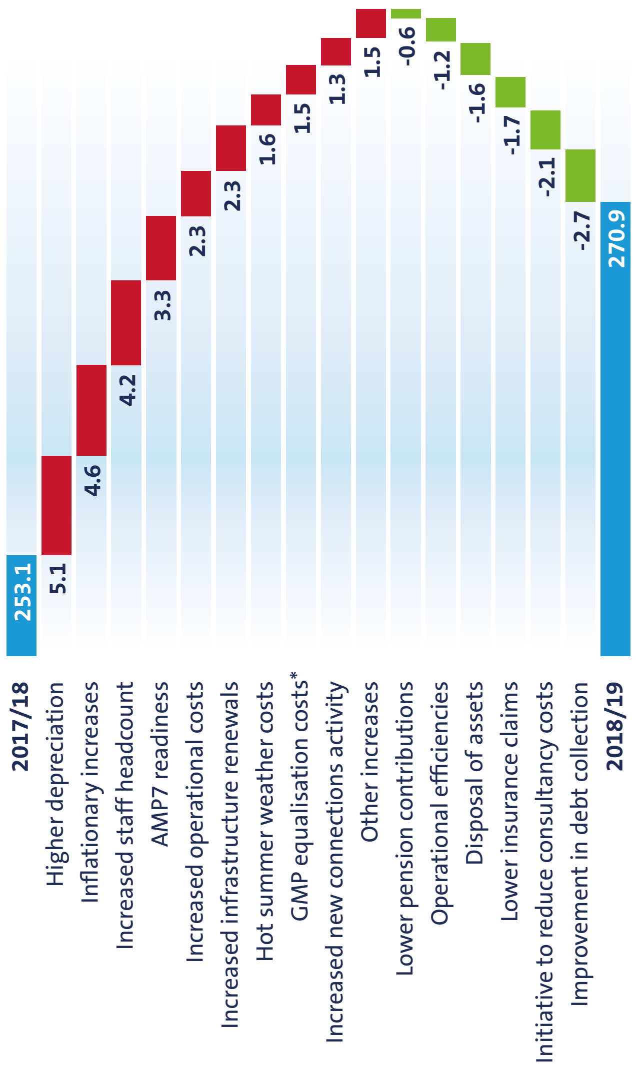
Stuart Ledger

Chief Financial Officer

Strategic report continued

Chief Financial Officer's review (continued)

2018/19 FINANCIAL PERFORMANCE (CONTINUED)



*Refer to explanation below

The key drivers for our increased operating costs during the year were our AMP7 readiness preparations, which are transforming our supply chain and network works delivery model, and restructuring our business to be able to deliver significant efficiencies planned for AMP7.

Staff costs increased due to a higher headcount and an increase in the number of operational jobs completed during the year, as well as a £1.5m increase in our defined benefit pension plan cost as a result of the court ruling in October 2018 to remove historical gender inequalities in relation to Guaranteed Minimum Pensions ('GMP'). This has been partially offset by lower contributions being paid by the company as a result of our pension plan becoming fully funded basis on a self-sufficiency basis.

Our operational costs increased due to higher maintenance and repair job volumes and increased leakage detection. The hot summer weather also had an impact, resulting in additional energy and bulk water import costs during that period.

There were a number of initiatives throughout the year aimed at reducing our costs. Through procuring and locking into favourable base rate prices for our energy usage we realised savings on our energy costs. We also ran an energy optimisation programme to reduce our energy usage across our production sites. Furthermore there has been an initiative to decrease the number of consultants being used by the business resulting in a cost saving. We took steps to improve our debt recovery. This included an initiative programme to drive improved cash collection against some of our oldest debt as well as identifying and crediting invoices raised against empty properties, which led to a reduction in our bad debt charge during the year.

The net finance expense of £44.9m was £2.4m lower than last year, primarily as a result of the net interest receivable on the £135.0m RPI linked inflation swap, which was entered into during the current year. This was partially offset by a £2.4m fair value loss on financial derivative in relation to the RPI inflation swap. For more detail refer to note 6 of the statutory financial statements.

Profit before tax decreased by £22.2m (61.8%) to £13.7m (2018: £35.9m), primarily due to the increase in operating costs and the fair value loss as explained above, as well as the effect of the disposal of the non-household retail business in the prior year.

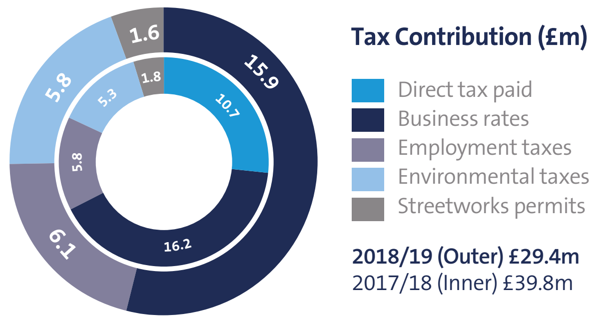
TAXATION

The income tax expense on profit before tax was £3.1m (2018: £6.3m). The effective current tax rate (28.6%; 2018: 7.5%) was higher (2018: lower) than the UK corporation tax rate of 19.0% (2018: 19.0%). Further information and a full reconciliation of the current tax charge are set out in note 7.4 of our statutory financial statements.

All our profits are taxed in the UK, and we do not use artificial tax avoidance schemes or tax havens to reduce our tax liabilities. We comply with what we understand to be both the letter and the spirit of the tax legislation and in February 2019, we were awarded the Fair Tax Mark. Details of the tax strategy for our regulated business can be found on **page 244**, and the group tax strategy of Daiwater Investment Limited, our ultimate holding and controlling company in the UK, can be found on our website:

stakeholder.affinitywater.co.uk/investor-library.aspx

We paid no corporation tax during the year (2018: £10.7m), as a result of an overpayment in the prior year. Our indirect taxes paid for the year were £29.4m (2018: £29.1m) consisting of £15.9m (2018: £16.2m) business rates payable to local authorities, £6.1m (2018: £5.8m) employer's national insurance, £5.8m (2018: £5.3m) environmental taxes and £1.6m (2018: £1.8m) streetworks permits.



DIVIDENDS

Equity dividends of £6.6m were paid during the year (2018: £58.5m), none of which related to the regulated business (2018: £50.5m) reflecting the anticipated penalty in relation to not achieving our leakage reduction target and financial underperformance in the year. Higher dividends in 2017/18 can also be attributed to proceeds from the disposal of the company's non-household retail business.

CASH FLOW

Net cash inflow before tax and financing[1] for the year was £42.3m being a 24.9% decrease on last year (2018: £56.3m). The decrease is primarily due to £27.0m received from the disposal of the non-household retail business in the prior year, as well as £20.0m lower cash generated from operations (2019: £117.7m; 2018: £137.7m), despite an increase in cash collected from customers, offset by £33.0m lower fixed asset net expenditure (2019: £75.4m; 2018: £108.4m).

CAPITAL EXPENDITURE

Capital expenditure in the year was £107.2m (2018: £123.3m), and was incurred principally in our water treatment, integrated water savings, mains renewal, trunk mains replacement, leakage, IT asset, sustainability reductions, National Environment and lead pipe replacement AMP6 programmes. This excluded £17.3m (2018: £14.6m) of infrastructure renewals expenditure, which is treated as an operating cost under FRS 101. Capital expenditure is lower than the prior year due to profiling of the AMP6 budget.

We are a business with a long-term outlook and expenditure commitments, which need to be matched with long-term sources of debt finance. Our financing subsidiaries have outstanding external bonds totalling £1,014.2m, raised in the debt capital markets and on-lent to the company on the same terms.

AMP6 TOTAL EXPENDITURE ('TOTEX')

Our totex forecast included in our re-submitted AMP7 Business Plan results in an overall AMP6 overspend of 2.5%, £30.5m, although the amount we expect customers to fund through the sharing mechanism is only £2.8m (in 17/18 prices). This is primarily due to higher pension deficit costs than allowed in our PR14 Final Determination (we have paid more into our pension scheme to take it to a fully funded basis on a self-sufficiency basis), which are outside of the sharing mechanism and therefore have been fully at the company's expense, and offsetting the financing cost of the underspend in the first few years. The main variances on cumulative totex for AMP6 up until 31 March 2019 compared to our allowance are discussed in detail under table 4B of our regulatory Annual Performance Report

NET DEBT AND GEARING

Our net debt as at 31 March 2019 was £959.5m, an increase of £10.5m since last year (2018: £949.0m) due to accretion on index-linked bonds, the fair value loss on financial derivative and lower cash held at the year end. Our gearing of net debt to regulatory capital value ('RCV') at 31 March 2019 was 78.3% (2018: 78.6%). While we have at first sight higher gearing than some of our peers in the water industry, this measure does not necessarily reflect the actual cost of this debt, and our strong pension position. It is our intention to reduce our gearing over AMP7.

[1] This "non-GAAP" measure is calculated as the total of the following line items per the statement of cash flows (refer to **page 135**): cash generated from operations; purchases of property, plant and equipment; capital contributions; proceeds on disposal of property, plant and equipment; and purchase of intangibles.

Strategic report continued

Our industry

The industry in which we operate is subject to extensive legal and regulatory requirements with which we must comply. We need to comply with the laws, regulations and standards, and the policies published by a number of regulators, including:

Water Services Regulation Authority ('Ofwat')

Our economic regulator.
ofwat.gov.uk

Environment Agency

The Environment Agency controls how much water we can abstract from the environment.
gov.uk/government/organisations/environment-agency

Drinking Water Inspectorate ('DWI')

The DWI ensures we comply with the drinking water quality regulations.
dwi.gov.uk

Department for the Environment, Food and Rural Affairs ('Defra')

Defra is the UK government department responsible for water policy.
gov.uk/government/organisations/department-for-environment-food-rural-affairs

Natural England

Responsible for the protection of designated sites for nature conservation.
gov.uk/government/organisations/natural-england

Consumer Council for Water ('CCW')

The CCW investigates customer complaints relating to service, price and value for money.
ccwater.org.uk

POLITICAL AND REGULATORY ENVIRONMENT

The debate over water companies' regulation and governance, and their long-term requirements continued during the year, with nationalisation of the industry remaining a key topic. The Labour Party has stated that it intends water and sewerage companies to be run by local councils, workers and customers, although it has not yet commented on the risks involved with a local government-run water industry, or the detail of how it would meet future funding and investment requirements.

Affinity Water and its predecessor companies were private companies already before the general privatisation of much of the industry in 1989. We are happy to contribute evidence and do so where it is useful to help the public policy debate on this and other matters.

We have captured a risk in our strategic risk register this year to reflect that nationalisation could be conducted in such a way that would result in the company no longer being viable.

ECONOMIC REGULATION

Our business is a regional monopoly and is subject to incentive-based economic regulation by Ofwat. For AMP6 we are subject to a strict revenue control regime, designed to drive efficient investment decisions. Ofwat set three separate controls for 2015-20 in order to separate wholesale activity, related to production and distribution, from customer-facing retail activity, divided between household and non-household customers.

We exited the non-household retail market through a sale of our business on 1 April 2017 and from 1 April 2017 have only operated in the retail household and wholesale price controls, both of which are monopoly activities. The wholesale revenue price control is based on incentives related to total expenditure. Household retail price controls are based on an industry-wide 'average cost to serve' principle in order to drive efficiency across the sector.

For AMP6, Ofwat assesses companies' operational performance against agreed performance commitments. Each performance commitment contains an Outcome Delivery Incentive ('ODI'), which can carry a financial reward or penalty or both that will be realised as part of the next price review process. There are also reputational consequences for failing to meet these performance commitments.

During the year we have been working on our submission for the price review ('PR19'), which will set prices for AMP7. A net ODI penalty of £10.6m (in 2012/13 prices) in relation to our performance for AMP6 to 31 March 2019, excluding the ODI penalty in relation to our restated 2017/18 leakage performance, has been captured in our PR19 submissions. The net ODI penalty of £11.6m (in 2012/13 prices) in relation to our performance for AMP6 to 31 March 2019, including the ODI penalty in relation to our restated 2017/18 leakage performance, will be captured in the prices that will be set for AMP7. Any ODI penalties or rewards in relation to our performance for 2019/20 will be considered as part of the price review process for the 2025-30 price control period (Asset Management Plan 8, 'AMP8').

Ofwat published its final methodology for PR19 in December 2017. This document clarified that prices in the industry will in future be indexed to the Consumer Price Index ('CPI') instead of RPI. In order to help the transition from RPI to CPI, a portion of water companies' regulatory capital value ('RCV') will still be indexed to RPI beyond 2020. For more information refer to risk number 9 in our principal risks and uncertainties section on **pages 48 to 57**. Ofwat will set final price limits in December 2019.

The wholesale price control will be further disaggregated into a 'water resources' control (abstraction) and a 'network plus' control (raw water transport, storage and treatment, and treated water distribution).

Ofwat has consulted on outcomes and customer measures for AMP7. Ofwat and the industry have conducted projects to 'standardise' the measurement of certain metrics in the industry, in particular, leakage and supply interruptions. This will enable Ofwat to use comparative information in setting and agreeing target benchmarks.

We submitted our AMP7 Business Plan in September 2018. Ofwat's Initial Assessment of Plans published in January 2019 placed us in the 'significant scrutiny' category. Ofwat challenged us to make a set of very demanding targets proposed for AMP7 even more 'stretching'.

We carefully listened to Ofwat's feedback and improved our original plan in a range of specific areas to deliver even more for our customers and communities.

As set out in our resubmission in March 2019, we plan to do more for less, by:

- reducing the average household bill. We now plan to reduce our average bill by 1.6% in real terms by 2025 compared to an increase of 2.1% in our September 2018 submission;
- stretching ourselves further through our commitments, including on leakage where we have increased our reduction target from 15.0% to 18.5% (equivalent to 30 Ml/d); and
- adding additional commitments that are dedicated to supporting customers in vulnerable circumstances, and those who will benefit from our Priority Services Register.

More information is available on our stakeholder website:

stakeholder.affinitywater.co.uk/business-plan.aspx

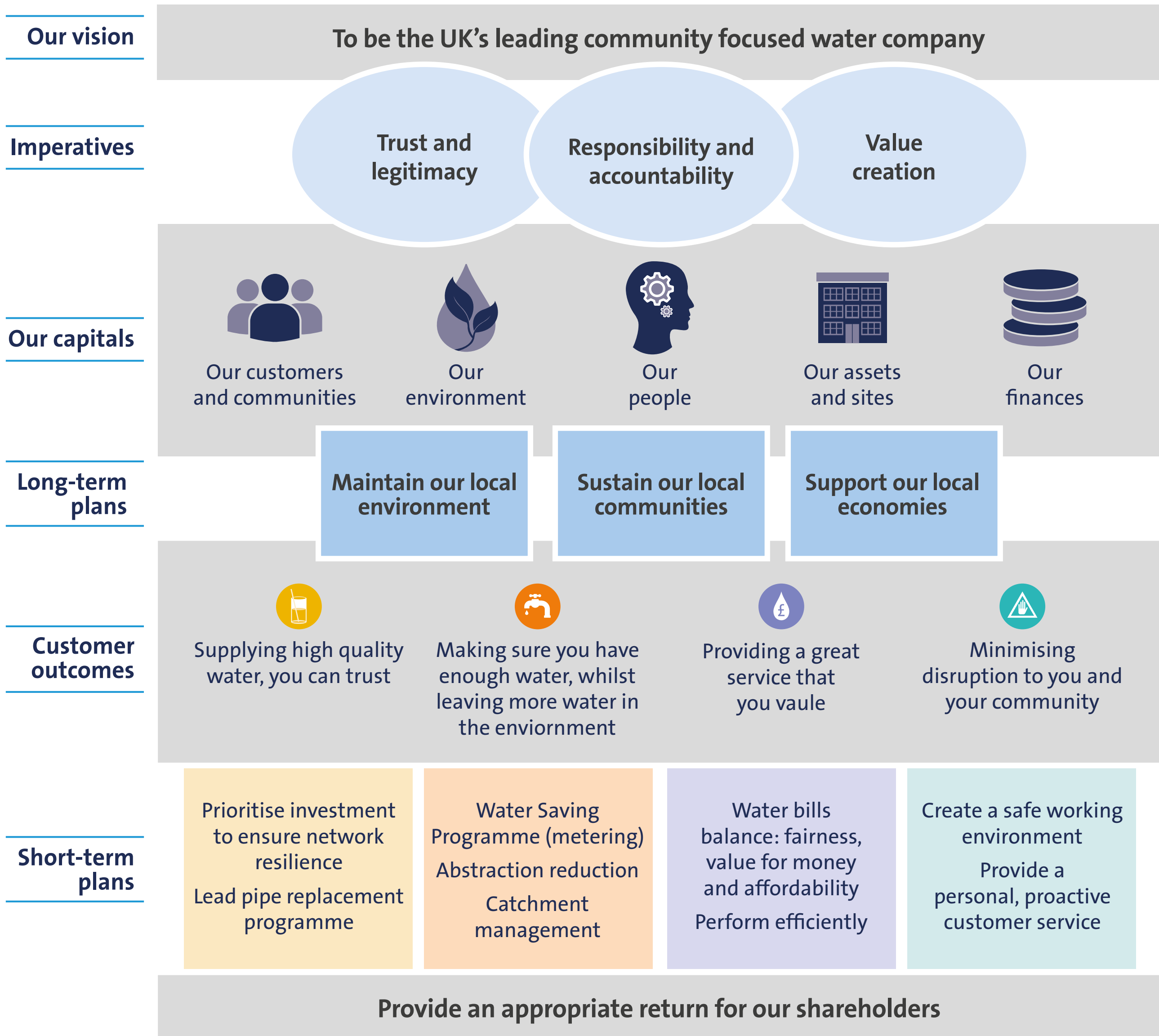
Strategic report continued

Our business model

Our vision is to be the UK's leading community-focused water company, so that we can help our customers better understand the value of water, reduce consumption and support the ongoing protection of the environment.

The way in which we operate and utilise our resources is key to creating value. We create long-term value for our customers and stakeholders by maintaining our local environment, sustaining our local communities and supporting our local economies.

We draw upon our capitals as inputs for our business and transform them through our operating activities into our customer outcomes, continuously balancing potentially competing imperatives to ensure alignment between the interests of customers, our people, our investors, regulators and stakeholders. This report shows how we are using our capitals to better understand our business impacts and dependencies, and the total contribution that we are making to all our stakeholders.



Our community model

In the last few years, we have built the foundations of our community approach. In March 2018, we established a Community Committee as a subcommittee of the Board to oversee and continue to enhance our Community Strategy.

We have developed the Committee during the year and have established a Community Working Group identifying core principles for our strategy and developing a fresh framework for community leadership. We submitted our draft community model and measurement framework in our AMP7 Business Plan in September 2018.

We also engaged with our customers and stakeholders to understand their view of community and topics that resonate most strongly with them. Their feedback indicated that we should be using simpler, meaningful, customer-centric language as the starting point for the strategy. They have proposed three focus areas that are important to them:

These focus areas will act as a framework to provide clear information on the actions we take and the work we do for and with our communities, such as helping them to save water and money, providing educational opportunities on water and its value, being visible at community events, supporting charities, volunteering and protecting the environment and health of local rivers. We have included case studies throughout our strategic report which demonstrate our Community Strategy in action.

Working with our CCG, we are now refining the model to ensure it reflects our joint needs and goals. Workshops began in November 2018 which provide a forum for us to work with our customers to truly understand the key issues that matter to them. We will continue to define and test our Community Strategy approach for the remainder of AMP6.

During 2019/20 the Board is absorbing responsibility for the work of the Community Committee. This will enable the Board to ensure we are delivering the commitments expected of a water company whose vision is to be 'the leading community focussed water company'.

Strategic report continued

How we create value

Our capitals

Our customers and communities
Relationship and trust between us and our stakeholders.
(pages 24-30)

Our environment
The natural resources that we rely on.
(pages 28-30)

Our people
Our experience, skills and competences we share.
(pages 32-34)

Our assets and sites
The lifecycle of our assets and investment projects.
(pages 36-38)

Our finances
Finance available to sustain our business.
(pages 40-42)

Our AMP6 commitments

We will maintain high quality drinking water.

We will implement a targeted programme of lead pipe replacement to meet more stringent legal standards.

We will reduce the amount of water we take from the environment by 42 million litres per day.

We will encourage our customers to use less water through our Water Saving Programme, reducing average water use by 7%. This includes installing 280,000 meters by the end of AMP6.

We will invest £500 million in our network to reduce leakage by 14% - the equivalent of 27 million litres per day.

Average household bills will reduce before inflation between 2015 and 2020.

We will promote our social tariff (LIFT) to support those least able to pay their bill.

We will make £106 million of efficiency savings in our running costs to keep bills as low as possible over the five years of AMP6.

We will make ourselves accountable to our communities for our performance.

We will invest in increased flexibility in our network so we can transfer water more effectively around our communities.

Our AMP7 commitments

We will continue to support the quality of our water resources through our catchment management and river restoration programmes to help habitats and biodiversity of rivers in our supply area.

We will reduce the amount of water we take from the environment by 36 million litres per day.

We will reduce leakage from water pipes by 18.5% on top of a 14% reduction between 2015 to 2020.

We aim to reduce average consumption from 147 to 129 litres per person per day, operating at the forefront of demand-side management, and working with partners and communities to prompt behavioural change with regard to water conservation.

Average annual customer bills will reduce by 1.6%, and we will deliver over £200.0m of efficiencies to keep bills as low as possible.

An additional 30,000 customers will benefit from our social tariff and we aim to increase the number of customers on our Priority Services Register.

We will listen to customer needs and invest in the right technologies to deliver great customer interaction, increased engagement and cost efficiencies.

We will invest £1.37 billion in our wholesale business to maintain core network assets to keep services running 24 hours a day, 7 days a week and 365 days a year, investing in local level assets such as pumps, mains upgrades, new mains and investment in service reservoirs that allow us to move water to where we need it.

Our customer outcomes[1]

Supplying high quality water, you can trust
KPI: Water quality **(page 44)**

Making sure you have enough water, whilst leaving more water in the environment
KPI: Sustainable abstraction reductions **(page 44)**
KPI: Leakage **(page 45)**

Providing a great service that you value
KPI: SIM **(page 45)**

Minimising disruption to you and your community
KPI: Mains bursts **(page 46)**
KPI: Unplanned interruptions to supply over 12 hours **(page 46)**

[1]Our policies provide for dividends and executive remuneration proportionate with long-term returns and performance of the company, whilst not impairing its longer term financeability. Performance comprises our financial performance as well as an assessment of performance in the following areas: customer service, operational commitments and community commitments, linked to customer outcomes, and people.

Strategic report continued

Our customers and communities

23,000
children engaged through our Education Services

Our people have committed
OVER 160 DAYS
volunteering to help local community partners and charities through Affinity Days

10
awards for customer service

Our vision to be the UK's leading community-focused water company reflects the importance we place on the way our people work within the communities we serve. It also reflects the emphasis we place on understanding and responding to the needs of different communities, helping our customers connect with the service they receive to achieve a more water resilient future for our region.

Our customers rightly expect that we place their interests at the centre of our operations and that their needs shape the way we deliver our services. During the new year, we undertook an extensive and multi-phased programme of customer and stakeholder engagement to ensure our Business Plan focuses on those things that matter the most to our customers.

Our customers support maintaining high water quality, and ensuring supplies are resilient whilst reducing abstraction, leakage and consumption. We have identified that our interaction with our customers is currently limited and recognise that we have an opportunity to engage more effectively with customers around the service they receive.

Our customers are at the heart of our business and understanding our customers allows us to shape the way we work to better suit their needs. We listen to feedback and conduct regular research to ensure we know who we are supplying, to understand our customer's priorities and to account for their needs.

We continue to respond and adapt to meet our customers' expectations, whether this is in the way we provide and share information, provide services, enable our customers to manage their bills or provide explanations when we do not meet the standards they expect.

The way we interact with our customers and communities is key to providing a service that represents value for money. We continue to use insight gained from surveys to inform customer service decisions and have delivered significant performance improvements. By continually increasing our focus on customers we have been able to deliver improvements in the following areas:

- we have used customer feedback to drive improvements on My Account, our digital self-serve portal, and have seen a 75% rise in new customer registrations compared to the prior year. Customers can now do more themselves online such as securely viewing or downloading a statement of account and managing their direct debit, including changing their bank details or the date payment is taken (refer to the case study on **page 47** for more information);
- our 'Moving Home' journey has also been added to My Account allowing customers to address any potential billing issues when they move in and out of properties in our supply area and to receive updates throughout the process;
- we have successfully delivered a targeted winter communication plan through multiple digital channels. Our email campaign achieved an average open rate of 43%, which is 24% higher than the industry average and our views on our YouTube video on protecting pipes doubled since the start of the campaign; and
- we launched a newly designed bill and based on customer feedback we have reduced and consolidated the information provided within the bill pack, thus reducing the number of accompanying inserts.

[1] Our operational key performance indicators ('KPIs') are based upon these commitments and our performance is recorded against them. Please refer to page 39 for further details.

CUSTOMER SATISFACTION

Customer satisfaction is of utmost importance to us. We have seen an 18% reduction in unwanted contact, a 22% reduction in the number of complaints received and a 41% reduction in the number of escalated complaints compared to 2017/18.

We have made huge strides in our internal customer satisfaction measure since 2015/16 when we scored an average of 4.42 (out of 5), increasing in each and every one of the intervening years to 4.65 in 2018/19. The numbers of customers rating themselves satisfied or very satisfied with us grew from 86% in 2015/16 to 92% at March 2019 reflecting improvements in the service levels customers are receiving. From an external position we narrowly missed our SIM target for the current year despite making significant reductions in unwanted calls, complaints and escalations. Unfortunately our SIM score remains below the industry average. For more information on our SIM performance refer to our operational performance on **page 44**.

In 2018/19 we received several customer service awards. Our successes included a gold award at the 2018 UK Customer Experience Awards for 'Best Use of Insight and Feedback' and a bronze award for 'Best Engaging the Customer Online'. At the 2018 European Contact Centre & Customer Service Awards, we won another gold award for 'Best Customer Insight Initiative' and were highly commended for 'Most Effective Business Transformation Programme in Customer Service'. We also won the 'Best Online Customer Experience' at the 2018 Engage Awards.

Looking forward, as well as continuing to build on the success of this year, we plan to continue delivering our customer service transformation by rolling out more digital services. The key focus for 2019/20 is continuing to deliver new improved customer interactions across all channels and delivering a digital customer service solution that exceeds customer expectations.

We received around 122,000 pieces of customer feedback in 2018/19 and plan to expand our channels to take into account web chat and e-mail feedback.

In December 2018 we rolled out additional capability which allows our customer service advisers to see their own feedback and to compare to their peers, increasing employee engagement.

We are continuing to provide customers with the ability to connect with us in the way it suits them. Our customers can connect with us through multiple channels including email, SMS, phone, web chat and Amazon Alexa. By overlaying an agile approach to digital development, we have been able to realise a continuous cycle of development, benefit realisation, customer feedback and improvement.

POSITIVE FEEDBACK FROM OUR CUSTOMERS:

"Genuine care and patience from the person on the phone. Interested to listen and answer my questions."

"My experience was so great because the team are always so very polite and helpful. They are all so understanding of people's circumstances and are a real pleasure to talk with."

"It's always nice to speak with anyone from Affinity Water because they have a great customer service and are very helpful."

"You guys never fail to provide great customer service. The chap I just spoke to was an absolute angel in understanding my situation."

"On behalf of everyone in this area please pass on our thanks to your teams that have been on site since around 06:00 this morning dealing with the burst water main. I've no doubt it would have been a miserable Christmas Day without any water if it wasn't for your staff."

"Top job by your teams tonight – not only sorted my water emergency but attitude and general customer service was fantastic."

"I would like to confirm that I received the new bill online. I also appreciate that you called back to explain the process back on Monday."

Strategic report continued

Our customers and communities (continued)

SERVING OUR COMMUNITIES

We are privileged to serve our communities. Being the monopoly supplier and steward of a precious resource for future generations, we are acutely aware that we must continually invest in building trust and legitimacy with our customers and make ourselves accountable to our communities for our performance. This is central to achieving our vision of being a community-focused, sustainable and responsible business.

We are adopting a partnership approach with our communities, understanding that we are not always best placed to drive change or influence behaviours and should draw on the skills of subject matter experts. We must make use of existing networks and communities, working in collaboration to develop a view of what we want the future to look like and a shared plan on how we will get there together. It will require us to be catalysts, supporting communities to facilitate and advocate change.

We value the input of our customer representative groups. Our CCG is an independent group which holds us to account on how we are performing against our AMP6 commitments. Our CCG continues to provide advice and constructive challenge to the company on behalf of the customer, and invites members of the Board and senior managers to meetings from time to time to discuss issues of relevance to customers.

We also consult regularly with other groups which are representative of customer interests such as the CCW, which is an independent national statutory customer representative body, as well as Citizens Advice Bureaus, local charities and politicians with constituencies in our supply areas.

During the year we continued to hold stakeholder meetings across our communities, including our first Stakeholder Assembly with a cross section of delegates. These meetings enable us to understand the priorities of stakeholders in each area and allow them to voice concerns and feedback on our plans. Currently, we include a report of our performance on our website broken down into eight communities based on our water resource zones; yet, we are moving towards a more tailored approach so that we can focus on specific needs within those communities and target our interventions appropriately.

To meet our commitment of being open and transparent we provide information in 'Our Year in Review', which reports our performance for the year to customers and stakeholders both at a company level and broken down by community against our regulatory targets. For more information please refer to the Our Performance page of our stakeholder website:

stakeholder.affinitywater.co.uk/company-performance.aspx

We treat all members of our communities fairly and inclusively. We recognise our customers' needs and invest in the right technologies to deliver great customer experiences and increase their engagement with the water sector.

Since October 2017 we have made improvements to our website to make it more accessible for all users and we have added an 'ease' question for priority service customers, so we can check how easy they are finding interactions with us. We maintain a Priority Services Register and include messages in our literature and on our bills to signpost customers to the help they need. We have trained our team members to recognise triggers that may indicate that a customer is in a vulnerable circumstance and to act accordingly. We have met the standards for Inclusive Service Provision as certified by the British Standards Institute during the year, recognising that all customers are different with a wide range of needs, abilities and personal circumstances.

Our Community Strategy in action

AFFINITY DAYS

CARING FOR PEOPLE AND COMMUNITIES

Working with charity partners, we organise a variety of events and volunteering opportunities that employees can participate in, including conservation projects, charity fundraising and social impact projects to deliver help within our communities and further afield in developing countries.

OUR CAPITALS

- Over 200 people have been involved in26 'Affinity Day' events across all eight of our communities this year
- 32 events, guided walks, talks and 38 volunteering opportunities with local communities at our landholdings; Stockers Lake, Hilfield Park reservoir and Springwell Lake.

KEY STAKEHOLDERS

- Water Aid
- White Cliffs Country Partnership
- Wildlife Trusts
- Wild Trout Trust
- Environment Agency
- Kit Aid

ACTIONS AND OUTPUTS

- Improving the habitat of local land and rivers so that ecosystems can thrive, increasing their resilience and creating amenity value for local people.
- Increased motivation and wellbeing of our employees with new skills and knowledge gained, helping to develop a strong team.
- Engaging people on local issues to create an improved sense of community.
- Collaboratively working with our partners and local charities to help deliver their objectives.

Strategic report continued

Our environment

1.85KM
of river restored to natural conditions as part of five large scale chalk stream restoration projects

1,800KG
reduction in metaldehyde use as a result of our metaldehyde free scheme

INVASIVE SPECIES
on our sites treated to prevent spread

All three of our supply regions have been designated as areas of 'serious water stress' by the Secretary of State for the Environment, Food and Rural Affairs[1]. Government and regulators have emphasised the importance of resilience and long-term planning in adapting to increased water stress.

We know that the future will provide new challenges across all our areas. We have estimated that the population within our supply area is forecast to increase in the order of 8% by 2025, 20% by 2045 and 38% by 2080 (equivalent to approximately 1.4m more people). This means that if consumption per head remains constant, total domestic water demand in our licence area will increase and could exceed available supplies.

During 2018/19, we have delivered 23,000 Home Water Efficiency Checks. Through taking the time to meet our customers, we have been able to understand their water usage behaviours and reduce their consumption, contributing to the achievement of our PCC target in 2018/19.

We submitted our WRMP to the Secretary of State on 7 June 2019, which sets out how we plan to meet these long-term resource challenges, having consulted extensively with various stakeholders. It is available in on our website:

affinitywater.co.uk/water-resources.aspx.

We plan to meet the changing needs of the future by:

- reducing demand for water: reducing leakage to between 11% and 13% of the water we put into supply by 2045 (an overall reduction of nearly 50% from 2015); and aiming to reduce water use to between 110 and 120 litres per person per day by 2045, but only if this is affordable for customers and delivered in a way that is acceptable to them. Our actions will include: installing more water meters; engaging with customers on their water usage, providing them with more regular information on their water consumption; providing water audits to encourage water efficiency; supporting a national water efficiency campaign and working with the UK government to introduce new policies to reduce consumption; and working with retailers to improve water efficiency;
- increasing the supply of water: maximising the use of existing water sources, including making full use of water imports from neighbouring water companies where cost efficient and delivering improvements to our network that will help us move water to areas where customers will need it; and developing reliable long-term regional strategic solutions;
- collaborating with neighbouring water companies and other parties to secure the additional resources needed; and
- improving resilience to droughts, reducing the risk of resorting to exceptional measures to manage drought, such as the use of permits or orders that would temporarily increase abstraction and hence affect the environment, or even Emergency Drought Orders to restrict customer use, to a 25% chance (as a one-off event) over the sixty years from 2020 to 2080.

We have led work with other water companies to encourage best use of existing resources with new transfers of water, which will enhance our role as a key regional water trading hub.

[1] Areas where the current household demand for water is a high proportion of the current effective rainfall which is available to meet that demand; and/or the future household demand for water is likely to be a high proportion of the effective rainfall available to meet that demand.

We have established an environmental innovation performance committee to deliver eight innovative environmental projects, one in each of our communities. We also continue to be highly innovative in delivering sustainability reductions, reducing abstraction by 42.1 Ml/d since 2015. We are directing our strategy to adapt our water treatment processes to maximise the use of renewable energy, with 40% of our energy planned to come from renewable and alternative energy sources by 2030.

LEAVING MORE WATER IN THE ENVIRONMENT

Customers expect us to work diligently and respectfully to safeguard the environment. We have a high dependency on groundwater sources, which account for around 64% of the water we supply, and need to be replenished each year by winter rainfall. Other than natural aquifers, we do not have significant storage for untreated water. This means we are particularly susceptible to effects of planned sustainability abstraction reductions, pollution events and periods of prolonged dry weather.

We had a period of exceptionally hot, dry weather during summer 2018 and resultantly had 36 consecutive days where demand exceeded 1,000 Ml/d including 12 days where demand exceeded 1,100 Ml/d, challenging both our water production plants and our network. By carefully managing our network and working with other water companies to share water, we were able to meet this exceptional demand without the need to introduce temporary usage restrictions. The experience and dedication of our operational teams helped to ensure that we maintained a reliable supply of water for the vast majority of our customers.

Following the dry summer, we experienced a third consecutive winter of below average rainfall, which had a detrimental impact on groundwater levels, which were below average as at 31 March 2019. We are continuing to monitor the situation closely with our drought management group and have plans in place to make sure we are fully prepared should we experience a dry winter in 2019/20. We continue to work actively regionally to promote water efficiency messages whilst seeking new opportunities to share water resources.

Our WRMP sets out our plan to secure the long-term provision of resilient and sustainable water supplies for customers from 2020 to 2080. It emphasises that our customers will have enough water while leaving more water in the environment.

Through our industry leading abstraction reductions initiative, we are addressing the environmental challenges of protecting our precious local rivers and habitats while encouraging behavioural change. In our AMP6 Business Plan, we committed to reducing the amount of water we take from the environment by 42.1 Ml/d and have achieved this 12 months earlier than planned. We will be making further sustainability reductions of 36.3 Ml/d by 2024.

Most of the world's chalk streams are in the South East of England with many flowing through our supply area. They are particularly at risk of drying up if water tables in the chalk bedrock are lowered by too much abstraction. As part of our National Environment Programme ('NEP'), we are carrying out river restoration work and habitat improvements across our catchment areas where we are also reducing water abstraction (refer to our case study on **page 31** for more information). We must compensate for lower abstraction by reducing leakage and encouraging customers to use water more efficiently through our Water Saving Programme.

The average metered household used 149.2 l/d in 2018/19, compared to 151.0 l/d in the prior year. despite an increased demand over the hot, dry summer period. Our metering programme, home visits and communications with customers are proving effective with initial results suggesting a PCC reduction greater than our PR14 target of 13% as we aim to reduce PCC to 147.0 l/d by the end of AMP6 and to 129.0 l/d by the end of AMP7.

We provided 42,000 free water saving devices to our customers during the year and are developing a new consumption tool for My Account, our digital self-serve portal. This innovation will allow customers to see their consumption and compare it to their previous usage or an average for their local area. More information on our Water Saving Programme is available on our website:

affinitywater.co.uk/water-saving-programme.aspx

Strategic report continued

Our environment (continued)

REDUCING LEAKAGE ON OUR NETWORK

We are investing £500m in our assets over AMP6 (£776m over AMP7) mainly on infrastructure, improving it to ensure customers have enough water whilst leaving more water in the environment. Meeting this commitment requires us to reduce leakage on our network by 14% over AMP6. We are very disappointed to have failed our targets for 2017/18 and 2018/19 but we are taking action to ensure we achieve our overall target for the AMP6 regulatory period. For AMP7 we plan to reduce leakage by a further 18.5%. Please refer to **page 45** for more detail on our leakage performance.

We estimate that around a third of total network leakage occurs from customers' supply pipes. The installation of meters along with our Home Water Efficiency Project provide us with critical data for our understanding of usage and where leaks occur. We have installed more than 158,000 meters as part of our Water Saving Programme to date. We believe that the meters installed to date will have helped us identify 16Ml/d of customer side leakage by the end of AMP6. We have also installed 20,000 acoustic loggers on our network to help us identify and repair small leaks early in their life before they grow.

SUPPLYING HIGH QUALITY WATER

Maintaining the high quality of the water we supply to customers is vital. During 2018/19, we carried out 180,000 tests on water leaving water treatment works, at reservoirs and at customers' taps as part of our regulatory monitoring programme. In addition, we carried out over 600,000 tests on operational samples, with all plastic bottles used in the process being sent for recycling.

In line with our environmental policy, we are committed to meeting the EA's expectations on preventing pollution and minimising harm done to the environment. There were no Category 1 and 2 notifiable pollution events in 2018/19 (2017/18: none). However, the company continues to be proactive with regards to the environmental impact from bursts on the water network and to report to the EA burst events that have the potential to cause pollution.

Our overall water quality compliance performance in 2018, as regulated by the DWI was 99.96%, outperforming our regulatory target. Please refer to **page 44** for more detail on our water quality performance.

The risk of pollution impacting our water resources from activities such as pesticide or fertiliser losses from agriculture means that it is important that we promote effective catchment management. Our Catchment Team investigates the sources of pollution posing a risk to drinking water and works collaboratively with a range of stakeholders including regulators, land owners, farmers, advisers, environmental groups and businesses to minimise the impact pollution has on the water environment and public water supply. Our team gave talks and presentations at 21 local, regional, national and international events throughout the year to promote key messages on protection of water from pollution.

We have been working in partnership with other water companies in the Thames River Basin to develop our understanding of high risk areas for pesticide pollution. We now operate pesticide reduction schemes in approximately 600km^2 of river catchment upstream of our water treatment works where the risk is greatest. This has led to improvements in water quality in all of these catchments.

We have also been running five cover crop trials on farms in our Lee and Dour communities. A cover crop is a crop that is not harvested but is grown primarily to improve the soil and reduce nitrate leaching into groundwater. By covering otherwise bare land with a cover crop for the winter months, nitrate leaching can be vastly reduced. Alongside these trials we ran four events for local farmers to observe the trials and learn more about cover crops. More than 120 farmers attended these events and we are implementing a project to work with farmers in our high risk catchments using an innovative catchment-trading platform in order to incentivise them to plant more cover crops to protect water and improve biodiversity.

Our Community Strategy in action

RIVER RESTORATION PROJECTS

LOOKING AFTER ENVIRONMENTS WITH PEOPLE AND COMMUNITIES

This year we have completed three river restoration projects delivered in collaboration with local councils, catchment partnerships and the Environment Agency. The river restoration work is part of a wider programme to restore globally rare chalk streams to their natural flow and help create sustainable habitats to allow fish, insects and plants to flourish.

OUR CAPITALS

River restoration projects have been delivered at three chalk streams in our supply area.

The rivers and open spaces provide high amenity value for our communities to enjoy and improve their wellbeing.

KEY STAKEHOLDERS

- Luton Borough Council
- The Luton Lea River Catchment Partnership
- Dacorum Borough Council
- The Environment Agency, as part of the Revitalising Chalk Rivers Partnership

ACTIONS AND OUTPUTS

- A new meandering river channel has been created for the River Lee at Manor Park, which will help ease flood water further downstream during times of high flow and better support a variety of plants and wildlife.
- Obstructions, such as weirs, have been removed and riffles and pools have been installed to create the new river channel, which promotes greater biodiversity and native species on the River Gade at Gadebridge Park.
- Tree works and bund construction have taken place on a 270m length of the River Misbourne to improve habitat, divert flow and to narrow the river channel.
- We have restored and improved 1.85km of chalk streams through five large scale river restoration projects.

Strategic report continued

Our people

£14,000 raised by our people through our 'Time to Give' initiative and distributed to 11 local charities

We have **10 NEW** ambassadors supporting 'Challenge: Water' students by sharing their knowledge of the water industry

We have **24 SCIENTISTS** who are members of various professional science bodies, with seven of these holding chartered status

Our people play a critical role in creating long-term value. They are our ambassadors, living and working in the communities we serve. They have the local knowledge and understanding to make sure we deliver what our communities expect of us and to ensure that our contribution really makes a difference.

Attracting and retaining highly motivated people who are proud to work for us is central to our ability to deliver an outstanding service for customers. We surveyed our people during the year to 31 March 2019, with 78% participation, to ask them key questions about working for us. Our participation rate decreased slightly and our overall engagement score was 58% (5% down on the last survey in November 2017), although our analysis has shown this not to have had an impact on our attrition rate.

During the year, our Executive Management Team conducted a series of Directors' Roadshows to hear face to face some of the challenges being faced by employees. We plan to demonstrate our commitment to make Affinity Water a great place to work by implementing actions to address the resultant findings to ensure we achieve an improvement in employee engagement going forward.

The search for continuous innovation is embedded in everything we do and is driven from our Board through our Executive Management Team to all parts of our organisation. We are continuing to shift our working practices to be more agile and more responsive as well as transforming customer experience.

In order to stay within our target of unplanned interruptions to supply over 12 hours we have established a Rapid Response and Restoration team (for more information, refer to the case study on **page 39**). We saw a significant improvement in our performance as a result, compared to the prior year.

Our suppliers and contractors provide us with essential services which we rely on to deliver our short and long-term plans. It is vital that we work closely with them, for example on large capital projects where delivery on time, to budget and with minimal customer impact has economic, societal and environmental benefits. Close collaboration is important to help support the delivery of these benefits and we have framework agreements with our key suppliers to encourage and reward responsible business practice.

Our Code of Conduct sets out the principles by which we work every day, take actions and decisions, and interact with each other and our wider communities. It explains what we stand for and shows others they can rely on us.

The Companies Act 2006 requires us, to the extent necessary for an understanding of the development, performance or position of the company's business, to include information about human rights issues. Given our operations are limited to the South East of England and that we are a highly regulated business, we do not believe this information is necessary for such an understanding and have therefore not included it.

The Board has approved a Modern Slavery and Human Trafficking Policy and approves the company's annual statement on Modern Slavery and Human Trafficking, published on our website:

stakeholder.affinitywater.co.uk/corporate-responsibility.aspx

We put in place training for our employees on modern slavery and human trafficking issues, and ensure robust systems and processes are in place to assess our supply chain.

TRAINING AND DEVELOPMENT

We have created a strong culture of learning and development, investing in training, and we are building a culture of coaching and mentoring to release the potential of our people. We constantly rely on the professionalism and dedication of our people and our contractor partners. We recognise that we have an ageing workforce and are taking the necessary actions in equipping our business for the future.

We are investing in training and the up-skilling of our people to maximise our own internal talent through development and succession planning. We will also continue to use innovation to identify new ways of working and develop our own teams to reach their full potential.

Our revitalised Production Apprenticeship programme was initiated in June 2018 with the view to upskilling nine of our people into fully qualified Production Technicians by 2021. The programme consists of a combination of classroom theory, workshop practical and on-the-job learning. By the end of the three-year programme our apprentices are expected to have achieved the City and Guilds Level 3 Electrotechnical Qualification and the Maintenance and Operations Engineering Technician qualification. This involves successful completion of end-point assessment and passing exams.

Our Quality Policy commits line managers to use trained and competent people. Our staff and training corporate standard establishes that our people:

- are trained to perform their tasks safely, efficiently, and effectively;
- have the opportunity to request training as part of their continued development; and
- provide appropriate documentary evidence to support training.

In order to fulfil this, the standard requires line managers to:

- conduct regular appraisals; and
- review the competence and resulting training requirements of their team members.

Our people are essential to improving the service customers receive. We have been awarded Continuous Professional Development Approved Employer status which recognises our commitment to professional standards. Please refer to our case study on **page 35** for more information on how we support our people's professional development.

A new digital learning portal was launched in April 2018 offering a catalogue of online training courses. Through this platform, all our team members completed General Data Protection Regulation training ahead of the new legislation coming into effect in May 2018.

Over the past year we have taken significant steps to develop our learning and development offering for employees who have a role that could impact on the water quality provided to our customers by achieving Competent Operator Scheme Certification from the EUSR and endorsed by Water UK in February 2019.

The Water Industry Competent Operator Scheme is a framework of thirteen clearly defined principles for evaluating and assessing a water company's competence management system against agreed industry criteria. It provides assurance that every licensed operator is working to minimum standards of operational good practice. In order to gain certification, we:

- developed our digital learning portal to keep all our colleagues' development information in one place;
- gave our people and managers the support they need in their jobs by introducing training plans, competency frameworks and assessments, which are reviewed on training completion and annually; and
- stored all our competency data in one system for greater visibility and to better understand our peoples' skills, competencies and development needs.

The certification, which is renewed every five years, confirms to the DWI and our customers that we are mitigating the risk of water quality failures due to human error.

SAFETY AND HEALTH

The safety, health and wellbeing of our people and suppliers are priorities we take very seriously. Our vision and the customer expectations that we will continue to meet are all set in the context of our commitment to operating our business without harm.

Our new digital learning portal includes an offering of safety and health courses including a bespoke course for Sphera, our system for recording and managing safety and health incidents. All employees have a licence to access Sphera and we have also invested in the Sphera mobile application, allowing community-based colleagues to report incidents in real time.

Strategic report continued

Our people (continued)

SAFETY AND HEALTH (CONTINUED)

Awareness of safety and health has steadily increased during the period, with the number of safety observations reported on Sphera increasing from 2.17 per person per month in March 2018 to 3.90 as at March 2019, and the number of lost time injuries per 100,000 hours worked decreasing year on year (refer to **page 46**).

We have also seen significant improvements in the leading safety behaviours that we have measured targets for. These behaviours include line managers carrying out site safety tours, improvement in completion of incident investigations and completion of self-assessments against our Common Safety Standards, which help to ensure safety compliance.

In addition to these we have also:

- streamlined communications by improving our monthly safety brief, which is distributed to all employees;
- re-established regular safety and health meetings with our recognised trade unions;
- improved how we feedback to the business following our quarterly reviews of incidents;
- progressed our occupational health plan towards a more systematic approach;
- standardised activities around utility strike avoidance across all our direct labour and contractors;
- created more openness around incidents with the inclusion of union representation at each of our Incident Review Boards; and
- continued to work with our contractors to raise standards of works through inspection programmes, safety stand downs and regular senior leadership forums.

DIVERSITY AND EQUALITY

We are committed to building a more inclusive culture and promoting equality of opportunity in all areas of employment including recruitment, internal promotions, opportunities for training and pay and benefits. By committing to inclusivity, we ensure that our company and its values best reflect the communities we serve. For more information refer to our Chairman's introduction to our Governance section on **page 64**.

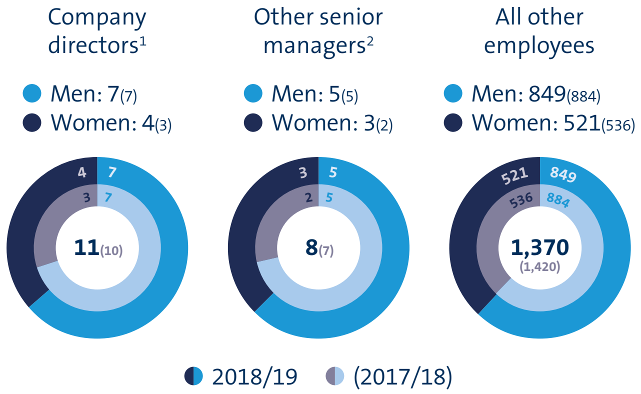
We have published our gender pay gap report for April 2018 on our stakeholder website:

stakeholder.affinitywater.co.uk/corporate-responsibility.aspx

which showed a 2.3% reduction in our mean gender pay gap from 24.8% in April 2017 to 22.5%. Initial work on our April 2019 reporting indicates a further reduction of 3.5% to 19.0%. Our analysis suggests that gender pay differences are attributable to factors which are common to our industry, including more male employees in senior roles and more male employees in roles where allowances are paid that relate to working patterns of their roles.

All of our employees are eligible to receive a bonus based on company performance and our median bonus gap in April 2018 was 0%. Our April 2018 report showed a higher proportion of male employees receiving a bonus, due primarily to timing of employees joining and leaving the business.

We have introduced gender monitoring so that we can identify and respond to any trends in the proportion of males and females applying for roles and being recruited, and the proportion leaving the organisation and their reasons for leaving. We are keeping our flexible working arrangements under review and continue to seek ways to enable more of our employees to balance work and personal commitments through technology. We have increased the proportion of females on our Board and Executive Management Team as at 31 March 2019 as shown in the graphic below:



[1] Company directors consist of our Board members, as detailed on **pages 69 to 74**.

[2] 'Other senior managers' are as defined in the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013, and include persons responsible for planning, directing or controlling the activities of the company.

Our Community Strategy in action

SUPPORTING OUR PEOPLES' PROFESSIONAL DEVELOPMENT

WORKING TOGETHER WITH PEOPLE AND COMMUNITIES

We are committed to developing a learning culture that actively encourages employees to engage in professional development. Our Professional and Academic Policy outlines the support available to those who wish to undertake formal education and training as part of their career development within Affinity Water. We can provide financial support and mentors to help our people achieve charterships and professional body memberships.

OUR CAPITALS

Our people are our most valued asset. Professional registration builds confidence, motivates people and ensures continuity of business by aiding succession planning.

We have paid professional fees for memberships and subscriptions on behalf of employees to over 30 different associations and professional bodies, worth over £30,000.

KEY STAKEHOLDERS

- Professional bodies
- Line managers
- Employees

ACTIONS AND OUTPUTS

- We have been recognised by the Science Council by achieving Employer Champion status as we are committed to promoting the values of professional registration and supporting our scientific staff through the registration process.
- Our people are members of more than 30 different professional bodies from a range of disciplines including engineering, chemistry, biology, environmental management and accountancy.
- We are a Corporate Affiliate of the Association for Project Management, allowing our people to access a range of member tools and resources, and join networking events and conferences.

Strategic report continued

Our assets and sites

We provided site tours to engineering students and stakeholder groups to explore what it takes to treat, pump and store water

We produced **16,000 TONNES** of sludge cake at two of our water treatment works sites which is then taken and used for agricultural purposes

87 ecological surveys were completed on our landholdings as part of our Biodiversity Programme

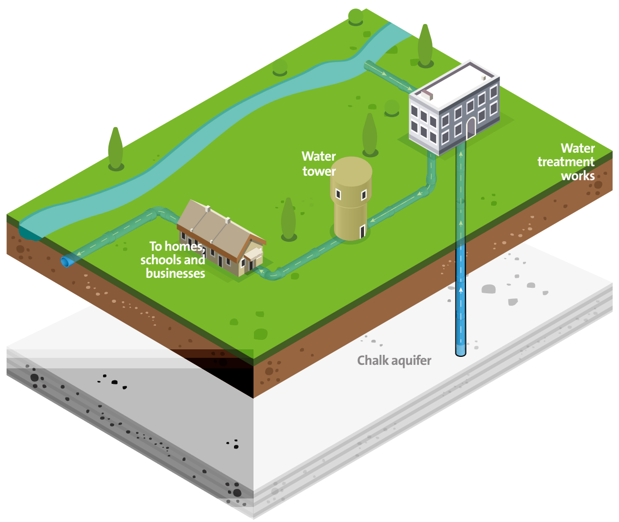
Our assets allow our people to make use of the water resources provided by the environment to supply customers. We distinguish between two main classes of assets in the way that we manage our business.

Our above ground assets collect water from groundwater or river sources and deliver it to our 94 treatment works where we convert raw water into high quality wholesome drinking water. Our below ground network of assets takes water from treatment works and delivers it to homes and commercial premises through more than 16,700km of mains. Particularly strict standards of hygiene are applied to these assets.

The security of our assets and sites is also extremely important to be able to provide a continuous supply of high quality water. We have commenced a programme of work to protect our sites in line with the Security and Emergency Measure Directive obligations. 178 of our 282 sites are now compliant using a range of physical and electronic protective features, and we expect to be fully compliant by March 2020.

Maintaining the health of our assets is essential so we invest in tools and equipment to measure and record their condition. Our industry-leading Asset Performance laboratory aims to improve our understanding of the health of our pipeline assets and inform our rehabilitation strategy. When a pipe bursts or scheduled renewal work takes place, samples are sent to the lab team so that we can understand how the soil environment and internal chemistry affect the lifespan of the pipes.

Since its inception in 1992, the Asset Performance lab has processed more than 6,000 pipe samples, capturing the data in our Geographical Information System. The information is used to determine the deterioration rates of the network and the remaining useful life of the pipes, informing future investments.



We are constantly innovating and exploring new ideas and techniques to check whether our assets are running at optimum efficiency. We can now monitor our pumps in real time and identify the optimum mix of pumps to use by measuring small temperature changes across a pump to within one thousandth of a degree.

We have successfully trialled technologies to monitor and warn of degradation of our mechanical plants enabling us to make preventative repairs and avoid unplanned interruptions to supply. We have also developed an instrument that monitors bacterial sized particles at our production sites. This will help us gain a better understanding of what comes through our filters and whether there is a possibility of bacterial regrowth in our distribution system.

PRODUCTION AND SUPPLY

We experienced some significant challenges this year with environmental events, firstly recovering from the 'freeze/thaw' event in March 2018 and then the exceptional hot, dry summer weather period.

Our production estate performed well under both events. We were able to maintain supply to our customers during the hot weather period with minimal disturbance.

New peak outputs were achieved and maintained at many of our water treatment works. During these events we demonstrated our ability to support the broader region increasing volumetric support to Thames Water and South East Water even at times of peak demand.

In November 2018 we detected cryptosporidium oocysts at two of our key water treatment works. This unusual occurrence had the potential to trigger a significant water quality event which mobilised our emergency response team. Water quality samples taken on subsequent days confirmed the water quality was satisfactory and the most likely root cause was a short lived contamination of the River Thames. In response to the event and alongside immediate short-term activities, we have enhanced catchment activities and undertaken a more detailed review into contingency arrangements, catchment and treatment controls.

We continued to encounter a number of short duration reservoir failures during the year. As a result, we had to import more water to make up for the outages. We are committed to prioritising water quality and have increased inspection frequency and reduced the time taken to remove reservoirs from service. In order to establish a longer-term solution for our supply failures, further changes have been made to our inspection and maintenance regime following detailed operational condition assessments.

We continually seek operational efficiency and have achieved further reductions in our costs of production through chemical optimisation and water source selection. As part of our AMP6 capital programme we have delivered a major improvement to our granular activated carbon filters at one of our largest water treatment works, which has improved our resilience to pesticide treatment.

In 2018/19 we focused on improving our unplanned interruptions to supply over 12 hours, recognising that we had underperformed in this area since the start of AMP6. We launched new initiatives and ways of working, establishing a 24-hour Network Control Desk to work alongside the Production Control activities at the heart of our supply team. We also created an interruption to supply delivery team to formulate the procedures that will govern how our restoration and repair solutions will be delivered more rapidly and consistently.

As a result, we achieved our target of fewer than 320 properties experiencing unplanned interruptions to supply of more than 12 hours this year, a marked improvement on the previous four years. Please refer to **page 44** for more details on our operational performance.

Strategic report continued

Our assets and sites (continued)

MAINTAINING OUR ASSETS

Our AMP6 Business Plan sets out how we ensure that customers continue to receive the high quality of water that they expect in AMP6 and beyond by investing in our treatment works and targeting lead pipe replacement to further increase the resilience of our network. Our Lead Programme continued to make progress this year and remains on course to remove all lead service pipes from Finchley and Watford as well as from all educational establishments, where children 11 years or younger are present, across our entire supply area by the end of AMP6.

Sustained progress throughout the year continued to be realised across our mains renewals programme, with more than 300km of mains replaced in this AMP. We also replaced 10km of our trunk main network this year, bringing our AMP6 total to 39km.

The majority of our assets do not have moving mechanical parts and therefore have long operational lives (pumps being a major exception). As a result, we have a large collection of assets of various vintages, designs, and materials that have accumulated since the mid-nineteenth century. Stewardship of these long-lived assets is therefore a key requirement.

Our business needs to operate 24 hours a day, 365 days a year, so our assets need to have high levels of reliability. Emergency responses to failure are an important aspect of our business, as are maintenance planning and failure prevention.

TECHNOLOGY AND BUSINESS CHANGE

Technology will play a vital role in our ability to deliver against our very challenging AMP7 targets. Building on our existing work with smart sensors and connected device technologies to get a view of asset condition and performance from 'source to tap' are essential to our future strategy.

We will continue to turn data into actionable insight by using cloud technologies to bring all our data into one place, on one platform, to inform real-time operational decision making. We are also increasingly introducing intelligent data management, machine learning, robotics and artificial intelligence to our business.

We continue to use advances in technology to minimise disruption in our communities when we carry out essential maintenance work. We have developed a custom-built solution which uses machine learning and artificial intelligence to recognise pattern changes in the water pressure across our 3,000 sensors. This helps our network teams to identify issues much more quickly and is fundamental to our ability to meet our interruptions to supply targets. This technology can be further enhanced to include water flow pattern recognition, weather and temperature variations and automated modelling.

Our business strategy has innovation at its core. We are on a journey to move key applications out of data centres to cloud-based systems to support and minimise disruption to our IT systems. This will help to drive future efficiencies and we will now seek to maximise the benefits of these new systems to ensure that they have a positive impact on our levels of customer service.

Information Security is another priority for us and we have made significant improvements to both data security and resilience of our IT assets. Our team members have been trained in phishing identification and cyber security.

The rollout of Maximo, our new Works Management System, was completed during the year. All our operational engineers now have access to Maximo on Toughbook devices which means better access to the right information in the field so we can respond quicker and ensure we get things right first time whilst keeping our customers informed. Our recent technology transformations have improved our resilience and have laid the foundations to continue to innovate and enhance our business as we progress into AMP7.

Our Community Strategy in action

RAPID RESPONSE AND RESTORATION TEAM

CARING FOR PEOPLE AND COMMUNITIES

We created the Rapid Response and Restoration team to deliver improvements to our response time; minimise interruptions to supply; limit any adverse impact for our customers; and meet our industry targets. We have also set up a 24 hour Network Control Desk to co-ordinate our teams and developed a suite of decision-making tools to help teams understand what restoration options are available and when they should be deployed.

OUR CAPITALS

Three of our sites have been identifed as Rapid Response and Restoration Hubs and are ready to be deployed in case of emergency.

Over 100 of our team members have been briefed on this process so far.

£500,000 investment on plant, equipment and fittings to ensure we have stock available.

KEY STAKEHOLDERS

- Our customers
- Our operational teams
- Our production teams
- Our Water Quality department
- Our Network Control Desk
- Our Operational Service Desk
- Our support services teams

ACTIONS AND OUTPUTS

- Our people have received specialised training and opportunities to gain experience of dealing with unplanned events that need prompt resolution.
- Our customers will receive an improved service, thanks to greater emphasis on restoration and a refocus of our resources when dealing with interruptions to supply.

Strategic report continued

Our finances

£46,000
donated to 24 local community groups and charitable causes

Almost **7% REDUCTION**
in water bills in real terms since 2015

60,000
households supported by our social tariffs

We are a business with a long-term outlook and expenditure commitments, which need to be matched with long-term sources of debt finance. We consider the most cost effective way to raise long-term debt is through the debt capital markets. In February 2013 we raised £575.0m in these markets to refinance the bank debt used to fund the acquisition of the company from Veolia Environment S.A. We took the decision to set up a bond issuance programme in the process, which enables us to issue further bonds without the need for significant additional documentation.

Since then we have issued further bonds, both new and tap issues, to raise a further £189.2m. **See pages 95 to 96** for further details of our financing arrangements, including the maturity profile of all our bonds, which also include a further £250.0m bond issued in 2004.

We have secured financing for the remainder of AMP6 and into the beginning of AMP7. Further financing will be required in AMP7 to fully fund the investments planned for AMP7. We expect to undertake our next refinancing exercise in July 2026 when the £250.0m fixed rate bond matures. The maturity profile of all our borrowings is set out in note A4 to our statutory financial statements.

In January 2019, we completed the substitution of our Cayman Islands financing entity with a UK entity as part of simplifying our group structure.

We plan to invest £1.37bn in our assets and as operating expenditure during AMP7. This will be key to maintaining resilience and making sure our customers have enough water, whilst leaving more water in the environment by delivering sustainable abstraction reductions in line with our Water Resources Management Plan for the 60-year period from 2020 to 2080.

We will invest in local level assets such as pumps, mains upgrades and service reservoirs. Our enhancement programmes will contribute to ensuring resilience by delivering new access to water and increased capacity and flexibility to transfer water into and across our supply area.

Our plan for AMP7 keeps customers' bills as low as possible and ensures our business is financeable and able to withstand financial shocks. We have stress tested our plan, whilst maintaining the ratios within our covenants at a level consistent with our corporate family credit rating of Baa1 (as currently measured by Moody's).

LIQUIDITY AND ACCESS TO MARKETS

Our objective is to ensure we have banking arrangements and adequate, though not excessive, cash resources, borrowing arrangements and standby facilities to enable us at all times to have the level of funds available which are necessary for the achievement of our business and service objectives. At 31 March 2019, we had cash balances of £111.5m (2018: £114.8m).

Interest rate exposure is primarily managed by using a mixture of fixed rate, floating rate, CPI and RPI linked borrowings (refer to note A4 to our statutory financial statements). An RPI linked inflation swap with a nominal value of £135.0m, which is linked to the maturity of the Class A fixed rate £250.0m bond (July 2026), was entered into in August 2018 as this was the most efficient way to switch to a higher proportion of index linked debt. Ofwat's final methodology for PR19 has confirmed that prices in the industry will in future be indexed to CPI instead of RPI.

At the year-end, 62.3% of our gross borrowings were at fixed rates (2018: 62.8%), 32.1% (2018: 31.6%) at rates indexed to RPI, 5.6% (2018: 5.6%) at rates indexed to CPI and none (2018: none) were at floating rates. Taking into account the RPI linked inflation swap entered into during the year, the proportion of borrowings at fixed rates decreases to 49.7% and the proportion indexed to RPI increases to 44.7%.

To the extent that additional funding is required, as well as our cash balances, we have access to £100.0m of bank facilities (2018: £100.0m), which were undrawn at 31 March 2019 (2018: undrawn), to finance capital expenditure and working capital requirements.

In addition, we have access to a further £61.0m of liquidity facilities (2018: £58.0m), consisting of a 364 day revolving £38.0m facility to fund any debt service payments in the event of a liquidity shortfall that would otherwise prevent such payments being made and a 364 day revolving facility of £23.0m to fund operating and capital maintenance expenditure in the event of a liquidity shortfall.

At 31 March 2019, net debt, as defined in the financial covenants in the company's securitisation documentation ('compliance net debt'), was £959.5m (at 31 March 2018: £949.0m). Compliance net debt to RCV at 31 March 2019 was 78.3% (at 31 March 2018: 78.6%), below our internal maximum gearing level of 80.0% of RCV. This allows sufficient headroom within financial covenants, which are only triggered at a level of more than 90.0%. For more information, refer to table 1E of our regulatory Annual Performance Report.

PAYMENT PRACTICES

As part of the Government's initiatives to help small businesses in tackling late payments, a new set of regulations was introduced in April 2017 which requires the UK's largest companies and Limited Liability Partnerships ('LLPs') to report their payment practices on a half-yearly basis. Our first reporting period started in April 2018 and we published our payment policies and performance in October 2018 and April 2019.

We have seen an improvement in our performance between the two periods with a reduction in our average time to pay invoices (from 42 to 39 days) and late payments (from 49% to 40%) but recognise there is still room for improvement. We will continue to monitor our performance and maintain ongoing communication with all stakeholders to facilitate more efficient invoice processing and payments.

DIVIDEND AND REMUNERATION POLICIES

Our Board has approved revised dividend and executive remuneration policies available on the governance pages of our website:

stakeholder.affinitywater.co.uk/our-governance.aspx

that provide for dividends, and executive remuneration appropriate for the long-term returns and performance of the company, whilst not impairing its longer term financeability.

The amount of the dividend is dependent on the success of the company in generating cash flows and achieving its regulatory outputs. An assessment is also completed by the Board to determine if the payment or part payment of the dividend reflects and/or would compromise the long-term social, financial and operational commitments made to stakeholders, which include the following areas: customer service, operational commitments and community commitments, as well as employees and the health of the pension plan.

To ensure the business remains financially resilient, the Board is required to assess the long-term viability of the company, ensure that sufficient liquidity is maintained after a dividend is paid and that, based on projections, the company should maintain its credit rating within the headroom target set for gearing.

This is appropriate considering the requirements of Condition I of our licence that dividends paid will not impair our ability to finance our appointed business, and under a system of incentive regulation, dividends would be expected to reward efficiency and the management of economic risk.

Strategic report continued

Our finances (continued)

VALUE FOR MONEY BILLS

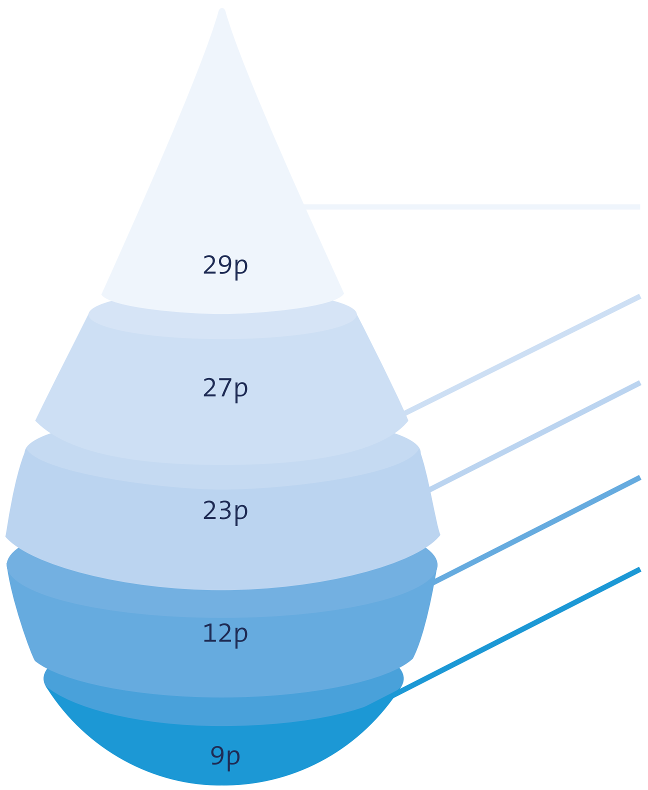
Our challenge is to achieve value creation for investors by performing efficiently while also achieving value for money for customers by maintaining our local environment, sustaining our local communities and supporting our local economies. Investor value can be created by outperforming in selected areas, thereby receiving regulatory rewards for doing so and through effective risk management to reduce cash flow volatility. Value for money for customers is achieved by delivering the standards of service customers expect along with the performance commitments included in our AMP6 and AMP7 Business Plans at a reasonable price (refer to the table on **pages 22 to 23**).

Our support for financially vulnerable customers who have a low household income or are claiming benefits has grown in the period with 60,000 households now supported by our social tariffs (LIFT and Watersure). Customers benefitting from these tariffs receive a reduced fixed rate. We plan to introduce a Customer Assistance Fund by 2020 and aim to expand our social tariff offering support to 82,000 customers in AMP7.

We have been addressing affordability issues through social tariff, value for money and living wage commitments. Affordability of our water bills is a particularly acute issue in some of the communities we serve. Any increase in sewerage charges, which are billed to the majority of our household customers and which we collect on behalf of other companies, can exacerbate underlying affordability concerns.

We have worked hard to keep our bills low whilst maintaining a high quality and trusted service. Our water bills are consistently lower than the industry average, and will have reduced in real terms by almost 7% across AMP6[1]. We plan to further reduce the average annual customer bill over the 15-year period to 31 March 2030 from £183.50 to £164.50 (before inflation) while also planning to invest £1.37bn during AMP7. This significant investment is being made to meet the environmental requirements and commitments supported by our customers. We have managed to keep bills low with our proposals to deliver over £200.0m of efficiencies in AMP7.

Each pound of our customers' bills is spent as follows[1]:



Our assets: 29p (2018: 31p)
Investment in our assets

Our suppliers for operating services: 27p (2018: 21p)
Operational cost of suppliers' services

Our people: 23p (2018: 18p)
Wages, salaries and pensions

Our bondholders: 12p (2018: 9p)
Interest paid on debt financing

Local and central government: 9p (2018: 10p)
Corporation tax, business rates, abstraction charges, employer's national insurance, Climate Change Levy and streetworks permits

Our shareholders: 0p (2018: 11p)
Dividends from our regulated business and interest on shareholder debt

[1] The average bill amounts are presented using the November 2016 CPIH index to represent a consistent 2017/18 price base; using the November index preceding the price base year in use is consistent with the Discover Water method applied for valuing average real bills through time.

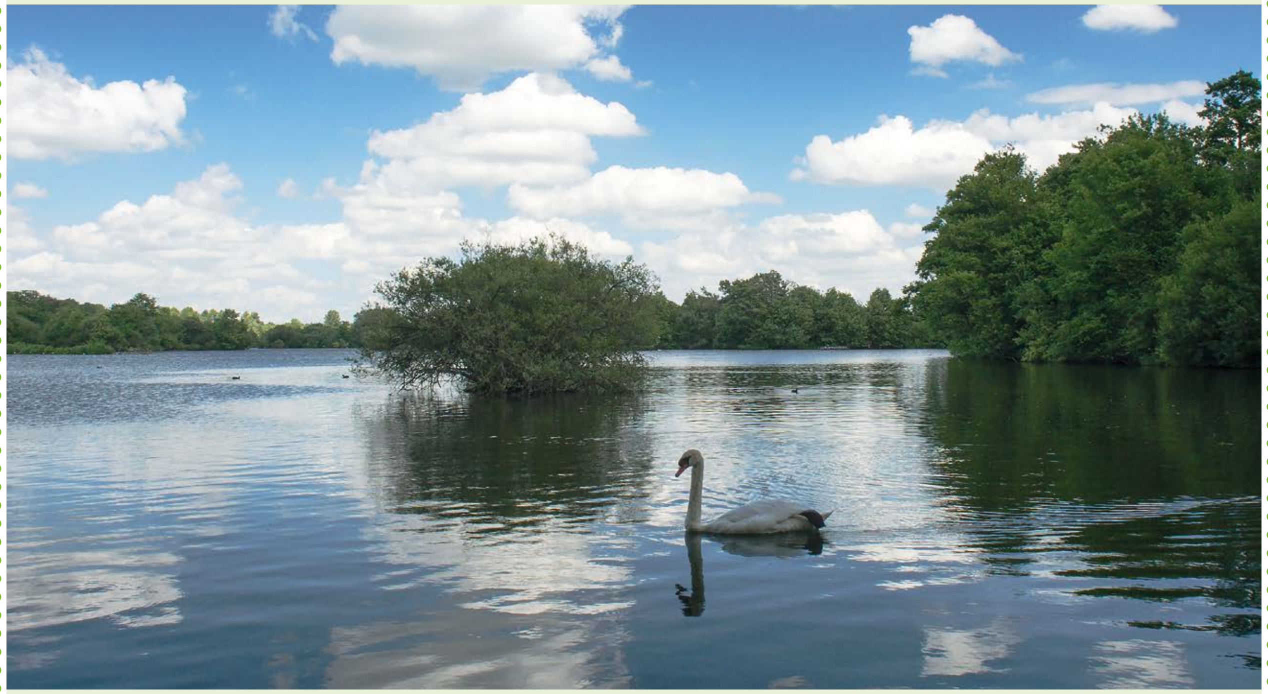
[2] Figures are based on our regulatory financial statements for the year ended 31 March 2019 and have been rounded. The amount spent on our people increased in 2018/19 due to a higher headcount and an increase in the number of operational jobs completed during the year, as well as a £1.5m increase to our defined benefit pension plan cost as a result of the court ruling in October 2018 to remove historical gender inequalities in relation to GMP. This was partially offset by lower contributions being paid by the company as a result of our pension plan becoming fully funded on a self-sufficiency basis.

Our Community Strategy in action

HERTS AND MIDDLESEX WILDLIFE TRUST PARTNERSHIP

LOOKING AFTER ENVIRONMENTS WITH PEOPLE AND COMMUNITIES

We have been working with the Herts and Middlesex Wildlife Trust for nearly 40 years managing our nature reserves for wildlife and local people. Our partnership is helping to deliver real environmental and community outcomes at three of our sites. Detailed management plans are in place and a schedule of educational events and volunteering provide great opportunities for local communities to get involved and learn about the local habitats.



OUR CAPITALS

Maintenance of the recreation and amenity facilities at Stockers Lake, Springwell Reedbed and Hilfield Park Reservoir.

Over £50,000 invested in 2018/19 as part of our Biodiversity Programme to maintain and enhance our Local Nature reserves for people and wildlife.

KEY STAKEHOLDERS

- Herts and Middlesex Wildlife Trust
- Friends of Stockers Lake
- Our communities

ACTIONS AND OUTPUTS

- Shared skills and learning from experts in the field of conservation and land management
- Directly engaging with nearly 600 people from local communities through a number of events, guided walks and volunteering opportunities inspiring them to undertake water and nature conservation
- Provided 150 school children with opportunities to learn about, experience and value nature
- Creation of new habitat and increased diversity of species

Strategic report continued

Operational performance

We have aligned our operational KPIs to our key performance commitments in response to customer expectations. We want customers and stakeholders to be able to assess our track record and hold us to account. We are required to report our performance against targets set by Ofwat, the DWI and Defra. These targets include the performance commitments made in our AMP6 Business Plan. Our performance in relation to these targets for 2018/19 is analysed in the table below.

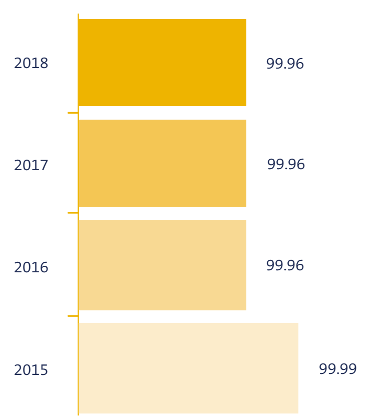
For more information on our performance for 2018/19 in relation to all the performance commitments we made in our AMP6 Business Plan refer to **pages 225 to 227** in our regulatory Annual Performance Report.

KPI: Water quality
MZC (%)

2018 actual:
99.96

2018 target:
99.95

2019 target:
99.95



In the calendar year 2018 there were 64 exceedances of standards from 180,000 compliance samples taken from our sites and consumer properties (2017: 68 exceedances from 160,000 compliance samples). Of these, 19 exceedances (2017: 32 exceedances) contributed to the MZC calculation. Another measure of our performance is the number of serious and significant incidents. During 2018 seven events notified to the DWI were classified as serious or significant (2017: four events).

We continue to work to reduce the number of exceedances and events, through:

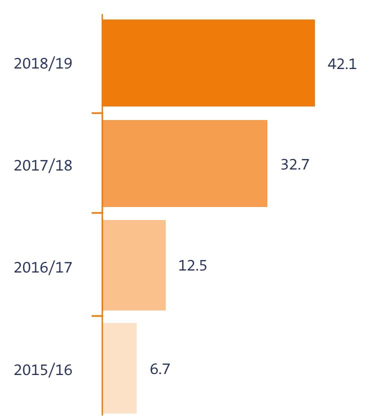
- making improvements to our asset resilience;
- coaching and developing our people;
- adherence to processes and procedures;
- auditing and control/completion of planned programmes such as pesticide removal schemes at our water treatment works; and
- replacement of lead pipes.

KPI: Sustainable abstraction reductions
Cumulative average annual reduction in water abstracted from our river catchments (Ml/d)

2018/19 actual:
42.1

2018/19 target:
42.1

2019/20 target:
42.1



We delivered a 42.1 Ml/d reduction in abstraction as at 31 March 2019, achieving our sustainability reductions in line with our AMP6 Business Plan.

We have constructed new infrastructure to enable us to move water around our network more effectively to maintain the level of service to our customers whilst also leaving more water in the environment, contributing towards the protection of chalk streams.

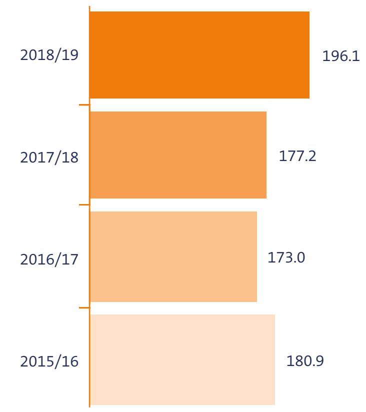
We have also made significant progress on our river restoration and habitat enhancement programme, completing projects on five chalk streams in our Central region. We continue our collaborative approach to delivering this work under our Revitalising Chalk Rivers partnership with the Environment Agency.

KPI: Leakage
Average annual water leakage from our network (Ml/d)

2018/19 actual:
196.1

2018/19 target:
167.7 or less

2019/20 target:
162.2 or less



We attach a high priority to meeting leakage reduction targets, as we want to demonstrate that we are playing our part when we are asking customers to save water, and also to overcome the loss of resources to improve conditions on local catchments.

We have fallen short on the leakage reduction we planned to deliver this year, leading to an ODI penalty of £6.972m that will be realised in AMP7.

A significant contributor was the discovery of a large burst at the outlet of one of our largest treatment works that ran for a large part of the year. We were also affected by 2018 summer's unusually warm and dry weather with increased bursts and pressure issues caused by the high demand. Our ability to target leakage was further complicated by the high night use seen.

In Autumn 2018, we triggered an action plan with additional resources to return leakage to target levels. Although our actions did not result in meeting the 2018/19 target, our current leakage performance has us on track to deliver our 2019/20 target of 162.2Ml/d. Our daily leakage level as at 31 March 2019 was 160.9 Ml/d.

We have learnt the lessons of 2018's long, dry summer and we are using technology and analytical insight in ever more effective ways to reduce leakage. These changes, combined with a revised operating structure and a strengthening of our internal skills and competencies (to reduce our reliance on the supply chain), means we believe we are in a strong position to meet our target of a 18.5% reduction in leakage by 2025.

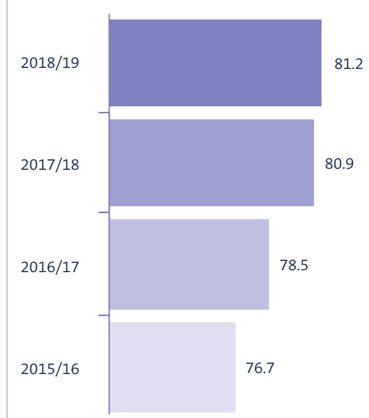
The large burst at the outlet of one of our largest treatment works has resulted in us restating our 2017/18 leakage figure. The burst caused an increase in leakage which averaged 5.7Ml/d for 2017/18. This means that instead of meeting our target for 2017/18 we failed by a total of 4.1Ml/d. As a result, we have incurred a penalty of £1.026m through our ODI regime that will be realised in AMP7.

KPI: SIM
(Score)

2018/19 actual:
81.2

2018/19 target:
81.3

2019/20 target:
82.3[1]



Our overall SIM score improved from 80.9 for 2017/18 to 81.2 for 2018/19 due to significant improvements within the quantitative SIM measure, by reducing unwanted contacts by 18% and complaints volumes by 22% compared to 2017/18.

Within the survey part of SIM, of 800 customers surveyed, 78% (2017/18: 79%) were satisfied or very satisfied with our service and only 10% (2017/18: 9%) were dissatisfied. Our average survey score for 2018/19 was 4.22 out of 5 compared to 4.26 in 2017/18.

[1]SIM is not being measured by Ofwat in 2019/20 and therefore will be measured from the C-MeX score and the continued reporting of unwanted calls and complaints by the company.

Strategic report continued

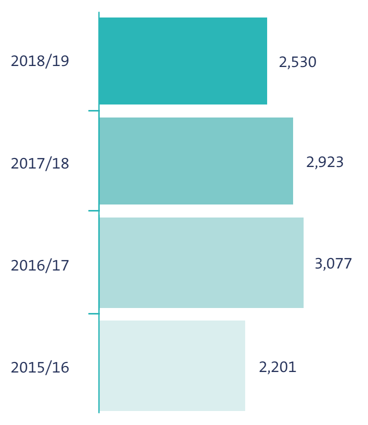
Operational performance (continued)

KPI: Mains bursts
(Number)

2018/19 actual:
2,530

2018/19 target:
3,100 or less

2019/20 target:
3,100 or less



Our mains bursts are again within the performance target of 3,100 for the year.

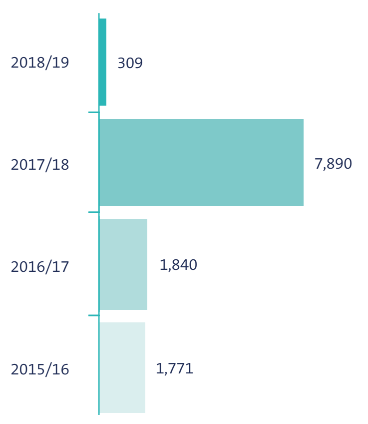
We continue to monitor and look for ways to reduce bursts and their effects on customers. Work has continued on producing ‘calmer networks’, looking to reduce night pressures and introduce ‘intelligent’ controls to existing district pressure control valves. We analyse where and when bursts occurr to inform our mains renewals programme as to the areas of the network most in need of replacement.

KPI: Unplanned interruptions to supply over 12 hours
(Number of properties)

2018/19 actual:
309

2018/19 target:
320 or less

2019/20 target:
320 or less



We have achieved a marked improvement in our unplanned interruptions to supply over 12 hours performance. This is the first year in this AMP period that the performance commitment has been achieved.

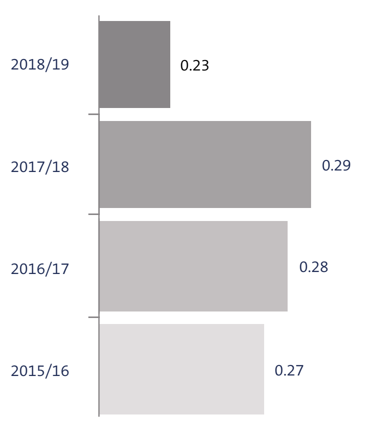
The improvement in performance is a result of both a reduction in the number of large diameter mains bursts and greater focus on innovative solutions to restoring supplies to customers by alternative means where repair of a main is likely to be difficult and protracted. The introduction of a restoration team for significant incidents has enabled one team to focus on re-zoning the network and providing alternative supplies whilst another team concentrate on the actual repair and full restoration of the network.

KPI: Accident frequency rate
(Number of lost time injuries per 100,000 hours worked)

2018/19 actual:
0.23

2018/19 target:
0.22 or less

2019/20 target:
0.22 or less



We have continued to work towards improvements in both health and safety, with a particular focus on occupational and mental health. During the year, we recorded 0.23 lost time injuries per 100,000 hours worked, compared to 1.02 in 2014/15 (our baseline figure at the start of AMP6).

We recorded six work related lost time injuries during 2018/19, compared to eight in 2017/18. We failed to meet our stretching target of 0.22 accidents per 100,000 hours worked for the year.

We are looking to continuously improve and are focused on the following key priorities:

- ensuring our health and safety management system enables us to effectively manage risks and to support employees and our supply chain in delivering the highest standards;
- developing a strong health and safety culture through effective leadership and engagement;
- ensuring that our working environments are safe; and
- learning from information and experience and using this to develop action plans for future improvements.

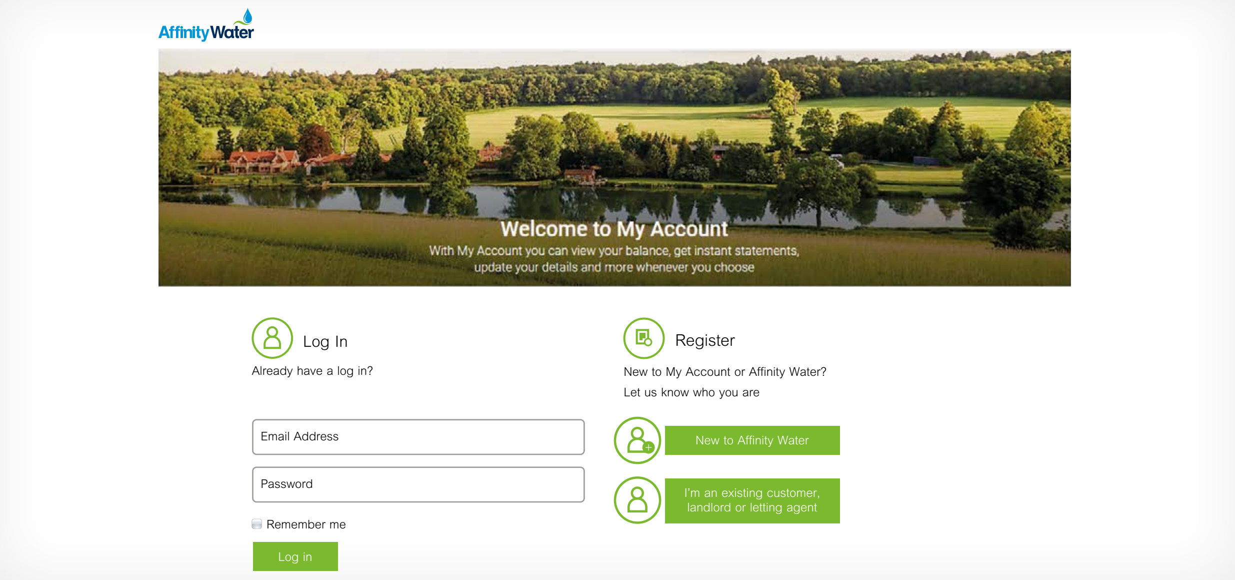
Our Community Strategy in action

BECOMING A DIGITAL UTILITY OF THE FUTURE

WORKING TOGETHER WITH PEOPLE AND COMMUNITIES

Over the past year, we have continuously improved and enhanced our digital self-serve experience for our customers, developing new journeys and functionality, which enables our customers to do more than ever online.

My Account provides our customers with a flexible and simple way to manage their water account online on their preferred device. Built on cloud infrastructure, it allows us to continuously upgrade and react to customer feedback and needs. The user-friendly account enables customers to view, print and pay their bills, download a statement, set-up a direct debit, tell us they are moving home and more.



OUR CAPITALS

Our customers are now able to complete more tasks on their account quickly and easily at their own convenience

Moving to a modern custom platform and cloud infrastructure has given stability and reliability of service enabling our customers to self-serve online

KEY STAKEHOLDERS

- Our customers
- Our Customer Experience team
- Our Digital Development team

ACTIONS AND OUTPUTS

- Over 420,000 customers have registered for My Account since it was launched.
- New customer registrations are 75% higher each month than in the previous year and our customer satisfaction score for self-serve is continually improving.
- Cost savings have been delivered through a reduction in the number of inbound calls and processing time.

Strategic report continued

Principal risks and uncertainties

RISK MANAGEMENT

We have an established framework for identifying, evaluating and managing the key risks we face. A key aim is to foster a culture in which teams throughout the business manage risks as part of their management of day-to-day operations. Operational risks are recorded and assessed, including existing management and control processes, and action plans are prepared, if necessary, to implement further mitigation. Activities against these plans are monitored on an on-going basis. Operational risks are also ranked by our teams during the year. Based on these rankings the most significant risks are discussed by our senior management and included in the strategic risk register, which is reviewed by the Board and the Audit Committee. The latter reviews senior management's work on risk management and reports to the Board on the effectiveness of risk management processes. For more information on the responsibilities of the Board and the Audit Committee in relation to risk management and internal control refer to **page 83**.

The following have been identified from our risk management analysis as potentially having a material adverse effect on our business, financial condition, results of operations and reputation. They are managed as described but are not always wholly within our control and may still result in a material adverse impact. Factors other than those listed could also have a material adverse effect on our business activities.

PRINCIPAL RISKS

We have identified 16 principal risks to our business in three categories:

- Operational risks
- Regulatory risks
- Financial risks

Further detail on each risk and the mitigation we have in place is included in the following table.

TABLE KEY

- (a) Risks included in the sensitivity stress testing for the viability statement **(refer to pages 58 to 61)**
- (b) Risk included in the scenario stress testing for the viability statement **(refer to pages 58 to 61)**
- ◆ Residual/net risk unchanged during the year (after the application of control activities)
- ▲ Residual/net risk increased during the year (after the application of control activities)
- ▼ Residual/net risk decreased during the year (after the application of control activities)
- # New risk

OPERATIONAL RISKS

1. Failure to prevent injuries and accidents to our people and the public (a)

Risk: Failing to manage this risk may result in personal injury or occupational ill-health, disruption to operations, reputational damage, criminal fines, civil damages and regulatory penalties.

Mitigation: We seek to operate our business using our safety and health management system, which is certified to OHSAS 18001, and we provide our employees with appropriate arrangements to enable them to take personal responsibility for their own safety, occupational health and well-being, and that of others.

Our safety and health strategy focuses on active leadership and engagement. We have introduced a safety leadership model for our employees and our improvement plan sets out measurable objectives for individuals and teams across our organisation. For more information on our safety and health performance refer to **page 46**.

2. Failure to meet our water supply obligations (b)

Risk: We are required to maintain a continuous supply of high quality water for customers.

Interruptions to supply (or supply restrictions) caused by drought, water resource restrictions, deliberate or accidental contamination of water supplies, extreme weather events (extremely cold or prolonged hot weather), flooding events, terrorist attacks, cyber events, civil unrest, or misinformation in the media with regards to the quality of our water could impact on the health, safety and security of our people or communities, or on our financial position and our reputation.

The risk with respect to availability of water remains relatively high for us, as we operate in an area of serious water stress. The construction of the High Speed Two ('HS2') railway, together with plans for a third runway at Heathrow Airport and the Western Rail Link to Heathrow may further increase this risk in the future.

Furthermore, long-term weather trends, such as global warming, appear to be contributing to a more unpredictable climate in the UK. A lack of resilience to these extremes could result in disruptions to customer service and impinge on delivery of our business plan.

Mitigation: We manage this risk through:

- our WRMP which identifies, over a 60 year period, how we will balance available supplies and required demand with sufficient headroom for unplanned outage (we submitted our final WRMP covering the period 2020 to 2080 to the Secretary of State on 7 June 2019);
- our Water Saving Programme, including new customer meters, water efficiency and leakage reduction, which allows us to maintain headroom as demand grows through new building developments and our supply base is eroded by committed sustainable abstraction reductions;
- our drinking water safety plans which provide a comprehensive risk assessment and risk management approach to our water supply chain, supported by our distribution and operations management strategy. We use these plans to inform our investment and maintenance programmes;
- investment in our trunk main assets to keep their condition stable through targeted renewal. We are also implementing trunk main burst mitigation schemes to reduce the number of customers potentially affected by any one incident;
- our implementation of improvements to increase resilience through measures such as moving and protecting pipework, protecting electrical and control infrastructure, and increasing connectivity to provide greater flexibility of operation;
- our Drought Management Plan which is approved by the Secretary of State; and
- our emergency and business continuity plans. Should water supplies be compromised, we have plans in place to ensure the provision of essential water supplies at all times. Our contingency plans are audited annually by an independent certifier whose reports are shared with the Secretary of State. We have more detailed functional level plans that sit beneath these higher-level emergency plans.

Following the freeze/thaw event in March 2018 we reviewed our plans for dealing with unplanned interruptions and made further enhancements. We have also updated our Event and Incident Plans to ensure that they are suitable to manage issues that require careful coordination but do not necessarily meet Emergency Plan triggers. We are now working more closely with Local Resilience Forums and specialist voluntary organisations, such as the Red Cross.

We have good working relationships with our neighbouring water companies from whom we import and to whom we export water. During the freeze/thaw event in March 2018 and throughout the prolonged period of hot weather in summer 2018, we demonstrated collaborative methods of working to ensure that we collectively met our customers' needs.

In advance of the winter of 2018/19, we reviewed and updated our winter readiness plans to ensure that we had appropriate triggers and action plans in place for any severe weather event. These plans cover the following aspects: people; assets; sites; customer and stakeholder communications (including media); and alternative water supplies.

Strategic report continued

Principal risks and uncertainties (continued)

OPERATIONAL RISKS (CONTINUED)

3. Failure to supply high-quality drinking water (b)

Risk: The supply of high-quality water to customers is critical to public health in general and to the overall success of our business.

Failure to achieve this would have the potential effects of losing the confidence of customers in their drinking water, and legal and reputational risks for our business.

The detection of cryptosporidium oocysts at two of our water treatment works in November 2018 (refer to **page 37** for further details) has caused us to reassess this risk in the year, as we have been issued with a notice from the DWI to review the site risk assessments.

We took all necessary action immediately upon detection, including engagement with Health Protection England and local Environmental Health Officers.

We continue to closely monitor water quality in the environment and at relevant treatment works and all treated water samples taken since November 2018 have been satisfactory.

We believe that the root cause was a short-lived but significant increase in cryptosporidium oocysts in the River Thames.

Mitigation: our drinking water safety plans ('DWSP') provide a comprehensive risk assessment and risk management approach to our supply from source to tap.

DWSP are prepared for full submission to the DWI in October each year and changes are submitted monthly. The process will be improved through the delivery of a new DWSP database. The DWI is working with the water industry to develop a standard for DWSP risk assessments, which will be externally assessed as part of a formal accreditation to provide independent assurance that risks are being captured accurately and consistently.

Our laboratory and sampling teams are UKAS accredited against ISO 17025. In addition, National Quality Assurance ('NQA') assess water quality procedures as part of the ISO 9001 annual audit. Internally the water quality team audits production and storage sites against our own procedures and those used by the DWI. We also audit network sites to ensure any interventions are in line with our procedures and do not adversely impact public health or quality standards. There are also several sub-groups that review specific areas of risk including treatment chemicals and reservoir and storage facilities. The water quality senior management team reviews strategic risks on a monthly basis to ensure controls are working effectively and reports this to the Executive Management Team each month.

In 2018, we carried out 180,000 tests on our water and our overall compliance performance was 99.97% while our MZC, the measure used by the DWI, was 99.96%.

4. Failure to recruit and retain good quality employees (a)

Risk: We rely on the availability of skilled employees and contractor resources to maintain service levels and implement our investment plans. In the event of these resources being unavailable, we may experience significant disruption to our service, damage to our reputation and consequent regulatory action.

The risk has remained medium during the year with ongoing significant construction activity around London, including construction of the Thames Tideway Tunnel, currently underway, reducing contractor availability.

Mitigation: We seek to mitigate this risk by maintaining a constructive relationship with employees regarding their remuneration through our Joint Negotiating and Consultative Committee, succession planning and investing in our employees through training, graduate and apprenticeship schemes.

During 2018/19, as required by the DWI, we gained certification for our Competent Operator Scheme. Currently, the scope of this certification covers only those employees in roles which could impact on the quality of water supplied to customers. We plan to expand the scope of our certification to cover all roles in the company, and believe this will contribute to us recruiting and retaining good quality employees in the future.

5. Information security, protection of personal data and data quality failure (b)

Risk: Customer information and our data are at risk from unauthorised disclosure and improper use.

The General Data Protection Regulation ('GDPR') places a legal obligation on organisations to handle personal data securely, in order to avoid that data being put at risk from unauthorised or unlawful processing, accidental loss, destruction or damage.

Failure to protect such information may lead to increased costs of operation, reputational damage, criminal fines and civil damages, and a reduction in the confidence that stakeholders can place in the information that we publish.

Non-compliance with GDPR could result in a fine of up to 4% of worldwide turnover compared to a previous maximum £500,000 fine under the Data Protection Act.

As the use of online communications, cloud-based technology and the sophistication of hackers continue to increase, so too do the risks of cyber-attack and other external threats.

There is a further risk that the data that we publish is not accurate, consistent and transparent. This risk has heightened in the year following Ofwat's initial assessment of our AMP7 Business Plan submission and its 2018 Company Monitoring Framework assessment, in which Ofwat raised a number of concerns with regards to the integrity, consistency and quality of our data.

Mitigation: We continue to strengthen our capabilities to ensure that technical and organisational controls to prevent the unauthorised disclosure, loss or improper use of data are kept under review and improved where appropriate.

Alignment with ISO 27001, the global information security standard, will demonstrate our commitment to security best practices and ensure that we meet relevant regulatory requirements.

We continue to monitor and enhance our information security management system, designed to protect us against current and future threats.

In March 2019, we submitted to the DWI a completed Cyber Assessment Framework which describes how we manage cyber security risks in relation to the production and delivery of wholesome water.

During 2018/19, we successfully enhanced relevant business processes to take account of GDPR, which came into effect in May 2018. All employees were trained on the new requirements which are now embedded in our day-to-day operations. The Board also appointed the Company Secretary as the company's Data Protection Officer during the year to oversee the company's Privacy Policy and Guidelines and, as applicable, develop related policies and privacy guidelines.

Privacy impact assessments are carried out for all projects and initiatives to analyse the potential effects on the privacy of individuals.

Our enterprise-level security controls, aligned with ISO 27001, are designed to secure all our information assets and therefore contribute to the protection of all personal data which we process.

As part of our AMP7 Business Plan submission, we published our Data Strategy for AMP7. Following Ofwat's initial assessment of our AMP7 Business Plan and its 2018 Company Monitoring Framework assessment, we have initiated a significant programme of work to implement this strategy and achieve a number of objectives, including improvements to increase stakeholders' trust and confidence in the data and information that we publish.

Strategic report continued

Principal risks and uncertainties (continued)

OPERATIONAL RISKS (CONTINUED)

6. Failure to provide adequate levels of customer service (a)

Risk: It is crucial that we provide consistently high levels of service to all customers and that they are demonstrably satisfied that we are doing so.

Failure to maintain and continually improve our levels of service in the eyes of our customers will severely impact customer satisfaction levels, volumes of unwanted contact and complaints, and our reputation.

From 2015/16 to 2018/19 Ofwat used SIM to measure our customer service performance against that of other water companies. Our performance when compared to our industry peers has been sub-median and we anticipate that this will attract significant financial penalties.

From the start of AMP7, two new measures of customer service are being introduced: C-MeX is a mechanism to incentivise water companies to provide an excellent customer experience for residential customers, across both the retail and wholesale parts of the value chain; D-MeX is a mechanism to incentivise water companies to provide an excellent customer experience for developer services (new connections) customers.

We await Ofwat's final decisions on all aspects of the design of C-MeX and D-MeX. However, it is already clear that they will both have an increased focus on customer satisfaction, experience and perception.

Mitigation: We adopt a continuous improvement strategy with regards to customer service. Our Customer Experience Improvement Board meets monthly and is attended by our CEO.

We hold Customer excellence days twice-yearly at which we review our performance, celebrate successes, and consider opportunities for further improvement. These events include presentations by external speakers so that we can learn from other companies' experiences with regards to customer service.

We have an ongoing programme of improvements to on-line capabilities for customers and to the customer journey in general.

We actively engage with our customers on a day-to-day basis. As part of our PR19 business planning we conducted an extensive, multi-phase customer engagement programme in order to fully understand customers' needs and expectations.

We employ a third-party customer feedback partner to measure our customer service performance. In 2018/19, our partner surveyed 122,000 customers with whom we had experienced some interaction. Of those surveyed, 92% expressed themselves as "satisfied" or "very satisfied".

We analyse all complaints and ensure that any required remedial actions are promptly addressed.

We will continue to participate in pilots for both C-MeX and D-MeX throughout 2019/20. We are taking all necessary steps to ensure that we are able to deliver excellent performance against both these measures throughout AMP7.

7. Supply chain failure (a)

Risk: Much of our capital delivery programme and field activity in our Central region is outsourced to third parties. Existing contractors have little or no capacity to take on additional work due to the volume of large-scale infrastructure projects in some of our operational areas.

Mitigation: We seek to ensure that our relationship with critical suppliers is secured under long-term agreements, where appropriate. For key activities, we may retain more than one supplier to mitigate the risk of supplier failure. We also undertake significant due diligence in the selection and on-going management of suppliers through audit, inspection and verification of performance.

8. Brexit (a)

#

Risk: As a UK based utility company, we do not expect Brexit to have a direct impact on our business model and strategy. However, there is likely to be disruption in three areas, especially if a disorderly ('no deal') Brexit is the outcome:

- labour: certain roles in our business are filled by non-UK EU citizens. It is unclear what their reaction to Brexit, an uncertain future and potential change in culture will be and there is a risk of departures;
- supply chain: our reliance on single-source suppliers, based in the EU, for key chemicals means any barriers to imports could have significant impact. Interruptions to our service may also lead to civil unrest and disobedience targeted at utilities, which may further exacerbate supply chain problems; and
- financing: our ability to secure appropriate financing would be impacted by a credit rating downgrade, the risk of which may increase in the event of a disorderly Brexit. Also, increases in inflation will put pressure on gearing. Although the company's pension plan is currently in an accounting surplus, large market movements may reduce or eliminate this surplus.

Mitigation: Water UK has coordinated a response to the risk of disruption to our chemical supply chain, including collaboration between water companies in the event of shortages. Our Human Resources team has delivered a number of drop-in sessions for our non-UK EU nationals to enable them to raise and discuss their concerns.

The company's exposure to inflation rates is broadly hedged because (i) revenue is linked to inflation and (ii) the fact that some significant costs are already secured to the end of AMP6. The company has also secured financing for the remainder of AMP6 and into the next price control period, AMP7. Refer to risk 16 for details of our mitigation in relation to pension risks. The company is exposed to foreign exchange rate movements, as some foreign purchase contracts are unhedged; however this exposure is minimal.

REGULATORY RISKS

9. Changes to the regulatory framework (a)

Risk: Changes to the regulatory framework by Ofwat or the government may have an adverse effect on our operational or financial performance.

Ofwat's final methodology for PR19 price setting set out its approach to the design of the regulatory framework for the water industry for 2020-2025. The final price setting framework aims to make greater use of markets in relation to the areas of sludge and water resources with separate binding price controls for both. For PR19 Ofwat also confirmed its intention to use CPIH, rather than RPI, for indexing revenues (and therefore prices) and RCV to be indexed using a combination of CPIH and RPI. The final price setting methodology also continues to use econometric cost assessment to determine efficient levels of cost allowance for separate binding price controls.

During the year this risk has heightened, as Ofwat confirmed its final position for PR19 price setting on financing cost sharing requirements that will reduce the earnings of companies with gearing levels of 70% and above.

Mitigation: We continue to contribute fully to consultations with our regulators and seek to ensure our voice is heard on emerging changes through strong relationships with all our stakeholders.

Strategic report continued

Principal risks and uncertainties (continued)

REGULATORY RISKS (CONTINUED)

10. Adverse change in the social and/or political climate (a)

Risk: We are exposed to risks arising from the general social and political climate, for example, debate around the merits of the current water ownership model, political pressure to restrict price increases and other issues, such as the adequacy of our water resource management plans and some objections to compulsory water metering. These pressures may lead to a reduction in revenue or have a reputational impact.

Political uncertainty, particularly around Brexit, has significantly worsened in the past year such that overall this risk has again increased. Refer to **page 18** for further details of the debate over water companies' regulation and governance, and their long-term requirements that continued during the year, with nationalisation of the industry remaining a key topic.

Nationalisation could be conducted in such a way that would result in assets and liabilities being transferred out of the company to leave a shell company that would no longer be viable.

Mitigation: We continue to engage with our stakeholders, customers and their representatives to understand and respond to their issues and concerns.

11. Failure to comply with laws, our Instrument of Appointment and other recognised standards (a)

Risk: We need to ensure that our activities and outputs comply with licence conditions or statutory requirements arising from our appointment, and applicable laws and standards.

Failure to do so may result in an enforcement order, a fine up to 10% of appointed turnover or termination of our appointment and special administration.

Mitigation: We continue to operate our abstraction, treatment and supply activities to environmental standard ISO 14001 and have adopted the principles of other relevant management systems and standards.

Our compliance programme is designed to ensure that:

- all employees are adequately educated on the legislation and regulations particularly relevant to their specific job roles; and
- appropriate assurance activities are in operation to provide positive evidence of compliance.

12. Failure to deliver our Business Plan obligations (a)

Risk: We have made a number of performance commitments in our Business Plan which, if not met, may result in us incurring financial penalties and suffering reputational damage in the eyes of our regulators and other stakeholders.

We must implement the investment programme set out in our Business Plan. Failure to do so may lead to the imposition of sanctions, including financial penalties or other enforcement action.

This risk has heightened in the year as we failed to meet our leakage reduction target for the year and identified that we had failed to meet our leakage reduction target for 2017/18 as a result of a burst at one of our largest treatment works. We have the industry's largest leakage percentage reduction target for AMP6.

Mitigation: We have an established programme management function with responsibility for delivering the investment programme. The Board and senior management team monitor performance and ensure that corrective action is taken when required.

We continually monitor our performance on a wide range of Business Plan metrics and commitments, and take prompt corrective action to address any indicators of under-performance.

We have made changes to our organisation structure to provide clearer accountability and analytical capabilities in relation to leakage reduction. We have insourced detection activity and upskilled our team members resulting in less reliance on our supply chain. We will make smarter use of technology and data to improve our planning and deliver our leakage reduction target.

We continue to manage actively engagement with all our regulators and other stakeholders. In particular, we work closely with our CCG, an independent body with an independent Chair, which advises, challenges and supports us in the development of our plans, to ensure that they reflect customers' priorities.

FINANCIAL RISKS

13. Failure to achieve a favourable PR19 outcome (a)

Risk: We submitted our initial Business Plan submission to Ofwat on 3 September 2018. Our plan covers the period 2020–25, incorporating how much we are going to charge customers and how we are going to use the money raised to ensure that we meet those customers' expectations as well as balance the competing priorities of multiple stakeholders.

Ofwat stressed four key themes in its methodology:

- Great customer service
- Resilience
- Affordable bills
- Innovation

Ofwat also stressed that water companies must deliver more of what matters for customers through effective engagement, lower costs and better performance.

In its initial assessment, published on 31 January 2019, Ofwat concluded that our Business Plan was subject to 'significant scrutiny', heightening this risk in the year.

Companies that are placed into the 'significant scrutiny' category as a result of Ofwat's assessment of their revised business plans submitted in March 2019 will be subject to harsher cost sharing arrangements, which will mean that a larger proportion of companies' totex underperformance (overspend) will be shared with customers through a reduction in customer bills in the following price control period.

Mitigation: Our PR19 programme and governance arrangements were established early in 2017 and this has enabled the development of our plan to be monitored by our Board and managed day-to-day by a PR19 Steering Committee. The Steering Committee oversees a number of work streams each with dedicated leads and accountable Executive Management Team sponsors.

We completed various programmes of work to develop our PR19 submission including a multi-phase customer engagement programme to understand customer priorities.

We appointed a third party independent assurance partner, who developed a three-phase programme of work to provide an overall strategic assurance framework, assurance of the programme delivery and governance, and detailed assurance of all financial data tables.

We have been working closely with Ofwat since 31 January 2019 to address its concerns in their initial assessment and improve the overall quality of our plan and, therefore, the service we intend to provide to our customers. A revised business plan was submitted in March 2019.

Strategic report continued

Principal risks and uncertainties (continued)

FINANCIAL RISKS (CONTINUED)

14. Failure to achieve approval of our WRMP (a)

Risk: Every five years, water companies are required to publish a WRMP to cover at least 25 years of planning. These plans show how companies intend to maintain the balance between supply and demand for water.

Failure to achieve approval by the Secretary of State of our WRMP may result in legal costs being incurred in the current and next price control period if the company appeals against the decision. Longer term forecasts looking out beyond the current and next two price control periods would need to be updated to accommodate additional expenditure required in addressing concerns that prevented approval by the Secretary of State.

Mitigation: Between 19 March 2018 and 23 May 2018 we undertook a statutory consultation on our draft WRMP 2019, which presented two different options: a 'Preferred Plan' and an 'Alternative Plan'. The Alternative Plan gained favour amongst many consultees and received endorsement. We carefully considered comments received in respect of the Alternative Plan and made changes, where considered necessary, to develop our revised draft WRMP.

We adopted an intensive approach to assurance of our revised draft WRMP prior to its publication on 1 March 2019. We invited customers, regulators and stakeholders to give us their feedback and views by 26 April 2019, and submitted our final WRMP to the Secretary of State on 7 June 2019. We expect to publish our final plan in late 2019.

15.Failure to secure appropriate financing for our business activities (a)

Risk: Our business has an on-going liquidity requirement, driven by the operational cash flows of the business and our substantial capital investment programme. This results in liquidity risk in the event that we are unable to meet our cash flow requirements as and when they fall due.

We are subject to a number of covenants in relation to our borrowings. If a covenant is breached, this could lead to an event of default with any outstanding borrowings, becoming immediately repayable. This could also impact our ability to raise funds on sufficiently favourable terms in the future.

During the year we submitted our AMP7 Business Plan in which we have increased our expected level of investment, such that further funding will be required in AMP7 (refer to **page 40** for further information), which has heightened the risk. If credit rating agencies consider that we have insufficient financial flexibility to accommodate lower returns as a result of an unfavourable PR19 outcome, there is a risk that we may be downgraded, which may impact on our ability to raise funds on sufficiently favourable terms.

Mitigation: We have revolving loan facilities, cash balances and standby loan facilities to meet our forecast cash flow needs. Our treasury policy requires us to maintain a minimum level of liquidity capable of covering at least 12 months' forecast cash flow requirements.

Longer term financing needs are sourced from the private and public bond markets. We have secured financing for the remainder of AMP6 and into the beginning of AMP7. We have £14.2m of debt maturing in AMP7 and a spread of maturity beyond this. Our policy is to maintain a diverse portfolio of counterparties through which we can access liquidity at all times. This ensures we are not reliant on any single treasury counterparty.

We have a regular monitoring and certification process of the financial covenants within our Whole Business Securitisation ('WBS') documentation. This covers information, financial and general covenants. Our treasury policy requires that financial covenants, which include gearing and interest cover ratios, are monitored and reported on a regular basis to the Board.

16. Macro-economic risk (interest rate and inflation risks) (a)

Risk: Movements in interest rates can result in an increase in the cost of our debt.

We have a financial covenant within our WBS documentation stipulating that at least 85% of our outstanding debt is hedged against movements in interest rates.

Our wholesale revenues in a given financial year are explicitly linked to the RPI published the previous November. An inability to control our cost inflation on the same basis would lead to a reduction in the company's profitability. Our RCV is also linked to inflation and nominal returns are therefore likely to be further reduced in a low inflation environment.

We operate a pension plan providing defined benefits based on final pensionable salary. The assets and liabilities within the plan depend on a number of external factors outside our control, including performance of equity markets, interest rates and future inflation, which may increase the cost of our cash contributions.

Customer debt and affordability remain key areas of focus for our business. A downturn in the economy may lead to an increase in unpaid water customer bills. We are not permitted to disconnect water supplies to household and certain other types of premises in the event of non-payment, resulting in loss of revenue and increased cost of collection.

Mitigation: Interest rate risk is primarily managed by using a mixture of fixed rate and inflation-linked borrowings, and approved hedging instruments (refer to note A4 to the financial statements for further information).

Each year we undertake a robust and challenging budgeting process to ensure costs are clearly understood and then subsequently controlled during the financial year. We also use inflation-linked debt to ensure a proportion of our interest costs is linked to inflation and therefore offsets an element of the reduction in revenue and RCV that results from lower inflation. In August 2018, we transacted a RPI linked inflation swap increasing the proportion of debt linked to inflation to 50%.

The defined benefit pension plan has been closed to new members since September 2004 and the assets of the plan are held separately from those of the company. We have invested in our defined benefit pension plan so that it is in a surplus on a technical provisions basis (refer to notes 11 and A5 to the financial statements) and the latest actuarial valuation of the defined benefit section of the AWPP, determined by an independent qualified actuary, completed in the year concluded that the pension plan was fully funded on a self-sufficiency basis as at 31 December 2017. The company signed a new schedule of contributions effective from October 2018 and no further deficit payments are required. 90% of the interest rate and inflation risk associated with the plan's liabilities are hedged by the plan's assets through Liability Driven Investment.

We have processes and teams dedicated to the efficient collection of customer debt, and outsource the recovery of debt where initial recovery action has taken place to a number of debt collection agencies. For those customers who want to pay their bill but struggle to do so, we have payment arrangements that are as flexible as possible and we encourage customers who find themselves in difficulty to contact us as early as possible. We also have a social tariff (LIFT) to help support customers who are least able to pay their bills.

Strategic report continued

Viability Statement

The directors have assessed the company's financial viability over the ten-year period to 31 March 2029 (the 'lookout period'). As part of the PR19 process we assessed the robustness and financeability of our projections over a ten-year period. This highlighted additional risks to be considered as part of this assessment, for example failure to secure financing for expected expenditure commitments beyond AMP7. The directors have decided to continue with this approach for the viability statement and the lookout period has therefore been extended from five to ten years.

The forecasts used in the assessment of financial viability, therefore, project beyond the current and next price control periods taking into account both our revised AMP7 Business Plan and our WRMP.

In their analysis, the directors have not assessed the impact of nationalisation of the company. If nationalisation occurs, it could be conducted in a way which affects the viability of the company.

The directors also reviewed the principal risks and uncertainties facing the company set out in the previous section, and determined that it was reasonable to expect that none of the individual principal risks identified in the principal risk table on **pages 48 to 57** with the icon (a), if these were to occur, would in isolation compromise the company's financial viability during the lookout period. Instead these risks could be considered as part of a number of different severe, plausible and reasonable sensitivities set at a level reflecting an assessment of how actual cash flows could vary during the lookout period.

Stress-testing was performed on a Board approved base case cash flow forecast (the 'base case cash flow forecast') reflecting the company's actual capital structure with 80% gearing, projected revenues for the period to 31 March 2020 as allowed by Ofwat's final determination of price controls and anticipated expenditure for AMP6, the Business Plan submitted in March 2019 for the next price control period, AMP7, and an extrapolation of the AMP7 Business Plan for the first four years of AMP8.

The projections for the ten year lookout period apply the PR19 mechanism for sharing financial outperformance with customers.

The base case cash flow forecast also assumes a further £112.1m of debt is raised in AMP7 and £9.1m of our existing short-term borrowing facilities is utilised to fully fund the investments planned for AMP7 and £14.2m of our existing debt that matures in September 2022. An average all-in interest rate of 2.6% is projected for this financing, based on our current expectations of the long-term debt market and the terms of our existing short-term borrowing facilities. If the expected capital restructuring of the wider Affinity Water group is completed to de-gear the company, this cash need will be met mainly by the restructuring.

A further refinancing exercise is forecast to take place in July 2026 when a £250.0m fixed rate bond matures (refer to **page 95** for details of our bond maturities). An all-in interest rate of 4% has been projected for this refinancing, which is consistent with the assumptions used in assessing the financeability of our AMP7 Business Plan.

Tests were applied to the base case cash flow forecast to assess for resilience against financial shocks, compliance with financial covenants and availability of cash reserves. Financial ratio targets (including targets for cash interest cover, adjusted interest cover, funds from operations to debt, return on capital employed and return on regulatory equity) to evaluate the results of the stress testing were set to align with the levels required to meet our Baa1 credit rating under Moody's current methodology and to maintain an investment grade credit rating. A key assumption of this viability statement is that the company maintains an investment grade credit rating, in line with its Instrument of Appointment.

The targets maintain headroom against the trigger and default levels set out in the company's WBS documentation. Trigger levels, if reached, would require increased reporting to the WBS lenders and would lock up dividend payments. If default levels are reached, the company would be in breach of its WBS arrangements.

The directors regularly review the base case cash flow forecast and formally review the output of the stress-testing on an annual basis.

The following sensitivities, approved by the Audit Committee, were separately applied to stress-test the base case cash flow forecast.

S1: 10% increase in total expenditure;

S2: 5% increase in unpaid water customer bills represented by a 5% reduction in revenue;

S3: 1% decrease in all three inflation metrics (RPI, CPI and CPIH);

S4: 1% decrease in inflation impacting revenue only;

S5: replacing the base inflation forecast with a negative 1% forecast, while maintaining a 1% increase in expenditure;

S6: 1% decrease in inflation impacting revenue only, 5% increase in total expenditure and 5% increase in unpaid water customer bills;

S7: 2% increase in cost of debt; and

S8: 100% decrease in cash generated by the company's non-appointed business.

The sensitivities applied in relation to total expenditure, revenue and unpaid water customer bills were in line with those used in testing performed during the PR19 process to assess the robustness and financeability of our AMP7 Business Plan.

The directors consider that the sensitivity applied in relation to total expenditure is of a sufficient magnitude to capture the financial impact of exceptional items, such as regulatory fines and legal costs; costs associated with extreme weather events; and costs not taken into account by Ofwat in setting our price controls (i.e. unfunded costs).

The sensitivity applied in relation to unpaid water customer bills reflects a severe, plausible and reasonable scenario considering that the risk is spread across our whole customer base. The directors consider that this sensitivity is of a sufficient magnitude to capture also the financial impact in severe, plausible and reasonable scenarios of ODI penalties incurred through worse than planned operational performance.

The inflation sensitivities reflect severe, plausible and reasonable scenarios in the context of the company's inflation-linked debt and inflation-linked costs (for example staff costs), which act as natural hedges to lower revenue.

The scenario of negative inflation combined with an increase in expenditure is intended to reflect conditions during an economic recession, such as those experienced in 2008/2009. This scenario captures a realistic expectation, when considering the structure of the company's cost base, that in general costs will not fall during a period of negative inflation.

The scenario of a decrease in inflation impacting revenue only, together with a 5% increase in total expenditure and 5% increase in unpaid water customer bills is intended to reflect severe, plausible and reasonable conditions during a downturn in the economy.

Two additional sensitivities have been used in stress-testing the base case cash flow forecast this year.

A sensitivity has been applied in relation to cost of debt, as £264.2m of the company's existing bonds are due to mature in the ten year outlook period, and the company has not yet secured financing for all AMP7 expenditure commitments and expected expenditure commitments beyond AMP7.

The directors consider that this sensitivity reflects a severe, plausible and reasonable scenario of an increase to cost of debt in the context of how the ten-year gilt has performed over the last 20 years. To achieve an all-in coupon a credit spread has been included that is consistent with the current and historic performance of the £250.0m fixed rate bond, forecast to be refinanced in the lookout period.

Strategic report continued

Principal risks and uncertainties (continued)

VIABILITY STATEMENT (CONTINUED)

The directors consider that the sensitivity applied in relation to cost of debt is of a sufficient magnitude to capture the financial impact in a severe, plausible and reasonable scenario of a credit rating downgrade as a result of a failure to achieve a favourable PR19 outcome. As stated in previous paragraphs, a key assumption is that, even if downgraded, the company's credit rating remains investment grade.

The sensitivity of a 100% decrease in cash generated by the company's non-appointed business reflects a severe, plausible and reasonable scenario that companies may decide to no longer procure non-appointed services from us.

For the principal risks identified in the principal risk table on **pages 48 to 57** with the icon (b), the directors considered that these risks, if they were to occur, might in isolation threaten financial viability potentially leading to significant unforeseen additional cash requirements during the lookout period in the event of:

- a major asset failure resulting in large scale interruptions to operations;
- a major water quality issue;
- a severe drought incident within our supply region as considered in our Drought Management Plan; or
- a significant cyber-attack leading to a major loss of customer data or interruption to operations.

Stress-testing was performed on the base case cash flow forecast to model specifically the effects on cash flow of these reasonably plausible but severe events. This resulted in a further sensitivity (S9). For each of the situations described, it was assumed that there would be a significant (£60.0m) impact on cash flow in the year that the event occurs.

The cash impact (£10.0m each year) of returning operations to performance levels as assumed in the base case cash flow forecast and paying any legal or regulatory fines or penalties, either resulting directly from the event or due to a decline in performance levels following the event, was also reflected over a four-year period in the stress-testing for S9, as the directors consider this is a reasonable period within which the business would expect to recover from these events.

The directors expect that the company will meet its covenants and maintain headroom against those covenants over the lookout period under the base case scenario. In each of the stress test scenarios, covenants do not breach default levels and an investment grade credit rating is expected to be maintained (based on Moody's current assessment process).

The directors also expect that covenants will not breach default levels in relation to our debt covenants and to be able to maintain an investment grade credit rating over the lookout period under the base case scenario and when the stress tests are applied under three different levels of capital structure in the context of the PR19 price setting mechanism for sharing financial outperformance with customers:

- a capital structure with 75% gearing;
- a structure with 70% gearing; and
- a structure that reflects the expected de-gearing scenario detailed in our AMP7 Business Plan.

The directors consider that the impact on the company's cost of debt in the lookout period as a result of a lower investment grade rating of Baa2/Baa3 under a severe, plausible and reasonable scenario is captured by the 2% increase in cost of debt stress test.

Scenario	Rating agency measures		Key covenants		Rating agency measures		Key covenants	
	Adjusted interest cover	Funds from operations to debt ratio	Interest cover ratio (confirmed Class A adjusted)	Gearing (senior net indebtedness to RCV)	Adjusted interest cover	Funds from operations to debt ratio	Interest cover ratio (confirmed Class A adjusted)	Gearing (senior net indebtedness to RCV)
	Without mitigation				With mitigation			
Base	Met	Met	Met	Met	Met	Met	Met	Met
1	Met	Met	Met	Met	Met	Met	Met	Met
2	Met	Met	Met	Met	Met	Met	Met	Met
3	Met	Met	Met	Met	Met	Met	Met	Met
4	Met	Met	Met	Met	Met	Met	Met	Met
5	Met	Met	Met	Trigger	Met	Met	Met	Met
6	Met	Met	Met	Trigger	Met	Met	Met	Met
7	Met	Met	Met	Met	Met	Met	Met	Met
8	Met	Met	Met	Met	Met	Met	Met	Met
9	1 year not met, recovers in future periods	Met	Met	Met	Met	Met	Met	Met

As set out in the table above, under each of the sensitivities S1 to S9, default levels were not breached. Trigger levels were reached for the negative inflation (S5) and combined (S6) scenarios, but these do not constitute defaults. The directors' view is that the company remains financeable throughout the lookout period.

In order to test what sensitivities would result in default levels and require management intervention, the combined (S6) and cost of debt (S7) stress tests were added to the reasonably plausible but severe event scenarios (S9). This resulted in a further sensitivity, which would result in breaches of the default levels and could result in a credit rating downgrade to below investment grade.

In such an extraordinary situation, the company's investment programmes would be re-prioritised to reduce cash outflows to prevent breaches of the gearing default level. Management would also intervene to reduce operating costs to prevent breaches of the interest cover ratio default level.

Together with the results of the stress-testing (summarised in the above table), the directors also considered the following:

- the company's available liquidity;
- the company's ability to renew its existing short-term borrowing facilities under most market conditions;
- the likely effectiveness of current and mitigating actions, as detailed in the principal risk section;
- the ability to restrict dividend payments as a key mitigating action;
- the company is financially and operationally 'ring-fenced' from the rest of the Affinity Water group by way of the WBS (refer to **pages 91 to 96** for further details); and
- the protections which exist under the regulatory model that a primary legal duty of Ofwat is to ensure that water companies can finance their functions.

To conclude, based on the above assumptions and analysis, the directors confirm that they have a reasonable expectation that the company will continue to operate and meet its liabilities, as they fall due, for the lookout period.

Approval of the strategic report

By order of the Board

Tony Cocker

Chairman

25 June 2019

Governance

CONTENTS

The Board room at our headquarters in Hatfield, Hertfordshire.

Governance

Introduction from the Chairman

PRINCIPLES OF CORPORATE GOVERNANCE COMPLIANCE

The Code is founded on the principle of "comply or explain" which recognises that departure from specific provisions may be justified provided reasons for the departure are clearly explained. The Board considers that the company complied with the principles of the Code during 2018/19, except in terms of:

- Board composition*
- Appointment of a senior independent director ('SID')**
- Re-election of directors

The reason for each departure is explained within the relevant section of this corporate governance report. The Board considers our governance arrangements appropriate for a company owned by private investors.

* *The Board appointed an additional independent non-executive director on 24 January 2019 and therefore became fully compliant with regard to the Code requirements set out for board composition from that date.*

** *The Board appointed a Senior Independent Director during the year and therefore became fully compliant with the Code requirement from the appointment date.*

Our governance also has regard to:

- the Guidelines for Disclosure and Transparency in Private Equity (the Walker Guidelines) and the work of the Private Equity Reporting Group established to monitor conformity with the Guidelines;
- the OECD Principles of Corporate Governance (2004); and
- Ofwat's board leadership, transparency and governance principles. See **page 76** for more information on Ofwat's revised principles that came into effect from 1 April 2019.

I am delighted to present our Corporate Governance Report for 2018/19 on behalf of the Board, which has been prepared in accordance with the principles of the UK Corporate Governance Code 2016 ('the Code'). The Report reflects the principles within the Code and provides details on the activities and governance processes of the Board and its Committees.

My role is to ensure that we operate to the highest standards of governance, and the Board and I continually assess how we align with best practice principles. Transparency in the way we manage our standards of governance is key to achieving these, and we support the principles of good corporate governance set out in the Code.

Our Governance Code, available on the governance pages of our website:

stakeholder.affinitywater.co.uk/our-governance.aspx

sets out for our customers, investors, regulators and other stakeholders how we strive to govern and operate our business to the highest standards of Board leadership and good governance: accountability, transparency, probity and focus on the sustainable success of our business. These standards are founded on the obligations and conditions within the company's Instrument of Appointment with respect to the governance and ring-fencing of our regulated business, and Ofwat's Board leadership, transparency and governance principles, revised in January 2019.

We consider these revised principles to be a good progression from the existing principles, reflecting recent developments in corporate governance. We believe that we already meet many of the proposed principles and sub-principles and would be in a position to be fully compliant by the end of the proposed transitional period in April 2020. See **pages 75 and 76** respectively for more information on Ofwat's revised principles and the revised UK Corporate Governance Code, June 2018 that came into effect from 1 April 2019.

Our shareholders have an important role to play and a direct interest in the strong and effective governance and stewardship of our business. The Board recognises the importance of representing and promoting the interests of its shareholders and that it is accountable to shareholders for the performance and activities of the company. In line with the Code, we recognise the Board's overall responsibility for ensuring satisfactory dialogue with shareholders takes place.

We explain how we engage with our shareholders and involve them in decision making in our publication: *'Engaging with our Shareholders'* and further detail on this is set out on **page 90**.

We continue to meet Ofwat's expectations for independent non-executive directors to form the largest single group on the Board, compared to investor-appointed non-executive directors and executive directors. I regularly seek views from our independent non-executive directors on governance and any other matters of concern they may have, without the presence of the executives or shareholders.

At Affinity Water, we are committed to building a more inclusive culture, allowing all members of our workforce to bring their true selves to work, to enable them to thrive and to reach their full potential. We have a vision to be the UK's leading community-focused water company. By committing to inclusivity, we ensure that our company and its values, best reflect the communities we serve and allow us to strive to be world class in what we do.

The Board continues to strive for genuine diversity of directors and employees, and has taken steps to strengthen the role of the Nomination Committee to help facilitate this approach. We are building on graduate, apprenticeship and leadership programmes to ensure inclusivity is embedded in both our organisation and in our succession planning and talent development to strengthen our pipeline, ensuring appropriate representation from minority ethnic candidates, as well as other relevant diverse cohorts. More detail on our diversity commitments and inclusivity can be found on **page 87**.

The Board has had a varied agenda across the financial year: addressing strategic challenges, such as PR19 and ensuring a continuous supply of high quality water to customers was maintained during summer 2018's hot, dry weather, while continuing to focus on governance across the business and the changes being implemented, and the company's risk management and internal control systems. Further detail of how risk assessment activities were carried out can be found on **page 48** of our strategic report.

Customers continue to be at the forefront of our attention as our focus on topics such as our performance relative to the rest of the industry and customer experience demonstrates. The Board's activities and items considered at meetings can be found on **page 79** and while the Board continues to challenge robustly where appropriate, it also continues to foster a culture of ownership, stewardship and integrity across the organisation.

The annual report and financial statements remain the principal means of reporting to our stakeholders on the Board's governance policies and set out how our approach to good governance has been applied in practice.

Tony Cocker

Chairman

CODE COMPLIANCE

Since May 2017, our business has been owned by a consortium of long-term private investors. The version of the Code applicable to the 2018/19 reporting period is the April 2016 UK Corporate Governance Code. In June 2019, the Financial Reporting Council (the 'FRC') published a revised code and we will apply the new Code to our financial year ending 31 March 2020. See **page 75** for an update on activity already undertaken to comply with the revised 2018 Code.

Reporting in relation to each principle of the Code is as follows:

Leadership

Details of the Board are set out including their skill set and experience and an overview of the governance structure. The differing roles of Chairman, executive directors and non-executive directors are also set out. Refer to **pages 66 to 73**.

Effectiveness

An overview of the process for appointment, induction and evaluation of directors, with further detail on the activities of the Nomination Committee in the year is provided on **pages 74 to 82**.

Accountability

The report of the Audit Committee details the corporate reporting, risk management and internal control measures that are overseen by the Board. Refer to **pages 97 to 102**.

Remuneration

The Directors' Remuneration Report provides full details on remuneration. Refer to **pages 103 to 116**.

Relations with shareholders

Details of Affinity Water's engagement with its shareholders are set out on **page 90**.

Governance continued

Board leadership, transparency and governance

GOVERNANCE INFORMATION

Leadership

There is a clear division of responsibility between the non-executive directors whose role is to challenge and advise and the executive directors who have the responsibility of running the day-to-day operational business. The Board sets the tone for the culture, values and behaviour within the organisation.

Senior Independent Director ('SID')

The Code requires the appointment of a SID who acts as an intermediary for the other Directors, acts as a sounding board for the Chairman and leads the annual appraisal of the Chairman's performance. This appointment took place in the year.

Roles of the Chairman and Chief Executive Officer

The roles of Chairman and the Chief Executive Officer are separate. The division of responsibilities is clearly set out in writing, approved by the Board and published on our website.

The Chairman

The Chairman leads the Board and is responsible for its effectiveness. He scrutinises performance of executive management and ensures effective communication with our shareholders and other stakeholders.

In accordance with the Code, the Board considered Tony Cocker to be independent on his appointment, taking into account his other directorships. Appraisal of the Chairman will be conducted by the SID ahead of the Annual General Meeting ('AGM').

The CEO

The role of the CEO is to develop and implement the strategy as approved by the Board, set the cultural tone of the organisation and promote the highest standards of integrity, probity and governance.

TRANSPARENCY

We are committed to being accountable to customers and our communities. We aim to maintain legitimacy with them by being open and transparent about our governance. Our Governance Code is available on the governance pages of our website:

stakeholder.affinitywater.co.uk/our-governance.aspx

CODE PRINCIPLE - LEADERSHIP

BOARD LEADERSHIP

Our Board is collectively responsible for the long-term success of the company. It sets our strategic aims, ensures that the necessary financial and human resources are in place to meet our objectives and reviews management performance. It sets our values and standards and ensures that our obligations to shareholders and others are understood and met. The Board safeguards both the long-term success and customers' interests and creates shareholder value.

Our Chairman, Tony Cocker, leads our Board and is responsible for ensuring its effectiveness in all aspects of its role and that all directors are cognisant of their statutory duties. Composition is subject to the requirements of the Code and all appointments are made following a rigorous process to ensure the Board is well equipped to carry out long-term strategic and sustainable decision-making in the interests of our customers and shareholders.

The Board's role is to ensure that the company has competent, prudent and effective executive management, and that all necessary management systems and processes are in place and working effectively. The Board also has responsibility for reviewing performance, resources and standards of conduct.

The Board leads the company within a framework of effective controls which enable risk to be assessed and managed and is responsible to all stakeholders, including the shareholders, for the approval of the strategic objectives. Responsibility for the implementation and development of the strategies and overall commercial objectives is delegated to the Chief Executive Officer who is supported by the Executive Management Team.

SENIOR INDEPENDENT NON-EXECUTIVE DIRECTOR

The Board appointed Chris Bolt as the SID in March 2019. His role is to work closely with the Chairman, providing support and a sounding board for the Chairman and acting as an intermediary for the other directors where necessary. As part of his role as the SID, he:

- acts as an intermediary for other directors as and when necessary;
- is available to shareholders and other non-executives to address any concerns or issues they feel have not been adequately dealt with through the usual channels of communication (i.e. through the Chairman, the CEO or CFO);
- meets, at least annually, with the non-executives to review the Chairman's performance and succession planning for the Chairman's role; and
- attends enough meetings with major shareholders to obtain a balanced understanding of their issues and concerns.

Although appointment of a SID was not made until March 2019, representing a departure from the Code until the appointment date, the Board considers that it remained effective across the year working within a culture that encourages Board members to challenge, and with annual Board assessments that provide key information on areas that require further work or input. Areas highlighted for further work are then structured into the Board's forward annual planner.

In line with the Code, we implemented the Board's first externally facilitated appraisal in the year, details of which can be found on **page 82**. An evaluation of the Chairman's performance will be carried out by the SID ahead of the AGM to complete the externally facilitated board effectiveness review.

Governance continued

Board leadership, transparency and governance (continued)

BOARD OF DIRECTORS

Our directors and their biographies are shown on the following pages. Where a director holds other directorships within the Affinity Water group, the numbers listed alongside his or her name are cross referenced to the relevant company shown on the structure chart on **page 92**.

Director membership of our Board Committees is also listed by letter, alongside the relevant director's name:

- A Audit Committee
- R Remuneration Committee
- N Nomination Committee
- C Community Committee
- S Safety, Health, Environment and Drinking Water Quality Committee

Former directors

Name	Former Role	Period of service
Simon Cocks	Chief Executive Officer	1 June 2015 to 30 April 2018
	Non-executive director	22 May 2018 to 1 October 2018
Gareth Craig	Non-executive director	19 May 2017 to 25 July 2018

TONY COCKER

Chairman R N C

Appointment to the Board
15 January 2018 (appointed Chairman on 30 January 2018)

The Board considered Tony Cocker to be independent on his appointment.

Qualifications
Tony has a BA and D.Phil from Oxford University, and a Master of Business Administration ('MBA').

Skills and career experience
Tony has significant experience in the utilities industry, having worked for E.ON SE for 20 years, most recently as CEO and Chairman of E.ON UK plc. Prior to this he was Strategic Planning Manager of Bass plc and Associate Manager at LEK Consulting.

Other current business interests
Tony is Governor and Deputy Chairman of Warwick Independent Schools Foundation and is non-executive Chairman of Infinis Energy Management Limited. He is also non-executive Chairman of the Energy Innovation Centre and in May 2018 was appointed a non-executive director of SSE plc.

PAULINE WALSH

Chief Executive Officer ('CEO') C S 2 3

Appointment to the Board
1 May 2018

Qualifications
Pauline has a BEng (Hons) in mechanical engineering from University College Dublin and an MBA from the International Institute for Management Development in Switzerland. She is an honorary fellow of the Institute of Engineers of Ireland.

Skills and career experience
Pauline has broad international experience and a track record in leading transformational changes in large scale operations. She was previously Director of Gas Transmission for National Grid responsible for building and maintaining the assets of the UK's high pressure national gas transmission system. Prior to joining National Grid in 2015, Pauline held senior leadership roles at Ford Motor Company, Philips Electronics, Havells-Sylvania, and Fred. Olsen.

Other current business interests
Pauline is a non-executive director at Buccleuch, a business which is focused on the sustainable economic development of vast land resources and deploying renewable energy technologies.

STUART LEDGER

Chief Financial Officer ('CFO') C 2 3 4 12 13 14

Appointment to the Board
9 October 2017

Qualifications
Stuart has a BA from Liverpool John Moores University, is a Chartered Accountant and a member of the Pensions Management Institute.

Skills and career experience
Stuart has significant experience in utilities and has held a number of senior finance roles, most recently Chief Financial Officer for Retail at Thames Water. Before joining Thames Water in 2008 as the Group Financial Controller, he was the Financial Controller at Wolseley and started his career at EDF Energy.

Other current business interests
Stuart is a director of Landlord Tap Limited, which provides a website for landlords and managing agents of residential properties to provide water companies with details of those responsible for the payment of water and/or sewerage charges for their tenanted properties. Stuart is also a trustee of Rett UK, a charity that supports those who suffer from Rett Syndrome, and their families and carers.

Governance continued

Board leadership, transparency and governance (continued)

BOARD OF DIRECTORS (CONTINUED)

CHRIS BOLT

Independent non-executive director A R S

Appointment to the Board
26 February 2015

Appointment as the SID
March 2019

Qualifications
Chris has a BA Economics from Gonville & Caius College Cambridge and a MSc (Econ) from the University of London.

Skills and career experience
Chris has worked in the field of economic regulation for more than 20 years, holding senior roles in both the public and private sectors. He was the statutory Arbiter for the London Underground Public-Private Partnership Agreements from 2002 to 2011, and the first Chairman of the Office of Rail Regulation from 2004 to 2009. His regulation experience has included Transco plc from 1999 to 2002, the Office of the Rail Regulator from 1994 to 1999 and Ofwat from 1989 to 1994.

Other current business interests
Chris provides independent regulatory advice to the government, companies and regulators.

PATRICK O'D BOURKE

Independent non-executive director A N

Appointment to the Board
24 July 2013

Qualifications
Patrick has a MA from the University of Cambridge and is a Chartered Accountant.

Skills and career experience
Patrick was previously Chief Executive of Viridian Group, having first undertaken the role of Group Finance Director and prior to that was Group Treasurer of Powergen plc. As chair of our Audit Committee he brings a wide range of experience in regulated businesses operating within the private and quoted sectors.

Other current business interests
Until May 2019, Patrick was Group Finance Director of John Laing Group plc.

TREVOR DIDCOCK

Independent non-executive director A C S

Appointment to the Board
30 November 2015

Qualifications
Trevor has a BSc (Hons) in Mechanical Engineering from the University of Nottingham, and a MBA and Marketing Diploma from Cranfield Business School.

Skills and career experience
Trevor was Chief Information Officer at EasyJet plc from 2010 to 2015, HomeServe plc from 2008 to 2010, the Automobile Association Limited from 2003 to 2007 and Group IT Director at RAC Motoring Services Limited from 1999 to 2003. Trevor now provides advisory services to organisations in IT and transformational change.

Other current business interests
Trevor is a non-executive director at Futurice Oy and a non-executive member of the Transformation Programme Board at the Civil Aviation Authority.

SUSAN HOOPER

Independent non-executive director R N C

Appointment to the Board
30 November 2015

Qualifications
Susan has a MA and a BA from Johns Hopkins University.

Skills and career experience
Susan works with private equity companies developing opportunities in the travel industry. Susan was previously Managing Director of British Gas Services Limited and Chief Executive of the Acromas Group's travel division from 2009 to 2013, where she was responsible for Saga Holidays, Hotels, Cruises, the AA Travel division and Titan Travel.

Other current business interests
Susan is a non-executive director at Rank Group plc, Wizz Air Holdings plc, Uber London Limited, Uber Britannia Limited and the Department for Exiting the EU.

Governance continued

Board leadership, transparency and governance (continued)

BOARD OF DIRECTORS (CONTINUED)

CHRIS NEWSOME

Independent non-executive director S

Appointment to the Board
24 January 2019

Appointment as the SID
March 2019

Qualifications
Chris has a BSc in Civil Engineering from Loughborough University, a MBA from the Manchester Business School and a post-graduate diploma in Structural Engineering from the University of Bradford.

Skills and career experience
Chris has extensive experience across large, regulated infrastructure businesses and over 40 years' experience within the water industry (at Yorkshire Water, Kelda Water and more recently Anglian Water). He has a passion for carbon reduction and innovation and was awarded an OBE for services to Civil Engineering and Carbon Reduction in 2017.

Other current business interests
Chris is a member of the government's Green Construction Board and Chairman of the Infrastructure Working Group driving down carbon in infrastructure assets. He is Chairman of UK Water Industry Research Limited, President and Chairman of the Institute of Asset Management, a director of UK Water Partnership Limited and a board advisor for Barhale Limited.

JAROSLAVA KORPANEC

Non-executive director R N 2 3 4 5 6 7 8 9 10 16 19

Appointment to the Board
19 May 2017

Qualifications
Jaroslava has a law degree from the University of Cambridge, and is a member of the New York bar and a solicitor of the Supreme Court of England and Wales.

Skills and career experience
Jaroslava is Managing Director at Allianz Capital Partners and heads up the London office. Since joining Allianz in 2008, she has led the investments made in a number of infrastructure assets, including the Thames Tideway Tunnel, Porterbrook (the train rolling stock leasing business) and the gas distribution business of National Grid. Before joining Allianz Capital Partners in 2008, Jaroslava worked at AIG Financial Products on several debt and equity investments, including the acquisition and management of London City Airport.

Other current business interests
Jaroslava is also on the Boards of the gas distribution company, Cadent Gas, and Net4Gas, the gas transmission company of the Czech Republic.

ANTHONY ROPER

Non-executive director A N 2 3 4 5 6 7 8 9 10 19

Appointment to the Board
25 July 2018

Qualifications
Tony has a MA in Engineering from the University of Cambridge and is a qualified ACMA-CGMA accountant.

Skills and career experience
Tony started his career as a structural engineer with Ove Arup and Partners. In 1994, he joined John Laing Group plc to review and make equity investments in UK and global infrastructure projects, and then in 2006 he joined HSBC Specialist Investments ('HSIL') to be the fund manager for HICL Infrastructure plc. In 2011, Tony was part of the senior management team that bought HSIL from HSBC, renaming it InfraRed Capital Partners. Tony was a Managing Partner and a senior member of the infrastructure management team at InfraRed Capital Partners until June 2018.

Other current business interests
Tony is the Chairman of Aberdeen Standard European Logistics Income plc, a UK investment Trust. Tony is also Chairman of SDCL Energy Efficiency Income Trust plc.

ANGELA ROSHIER

Non-executive director A R C 2 3 4 5 6 7 8 9 10 17 19

Appointment to the Board
19 May 2017

Qualifications
Angela has a MA from the University of Cambridge and a MBA from London Business School.

Skills and career experience
For more than 20 years Angela has contributed to the origination and asset management of a wide variety of infrastructure assets in the public-private partnerships, water, oil tanking and railway sectors worldwide.

Other current business interests
Currently DIF's Partner and Head of Asset Management, Angela joined in 2010 and oversees the asset management of DIF's global portfolio of public-private partnerships, regulated assets and renewable energy investments. Prior to DIF, Angela was a member of 3i Plc and Actis's Infrastructure teams.

Governance continued

Board leadership, transparency and governance (continued)

GOVERNANCE INFORMATION

The terms of reference for each of the Board Committees are reviewed periodically and published on our website.

Re-appointment of directors

The company's articles provide that at each AGM any director appointed since the previous AGM, or any director appointed since the previous two AGMs without retiring or being re-elected, must retire and seek re-election.

While these arrangements depart from the Code with respect to annual re-election of all directors, the Board considers these arrangements for re-election appropriate for a company owned by private investors.

The following directors required to retire from office and seek re-election at this year's AGM are:

- Trevor Didcock;
- Susan Hooper;
- Chris Newsome; and
- Anthony Roper.

The terms of appointment for our independent non-executive directors are available on our website:

stakeholder.affinitywater.co.uk/our-governance.aspx

CODE PRINCIPLE - EFFECTIVENESS

THE COMPANY SECRETARY

The Company Secretary is responsible for advising the Board through the Chairman on all governance matters and ensuring the Board and its Committees receive regular written reports from management that are accurate, timely and contain clear information to enable them to discharge their duties effectively.

The Company Secretary works with the Chairman and respective Committee Chairs to develop and agree a forward agenda for the year ahead for the Board and Committee meetings.

Facilitating good information flows within the Board and its Committees and between senior management and non-executive directors is a key role of the Company Secretary. All directors have access to the advice and services of the Company Secretary and, where a director requires access to independent professional advice, it is the role of the Company Secretary to make appropriate arrangements at the expense of the company.

The appointment and removal of the Company Secretary is a matter for the Board as a whole.

CONFLICTS OF INTEREST

Directors are required to notify the Chairman of any potential conflict or potential new appointment or directorship in accordance with their statutory duties. The company's Articles of Association contain provisions which permit those directors who are not conflicted to authorise any situation giving rise to a known or potential conflict. All the directors are required to notify the Company Secretary if they believe a conflict situation might arise and directors are required to consider any conflicts at each board meeting. The Board reviews the position of each director annually along with the company's auditors.

The directors do not consider that during the financial year, any actual conflicts of interest have arisen between the roles of the directors as directors of the company, and any other roles which they may hold.

IMPLEMENTATION OF THE REVISED UK CORPORATE GOVERNANCE CODE, JUNE 2018 (THE '2018 CODE')

The Board has taken a considered and methodical approach with regard to changes to the Code and preparation for implementing these changes within the business. The Board has already set in motion the following:

Purpose, values and strategy: following the Board's effectiveness review, the Board commenced a review of the company's purpose, values and strategy to implement a clear strategy to promote the long-term success of the company while generating value for shareholders and contributing to the wider society in line with Principle A, Provisions 1 and 2 of the revised Code.

Whistleblowing: for the purposes of reporting within this financial year and following an annual review of the Audit Committee's terms of reference in February 2019, it was agreed the Whistleblowing Policy would remain as part of the Audit Committee's responsibilities. The Board will take the lead for any whistleblowing matters from June 2019, in line with Principle E, Provision 6 of the revised Code.

Stakeholder views: while the Board currently tracks individual metrics in respect of stakeholders and has actioned the introduction of a 'Stakeholder Map' to enable all Board members to have a common understanding of, and improve the quality of, current relationships with a range of stakeholders and the focus for the 2019/20 financial year. The information reported annually (current state of the relationship, actions for the coming year, ownership and review dates) will enable the Board to explain how it complies with the legislative requirements to have regard to employee and other stakeholder interests in line with Principles D and E, Provision 5 of the revised Code.

Mechanisms to engage with the workforce: the Board has set in motion a forward plan to have oversight of all workforce policies and practices designed to reinforce a healthy culture, aligning these with the company's values and in support of long-term sustainable success. It will assess how best to engage with employees across the business in a way that implements effective engagement with, and participation from these parties, in a way that meets the revised Code requirements while managing the interests of both the employees and the business, as set out in Principles D and E, and Provision 5 of the revised Code.

Annual re-election of all directors: the Board will consider recommending that the company's Articles of Association are amended to provide for the re-election of all directors at AGMs in line with Principle J, Provision 18 of the revised Code.

Governance continued

Board leadership, transparency and governance (continued)

IMPLEMENTATION OF OFWAT'S REVISED BOARD LEADERSHIP, TRANSPARENCY AND GOVERNANCE PRINCIPLES

The company has reported against the 2014 Ofwat principles that were in place during the year. The Board has noted the objectives of Ofwat's revised principles and will report compliance against these objectives in the company's annual report and financial statements for the year ending 31 March 2020. The objectives are:

Purpose, values and culture: the regulated company board establishes the company's purpose, strategy and values, and is satisfied that these and its culture reflect the needs of all those it serves.

Stand-alone regulated company: the regulated company has an effective board with full responsibility for all aspects of the regulated company's business for the long-term.

Board leadership and transparency: the board's leadership and approach to transparency and governance engenders trust in the regulated company and ensures accountability for their actions.

Board effectiveness: boards and their committees are competent, well run, and have sufficient independent membership, ensuring they can make high quality decisions that address diverse customer and stakeholder needs.

During the year the Board undertook a review of the company's governance arrangements in relation to Ofwat's draft principles. We believe that we already meet many of the objectives, principles and sub-principles; however, further work is underway to ensure the company's purpose, strategy and values are clear and transparent, and reflective of the needs of our stakeholders.

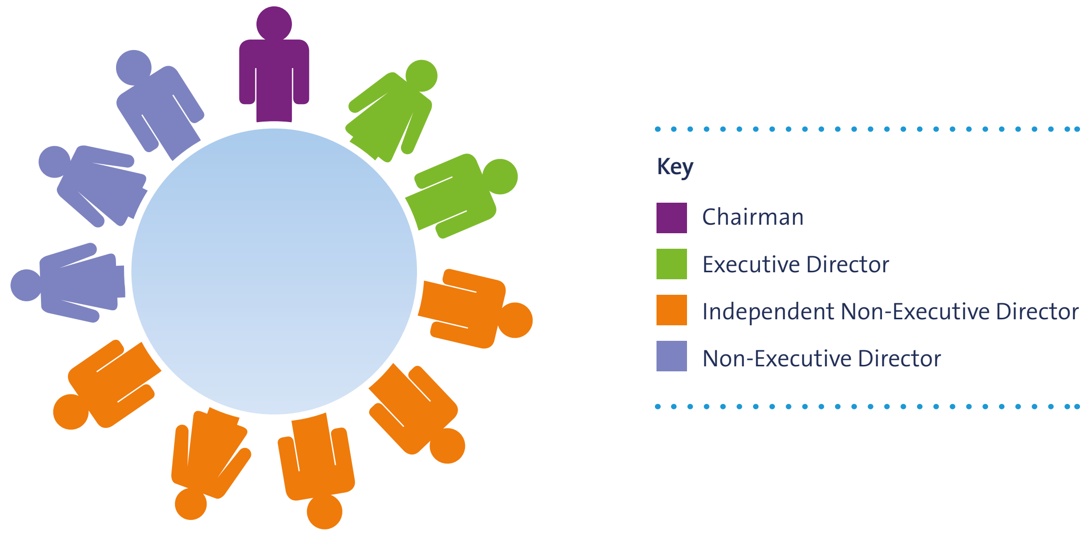
Both the revised Code principles and Ofwat objectives will be incorporated into the Board's governance framework. Key actions will be reviewed by the Board and its Committees, where applicable, to ensure clear reporting, responsibility and best practice to support the board of directors and the executive team in applying the changes.

BOARD COMPOSITION AND BALANCE

We consider that the Board and its Committees have the appropriate balance of skills, experience, independence and knowledge to enable them to discharge their respective duties and responsibilities effectively. There is a clear mix of high-quality skills including specialists with customer service, finance, IT, infrastructure and regulatory experience. Our non-executive directors are therefore considered to be of significant calibre and experience for their views to carry sufficient weight in Board decisions, and the independent non-executive directors are able to bring their invaluable commercial specialisms and regulatory experience into play at Board meetings.

The Board has been substantially refreshed following the change in ownership of the business on 19 May 2017 with a new Chairman, new CEO, new CFO, three new shareholder non-executive directors, a new independent non-executive director and the appointment of a SID. During the year the company met Ofwat's expectation that independent non-executive directors should be the largest single group on the Board. Although there was a departure from the Code provision for 'at least half the Board, excluding the Chairman, to comprise non-executive directors determined by the Board to be independent' until the appointment of Chris Newsome in January 2019, the Board is comfortable that the composition was appropriate for a company owned by private investors. No single director or group of directors can dominate the Board's decision making.

The composition of the Board at 31 March 2019 is illustrated in the diagram below:



Board composition at 31 March 2019	Directors	Independent (including Chairman)	Male	Female
	11	6	7	4

The Board is the principal decision-making body and provides entrepreneurial leadership within a framework of prudent and effective controls. Its role is to set the company's strategic aims, ensure that the necessary financial and human resources are in place to meet objectives, and to review management performance. The Board sets the company's values and standards, and ensures that its obligations to its shareholders and others are understood and met.

Executive responsibility for delivery of the objectives set by the Board is delegated to the Chief Executive Officer. The Board delegates certain roles and responsibilities to its principal Board Committees. The Committees report to the Board on matters discussed, decisions and actions taken. They make any necessary recommendations to the Board in accordance with their terms of reference and minutes of their meetings are made available to the Board.

Governance continued

Board leadership, transparency and governance (continued)

THE BOARD AND ITS COMMITTEES

The Board has established four standing principal committees each with their own terms of reference, which can be viewed on the governance pages of our website:

stakeholder.affinitywater.co.uk/our-governance.aspx

Other committees are formed as and when needed to deal with any specific issues that may arise. The principal committees are: the Audit Committee, the Remuneration Committee, the Nomination Committee and the Community Committee, which assist the Board in discharging its duties. Composition of these Committees at 31 March 2019 is listed in the table below.

Audit Committee	Remuneration Committee	Nomination Committee	Community Committee
Patrick O'D Bourke (Chair)	Susan Hooper (Chair)	Tony Cocker (Chair)	Tony Cocker (Chair)
Chris Bolt	Chris Bolt	Patrick O'D Bourke	Trevor Didcock
Trevor Didcock	Tony Cocker	Susan Hooper	Susan Hooper
Anthony Roper	Jaroslava Korpanec	Jaroslava Korpanec	Stuart Ledger
Angela Roshier	Angela Roshier	Anthony Roper	Angela Roshier
			Pauline Walsh

Susan Hooper was appointed a member of the Nomination Committee on 30 April 2018, ahead of the first Nomination Committee meeting of the year, thereby making independent members (including the Chairman) the majority and meeting the Code provision for nomination committees to comprise a majority of independent non-executive directors for the year.

Each committee operates in accordance with terms of reference approved by the Board and published on our website. Other committees are formed as and when required to deal with specific issues and appropriate terms of reference are established by the Board at the time.

INDEPENDENCE AND DIVERSITY

The composition of our Board Committees at 31 March 2019, in terms of independence and gender, is shown in the table below.

Composition at 31 March 2019	Members	Independent (including Chair)	Male	Female
Audit Committee	5	3	4	1
Remuneration Committee	5	3	2	3
Nomination Committee	5	3	3	2
Community Committee	6	3	3	3

Our directors have extensive professional experience in senior roles across the utilities and regulated assets industries, as well as in finance, operational roles and infrastructure. There is a wide range of skills and experiences to ensure a diversity of perspective that helps promote the company's long-term success. This is integral to effective oversight of the company's strategy, risk mitigation and management performance. The Board and Nomination Committee seek to drive the agenda of diversity across the whole company and are focussed on promoting a broader diversity and implementing a culture that is inclusive.

BOARD ACTIVITY FOR 2018/19

The table below outlines some of the matters considered by the Board during the year. Meeting agendas predominantly cover procedural matters (minutes, updates from the Chair and board committee Chairs, performance reviews, legal and governance, strategy and operations, and finance).

Aspect	Matters considered	
Environment	• Monitored water resources to evaluate the risk of drought • Reviewed progress in meeting AMP6 performance commitments for drinking water quality, sustainability reductions, reductions in leakage and reductions in per capita consumption	• Development of our revised draft WRMP, establishing a WRMP Committee, chaired by Tony Cocker, to provide oversight and scrutiny of the preparation; and to ensure it represents the most cost effective and sustainable long-term solution, and meets legal requirements and relevant guidelines • Reviewed environmental performance standards and commitments
Assets	• Reviewed progress in delivering the AMP6 capital programme, including the spend on IT infrastructure	• Reviewed how the capital programme in our AMP7 business plan submissions had been developed and the process by which options were assessed; the scope and deliverability of the investment programme; and alignment with our revised draft WRMP
Customers and communities	• Reviewed customer satisfaction, in particular performance against the SIM and Water UK service levels set for developer services	• Reviewed the CCG's annual report and met with the Chair of the Group to discuss their PR19 assurances submitted to Ofwat
People	• Reviewed the health, safety and wellbeing activities and consideration of safety and health incidents of employees and contractors	• Reviewed progress of pay negotiations with trade unions
Finance	• Approved interim and full-year financial statements and the Regulatory Annual Performance Report, including viability statement and regulatory certificates • Approved the company's first ever RPI linked inflation swap	• Approved simplification of the corporate structure, including substitution of the Cayman Islands financing company with a UK entity • Reviewed and agreed the schedule of contributions in place for the Affinity Water Pension Plan
Regulatory matters and PR19	• Reviewed charges publications for 2018/19 • Reviewed development of the AMP7 Business Plan submission in September 2018 and the revised submission in March 2019	• Reviewed Ofwat's revisions to Board leadership, transparency and governance principles, including the proposed changes to licence conditions
Risk Management	• Reviewed the principal risks of the company, including management's assessment of the likely impact of Brexit on our business model and strategy • Reviewed the company's preparations for the implementation of the General Data Protection Regulation and appointed the Company Secretary as the company's Data Protection Officer to oversee compliance	• Reviewed the effectiveness of the company's internal control systems and risk management processes, comprising financial, operational and compliance controls and including those relating to cyber security and information strategies
Governance	• Approved the appointments of a new Chief Executive Officer, independent non-executive director, shareholder non-executive director and SID • •Approved and updated policies relating to modern slavery and human trafficking, anti-bribery and corruption, and board diversity • Reviewed the performance of the external auditor and recommendation for reappointment	• Reviewed the company's governance arrangements regarding the requirements of the Code and Ofwat's governance principles • Carried out an externally-facilitated board effectiveness review

Governance continued

Board leadership, transparency and governance (continued)

BOARD AND COMMITTEE ATTENDANCE

Directors are expected to allocate sufficient time to the company to discharge their responsibilities effectively. In addition to formal Board and Committee meetings, directors are encouraged to participate in informal briefings from management. The expected time commitment of our Chairman and independent non-executive directors is recorded in their respective letters of appointment.

The table sets out attendance at scheduled meetings for the year ended 31 March 2019:

	Board	Audit Committee	Remuneration Committee	Nomination Committee	Community Committee
Number of meetings	**10**	**4**	**4**	**3**	**3**
Chairman					
Tony Cocker	10/10	-	4/4	3/3	2/3
Independent non-executive directors					
Chris Bolt	10/10	4/4	4/4	-	-
Patrick O'D Bourke	10/10	4/4	-	1/3	-
Trevor Didcock	10/10	4/4	-	-	3/3
Susan Hooper	8/10	-	4/4	3/3	2/3
Chris Newsome*	3/3	-	-	-	-
Executive directors					
Simon Cocks*	1/1	-	-	-	-
Stuart Ledger	10/10	-	-	-	-
Pauline Walsh*	1/1	-	-	-	-
Non-executive directors					
Simon Cocks*	4/4	-	-		-
Gareth Craig*	3/3	1/1	-	1/1	-
Jaroslava Korpanec	10/10	-	4/4	2/3	-
Anthony Roper*	7/7	2/3	-	1/2	-
Angela Roshier	10/10	2/4	4/4	-	1/3

* denotes not a member of the Board or Committee for the whole 12 months

– denotes non-membership of that Committee during the year

Simon Cocks appears twice in the above table, as he resigned as executive director on 21 May 2018 and remained in a non-executive director role until 1 October 2018. The company thereby continued to benefit from Simon's extensive knowledge of and operational experience in the utilities sector until 1 October 2018.

A number of unscheduled meetings were held in addition to the main board and committee meetings during the year to address specific matters arising, for example in relation to our AMP7 Business Plan submissions. The table below sets out attendance at all meetings held for the year ended 31 March 2019:

	Board	Audit Committee	Remuneration Committee	Nomination Committee	Community Committee
Number of meetings	**20**	**5**	**7**	**5**	**3**
Chairman					
Tony Cocker	20/20	-	7/7	5/5	2/3
Independent non-executive directors					
Chris Bolt	19/20	5/5	7/7	-	-
Patrick O'D Bourke	20/20	5/5	-	3/5	-
Trevor Didcock	18/20	4/5	-	-	3/3
Susan Hooper	17/20	-	7/7	4/5	2/3
Chris Newsome*	8/9	-	-	-	-
Executive directors					
Simon Cocks*	1/1	-	-	-	-
Stuart Ledger	20/20	-	-	-	-
Pauline Walsh*	19/19	-	-	-	3/3
Non-executive directors					
Simon Cocks*	8/8	-	-	-	-
Gareth Craig*	4/4	1/1	-	1/1	-
Jaroslava Korpanec	20/20	-	7/7	4/5	-
Anthony Roper*	14/16	3/4	-	2/4	-
Angela Roshier	19/20	2/5	7/7	-	1/3

* denotes not a member of the Board or Committee for the whole 12 months

- denotes non-membership of that Committee during the year

INDUCTION

Non-executive directors (including the chairman) who have been nominated for appointment attend a pre-appointment meeting with Ofwat. This meeting allows nominated directors to get an understanding of Ofwat's expectations for the role of non-executive directors of a regulated company and any other issues which Ofwat considers appropriate. It provides an opportunity to ask Ofwat any questions ahead of their appointment.

On appointment to the Board, directors follow a comprehensive induction process. This includes briefing directors about:

- the company's business model, key operations, processes and sites;
- its risk profile and approaches to management and assurance;
- its strategy, business plans and performance;
- its governance and regulatory framework; and
- their duties as directors, including details of the annual board (and relevant board committees) planner, effectiveness reviews and action plans.

The induction also includes visits to water treatment works and time spent with frontline employees.

Governance continued

Board leadership, transparency and governance (continued)

TRAINING AND CONTINUING PROFESSIONAL DEVELOPMENT

Our board members are conscious of the need to keep themselves properly informed about current issues and to deepen their understanding of the business. They receive updates on relevant issues, including legislative, regulatory and reporting matters to help improve their understanding and knowledge of the water industry and its regulatory environment. Training and updates for non-executive directors in relation to specific topics or key areas of interest have included attending regulatory working group meetings; attending forums for senior leaders in the business; and tours of water treatment works and other facilities. Non-executive directors also participate in industry events, including regular Ofwat events for non-executive directors.

In the year, the Nomination Committee took on responsibility for overseeing the training and continuing professional development of board members and aspires to develop further the training received by board members.

EFFECTIVENESS REVIEW

During the year, an externally facilitated review of the effectiveness of the Board and its Committees was undertaken by Boardroom Dialogue Group Limited, who are unconnected to the company. Each director, the Chairman and Company Secretary had a one-on-one interview with the external facilitator who also observed a board meeting. A full report was presented to and discussed with the Board in January 2019. The effectiveness of the Board was reviewed under the following headings: role of the board, leadership of the board and quality engagement, information and support, induction and development, succession planning and stakeholder management.

In summary, the external facilitator found that the Board was operating effectively, focussed on key issues and there was effective challenge and mutual respect between directors. Recommendations were made in the following areas, where work has already commenced:

- more opportunities for non-executive director-only interactions: the Chairman has set meetings across the next 12 months with himself and non-executive directors only;
- oversight of stakeholder engagement: development of a stakeholder map updating the Board annually on the strength of the relationship with each stakeholder has commenced; and
- succession planning for the Board and senior management team: the Nomination Committee is undertaking a review.

The Board continues to monitor progress in implementing the recommendations.

CODE PRINCIPLE - ACCOUNTABILITY

FINANCIAL AND BUSINESS REPORTING

Having taken into account all matters considered by the Board and brought to its attention during the year, the Board is satisfied that the annual report and financial statements taken as a whole are fair, balanced and understandable and provide the information necessary for shareholders to assess the company's position and performance, business model and strategy.

The Board believes that the disclosures set out on **pages 12 to 61** of the annual report provide the information necessary for shareholders to assess the company's performance, business model and strategy.

RISK MANAGEMENT AND INTERNAL CONTROL

The company's systems of internal control are designed to manage the risk of failure to achieve business objectives (though such risk cannot be completely eliminated), and provide reasonable, and not absolute, assurance against material misstatement or loss.

Particular features of the systems of risk management, planning and internal controls include:

- a suite of internal control procedures across both operational and financial matters, supported by segregation of duty matrices and detailed delegated levels of authority;
- an Internal Audit function, the head of which (the Head of Audit, Risk and Compliance) reports to the Audit Committee, together with other internal control and assurance resources which monitor compliance with laws, regulations, policies and procedures;
- the setting and monitoring of annual budgets at a detailed level supported by a five-year forecast;
- specialist planning teams retained within the organisation to work on major projects, such as business planning activities, supported by external specialists where appropriate; and
- the use of appropriate external assurance review, both fiscal and operational.

GOVERNANCE INFORMATION

Board accountability

Our Board is responsible for presenting a fair, balanced and understandable assessment of the company's position and prospects in the financial statements. All directors have a 'duty to promote the success of the company' (section 172 of Companies Act 2016).

The strategic report sets out the basis on which the company generates or preserves value over the longer term and the strategy for meeting the company's objectives.

Our Board has overall responsibility for monitoring the company's internal control systems and is advised by the Audit Committee on these matters. The Board is responsible for reviewing the effectiveness of these control systems, including:

- financial, operational and compliance controls; and
- risk management.

Board Committees' accountability

The Board and its Committees have an appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their duties effectively.

Committee membership is assessed and refreshed periodically when necessary to ensure that undue reliance is not placed on any one individual.

Only the Committee Chairman and its members are entitled to be present at the Audit, Remuneration, Nomination and Community Committee meetings, however, others may attend by invitation of the relevant Committee.

The terms of reference for the Board Committees are available on the governance pages of our website:

stakeholder.affinitywater.co.uk/our-governance.aspx.

Each Board Committee reviewed its Terms of Reference during the year.

Governance continued

Board leadership, transparency and governance (continued)

RISK MANAGEMENT AND INTERNAL CONTROL (CONTINUED)

The Board acknowledges that the data forming part of our AMP7 Business Plan submission in September 2018 fell significantly short of Ofwat's expectations for consistency and accuracy. As a 'prescribed' company under Ofwat's 2018 Company Monitoring Framework, the Board is committed to making the improvements necessary to restore confidence in the quality of our data.

The Board approves the company's annual budget and regularly reviews actual performance. All major transactions are reviewed and approved by the Board.

The main features of the company's internal control and risk management systems in relation to the financial reporting process include:

- a structured review process for year-end financial reporting, including review by the Audit Committee early in the drafting process;
- recruitment, training and development of appropriately qualified and experienced financial reporting personnel;
- formalised monthly close control procedures, including journal approval and validation, balance sheet reconciliations and ledger checks; and
- preparation of monthly management accounts on the same basis of accounting as year-end financial reporting.

A whistleblowing procedure is in place that supports the open culture that the company seeks to promote in its dealings with members of staff, and all people with whom it engages in its business activities. The procedure encourages employees to communicate their concerns about malpractice or misconduct in an open and honest manner without fear of any form of detriment to their employment or career prospects.

We have an established framework for identifying, evaluating and managing the principal risks the company faces, including those that would threaten its business model, future performance, solvency or liquidity. This framework has been in place for the year under review and up to the date of approval of this annual report and financial statements. Refer to **page 48** of the strategic report for further information.

The Board confirms that it:

- is satisfied that it has carried out a robust assessment of the principal risks facing the company, including those that would threaten its business model, future performance, solvency or liquidity; and
- has reviewed the effectiveness of the risk management and internal control systems including all material financial, operational and compliance controls (including those relating to the financial reporting process) and no significant failings or weaknesses were identified.

In reviewing the effectiveness of risk management and internal control systems, the Board took into account:

- its bi-annual review of the strategic risk register;
- the oversight of treasury matters;
- reports from the Executive Management Team, the Audit Committee, external Auditor and other assurance providers, and the Internal Audit function in relation to internal control and risk management systems; and
- Ofwat's 2018 Company Monitoring Framework assessment.

BOARD COMMITTEES

Audit Committee

During the year, membership of the Audit Committee was as follows:

Audit Committee members	Independence	Notes
Patrick O'D Bourke (Chair)	Independent	
Chris Bolt	Independent	
Trevor Didcock	Independent	
Anthony Roper	Shareholder appointed	Appointed 25 July 2018
Angela Roshier	Shareholder appointed	
Gareth Craig	Shareholder appointed	Resigned 25 July 2018

The Committee is chaired by Patrick O'D Bourke, an independent non-executive director who has relevant and up to date financial experience, and as a whole, members have competency relevant to regulated utilities and infrastructure businesses. The Chief Executive Officer, Chief Financial Officer, Head of Audit, Risk and Compliance, Financial Controller, external Auditor and other parties are invited to attend meetings as appropriate.

The Committee provides a key element of the company's governance structure and ensures the interests of shareholders, customers and other stakeholders are protected, and that responsible business practices are adhered to. The Committee is required to achieve compliance with best practice in terms of corporate governance, internal control, risk management and financial reporting and act as a link between external auditors and the Board of directors.

The Committee considers matters identified by the external Auditor in its report to the Committee and, where significant, reports these to the Board. It reviews the provision of non-audit services by the external Auditor to ensure they do not impinge on the external Auditor's independence in undertaking the statutory audit and has primary responsibility for making a recommendation on the appointment, re-appointment and removal of the external Auditor. Information received from the Internal Audit team and the external Auditor is reported at each Committee meeting (a fundamental part of our risk management process).

The Committee reviews policies and the overall process for identifying and assessing business risks, liaising closely with the external Auditor. It receives regular assurance reports from Internal Audit, management and others on the operational effectiveness of matters related to risk and control, and monitors the timeliness and effectiveness of corrective action taken by management. It also monitors and reviews the effectiveness of internal audit activities and carries out a robust assessment of the company's principal risks, reviewing the company's position and performance, business model and strategy. The Committee also considers the clarity of reporting to ensure that shareholder interests are properly protected in relation to financial reporting and internal controls.

An evaluation of the Committee was undertaken during the year by assessing its performance against a range of criteria aligned to the Committee's terms of reference. The assessment confirmed year on year improvement across the range of assessment criteria, in particular with regard to the concise, relevant information received, and all key issues being identified and reported back to the Board in a prompt manner. The following areas were highlighted as requiring further focus:

- improve understanding of risk appetite and risk management of the internal control framework in line with further work on the risk appetite; and
- identify training to support ongoing personal development activities to update members' skills and knowledge.

The duties of the Audit Committee and activities in the year are contained in the Audit Committee report on **pages 97 to 102**.

Governance continued

Board leadership, transparency and governance (continued)

BOARD COMMITTEES (CONTINUED)

Remuneration Committee

During the year, membership of the Remuneration Committee was as follows:

Remuneration Committee Members	Independence
Susan Hooper (Chair)	Independent
Chris Bolt	Independent
Tony Cocker	Independent
Jaroslava Korpanec	Shareholder appointed
Angela Roshier	Shareholder appointed

The Committee is chaired by Susan Hooper and meets Ofwat's expectations for there to be a majority of independent members, as well as the requirements of the Code.

The principal function of the Committee is to consider the remuneration of the directors. It determines and agrees with the Board the broad policy for the remuneration of the Chairman, independent non-executive directors, executive directors and other members of the Executive Management Team. No director or manager is involved in any decisions as to his or her own remuneration. The Committee seeks to ensure that executive directors' remuneration is designed to promote the long-term success of the company and performance related elements are transparent, stretching and rigorously applied.

Remuneration of employees other than the executive directors and Executive Management Team is considered by the executive directors and members of the Executive Management Team. Trade Unions are consulted as part of the annual pay review process. All employees are members of an annual bonus scheme which takes into account the company's operational, customer and financial performance.

With the implementation of the revised Code, the Board will assess remuneration policies and practices to facilitate alignment to company purpose and values, and to ensure the successful delivery of the company's long-term strategy. It will look to clarify reporting on remuneration, how it delivers company strategy and long-term success, and alignment with employee remuneration is in place.

Further information on the work of the Remuneration Committee during the year is contained in the full Remuneration Report on **pages 103 to 116**.

Nomination Committee

During the year, membership of the Nomination Committee was as follows:

Nomination Committee members	Independence	Notes
Tony Cocker (Chair)	Independent	
Patrick O'D Bourke	Independent	
Susan Hooper	Independent	Appointed April 2018
Jaroslava Korpanec	Shareholder appointed	
Anthony Roper	Shareholder appointed	Appointed 25 July 2018
Gareth Craig	Shareholder appointed	Resigned 25 July 2018

The Chairman does not chair any Nomination Committee meetings relating to the appointment of his successor. In these circumstances, the Committee is chaired by an independent non-executive director agreed by the remaining Committee members.

Susan Hooper was appointed a member of the Committee in April 2018, thereby making independent members (including the Chair) the majority, meeting the Code provision for nomination committees to comprise a majority of independent non-executive directors.

The Committee is responsible for considering and recommending to the Board, persons who are appropriate for appointment as executive and non-executive directors, so as to maintain an appropriate balance of skills and experience within the company and on the Board. The Committee:

considers succession planning for directors and other senior executives including reviewing board performance, paying specific attention to the structure, size and composition of the Board including skills, independence, knowledge and diversity;

oversees the training and continuing professional development of Board members;

keeps under review the leadership needs of the company to ensure the continued ability of the company to compete effectively in the market in which it operates; and

identifies and nominates for board approval, candidates to fill board vacancies.

The Committee oversees the preparation of a role specification that is then provided to an independent search firm. In addition to the specific skills, knowledge, independence and experience deemed essential, other criteria set out in the role specification include:

- a commitment to the highest standards of governance;
- strategic focus and a clear, independent point of view;
- a diversity of experience;
- a proven track record of creating shareholder value; and
- having the time and availability to manage the role.

The Board has approved a diversity policy and the company strives for a genuine diversity of its directors and employees. Diversity is crucial for the long-term success of the business and the company is striving to create gender-balance teams across the business. Achieving real change requires committed leadership at the top and real focus and effort to shift mindsets. The Nomination Committee therefore is mindful that continued focus in this area will ensure that progress is made regarding ethnicity, gender, disability and age within the organisation.

Governance continued

Board leadership, transparency and governance (continued)

BOARD COMMITTEES (CONTINUED)

Nomination Committee (continued)

Along with other UK utilities and their contractors, the company has set out its ambition to enhance the diversity of its workforce and be ever more inclusive. Supported by the Energy & Utility Skills Group, an employer-led membership organisation that helps to ensure the gas, power, waste management and water industries have the skills they need now and in the future, the commitment seeks to make the utility workforce more resilient, more reflective of customers and communities, and more innovative and productive. It is underpinned by five principles:

- Work collaboratively as a sector to drive change, challenging ourselves to do things differently, by sharing best practice and delivering sector priorities
- Focus on inclusion in its entirety, however our sector history requires targeted sector action to start by increasing gender, BAME and disability workforce representation
- Measure and be transparent about progress in our individual organisations and as a sector
- Ensure we create the culture we need to attract the workforce of tomorrow
- Be inclusive in the way we attract, recruit and develop our people

At Board level, the Nomination Committee has not set a specific male or female quota for Board members. All appointments are based on the diversity of contribution and required competencies, irrespective of gender, age or any other personal characteristics. The company is similarly committed to appointing the best available person to roles across the organisation, regardless of age, gender, disability or ethnicity. See **page 34** of the strategic report for the split between males and females within the business and how we are improving diversity across the talent pool.

The Committee met five times during the year to consider the appointment of an additional independent non-executive director appointment to the Board and to review succession planning for senior executive roles. The Committee evaluated the balance of skills, experience, independence and knowledge on the Board and within the Executive Management Team to ensure the needs of the business, customers, shareholders, the environment and other stakeholders are identified and met, and to achieve the representation and diversity required.

Heidrick & Struggles LLP, a member of the Voluntary Code of Conduct for Executive Search Firms which is unconnected to the company, was chosen from a number of executive search firms following presentations to the Committee to provide assistance with the appointment of an additional independent non-executive director. The Nomination Committee reviewed lists of candidates from Heidrick & Struggles LLP and interviewed a number of candidates for the role. The Nomination Committee recommended to the Board the appointment of Chris Newsome. The Board subsequently approved this recommendation.

Korn Ferry, a member of the Voluntary Code of Conduct for Executive Search Firms which is unconnected to the company, provided a shortlist of candidates early in 2018 for the position of CEO. Pauline Walsh joined the business on 25 April 2018 and was appointed director on 1 May 2018.

Community Committee

Membership of the Community Committee is as follows:

Community Committee members	Independence	Notes
Tony Cocker (Chair)	Independent	
Trevor Didcock	Independent	
Susan Hooper	Independent	
Angela Roshier	Shareholder appointed	
Stuart Ledger	Executive	
Pauline Walsh	Executive	Appointed May 2018
Simon Cocks	Executive	Resigned May 2018

The Committee's role is to:

- continue developing and implementing the company's community strategy that supports delivery of its vision to be the leading community-focused water company;
- oversee short and long-term objectives for the community strategy and ensure they are implemented and reported on; and
- ensure the company holds itself to account with the communities it serves in respect of the provision of its services to its customers.

Over the past 12 months the Committee has held four meetings and established a clear strategy to support the delivery of the company's vision to be the UK's leading community-focused water company. A draft community model has been developed alongside the implementation of community advocates and sponsors. Community advocates comprise members of the Executive Management Team, who have a Board director sponsor. The role of the advocate is to maintain regular contact with local community representatives, take time to understand stakeholders within the community, and attend local projects and events in their area of responsibility. Refer to **page 21** for further details of the company's community model.

During 2019/20 the Board is absorbing responsibility for the work of the Community Committee. This will enable the Board to ensure we are delivering the commitments expected of a water company whose vision is to be 'the leading community focussed water company'.

Safety, Health, Environment and Drinking Water Quality Committee

For 2019/20 a new Board Committee, the Safety, Health, Environment and Drinking Water Quality Committee is being established. The Committee will be chaired by Chris Newsome (independent), with Chris Bolt (independent), Trevor Didcock (independent) and Pauline Walsh (executive) as the other members. The Committee's role will include:

- reviewing and monitoring, on behalf of the Board, safety and health, environment, drinking water quality and security matters arising from the company's activities and operations, including monitoring performance against targets;
- keeping under review the adequacy of the framework of company policies and procedures (including training and competency assessment), and compliance with relevant legislation; and
- consideration of whether risks are being managed effectively.

Governance continued

Board leadership, transparency and governance (continued)

GOVERNANCE INFORMATION

Shareholder engagement

Mechanisms are in place to ensure shareholders are kept in touch with key activities and developments, including:

- shareholders may attend quarterly Leaders' Forums and regulatory working group meetings on business and regulatory strategy;
- key company notices and external communications are shared with shareholders;
- presentations and reports from the CEO and CFO are standard agenda items for Board meetings which are attended by shareholder-affiliated directors;
- shareholder approval is sought for the limited number of matters reserved for shareholder approval. Details of these matters are published in: '*Engaging with our shareholders*', available on the governance pages of our website.

Our shareholders discharge their responsibilities as shareholders through their representation on our Board and through their participation in, Board decisions to the extent not prohibited by condition I of the company's Instrument of Appointment (refer to **page 189** for further details). Executive management hold ad hoc meetings with shareholders as required.

CODE PRINCIPLE - REMUNERATION

Our Remuneration Report can be found on **pages 103 to 116**.

CODE PRINCIPLE – RELATIONS WITH SHAREHOLDERS

RELATIONSHIP WITH OUR SHAREHOLDERS

The Board has an open and transparent approach to its shareholders. The relationship is strong, with shareholders having clear access to the Chairman, executive and non-executive directors and senior executives.

There are three directors affiliated to our owners on the Board which ensures that the views of shareholders are taken into account in decision making. The Board is accountable to its shareholders for the performance and activities of the company and regularly facilitates effective face-to-face dialogue with shareholders to allow all the members of the Board, in particular the independent non-executive directors, to develop an understanding of shareholders' views. This provides our shareholders with the opportunity for open and transparent dialogue with the non-executive directors and assurance on the Board's stewardship of their investment.

There are a limited number of matters requiring shareholder approval, reflecting those matters in which a company with listed equity shares would typically involve shareholders in decision-making. The Board is responsible for ensuring that satisfactory dialogue with shareholders takes place. Shareholders have an important role to play in the strong, effective governance and stewardship of our business, and we maintain an open and transparent relationship with our shareholders to facilitate this.

By order of the Board

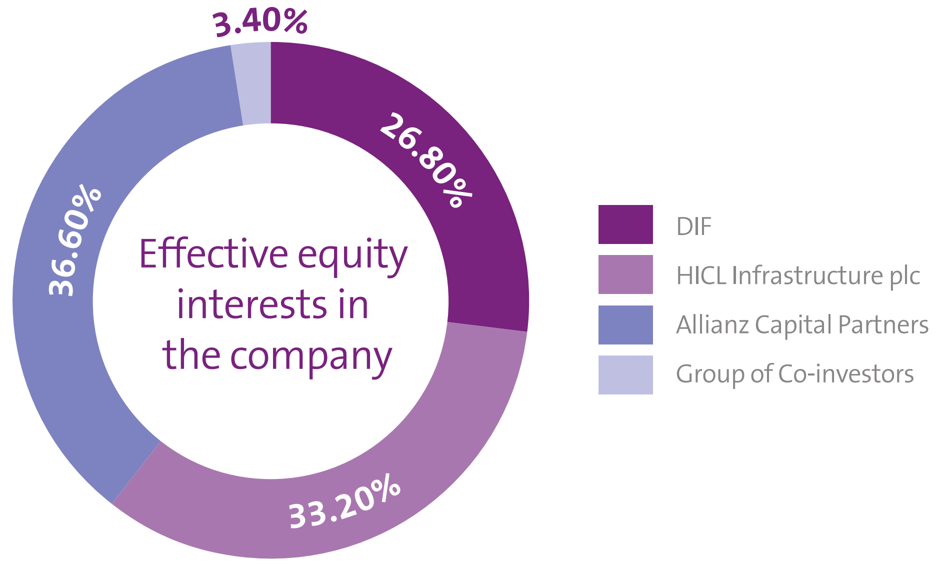
Tim Monod

Company Secretary
25 June 2019

Ownership and financing

OWNERSHIP

On 19 May 2017, Affinity Water Acquisitions (Investments) Limited was acquired by a consortium comprising DIF, HICL Infrastructure Company Limited (advised by InfraRed Capital Partners Limited) and Allianz Capital Partners on behalf of the Allianz Group. As part of the transaction, the consortium also acquired Veolia Water UK Limited's 10% equity interest stake in the company. Subsequent to the initial sale, HICL Infrastructure Company Limited (advised by InfraRed Capital Partners Limited) sold down 3.4% of its interest to a small group of co-investors, comprising UK local authority pension funds in June 2017. On 1 April 2019 HICL Infrastructure Company Limited transferred its investment portfolio, assets and liabilities to HICL Infrastructure plc, a new listed UK registered investment trust and shareholders of HICL Infrastructure Company Limited became shareholders of HICL Infrastructure plc.



The consortium made its investment through Daiwater Investment Limited, which has been our UK holding company since 19 May 2017. We consider the following entities to be our ultimate controllers, as they are in a position to exercise material influence over our policy and affairs:

- Allianz Infrastructure Luxembourg I Sarl
- DIF Management Holding BV
- DIF Management UK Limited
- HICL Infrastructure plc
- InfraRed Capital Partners (Management) LLP

These entities, together with Daiwater Investment Limited, have provided us with legally enforceable undertakings that they will:

- give us such information as may be necessary to enable us to comply with our obligations under the Water Industry Act 1991 and Instrument of Appointment;
- refrain from any action which would cause us to breach any of our obligations under the Water Industry Act 1991 or the conditions of our Instrument of Appointment; and
- use their best endeavours to ensure that our Board maintains three independent non-executive directors, who shall be persons of standing with relevant experience and who shall collectively have connections with and knowledge of the areas for which we are a water undertaker and an understanding of the interests of customers and how these can be respected and protected.

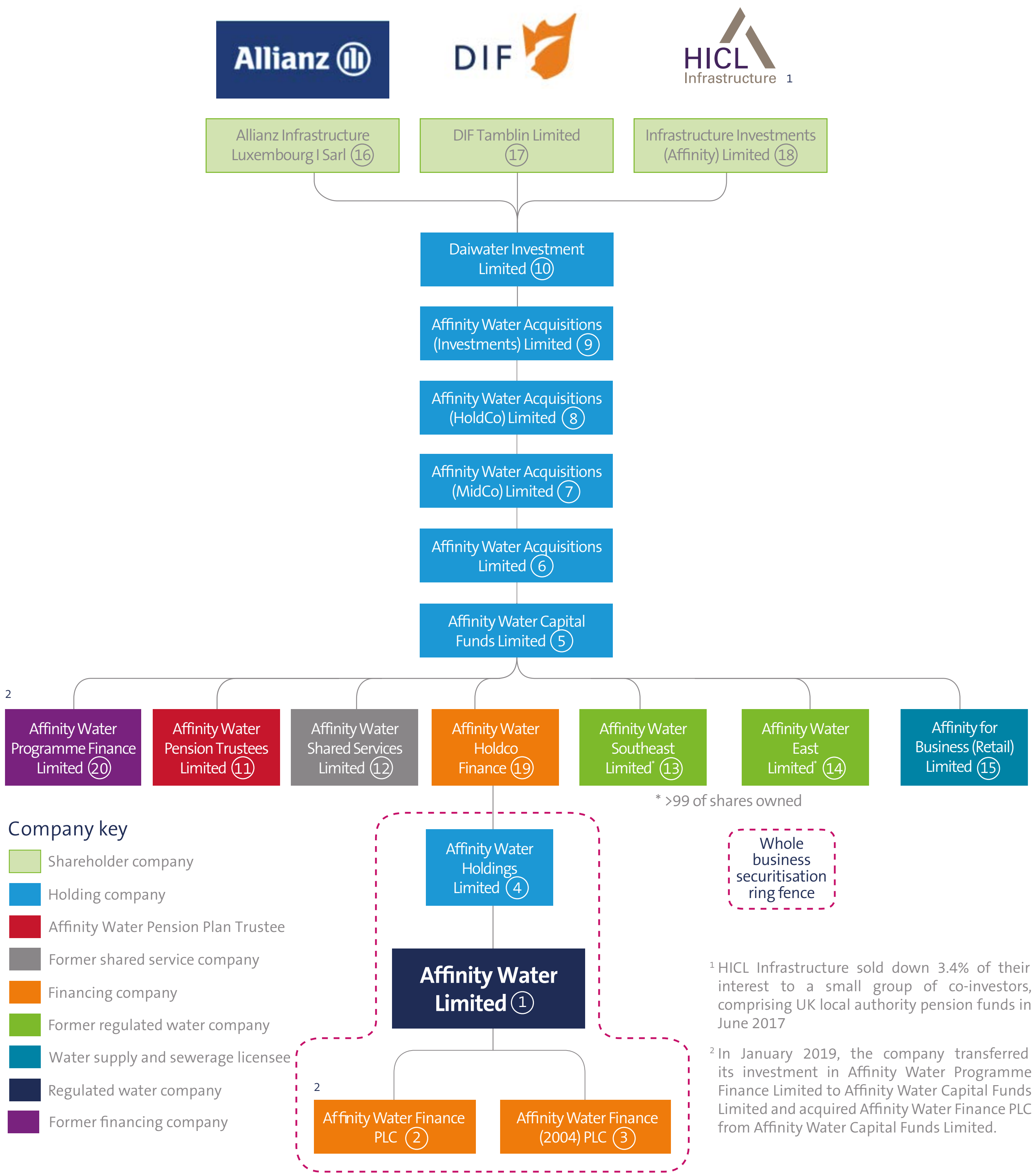
We are satisfied that these undertakings are being properly discharged and that we are able to fully meet our regulatory obligation to operate our appointed business as if it were substantially our sole business and the company were a separate listed company.

Governance continued

Ownership and financing (continued)

OWNERSHIP (CONTINUED)

The chart below shows the equity interests held by each owner and the structure of the group, excluding dormant subsidiaries, as at 31 March 2019. Unless otherwise indicated, all companies are wholly owned by the parent company shown. The numbers listed alongside the companies within the group structure may be cross referenced to the other group directorships of the company's directors, indicated within their biographies on **pages 68 to 73**.



[1] HICL Infrastructure sold down 3.4% of their interest to a small group of co-investors, comprising UK local authority pension funds in June 2017

[2] In January 2019, the company transferred its investment in Affinity Water Programme Finance Limited to Affinity Water Capital Funds Limited and acquired Affinity Water Finance PLC from Affinity Water Capital Funds Limited.

The following table provides further explanation of the group structure.

Structure chart reference	Company	Description	Place of registration
1	Affinity Water Limited	A water undertaker holding an appointment under the Water Industry Act 1991, supplying water to a population of around 3.6 million people in the South East of England. It is the principal trading company of the group.	England and Wales
2	Affinity Water Finance PLC	A financing subsidiary of Affinity Water Limited established in 2018 to issue bonds under a Euro Medium Term Note ('EMTN') programme. It lends monies raised from its bonds to Affinity Water Limited.	England and Wales
3	Affinity Water Finance (2004) PLC	A financing subsidiary of Affinity Water Limited established in 2004 to issue a bond. It lends monies raised from its bond to Affinity Water Limited.	England and Wales
4	Affinity Water Holdings Limited	Affinity Water Limited's immediate holding company. Its equity is provided as security to bondholders in the event of default.	England and Wales
5	Affinity Water Capital Funds Limited	The original holding company for Veolia's regulated water businesses, which was acquired by the group in June 2012 through Affinity Water Acquisitions Limited (the "target" company), which provides management services to the company.	England and Wales
6	Affinity Water Acquisitions Limited	The company which bid for and acquired Affinity Water Capital Funds Limited and its subsidiaries from Veolia Water UK Limited in 2012 (the "bid" company). It issued subordinated debt notes to Affinity Water Acquisitions (Midco) Limited as part of the acquisition finance.	England and Wales
7	Affinity Water Acquisitions (Midco) Limited	The holding company of Affinity Water Acquisitions Limited which holds subordinated debt notes issued by Affinity Water Acquisitions Limited. It issued subordinated debt notes and exists to enable the introduction or withdrawal of shareholder subordinated debt without impacting on agreements between the original acquisition consortia and Veolia Water UK Limited.	England and Wales
8	Affinity Water Acquisitions (Holdco) Limited	The holding company of Affinity Water Acquisitions (Midco) Limited. The inclusion of a holding company between Affinity Water Acquisitions (Midco) Limited and Daiwater Investment Limited enables the introduction or withdrawal of additional shareholders without impacting on shareholder agreements between the original acquisition consortia.	England and Wales
9	Affinity Water Acquisitions (Investments) Limited	The ultimate holding company of the group in the United Kingdom up until 19 May 2017.	England and Wales
10	Daiwater Investment Limited	The ultimate holding company of the group in the United Kingdom, paying dividends to the acquisition consortia subsidiaries.	England and Wales

Governance

Governance continued

Ownership and financing (continued)

OWNERSHIP (CONTINUED)

Structure chart reference	Company	Description	Place of registration
11	Affinity Water Pension Trustees Limited	The trustee company of the Affinity Water Pension Plan.	England and Wales
12	Affinity Water Shared Services Limited	A company which provided administrative and technical services solely to Affinity Water Limited until 31 March 2015. Prior to the acquisition of Veolia Water UK Limited's 90% equity interest in the group in June 2012 (and for a 12 month transitional period following), the company also provided services to the non-regulated businesses of Veolia Water UK Limited.	England and Wales
13	Affinity Water Southeast Limited	A company which formerly held an Instrument of Appointment as water undertaker for the Dour community of Affinity Water Limited's water supply area. The appointment was transferred to Affinity Water Limited on 27 July 2012. The company is no longer trading but continues to honour income assurances made to minority shareholders on transfer of its water undertaking to Affinity Water Limited.	England and Wales
14	Affinity Water East Limited	A company which formerly held an Instrument of Appointment as water undertaker for the Brett community of Affinity Water Limited's water supply area. The appointment was transferred to Affinity Water Limited on 27 July 2012. The company is no longer trading but continues to honour income assurances made to minority shareholders on transfer of its water undertaking to Affinity Water Limited.	England and Wales
15	Affinity for Business (Retail) Limited	A subsidiary of Affinity Water Capital Funds Limited operating as a water and wastewater retailer in the non-household retail market.	England and Wales
16	Allianz Infrastructure Luxembourg I Sarl	A company which holds indirectly Allianz Capital Partners' investment in the group.	Luxembourg
17	DIF Tamblin Limited	A company established in 2017 to hold indirectly DIF's investment in the group.	England and Wales
18	Infrastructure Investments (Affinity) Limited	A company established in 2017 to hold indirectly HICL Infrastructure Company Limited's (from 1 April 2019 HICL Infrastructure plc's) investment in the group.	England and Wales
19	Affinity Water Holdco Finance Limited	A financing subsidiary of Affinity Water Capital Funds Limited established in 2017. It lends monies raised to Affinity Water Capital Funds Limited.	England and Wales
20	Affinity Water Programme Finance Limited	A former financing subsidiary of Affinity Water Limited established in 2013 to issue bonds under a Euro Medium Term Note ('EMTN') programme. It's assets and liabilities were transferred to Affinity Water Finance PLC in 2019.	Cayman Islands

OUR FINANCING

Affinity Water Limited is financially and operationally 'ring-fenced' from the rest of the Affinity Water group by way of a WBS. The securitisation further enhances the ring-fencing provisions already in our licence. The sole business of our immediate holding company, Affinity Water Holdings Limited, is holding the shares of Affinity Water Limited.

We have two financing subsidiaries which have issued bonds which are listed by the UK Listing Authority ('UKLA') and the proceeds of which have been lent on to and are guaranteed by the company:

- Affinity Water Finance (2004) PLC has issued an external bond of £250m; and
- Affinity Water Finance PLC has issued external bonds totalling £764.2m.

We believe that the ring-fencing structure provides significant corporate benefits, providing better access to long-term debt markets and an opportunity to reduce the cost of capital employed in the regulated business for the benefit of customers.

Bonds issued by both Affinity Water Finance (2004) PLC and Affinity Water Finance PLC are subject to the Listing Rules and Disclosure and Transparency Rules, being listed by the UKLA.

The bonds issued by the company's subsidiaries at 31 March 2019 can be summarised as follows:

Debt	Bond (£m)	Coupon	Maturity Date
Class A fixed rate bond 2026*	250.0	5.875%	July 2026
Class A fixed rate bond 2036*	250.0	4.500%	March 2036
Class A RPI linked bond 2045*	190.0	1.548% (real)	June 2045
Class A fixed rate bond 2042*	85.0	3.278%	August 2042
Class A fixed rate bond 2033*	60.0	2.699%	November 2033
Class A CPI linked bond 2042*	60.0	0.230% (real)	November 2042
Class A fixed rate bond 2022*	14.2	3.625%	September 2022
Total Class A	**909.2**		
Class B RPI linked bond 2033	95.0	3.249% (real)	June 2033
Class B RPI linked bond 2033*	10.0	1.024% (real)	June 2033
Total Class B	**105.0**		
Total	**1,014.2**		

* Listed on the London Stock Exchange

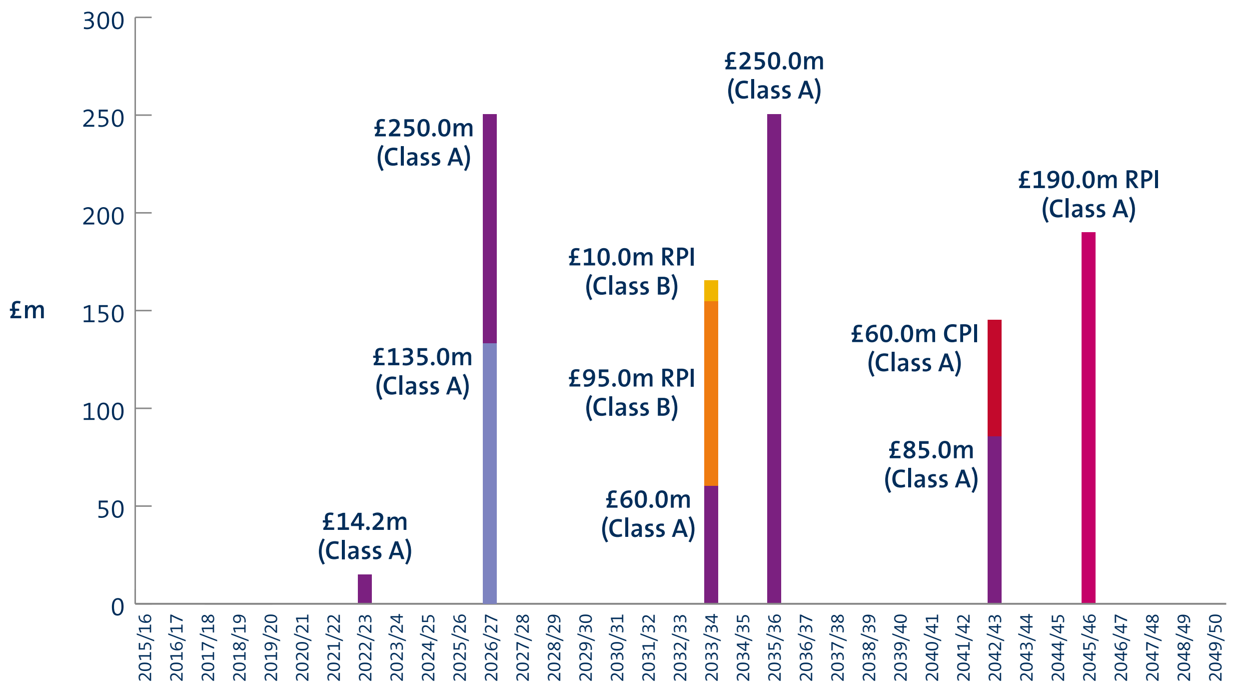
Governance

Governance continued

Ownership and financing (continued)

OUR FINANCING (CONTINUED)

The following chart shows the maturity profile of the bonds at 31 March 2019:



Class A Conventional Debt
Class A RPI Linked Swap
Class A RPI Linked Debt
Class A CPI Linked Debt
Class B RPI Linked Debt (private)
Class B RPI Linked Debt (public)

The credit ratings for our subsidiaries' bonds assigned by the rating agencies, Moody's and Standard & Poor's, at 31 March 2019 were as follows:

Bonds	Moody's	Standard & Poors
Class A	A3	A -
Class B	Baa3	BBB
Corporate family rating	Baa1	Not applicable

Moody's credit ratings were last affirmed in January 2019. Standard & Poor's ratings were reaffirmed in March 2019.

Audit Committee report

PATRICK O'D BOURKE

Audit Committee members

- Patrick O'D Bourke
- Chris Bolt
- Trevor Didcock
- Gareth Craig*
- Anthony Roper*
- Angela Roshier

In addition to the members set out above, the CEO and CFO, Head of Audit, Risk and Compliance, and the external Auditor normally attend, by invitation, all meetings of the Committee. Other members of senior management are also invited to attend, as appropriate.

For more information on the responsibilities of the Audit Committee and the qualifications of the Chairman, refer to **page 85**. The biographies of the remaining current Committee members are presented on **pages 68 to 73**.

In accordance with the Audit Committee terms of reference, key areas of focus are:

- Monitor and review the financial statements, accounting policies and any other formal announcements relating to the company's financial performance;
- Risk management and internal controls, including the viability statement;
- Oversight of internal and external audit;
- Review of the adequacy of the company's procedures for whistleblowing, anti-bribery and reporting fraud; and
- Regulatory reporting obligations.

* Gareth Craig resigned from the Audit Committee on 25 July 2018 and was replaced on the Audit Committee by Anthony Roper.

Dear shareholder,

I am pleased to present the report of the Audit Committee which details the role of the Committee and the work it has undertaken during the year. The Audit Committee understands and acknowledges its key role of protecting the interests of shareholders as regards the integrity of published financial information by the company. Some of the Committee's responsibilities are targeted at the regulated information in the annual report published by the company for the benefit of customers.

The Audit Committee is responsible for assisting the Board in discharging its oversight responsibilities for the integrity of the company's financial statements, and the assessment of the effectiveness of the system of internal control and risk management, and reports to the Board on how the Committee discharges its responsibilities in accordance with its terms of reference, available on the governance pages of our website:

stakeholder.affinitywater.co.uk/our-governance.aspx

The Committee also has responsibility for overseeing the relationship with our external Auditor (PricewaterhouseCoopers LLP, 'PwC'), including assessment of its ongoing objectivity, and overseeing the assurance of regulatory returns to Ofwat. In performing its duties, the Committee has access to the services of the Head of Audit, Risk and Compliance, the Company Secretary and, if required, external professional advisers.

Our work cannot provide absolute assurance that the company's risk management and internal control systems are operating effectively, nevertheless in summary we are satisfied that the control and compliance culture of the company is strong and the risk base is diversified which helps to provide reasonable assurance that the financial statements are free from material error and/or misstatement.

The Committee is further satisfied that the 2018/19 annual report and financial statements, taken as a whole, provide:

i. a fair, balanced and understandable assessment of the company's position; and

ii. the information necessary for shareholders to assess the company's performance, business model and strategy.

Governance continued

Audit Committee report (continued)

OVERVIEW OF THE ACTIONS TAKEN BY THE AUDIT COMMITTEE TO DISCHARGE ITS DUTIES

The significant matters considered by the Committee in relation to the 2018/19 financial statements were consistent with those identified by the external Auditor in its report on **pages 124 to 130**. The Committee has an extensive agenda of business which it deals with in conjunction with senior management, the external Auditor and the Internal Audit function. During the year, the Committee met six times. As part of one of these meetings, the Committee also met without management present, with both internal and external auditors.

The table below and continued on the next page highlights a summary of business considered since the beginning of 2018/19:

External Auditor	Recommended to the Board the re-appointment of PwC as external Auditor. Reviewed and agreed the scope of the audit work to be undertaken by PwC. Agreed the fees to be paid to PwC for its review of the September 2018 half-yearly report and its audit of the March 2019 financial statements, and fees for non-audit services above pre-approved limits. Conducted an assessment of the qualification, expertise, resources and independence of PwC and the effectiveness of the external audit process. This included consideration of a report on PwC's quality control procedures and its annual independence letter. Agreed that the non-audit services provided to the company did not impact PwC's independence, including the work completed on the AMP7 Business Plan in 2018/19.
Internal Audit	Agreed a programme of work for the Internal Audit function. Reviewed reports from the Head of Audit, Risk and Compliance on the work undertaken by Internal Audit, as well as management responses to proposals made in audits issued by the function during the year. Monitored and reviewed the effectiveness of the Internal Audit function. Reviewed the company's 2018/19 Assurance Plan required under Ofwat's company monitoring framework.
Financial and Other Reporting	Reviewed the September 2018 half-yearly financial results and the March 2019 annual report and financial statements. Reviewed changes to statutory reporting in relation to the adoption of IFRS 9: 'Financial instruments' ('IFRS 9') and IFRS 15: 'Revenue from contracts with customers' ('IFRS 15') in 2018/19 and the expected impact of adopting IFRS 16: 'Leases' ('IFRS 16') in 2019/20. Reviewed the March 2019 regulatory Annual Performance Report to ensure that the information met Ofwat's reporting requirements and addressed concerns identified by Ofwat in its January 2019 Company Monitoring Framework assessment report in relation to prior year reporting. Advised the Board on whether the annual report and financial statements, taken as a whole, were fair, balanced and understandable, and provide the information necessary for shareholders to assess the company's position and performance, business model and strategy. Reviewed the viability statement and stress test scenarios.
General	Reviewed and provided advice to the Board on the effectiveness of the company's risk management and internal control systems and associated disclosures made in the annual report and financial statements. Reviewed compliance certificates and investor reports required under the company's debt facilities. Received presentations across the year on: • the company's treasury policy; • tax matters; • the company's insurance programme and renewal; • 2018/19 tariffs and charging scheme; • non-financial regulatory reporting management plan and requirements for 2018/19; • Ofwat's Company Monitoring Framework; • the company's PR19 submissions and associated assurance; • compliance work carried out by the Level Playing Field Committee; • new statutory and regulatory reporting requirements for 2018/19; • Whistleblowing and Bribery Act update; • directors' and officers' liability insurance; • compliance with Security and Emergency Measures Direction 1998 ('SEMD') • the company's viability statement; and • information security and Brexit risks. Evaluated the effectiveness of the Committee by means of a questionnaire covering the range of its responsibilities and procedures as well as the understanding of its members. Approved the non-audit fee policy.

Governance continued

Audit Committee report (continued)

SIGNIFICANT ISSUES CONSIDERED BY THE AUDIT COMMITTEE IN RELATION TO THE 2018/19 FINANCIAL STATEMENTS

The Committee considered the appropriateness of the company's accounting policies and requirements to adopt new financial reporting standards applicable in the 2018/19 accounting period.

We discussed the critical accounting judgements and key sources of estimation for the relevant aspects of the financial statements and concluded based on the information available that the estimates, judgements and assumptions used were reasonable and that they had been used appropriately in applying the company's accounting policies. The company's viability statement, including information on the company's approach to preparing it, can be found on **pages 58 to 61**.

In relation to the company's existing accounting policies and the following principal areas of judgements and estimates, for all matters described below, the Committee concluded that the treatment adopted in the financial statements was appropriate:

Issue	How the issue was addressed by the Committee
Revenue recognition	The Committee reviewed during the year the methodology for the recognition of revenue, specifically the measured income accrual, and the impact of adopting IFRS 15 in the year and concluded that the approach and conclusions made were appropriate.
Policy for the provision for impairment of trade receivables	The Committee reviewed the policy for providing for the impairment of trade receivables, and the impact of adopting IFRS 9 in the year and concluded that the approach taken was appropriate.
Capitalisation policy	The Committee reviewed the processes and policies to distinguish between maintenance and enhancement costs and it was concluded that these would result in cost capitalisation in line with the company's policy and applicable accounting standards.
Defined benefit pension assumptions	The Committee reviewed the assumptions used in calculating the defined benefit pension surplus, including the impact of the High Court's ruling on 26 October 2018 that pension trustees are under a duty to amend pension plans in order to equalise benefits for men and women in relation to Guaranteed Minimum Pensions.
Adoption of the going concern basis in the financial statements	The Committee reviewed the assumptions underpinning the directors' decision to continue to adopt the going concern basis in the financial statements, including the expectation that loan covenants will continue to be met for a period of not less than 12 months from the date of signing the financial statements.
Viability statement	The Committee considered and provided input into the determination of which of the company's principal risks and combinations thereof might have an impact on the company's financial viability, and reviewed the results of management's stress testing of the company's base cash flow forecasts.

EXTERNAL AUDIT

PwC was appointed as external Auditor in 2013/14 following a competitive tendering exercise. The company intends to put the external audit contract out to tender at least once every ten years, as stipulated in the Audit Committee's terms of reference, to enable the Committee to compare the quality and effectiveness of the services provided by the incumbent external Auditor with those of other audit firms.

Owen Mackney has been the senior statutory audit partner since 1 January 2017.

To fulfil the Audit Committee's responsibility regarding the independence and objectivity of PwC, the Committee considered:

- PwC's plan for the current year, noting the role of the senior statutory audit partner signing the audit report, who, in accordance with professional rules, has not held office for more than five years, and any changes in key audit staff;
- the arrangements for day-to-day management of the audit relationship; and
- PwC's annual independence letter.

A key factor that may impair PwC's independence is the volume of non-audit services. The company has a policy for the provision of non-audit services, under which all proposals for such work are subject to pre-approved limits. Any non-audit service that exceeds these thresholds requires approval from the Audit Committee.

During the year, PwC:

- provided a non-audit service in delivering a technical accounting session for the company's finance team. PwC was engaged to provide this service as it is recognised as having expertise in this area;
- provided agreed upon procedures in relation to the accuracy of the company's forecast water charges;
- was appointed to provide assurance on our AMP7 Business Plan submission in September 2018 and resubmission in March 2019; and
- was engaged to provide agreed upon procedures as part of the company's regulatory compliance and annual reporting to Thames Water Utilities Limited and Anglian Water Services Limited. None of the procedures performed were advisory in nature.

Auditor objectivity and independence were safeguarded in these instances through the work being performed on a review and recommend basis with the final decision being taken by management, and through ensuring advice was only provided by partners and staff who are not involved in the statutory audit of the financial statements where the information is used for the purposes of the company's statutory financial statements.

No services were provided pursuant to contingent fee arrangements.

On the recommendation of the Audit Committee, the external Auditor's role is considered annually by the Board for reappointment.

To assess the effectiveness of PwC, the Audit Committee reviewed:

- its fulfilment of the agreed audit plan and any variations from the plan;
- the robustness and perceptiveness of its handling of key accounting and audit judgements; and
- the content of its reporting on internal control.

Based on the above review, we are recommending to the Board that PwC be re-appointed for the year ending 31 March 2020.

Note 2 to the financial statements includes disclosure of the auditor's remuneration for the year, including an analysis of audit services, audit-related services and other non-audit services under those headings prescribed by law.

Governance continued

Audit Committee report (continued)

INTERNAL AUDIT

The Head of Audit, Risk and Compliance has direct access to the company Chairman and the Audit Committee Chairman.

To fulfil our responsibilities relating to monitoring and reviewing the effectiveness of the Internal Audit function, we reviewed:

- Internal Audit's charter, reporting lines and access to the Audit Committee and all members of the Board;
- Internal Audit's plans and its achievement thereof;
- the results of key audits and other significant findings, including the adequacy of management's response and the timeliness of resolution;
- the function's resources, team members' qualifications and experience, and timeliness of reporting;
- the level and nature of non-audit activity performed by Internal Audit; and
- the company's whistleblowing policy which contains arrangements for the Head of Audit, Risk and Compliance to receive in confidence concerns about malpractice or misconduct, including complaints on accounting, risk issues, internal controls, auditing issues and related matters, for reporting to the Audit Committee as appropriate.

OVERVIEW

As a result of the Committee's work during the year, we concluded that we acted in accordance with our terms of reference and ensured the independence and objectivity of PwC.

I will be available at the AGM to answer any questions about the activities of the Committee.

Approval

On behalf of the Audit Committee

Patrick O'D Bourke

Chairman of the Audit Committee
25 June 2019

Remuneration report

SUSAN HOOPER

Remuneration Committee members

- Susan Hooper
- Chris Bolt
- Jaroslava Korpanec
- Angela Roshier
- Tony Cocker

We believe that the remuneration policy is working well to support the company's strategy. Customers, regulators and stakeholders rightly expect that the remuneration of executive directors and senior management is linked to standards of performance experienced by customers.

During 2019/20 we will continue to keep the reward packages for our executive directors and other senior managers under review to ensure they remain market competitive, incentivise company and individual performance, and focus on the achievement of short-term targets that will enable the company to fulfil its long-term vision.

During the year, we reviewed and approved a revised structure for the LTIP for 2018/19 and AMP7 with the objective of better incentivising the delivery of long term sustainable performance for customers and communities, employees and shareholders.

I am pleased to present the report on directors' remuneration, which sets out the remuneration paid to the directors of the company in the financial year ended 31 March 2019, and changes to the remuneration policy, as presented in last year's report, for 2018/19.

We continue to align executive pay to the company's performance and strategy of delivering value through high quality customer and operational performance whilst ensuring the cost of water remains affordable for customers by incentivising financial efficiencies. We offer competitive salaries and link directors' annual bonuses and long-term incentive plan ('LTIP') payments to the standards of performance we provide to customers as well as the value created for shareholders.

The remuneration of executive directors reflects the performance of the business through the annual bonus plan. The Remuneration Committee established measures of financial and non-financial performance for the year, including leakage, water quality compliance and other customer experience and operational measures. There is an increase in the weighting of customer service targets in the bonus in 2018/19. The achievement of performance against these targets provided the basis for determining the value of annual bonus awards.

We continue to link the remuneration of executive directors to the standards of performance experienced by customers by aligning the leakage and unplanned interruptions annual bonus plan targets for 2018/19 to the commitments for AMP6 in our Business Plan. These are ambitious commitments made to both Ofwat and customers, and they reflect our desire to continue to improve on what we do.

The annual bonus plan targets continue to be identical for the executive director, senior manager, selected manager and company-wide schemes. This ensures there is a common focus across the business, particularly with respect to service to customers.

We also have a LTIP to incentivise executive directors and senior management to meet both financial and strategic targets, including service and performance commitments over a five year period. A full review of the LTIP scheme was undertaken by Deloitte LLP, unconnected to the company, in 2017/18 to provide advice on the design and implementation of the 2018/19 and AMP7 LTIP schemes for our executive directors and other senior managers. See **page 107** for details of the policy which has now been implemented.

See **page 188** for a signed statement from the Board confirming the transparency of our disclosures.

Governance continued

Remuneration report (continued)

INTRODUCTION

We have prepared this report in accordance with the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (the 'Regulations'), which are applicable to companies whose equity shares are listed. The Regulations are not applicable to the company. The report also meets the relevant requirements of the Listing Rules of the FCA and describes how we have applied the principles relating to directors' remuneration in the Code. A resolution to approve the report will be proposed at the AGM of the company.

In relation to shareholder voting at our 2018 AGM, the single available vote was cast in favour of the resolution to approve the remuneration policy report, which is subject to a binding vote every year. A resolution to approve the remuneration implementation report, which is subject to an annual advisory vote, was also approved at our 2018 AGM.

The Regulations require the external Auditor to report to the members of a quoted company on certain parts of the directors' remuneration report and to state whether in their opinion those parts of the report have been properly prepared in accordance with the Accounting Regulations of the Act. We have asked PwC to report on this basis notwithstanding the Regulations do not apply to our business. The auditable part of the directors' remuneration report has been identified as 'audited'. Other information given is not required to be audited.

REMUNERATION POLICY REPORT

Remuneration Committee

The Remuneration Committee is responsible for determining the remuneration policy and terms and conditions of employment of the directors and senior executives. The Committee met on seven occasions during the year, and is chaired by Susan Hooper, an independent non-executive director.

Membership of the Committee during the year is shown in the table below:

Director	Independence
Susan Hooper (Chair)	Independent
Chris Bolt	Independent
Tony Cocker	Independent
Jaroslava Korpanec	Shareholder appointed
Angela Roshier	Shareholder appointed

Simon Cocks, Chief Executive Officer until 30 April 2018, Pauline Walsh, Chief Executive Officer from 1 May 2018, Stuart Ledger, Chief Financial Officer and the Human Resources Director attended the meetings when requested by the Committee. Tim Monod is the secretary to the Committee. Members of the Committee and attendees are excluded from discussions regarding their own remuneration and conditions of employment.

The Committee meets to review the performance of the business as well as the performance of executive directors and senior executives against planned targets. The Committee also meets to consider and apply an appropriate remuneration framework to retain high calibre management. Its focus is on ensuring that the company can attract, motivate and reward executives who can lead the business to achieve short and long-term targets and on ensuring those targets are closely linked to standards of performance which are of benefit to customers.

The remuneration framework is structured and appropriately balanced between fixed elements and incentive pay, to ensure that executives deliver a high standard of performance, whilst minimising risk. The Committee ensures that the performance measures are objective, easy to understand and motivational to the participants. The Committee also reviews and approves the senior managers' and selected managers', and company-wide bonus schemes.

Remuneration policy for non-executive directors

Tony Cocker was appointed as Chairman of the company on 30 January 2018 for an initial period of three years. Tony Cocker receives a fixed annual fee for his services, reflecting the time commitment and responsibilities of the role. A benchmarking exercise of chairman roles was undertaken by Deloitte LLP, unconnected to the company, in the year.

The other non-executive directors in office at 31 March 2019 fell into two groups.

Group A	Group B
Patrick O'D Bourke	Jaroslava Korpanec
Chris Bolt	Anthony Roper
Trevor Didcock	Angela Roshier
Susan Hooper	
Chris Newsome	

Our Board considers the directors in Group A to be independent. Each has a written agreement relating to his or her services. They receive a fee for their services which is not related to company performance. They are not in receipt of share options or an LTIP. The fees for these directors are set taking into account the market rate for non-executive directors, with particular reference to the water industry in the United Kingdom. A benchmarking exercise of non-executive director roles was undertaken by Deloitte LLP, unconnected to the company, in the year.

There are no specific termination payments applicable to these appointments. The appointment of the directors may be terminated by either the director or the company giving to the other three months' written notice.

The fee policy for the Group A directors in 2018/19 remained unchanged from that reported in the 2017/18 remuneration policy report and will apply during 2019/20, unless the Committee agrees changes during the year. Simon Cocks resigned as an executive director on 21 May 2018 and remained in a non-executive director role until 1 October 2018, receiving a fixed fee for his services in line with the remuneration policy for Group A directors.

The directors in Group B were appointed by our shareholders. They do not receive any fees or other forms of remuneration from the company in respect of their services.

At each AGM any director appointed since the previous AGM, or any director appointed since the previous two AGMs without retiring or being re-elected, must retire and seek re-election.

Remuneration policy for executive directors

The remuneration policy is designed to attract, retain and motivate executive directors of the calibre required to deliver the business strategy. Individual remuneration packages are structured to align rewards with the performance of the company for customers and stakeholders and the interests of shareholders. The remuneration arrangements incorporate performance measures which link to the standards of performance we provide to customers as well as the value created for shareholders.

The remuneration packages for all new executive directors are set in line with the company's approved policy. The Committee takes into account, in arriving at a total package, the skills and experience of the candidate, the market rate for a candidate of that level of experience, as well as the importance of securing the best candidate.

Annual bonuses and long-term incentives are awarded in line with the maximum limits outlined in the remuneration policy report on the next page. Participation in the plans is normally pro-rated for the year of joining.

The Committee may make additional cash awards if deferred pay is forfeited by an executive director on leaving a previous employer. Such awards would take into account the nature of awards forfeited (i.e. cash or shares), time horizons, attributed expected value and performance conditions.

Governance continued

Remuneration report (continued)

REMUNERATION POLICY REPORT (CONTINUED)

Remuneration policy for executive directors (continued)

Other payments may be made in relation to relocation expenses and other incidental expenses as appropriate.

Shareholder views on executive directors' remuneration for 2018/19 were considered through the presence of two directors appointed by our shareholders on the Committee.

The Committee did not consult with employees when drawing up the directors' remuneration policy but considered the average base salary increase of employees, which is subject to inflationary increases, in setting base salaries for the executive directors. The Committee also reviewed the results of a benchmarking exercise of the executive directors' and other senior managers' base salaries and annual bonuses, undertaken by Deloitte LLP, unconnected to the company, in the year. The base salary, the other taxable benefits and the pension related benefits elements of the remuneration package for executive directors remained unchanged during 2018/19.

The Committee reviewed and approved a revised structure for the LTIP for 2018/19 with the objective of better incentivising the delivery of long-term sustainable performance for customers and communities, employees and shareholders. Key changes from the previous LTIP for the year 2018/19 include:

- giving more weight to non-financial performance measures, with 50% of the award based on financial performance and 50% based on strategic outcomes including service and performance commitments;
- a cap on the award payable (150% of salary (CEO) and 125% of salary (CFO));
- staged payment of vested awards with the final payment made at the end of the fifth year of each LTIP; and
- no automatic vesting of unvested awards in the event of change of control.

Updated LTIP award documentation was prepared by Deloitte LLP, unconnected to the company, in the year.

Further changes have been introduced for the AMP7 LTIP scheme. Key changes include:

- further balance in the performance measures of the scheme, with 50% awarded for service and Business Plan commitments, 40% on financial targets and 10% on people and employee commitments;
- removal of threshold performance, with all targets linked to the stretching commitments in the AMP7 Business Plan; and
- no award will be made for a metric if performance for that metric is below target/plan.

The Committee reviewed and approved the following changes to the annual bonus scheme for 2018/19:

- an increase in the weighting of customer service in the bonus; and
- the removal of quarterly bonus targets.

Further changes have been introduced for the AMP7 annual bonus scheme. Key changes include:

- improving the balance of the bonus with 40% relating to financial performance and 40% relating to performance on customer service and stakeholder commitments;
- no award will be made for a metric if performance for that metric is below target/plan; and
- the introduction of a check that stops payment of the bonus if either the customer or the financial elements of the bonus fall below a set level.

During the year the arrangements for the 2018/19 base awards under the LTIP for executive directors and senior management were finalised. The Committee has also approved a one-off bonus arrangement for 2019/20 with performance measures linked to key transformation initiatives that must be delivered in relation to achieving AMP7 readiness. The details of these arrangements are presented in the following table.

Purpose and link to strategy	Policy and approach	Maximum potential value (as percentage of base pay)	Performance metrics	Changes for 2019/20 and AMP7
LTIP				
To incentivise executives to achieve long-term shareholder value whilst achieving high levels of customer experience performance, although both award and payment are discretionary.	Base awards are granted as a percentage of salary and are paid out in cash at the end of a three-year performance period, with 33% of the amount earned paid at the end of year three, 33% paid at the end of year four and 33% paid at the end of year five subject to the achievement of performance conditions. The scheme is based on three-year targets that are aligned to strategic delivery for the remainder of AMP6 and the start of AMP7. Base awards include clawback and malus provisions, as detailed below. The awards do not automatically vest on change of control of the business.	Up to 150% of base salary for the CEO and 125% of base salary for the CFO.	The award is determined on the performance of the company over the three years. 50% of the scheme pay-out is based on financial targets and 50% is based on strategic outcomes, including service and performance commitments.	No changes for 2019/20. Changes for AMP7 are detailed below: Further re-balance of performance commitments, with 40% of the scheme pay-out based on financial targets, including cash generated from operations and investment targets; 50% based on customer service and stakeholder commitments, including C-MeX and D-MeX position, water quality, helping vulnerable customers, leakage, consumption, mains bursts, abstraction and environmental innovation; and 10% based on employee commitments, including employee satisfaction surveys ('ESAT'), employee engagement and safety. No award will be made for a metric if performance is below target/plan.
2019/20 AMP7 readiness bonus				
The AMP7 readiness bonus is designed to provide a direct link between executive and company performance in 2019/20 in relation to achieving AMP7 readiness and the level of bonus awarded, although award and payment remain discretionary.	The bonus is based on non-financial and financial targets for 2019/20 aligned to the company's plans for achieving AMP7 readiness.	Up to 60% of base salary.	Total bonus is determined on the achievement of company operational and financial performance targets directly linked to the individual director's responsibilities in relation to four AMP7 readiness business priorities (cost, culture, community and leakage).	N/A - this is a one-off bonus plan for 2019/20.

Governance continued

Remuneration report (continued)

REMUNERATION POLICY REPORT (CONTINUED)

Remuneration policy for executive directors (continued)

Other elements of executive directors remuneration are included in the table below:

Purpose and link to strategy	Policy and approach	Maximum potential value (as percentage of base pay)	Performance metrics	Changes for 2019/20 and AMP7
Base salary				
To provide competitive fixed remuneration that will attract and retain key employees and reflect their experience and position in the company.	To target around market median, dependent on experience in the role	N/A	N/A	No changes were made to the policy for 2019/20 and AMP7 up to the date of approval of this annual report and financial statements.
Other taxable benefits				
To provide market competitive benefits.	Private health care insurance cover, life assurance and income protection are provided, together with a fully expensed company car (or car allowance).	N/A	N/A	No changes were made to the policy for 2019/20 and AMP7 up to the date of approval of this annual report and financial statements.
Annual bonus plan				
The annual bonus plan is designed to provide a direct link between executive and company performance and the level of bonus awarded, although award and payment remain discretionary.	Maximum bonus potential is set at a market competitive level. The bonus is based on budgeted non-financial and financial targets aligned to the company's commitments for AMP6 and AMP7, plus individual targets (AMP6 only).	Up to 100% of base salary for the CEO and up to 75% of base salary for the CFO. Simon Cocks will not be eligible for the annual bonus in 2018/19 following his resignation as executive director on 21 May 2018.	50% of the total bonus is determined on the achievement of the financial performance target, which is based on net cash outflow before taxation and financing. 25% of the total bonus is determined on the achievement of operational and customer and community performance targets. 20% of the total bonus is determined on the achievement of personal objectives. 5% of the total bonus is determined on the achievement of the company's safety and health target.	No change in 2019/20. In AMP7 there will be a rebalance of the bonus with 40% relating to financial performance and 40% performance on customer service and stakeholder commitments. The personal element of the bonus will continue to be 20%. No payment will be awarded if achievement is below the target/plan for that metric. There is also the introduction of a check that stops pay-out of the bonus if either the customer or the financial elements of the bonus fall below a set level. Reduce the discretion of the Committee to award any bonus outside the performance delivery.

Purpose and link to strategy	Policy and approach	Maximum potential value (as percentage of base pay)	Performance metrics	Changes for 2019/20 and AMP7
Pension related benefits				
To provide competitive post-retirement benefits.	Executives joining the company after 2004 are invited to participate in the company's defined contribution pension scheme. No current executives joined prior to this date. Under the defined contribution scheme, the executive contributes at a rate of 7% of salary and the company contributes at 20%.	In lieu of being a member of the company's retirement benefit schemes, Simon Cocks received a taxable allowance of approximately 24% of base pay until 21 May 2018.	N/A	No changes were made to the policy for 2019/20 and AMP7 up to the date of approval of this annual report and financial statements.
Compensation for the forfeit of variable remuneration from previous employer				
To provide compensation of forfeited remuneration from previous employers.	The Committee may make additional cash awards if deferred pay is forfeited by an executive director on leaving a previous employer. Such awards would take into account the nature of awards forfeited (i.e. cash or shares), time horizons, attributed expected value and performance conditions.	N/A	N/A	No changes were made to the policy for 2019/20 and AMP7 up to the date of approval of this annual report and financial statements.

Governance continued

Remuneration report (continued)

REMUNERATION POLICY REPORT (CONTINUED)

Executive directors' service contracts

The executive directors who served during the year each had service contracts, neither of which are fixed term, with notice periods as follows:

Chief Executive Officer Simon Cocks (resigned as executive director 21 May 2018) Pauline Walsh (appointed 1 May 2018)	Chief Financial Officer Stuart Ledger
From the executive to the company – 12 months	From the executive to the company – 6 months
From the company to the executive – 12 months	From the company to the executive – 6 months

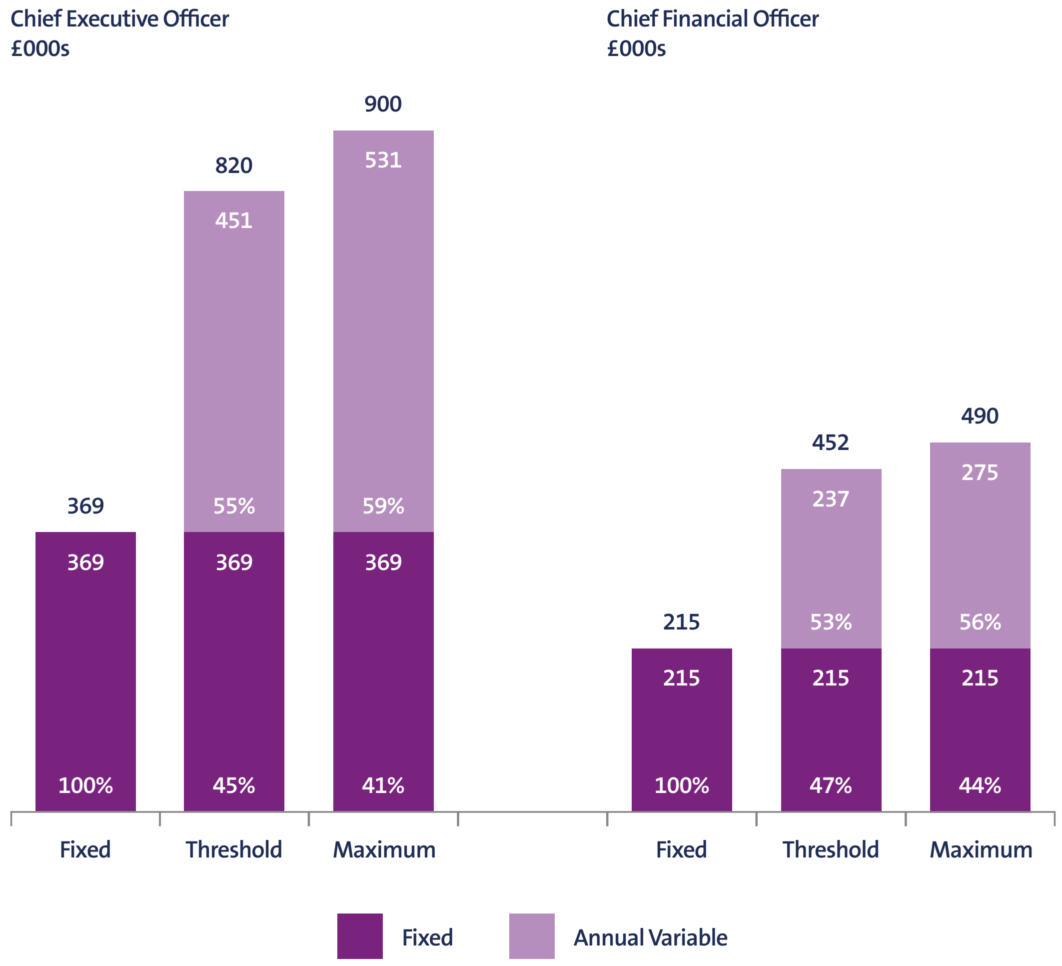
In the event of loss of office, the executive directors are subject to the terms and conditions as set out in their respective service contracts and employment letters with the company. These service contracts do not set out details of how the circumstances of the director's departure and performance during a period of office might be taken into account when exercising discretion in relation to loss of office payments. They also do not contain provisions implying an obligation on the company in the event of loss of office.

Base awards under the LTIP include provisions that would enable the company to recover sums paid or withhold the payment of any sum in a circumstance or circumstances of malus before the vesting of the award or within a clawback period of three years commencing on the payment date of the award. Circumstances of malus include wilful or gross misconduct, acts of personal dishonesty or fraud, conviction of certain criminal offences, conduct which results in significant losses to the company, material failure of related management or business units, material misstatement in the audited financial statements, and reputational damage. If an executive director ceases to hold office prior to the vesting date, other than in the event of death; ill-health, injury or disability, as established to the satisfaction of the Board; the company ceasing to be part of the group or transferred to another group company; or another reason at the Board's discretion, except where the director is summarily dismissed, their unvested award will lapse.

There are no arrangements in place for the remuneration of directors by any holding company or other company in the group.

Payouts under different scenarios

The following charts show the potential remuneration in respect of 2019/20 under the proposed arrangements for the Chief Executive Officer and Chief Financial Officer under different scenarios.



In developing the scenarios the following assumptions have been made:

Fixed	Consists of base salary and taxable benefits
Threshold	Based on what a director would receive if the threshold level of performance were achieved: annual variable pay out at 75% of maximum (assuming the financial, operational, customer and community, safety and health, personal and AMP7 readiness targets are met)
Maximum	Based on what a director would receive if the highest level of performance were achieved: annual variable pay out at 100% of maximum (assuming the financial, operational, customer and community, safety and health, personal and AMP7 readiness targets are met)

Governance continued

Remuneration report (continued)

REMUNERATION POLICY REPORT (CONTINUED)

Management

We operate a discretionary performance bonus scheme for other senior managers (the Executive Management Team) and selected managers who meet the criteria for inclusion in the scheme. At the date of approval of this annual report and financial statements, such managers continued to be entitled to participate in a performance-related discretionary bonus scheme of up to 40% of their salary. This is paid after the end of the financial year. Bonus awards are dependent on the success of the company. For other senior managers they are determined by reference to four components:

- 50% of the total bonus is dependent on the achievement of financial performance targets, which are identical to the executive directors' annual bonus scheme;
- 25% of the total bonus is dependent on the achievement of operational and customer performance targets, which are identical to the executive directors' annual bonus scheme;
- 20% of the total bonus is dependent on the achievement of personal objectives; and
- 5% of the total bonus is dependent on the achievement of the company's safety and health target.

For selected managers who meet the criteria for inclusion in the scheme, bonus awards are determined by reference to three components:

- 50% of the total bonus is dependent on the achievement of financial performance targets, which are identical to the executive directors' annual bonus scheme;
- 25% of the total bonus is dependent on the achievement of operational and customer performance targets, which are identical to the executive directors' annual bonus scheme; and
- 25% of the total bonus is dependent on the achievement of personal objectives.

In AMP7 there will be a re-balance of the other senior managers scheme with 40% of the bonus relating to financial performance and 40% to performance on customer service and stakeholder commitments. The personal element of the bonus will continue to be 20%.

The scheme is designed to provide a direct link between senior management and company performance and both bonus award and payment remain discretionary.

For 2019/20 there will be an additional discretionary performance bonus scheme for other senior managers, up to 60% of their salary, designed to provide a direct link between other senior manager and company performance in 2019/20 in relation to achieving AMP7 readiness.

REMUNERATION IMPLEMENTATION REPORT

Company-wide bonus scheme

The Committee reviews and approves a discretionary company-wide performance bonus scheme for all employees, who are not otherwise entitled to the discretionary senior manager or selected manager performance bonus scheme. The discretionary company-wide bonus scheme targets operational and customer performance measures and a financial performance measure.

At the date of approval of this annual report and financial statements, the bonus targets for operational, customer and financial performance continued to be identical for the executive director, senior manager, selected manager and company-wide schemes. This ensures there is a common focus across the business, particularly with respect to service to customers.

Relative importance of spend on pay

Out of each pound of our customers' bills, we spend the following on our people and our suppliers for assets:

Stakeholder	Description	2018/19*	2017/18*
Our people	Wages, salaries and pensions	**23p**	18p
Our assets	Investment in our assets	**29p**	31p
Our shareholders	Dividends form our regulated business and interest on shareholder debt	**0p**	11p

* Figures are based on our regulatory financial statements for 2018/19 and 2017/18 and have been rounded.

Further details of where each pound of our customers' bills is spent are presented on **page 42**.

The amount spent on our people increased in 2018/19 due to a higher headcount and an increase in the number of operational jobs completed during the year, as well as a £1.5m increase to our defined benefit pension plan cost as a result of the court ruling in October 2018 to remove historical gender inequalities in relation to GMP. This was partially offset by lower contributions being paid by the company as a result of our pension plan becoming fully funded on a self-sufficiency basis.

Governance continued

Remuneration report (continued)

REMUNERATION IMPLEMENTATION REPORT (CONTINUED)

Directors' remuneration 2018/19 (audited)

The following table shows directors' remuneration in respect of 2018/19.

	Base salary/fees[1] £000		Taxable benefits[2] £000		Pension related benefits[3] £000		Annual bonus £000		LTIP[4] £000		Other[5] £000		Total £000	
	18/19	17/18	18/19	17/18	18/19	17/18	18/19	17/18	18/19	17/18	18/19	17/18	18/19	17/18
Non-executive														
Current														
Patrick O'D Bourke	**48**	48	-	-	**-**	-	**-**	-	**-**	-	**-**	-	**48**	48
Chris Bolt	**45**	45	-	-	**-**	-	**-**	-	**-**	-	**-**	-	**45**	45
Trevor Didcock	**43**	43	-	-	**-**	-	**-**	-	**-**	-	**-**	-	**43**	43
Susan Hooper	**48**	46	-	-	**-**	-	**-**	-	**-**	-	**-**	-	**48**	46
Chris Newsome	**8**	-	-	-	**-**	-	**-**	-	**-**	-	**-**	-	**8**	-
Former														
Simon Cocks	**15**	-	**-**	-	**-**	-	**-**	-	**-**	-	**-**	-	**15**	-
Chairman														
Current														
Tony Cocker	**195**	42	**-**	-	**-**	-	**-**	-	**-**	-	**-**	-	**195**	42
Former														
Dr Philip Nolan	**-**	183	**-**	-	**-**	-	**-**	-	**-**	-	**-**	860	**-**	1,043
Executive														
Current														
Stuart Ledger	**203**	96	**6**	3	**41**	10	**48**	57	-	-	**-**	41	**298**	207
Pauline Walsh	**326**	-	**10**	-	**53**	-	**108**	-	-	-	**169**	-	**666**	-
Former														
Duncan Bates	**-**	57	**-**	4	**-**	15	**-**	-	**-**	434	**-**	**500**	**-**	1,010
Simon Cocks	**50**	350	**2**	14	**11**	80	**-**	268	**-**	1,228	**132**	**1,000**	**195**	2,940
	981	910	**18**	21	**105**	105	**156**	325	**-**	1,662	**301**	2,401	**1,561**	5,424

Neither the company nor its immediate parent entities have any listed shares and so the directors have not been offered any share incentives. The directors appointed by Allianz Capital Partners on behalf of the Allianz Group, DIF and HICL Infrastructure plc and the former directors appointed by Infracapital Partners II, North Haven Infrastructure Partners LP and Veolia Water UK Limited did not receive any emoluments from the company.

[1] 2017/18 fees for Chris Bolt have been restated to reflect additional amounts paid in 2018/19 relating to his services in respect of 2017/18 following a benchmarking exercise of independent non-executive directors and chairs undertaken by Deloitte LLP during the year identified inconsistencies between fees paid to the independent non-executive directors.

[2] Taxable benefits comprise company car allowance, living accommodation benefit and healthcare insurance.

[3] Pension related benefits for Stuart Ledger and Pauline Walsh comprise £41,000 and £53,000 respectively of contributions paid to money purchase schemes (2017/18: £10,000 and £nil); there were no amounts outstanding at year end. Pension related benefits for Simon Cocks include an allowance of £11,000 in lieu of being a member of the company's retirement benefit schemes (2017/18: £80,000). The same pension related benefits in 2017/18 for former director Duncan Bates included an allowance of £15,000.

[4] Prior year LTIP remuneration includes the 2014/15 LTIP amount paid which vested fully on 31 March 2018, and the 2015/16, 2016/17 and 2017/18 LTIP amounts paid which vested fully following the sale of the group on 19 May 2017.

[5] Other remuneration in 2018/19 for Pauline Walsh relates to discretionary payments made in connection with commencement of qualifying services during the year, including compensation for the forfeit of a variable remuneration arrangement with her previous employer. Other remuneration in 2018/19 for Simon Cocks relates to a discretionary bonus in relation to completion of targets associated with his transition from an executive to a non-executive role during the year. Other remuneration in 2017/18 for Dr Philip Nolan consists of remuneration received in relation to the arrangement described on **page 81** of the prior year remuneration policy report. Other remuneration in 2017/18 for both Simon Cocks and Duncan Bates consists of remuneration received in relation to the successful completion of the sale of the group on 19 May 2017, funded by former shareholders. Other remuneration for Stuart Ledger in 2017/18 relates to discretionary payments made in connection with commencement of qualifying services during the year, representing compensation for the forfeit of a variable remuneration arrangement with his previous employer.

Annual bonuses for executive directors (unaudited)

The annual bonus scheme is designed to provide a direct link between executive and company operational, customer and financial performance, and the level of bonus awarded, although award and payment remain discretionary. The table below shows the percentage of maximum annual bonus potential awarded in relation to the 2018/19 year for Pauline Walsh and Stuart Ledger for each of the performance measures. No amounts in relation to these bonuses have been deferred.

Performance measure		Link to strategy (refer to page 20)	2018/19 target	Weighting for 2018/19 (as a % of base salary)		2018/19 achievement (as a % of base salary)	
				Pauline Walsh	Stuart Ledger	Pauline Walsh	Stuart Ledger
Financial measure	Cash generated by operations: net cash outflow before taxation and financing[1]	Value creation imperative	£44.3m	50.00%	37.50%	0.00%	0.00%
Operational measures	Leakage: volume of water lost through leaks on the network (Ml/d)	Customer outcome	167.7 or less	3.57%	2.68%	0.00%	0.00%
	Water availability: volume of water lost from distribution due to unplanned outages at production sites (Ml/d)	Customer outcome	38 or less	3.57%	2.68%	3.27%	2.68%
	Water quality: number of water quality compliance failures	Customer outcome	44 or less	3.57%	2.68%	0.00%	0.00%
	Unplanned interruptions: number of properties without water for over 12 hours due to an unplanned interruption to supply	Customer outcome	320 or less	3.57%	2.68%	3.27%	2.68%
	Water Saving Programme: per capita consumption	Customer outcome	150.3 or less	3.57%	2.68%	3.27%	2.68%
Customer and community measures	SIM[2] : score	Customer outcome	81.33	7.15%	5.35%	0.00%	0.00%
Safety and health measure	Accident frequency rate (annual target): number of lost time injuries per 100,000 hours worked	Responsibility and accountability imperative	0.22	5.00%	3.75%	4.58%	3.75%
Personal performance[3]				20.00%	15.00%	16.50%	12.00%
Total % of base salary				**100.00%**	**75.00%**	**30.89%**	**23.79%**
Base salary						**£350,000**	**£204,000**
Bonus paid						**£108,000**	**£48,000**

[1] This "non-GAAP" measure is calculated as the total of the following line items per the statement of cash flows (refer to **page 135**): cash generated from operations; purchases of property, plant and equipment; capital contributions; proceeds on disposal of property, plant and equipment; and purchase of intangibles.

[2] SIM is the industry's measure of customer experience. One element is quantitative (the volume of unwanted contact and complaints we receive) and the other is qualitative (the quality of the experience derived from an independent quarterly survey).

[3] The Remuneration Committee exercised discretion in determining the level of bonus awarded in relation to the personal performance element of the executive directors' annual bonus within the pre-agreed base salary percentage cap. The Committee considered achievement of personal objectives set at the start of the year in exercising its discretion together with events occurring during the year.

[4] Pauline Walsh's annual bonus was calculated as a percentage of 11 months of her base salary.

Governance continued

Remuneration report (continued)

REMUNERATION IMPLEMENTATION REPORT (CONTINUED)

Director's remuneration relating to the change of control

Following the change in ownership of the business in the prior year on 19 May 2017, previously unvested LTIP totals for 2015/16, 2016/17 and 2017/18 became vested in full in accordance with the rules of the scheme and were paid in the prior year. The table below shows the additional LTIP and other remuneration paid to directors in the prior year as a result of the change in ownership.

	LTIP £000	Other £000	Total £000
Simon Cocks	1,228	1,000	2,228
Duncan Bates	159	500	659
Dr Philip Nolan	-	832	832
Total	**1,387**	**2,332**	**3,719**

Amounts paid to Simon Cocks and Duncan Bates included in the comparative figures in other remuneration in the table on **page 114** were paid by the exiting shareholders from the proceeds of the sale and were not funded by customers.

Percentage change in remuneration of CEO

In 2018/19, a one-year pay deal covering the period 1 April 2018 to 31 March 2019 was negotiated with trade unions resulting in the following:

- 2.5% increase to the basic pay of all employees
- 2.5% increase to all car allowances
- Increased company pension contributions for employees in the defined contribution scheme

In addition, employees earning up to £25,000 per annum were also awarded additional pay increases up to £250 per annum.

We have not reported the percentage year-on-year change in the remuneration of the director undertaking the role of Chief Executive Officer as the role was not filled by the same director during the year. Pauline Walsh was appointed on 1 May 2018 and did not have a salary increase in the year.

Statutory requirements

This remuneration report has been prepared on behalf of the Board by the Remuneration Committee. The report was approved by the Board on 25 June 2019 and signed on its behalf by:

Susan Hooper

Chair of the Remuneration Committee

Directors' report

INTRODUCTION

The directors present their annual report and the audited statutory financial statements of Affinity Water Limited ('the company') for the year ended 31 March 2019.

The company is a limited liability company registered in England and Wales and its immediate parent undertaking is Affinity Water Holdings Limited, a company also registered in England and Wales. The directors consider that Daiwater Investment Limited was the ultimate holding and controlling company in the United Kingdom at 31 March 2019. Details of the ownership of the company and the group structure are set out on **pages 91 to 92** of the governance section and note 26 of the financial statements. The address of the principal place of business is Tamblin Way, Hatfield, Hertfordshire, AL10 9EZ.

The strategic report on **pages 12 to 61** provides detailed information relating to the company, its strategy, the operation of its business and its results and financial position for the year ended 31 March 2019. Details of the risks and principal uncertainties facing the company are set out on **pages 48 to 57**

DIRECTORS

The directors of the company, together with their periods of office and their biographical details, are shown on **pages 68 to 73**.

SIGNIFICANT EVENTS DURING THE YEAR

Details of the significant events that occurred during the year are set out in the Chief Executive Officer's introduction on **page 12**.

RESULTS AND FINANCIAL PERFORMANCE

Profit for the year was £10.6m (2018: £29.6m).

The statement of financial position detailed on **page 133** shows total equity amounting to £208.6m (2018: £211.9m).

Further analysis of our financial performance can be found in the Chief Financial Officer's review on **page 15** of the strategic report.

INFORMATION REQUIRED UNDER THE LISTING RULES

During the year no interest was capitalised by the company (2018: £nil).

For disclosures in relation to relevant requirements of the Listing Rules refer to the remuneration report on **pages 103 to 116**.

BACK ROW Chris Newsome, Jaroslava Korpanec, Trevor Didcock, Angela Roshier, Tim Monod, Susan Hooper, Anthony Roper

FRONT ROW Stuart Ledger, Tony Cocker, Pauline Walsh, Chris Bolt, Patrick O'D Bourke

Governance continued

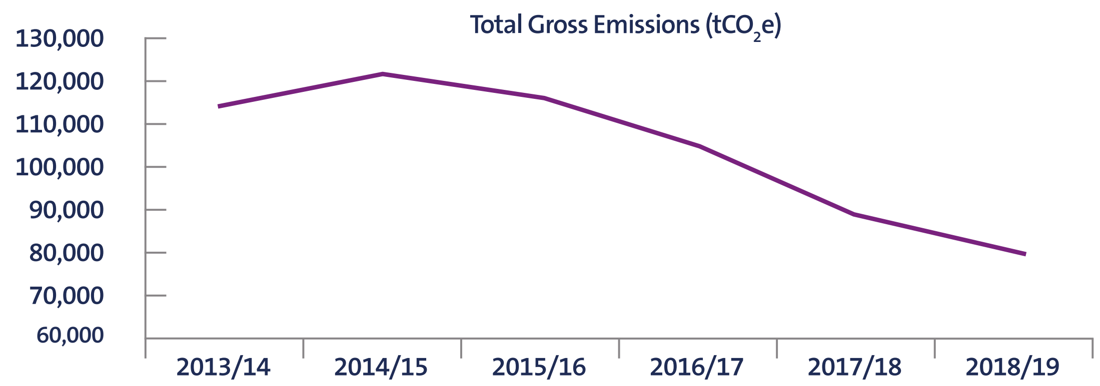
Directors' report (continued)

GREENHOUSE GAS ('GHG') EMISSIONS STATEMENT[1]

GHG emission source	2018/19 Gross[2] (tCO_2e)	2018/19 Intensity ($kgCO_2e$/Ml)	2017/18 Gross[2] (tCO_2e)	2017/18 Intensity ($kgCO_2e$/Ml)
Scope 1	**10,173**	**29.3**	6,204	18.7
Fuel combustion	**1,533**	**4.4**	1,501	4.5
Process and fugitive emissions	**4,335**	**12.5**	2,524	7.6
Vehicle fleet	**4,305**	**12.4**	2,179	6.6
Scope 2	**63,886**	**184.1**	75,580	228.4
Purchased electricity	**63,866**	**184.1**	75,580	228.4
Statutory total (scope 1 & 2)[3]	**74,059**	**213.4**	81,784	247.1
Scope 3	**5,625**	**16.2**	7,325	22.2
Business travel in other vehicles	**25**	**0.1**	32	0.1
Outsourced IT activities	**154**	**0.4**	226	0.7
Electricity- transmission and distribution	**5,446**	**15.7**	7,067	21.4
Total gross emissions	**79,684**	**229.6**	89,109	269.3

Our total gross GHG emissions have reduced by 11% this year. Similar to businesses across the UK, emissions associated with our purchased electricity (accounting for 86% of our statutory total) benefited from more renewable generation. This more than offset the impact of higher electricity usage during the year (2018/19: 226,190,332kWh; 2017/18: 214,998,163kWh), which increased in line with higher demand during the hot, dry summer weather period and water levels lowering in our underground aquifers.

A 28% decrease in intensity to 229.6 $kgCO_2e$/Ml demonstrates a more efficient use of energy in the year, as we ran an energy optimisation programme across our production sites. Our strategy is increasingly to adapt our water treatment processes to maximise the generation of renewable energy with 40% of our energy coming from renewable and alternative energy sources by 2030.



[1] We report our GHG emissions following the 2013 UK Government Environmental Reporting Guidance and using the 2018 UK Government Conversion Factors for Company Reporting. We have included emissions within the direct management responsibility of the company. This is consistent with our financial reporting boundary with the exception of scope 3 emissions, which are off-balance sheet emissions. Significant scope 3 emissions have been quantified for outsourced data support and emissions from the distribution and transmission of grid electricity. The data has been externally verified as part of our regulatory reporting requirements. All emissions reported relate to emissions in the United Kingdom and offshore area.

[2] We measure our gross GHG emissions in tonnes of carbon dioxide equivalent ('tCO_2e').

[3] Statutory carbon reporting disclosures required by the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013.

DIVIDENDS

The directors declared and paid the following ordinary dividends during the year ended 31 March 2019:

	£m
Paid: First interim of 1.89p per share in June 2018	5.0
Paid: Second interim of 0.60p per share in December 2018	1.6
	6.6

This compares to dividends of £58.5m declared and paid in the year ended 31 March 2018. No final dividend is proposed (2018: £nil). All of the dividend declared and paid in the year ended 31 March 2019 related to the company's non-appointed business (2018: £8.0m of the £58.5m dividends declared and paid).

RESEARCH AND DEVELOPMENT ACTIVITIES

The development and application of new techniques and technology is an important part of the company's activities. The company is a member of UK Water Industry Research ('UKWIR'), and participates and benefits from its research programme. The UKWIR programme relating to Affinity Water is currently divided into the following topics: drinking water quality and health; toxicology; water resources; climate change; water mains and services; leakage and metering and regulatory issues. The company is also a member of other water industry research and innovation groups: Technology Approval Group ('TAG'), Sensor for Water Interest Group, the Water Regulations Advisory Scheme ('WRAS') and Cranfield Water Network. In addition, the company carried out more specific research during the year in the fields of treatment optimisation, new technologies for micro-pollutant removal and emerging contaminants and risks to water quality when changing sources of supply.

POLITICAL CONTRIBUTIONS

No political contributions were made during the year (2018: £nil), in accordance with the company's policy of not making political contributions.

EMPLOYEE MATTERS

We consult and inform our employees on all aspects of business performance through formal and informal consultation bodies, regular team meetings, email and the intranet. We discuss ways to enhance and improve our communications and consultation channels directly with employees as well as with the Trade Unions to which a number of employees belong.

We maintain a network of trained mental health first aiders within the business and continue to publicise offerings for our Employee Assistance Programme. The re-scoping of our occupational health surveillance will ensure we give the correct level of health screening for each job role.

Employees are kept informed of changes in the business and general, financial and economic factors influencing the company together with performance targets. This is achieved through regular briefings or presentations and electronic mailings. We also produce a regular employee magazine, which is sent to all company sites.

We aim to ensure that each employee or applicant for employment receives the same treatment irrespective of race, gender, disability, sexual orientation, religious belief, creed, marital or parental status. This extends through all company policies including recruitment where the candidate's particular aptitudes and abilities are consistent with the requirements of the job. Opportunities are available to disabled employees for training, career development and promotion. Employees who become disabled whilst employed by the company are actively supported to maintain and/or find appropriate employment within the business.

Governance continued

Directors' report (continued)

FINANCIAL INSTRUMENTS DISCLOSURES

Details are included within risk number 16 on **page 57** of the strategic report and in note A4 of the financial statements.

FUTURE DEVELOPMENTS

Likely future developments in the business resulting from expected changes in the regulatory and competitive environments that we operate in are discussed in the strategic report on **page 18**.

CORPORATE GOVERNANCE

The company's statement on corporate governance, including information required by the Disclosure and Transparency Rules, can be found in the board leadership, transparency and governance section on **pages 66 to 90** of this annual report and financial statements. This section forms part of this directors' report and is incorporated into it by cross-reference. We have voluntarily reported compliance against the principles of the Code within this report.

EVENTS AFTER THE REPORTING PERIOD

There were no significant events that took place after the reporting period.

DIRECTORS' QUALIFYING THIRD PARTY INDEMNITY PROVISIONS

The company has not granted any indemnity to its directors against liability in respect of proceedings brought by third parties, subject to the conditions set out in Section 234 of the Companies Act 2006.

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE FINANCIAL STATEMENTS

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulation.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 101 'Reduced Disclosure Framework', and applicable law). Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing the financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- state whether applicable United Kingdom Accounting Standards, comprising FRS 101, have been followed, subject to any material departures disclosed and explained in the financial statements;
- make judgements and accounting estimates that are reasonable and prudent; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006.

The directors are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

In the case of each director in office at the date the Directors' Report is approved:

- so far as the director is aware, there is no relevant audit information of which the company's auditors are unaware; and
- he or she has taken all the steps that he or she ought to have taken as a director in order to make himself or herself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

INDEPENDENT AUDITOR

In accordance with Section 485 of the Companies Act 2006, a resolution to re-appoint PricewaterhouseCoopers LLP will be proposed at the forthcoming AGM.

By order of the Board

Tim Monod

Company Secretary
25 June 2019

Registered Office:

Affinity Water Limited, Tamblin Way, Hatfield, Hertfordshire AL10 9EZ

Statutory Financial Statements

for the year ended 31 March 2019

CONTENTS

Affinity Water Limited

(Registered Number 02546950)

Members of the Executive Management Team take part in a fen clearance.

Statutory Financial Statements

Independent auditors' report to the member of Affinity Water Limited

Report on the audit of the financial statements

Opinion

In our opinion, Affinity Water Limited's financial statements:

- give a true and fair view of the state of the company's affairs as at 31 March 2019 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 101 "Reduced Disclosure Framework", and applicable law); and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements included within the Annual Report and Financial Statements (the "Annual Report"), which comprise: the statement of financial position as at 31 March 2019; the income statement and statement of comprehensive income, the statement of cash flows, the statement of changes in equity for the year then ended; and the notes to the financial statements.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

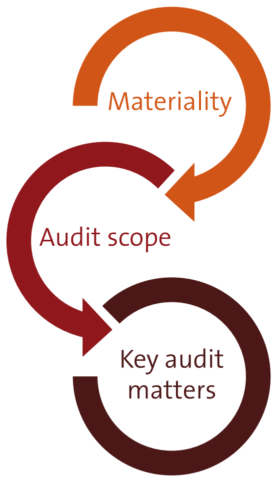
We remained independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

Our audit approach

Context

The terms of the company's license under the Water Industry Act 1991 require the company to report as if it had issued equity share capital listed on the London Stock Exchange and therefore the opinion below refers to the Listing Rules of the Financial Conduct of Authority (FCA).

Overview



- Overall materiality: £4.3 million (2018: £3.4 million), based on 3.5% (2018: 2.5%) of earnings before interest, tax, depreciation and amortisation ('EBITDA').

- The company has one finance function and operates a single general ledger system. The audit was carried out by one team at the UK headquarters in Hatfield, Hertfordshire.

- Accuracy of the measured income accrual.
- Adequacy of the bad debt provision.
- Assessment of cost capitalisation.
- Assessment of pension assumptions applied in the valuation of the pension scheme.

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we looked at where the directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain.

As in all of our audits we also addressed the risk of management override of internal controls, including evaluating whether there was evidence of bias by the directors that represented a risk of material misstatement due to fraud.

Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the 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) identified by the auditors, including 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, and any comments we make on the results of our procedures thereon, 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. This is not a complete list of all risks identified by our audit.

Key audit matter	How our audit addressed the key audit matter
Accuracy of measured income accrual Refer to **page 97** (Audit Committee Report), **page 136** (accounting policies) and **page 154** (note 13). The directors have recorded a measured income accrual of £32.4 million (2018: £28.7 million) relating to revenue from the provision of water services to customers on water meters that had not been read at the year-end date. Revenue recognition in respect of the measured income accrual is particularly judgemental, and clearly impacts directly on reported turnover and profit. The measured income accrual accounts for the timing difference between the last meter reading and the consumption of water from this point to the year end. It is calculated based on the average consumption over the past two years by small geographical groupings of customers. Given the range of factors underlying the estimate, there is a risk that the measured income accrual and revenue could be misstated.	We have confirmed the mathematical accuracy of the calculations supporting the measured income accrual and agreed a sample of the latest meter readings to the internal billing system from which they were extracted. We have reviewed management's analysis of the movements in the measured revenue compared to prior year and agreed these movements to supporting information including property statistic reports detailing additional households in the company's geographical catchment area and the average tariff reduction. We evaluated the historical accuracy of the estimation process by reviewing bills raised in the current year for all amounts accrued at the prior year end. We note that the prior year accrual differed by 1.0% (£0.3m) to the actual readings taken post year end. We have reviewed the customer amounts accrued at 31 March 2019 which have subsequently been billed and noted immaterial differences. At the time of our testing, the total amounts billed represent 6% of the year-end accrual. We have extrapolated this across the remaining accrual and noted no material difference. We have assessed the year on year movement in the measured income accrual and agreed the material movements to timing of billing.

Statutory Financial Statements continued

Independent auditors' report to the member of Affinity Water Limited (continued)

Key audit matters (continued)

Key audit matter	***How our audit addressed the key audit matter***
Adequacy of bad debt provision Refer to **page 97** (Audit Committee Report), **page 136** (accounting policies) **page 154** (note 13) and **pages 176 to 177** (note A4). The company estimates the recoverable value of its trade receivables and records a provision for impairment based on experience. The provision is calculated by applying a percentage based on historical cash collection rates to individual aged debt categories. Some customers continue to struggle to pay their bills or in certain instances, choose not to pay them. As there are limited steps that a water company can take to recover debt from domestic customers, there is an ongoing risk of aged debts not being collected. The provision needs to reflect all these factors and accordingly could be materially misstated. Our audit focused on the risk that the provision for impairment of trade debt receivable could be understated.	We have reviewed the methodology for calculating the bad debt provision and confirm that it is reasonable and consistent year on year. We verified the mathematical accuracy of the calculations supporting the provision and the underlying data including the measurement basis (measured v unmeasured) and ageing of debt. To ensure the appropriate classification of customers into ageing categories we have selected a sample of debt and ensured this had been correctly treated based on ageing, customer type and measurement basis. In addition, we have compared the actual provision rates used in the provision to prior year provision rates and reviewed the level of bad debt write offs which occurred in the year to 31 March 2019 to ensure the accuracy of management's previous estimates. We have not identified any material levels of bad debt which were not previously provided. The level of bad debt write offs are consistent year on year for water customers. We consider the level of provisioning to be materially accurate, based on historical cash collection rates and current ageing of the debt
Cost capitalisation Refer to **page 97** (Audit Committee Report), **page 136** (accounting policies) and **page 151** (note 8). The company capitalises expenditure with respect to its infrastructure assets where such expenditure enhances or increases the capacity of the network, or relates to material replacements of network components. The allocation of costs between capital and non-capital spend can be judgemental and has a direct impact on profit in any one year. The key judgement is management's assessment of what constitutes enhancement compared to maintenance expenditure and the allocation of overheads. Given the magnitude of capital spend at £110.3m there is a risk that incorrect classification could give rise to material misstatement.	We have reviewed the process for allocating costs to capital projects and are satisfied that this allocation has been made on a consistent basis and is in line with the company's capitalisation policy. We have selected a sample of items capitalised in the year and ensured these are consistent with the company's accounting policy and have been appropriately capitalised in line with IAS 16. We have examined the process of capitalising staff time through the inspection of time sheet data and tested a sample of staff costs capitalised. We have not noted any exceptions from our testing and conclude that the time capitalised relates to that spent on valid capital projects. In addition, we evaluated the nature of overheads capitalised and the basis of the overhead capitalised and found these materially relate directly to the asset construction operations of the business and therefore are appropriately capitalised.

Key audit matter	***How our audit addressed the key audit matter***
Assessment of pension assumptions applied in the valuation of the pension scheme Refer to **page 97** (Audit Committee Report), **page 136** (accounting policies), **page 153** (note 11) and **pages 180 to 183** (note A5). The company has a defined benefit pension plan and has recognised a net retirement benefit surplus of £101.2m (2018: £105.6m). The plan liabilities increased from £406.4m to £417.5m mainly as a result of changes in financial assumptions, such as increased inflation and salary rates. In addition, the plan assets increased from £511.9m to £518.7m. The valuation of the plan liabilities requires significant levels of judgement and technical expertise including the use of actuarial experts to support the Directors in selecting appropriate assumptions. Changes in a number of key financial and demographic assumptions (including salaries increase, inflation, discount rates, and mortality rates) can have a material impact on the calculation of the net asset.	We assessed the competence and independence of the actuary by confirming that the company is a member of the Institute and Faculty of Actuaries and confirming it is appropriately independent of the company. We agreed the discount and inflation rates, together with the expected rates of return on plan assets used in the valuation by the external actuary to our internally developed benchmarks. We confirmed that these were within our expected ranges and were consistently positioned within the range year on year. The mortality rates and the allowance for future improvements in longevity were agreed to be consistent with our internally developed benchmarks and based on national and industry averages. We agreed the salaries increase to be within our expected range based on the Consumer Price Index ('CPI') and Retail Price Index ('RPI').

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the company, the accounting processes and controls, and the industry in which it operates.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

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

Overall materiality	£4.3 million (2018: £3.4 million).
How we determined it	3.5% (2018: 2.5%) of EBITDA.
Rationale for benchmark applied	Consistent with last year, we used EBITDA as this is the measure that management focus on internally in their reporting. EBITDA also provides us with a consistent year-on-year basis for our audit.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £0.2 million (2018: £0.2 million) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Statutory Financial Statements continued

Independent auditors' report to the member of Affinity Water Limited (continued)

Going concern

In accordance with ISAs (UK) we report as follows:

Reporting obligation	*Outcome*
We are required to report if we have anything material to add or draw attention to in respect of the directors' statement in the financial statements about whether the directors considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements and the directors' identification of any material uncertainties to the company's ability to continue as a going concern over a period of at least twelve months from the date of approval of the financial statements.	We have nothing material to add or to draw attention to. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the company's ability to continue as a going concern. For example, the terms on which the United Kingdom may withdraw from the European Union are not clear, and it is difficult to evaluate all of the potential implications on the company's trade, customers, suppliers and the wider economy.

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic Report, Directors' Report and Corporate Governance Statement, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, the Companies Act 2006 (CA06) and ISAs (UK) require us also to report certain opinions and matters as described below (required by ISAs (UK) unless otherwise stated).

Strategic Report and Directors' Report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Directors' Report for the year ended 31 March 2019 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements. *(CA06)*

In light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic Report and Directors' Report. *(CA06)*

The directors' assessment of the prospects of the company and of the principal risks that would threaten the solvency or liquidity of the company

As a result of the directors' voluntary reporting on how they have applied the UK Corporate Governance Code (the "Code"), we are required to report to you if we have anything material to add or draw attention to regarding:

- The directors' confirmation on **page 83** of the Annual Report that they have carried out a robust assessment of the principal risks facing the company, including those that would threaten its business model, future performance, solvency or liquidity.
- The disclosures in the Annual Report that describe those risks and explain how they are being managed or mitigated.
- The directors' explanation on **pages 58 to 61** of the Annual Report as to how they have assessed the prospects of the company, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We have nothing to report in respect of this responsibility.

Other Code Provisions

As a result of the directors' voluntary reporting on how they have applied the Code, we are required to report to you if, in our opinion:

- The statement given by the directors, on **page 83**, that they consider the Annual Report taken as a whole to be fair, balanced and understandable, and provides the information necessary for the member to assess the company's position and performance, business model and strategy is materially inconsistent with our knowledge of the company obtained in the course of performing our audit.
- The section of the Annual Report on **page 97** describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.

We have nothing to report in respect of this responsibility.

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the Statement of Directors' Responsibilities set out on **pages 120 to 121**, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they 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.

Statutory Financial Statements continued

Independent auditors' report to the member of Affinity Water Limited (continued)

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

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

Use of this report

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

Companies Act 2006 exception reporting

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 by the company, or returns adequate for our audit have not been received from branches not visited by us; or
- certain disclosures of directors' remuneration specified by law are not made; or
- the financial statements are not in agreement with the accounting records and returns.
- We have no exceptions to report arising from this responsibility.

Owen Mackney (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Uxbridge

26 June 2019

Income statement for the year ended 31 March 2019

(Registered Number 02546950)

	Note	2019 £000	2018 £000
Revenue	1	**311,569**	307,969
Cost of sales		**(216,643)**	(201,584)
Gross profit		**94,926**	106,385
Administrative expenses		**(48,117)**	(42,612)
Net impairment losses on financial and contract assets	2.1	**(6,128)**	(8,884)
Other income	2.2	**17,896**	17,379
Operating profit	2	**58,577**	72,268
Profit on disposal of subsidiary	3	**25**	-
Profit on disposal of non-household retail business	4	**-**	10,958
Finance income	6	**6,590**	2,208
Finance costs	6	**(49,131)**	(49,496)
Fair value loss on financial instrument	6	**(2,389)**	-
Net finance costs		**(44,930)**	(47,288)
Profit before tax		**13,672**	35,938
Tax expense	7	**(3,103)**	(6,303)
Profit for the year		**10,569**	29,635

All profits of the company in the current period and prior period are from continuing operations.

The notes on **pages 136 to 185** are an integral part of these financial statements[1].

[1] Profit for the prior year includes the gain on disposal of the non-household retail business, which was transferred to Affinity for Business (Retail) Limited, a fellow group company, effective 1 April 2017.

Statutory Financial Statements

Statutory Financial Statements continued

Statement of comprehensive income for the year ended 31 March 2019
(Registered Number 02546950)

	Note	2019 £000	2018 £000
Profit for the year		**10,569**	29,635
Other comprehensive (loss)/income for the year which will not be reclassified to profit or loss:			
Re-measurements of post-employment benefit assets	11	**(8,747)**	28,990
Deferred tax credit/(charge) on items that will not be reclassified	7	**1,487**	(4,928)
Other comprehensive (loss)/income for the year, net of tax		**(7,260)**	24,062
Total comprehensive income for the year		**3,309**	53,697

The notes on **pages 136 to 185** are an integral part of these financial statements.

Statement of financial position as at 31 March 2019
(Registered Number 02546950)

	Note	2019 £000	2018 £000
Assets			
Non-current assets			
Property, plant and equipment	8	**1,419,556**	1,375,366
Intangible assets	9	**47,903**	51,356
Investments	10	**100**	60
Retirement benefit surplus	11	**101,194**	105,558
Other receivables	13	**2,215**	-
		1,570,968	1,532,340
Current assets			
Inventories	12	**2,716**	1,631
Trade and other receivables	13	**74,763**	65,066
Cash and cash equivalents	14	**111,531**	114,842
		189,010	181,539
Total assets		**1,759,978**	1,713,879
Equity and liabilities			
Equity			
Ordinary shares	15	**26,506**	26,506
Share premium	15	**1,400**	1,400
Capital contribution reserve	15	**30,150**	30,150
Retained earnings		**150,569**	153,860
Total equity		**208,625**	211,916
Liabilities			
Non-current liabilities			
Trade and other payables	16	**115,759**	99,291
Borrowings	17	**1,081,253**	1,072,543
Derivative financial instrument	18	**3,997**	-
Deferred tax liabilities	19	**178,961**	181,266
Provisions for other liabilities and charges	20	**4,907**	3,232
		1,384,877	1,356,332
Current liabilities			
Trade and other payables	16	**160,109**	145,347
Current tax liabilities		**4,205**	284
Provisions for other liabilities and charges	20	**2,162**	-
		166,476	145,631
Total liabilities		**1,551,353**	1,501,963
Total equity and liabilities		**1,759,978**	1,713,879

The notes on **pages 136 to 185** are an integral part of these financial statements. The statutory financial statements on **pages 131 to 185** were approved by the Board of Directors and were signed and authorised for issue on 25 June 2019 on its behalf by:

Tony Cocker Chairman

Stuart Ledger Chief Financial Officer

Statutory Financial Statements continued

Statement of changes in equity for the year ended 31 March 2019
(Registered Number 02546950)

	Note	Share capital £000	Share premium £000	Capital contribution reserve £000	Retained earnings £000	Total equity £000
Balance as at 1 April 2017		26,506	1,400	30,150	158,661	216,717
Profit for the year		-	-	-	29,635	29,635
Other comprehensive income		-	-	-	24,062	24,062
Total comprehensive income		-	-	-	53,697	53,697
Dividends	21	-	-	-	(58,498)	(58,498)
Total transactions with owners recognised directly in equity		-	-	-	(58,498)	(58,498)
Balance as at 31 March 2018		26,506	1,400	30,150	153,860	211,916
Balance as at 1 April 2018		**26,506**	**1,400**	**30,150**	**153,860**	**211,916**
Profit for the year		-	-	-	**10,569**	**10,569**
Other comprehensive loss		-	-	-	**(7,260)**	**(7,260)**
Total comprehensive income		-	-	-	**3,309**	**3,309**
Dividends	**21**	-	-	-	**(6,600)**	**(6,600)**
Total transactions with owners recognised directly in equity		-	-	-	**(6,600)**	**(6,600)**
Balance as at 31 March 2019		**26,506**	**1,400**	**30,150**	**150,569**	**208,625**

The notes on **pages 136 to 185** are an integral part of these financial statements.

Statement of cash flows for the year ended 31 March 2019
(Registered Number 02546950)

	Note	2019 £000	2018 £000
Cash flows from operating activities			
Cash generated from operations	22.1	**117,680**	137,689
Interest paid		**(39,757)**	(36,772)
Tax paid		**-**	(8,652)
Group relief paid		**-**	(2,000)
Net cash generated from operating activities		**77,923**	90,265
Cash flows from investing activities			
Investment in subsidiary		**(50)**	-
Disposal of subsidiary		**35**	-
Purchases of property, plant and equipment		**(101,007)**	(114,529)
Capital contributions		**30,746**	14,337
Proceeds from sale of property, plant and equipment		**1,058**	558
Proceeds on disposal of non-household retail business	4	**-**	27,000
Purchases of intangible assets		**(6,222)**	(8,757)
Interest received		**806**	254
Net cash used in investing activities		**(74,634)**	(81,137)
Cash flows from financing activities			
Proceeds from loan from subsidiary undertaking		**-**	119,083
Equity dividends	21	**(6,600)**	(58,498)
Net cash (used in)/generated from financing activities		**(6,600)**	60,585
Net (decrease)/increase in cash and cash equivalents		**(3,311)**	69,713
Cash and cash equivalents at beginning of year		**114,842**	45,129
Cash and cash equivalents at end of year	14	**111,531**	114,842

The notes on **pages 136 to 185** are an integral part of these financial statements.

Statutory Financial Statements continued

Accounting policies

BASIS OF PREPARATION

These financial statements have been prepared under the historical cost convention and in accordance with the Companies Act 2006 and Financial Reporting Standard 101: 'Reduced disclosure framework' ('FRS 101') as issued by the Financial Reporting Council. Under FRS 101, the company applies the recognition and measurement requirements of EU-adopted International Financial Reporting Standards ('IFRS'), but makes amendments where necessary in order to comply with the Companies Act 2006 and The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410).

GOING CONCERN

Having assessed the principal risks of the company and the other matters discussed in connection with the viability statement on **pages 58 to 61**, the directors considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements.

PRINCIPAL ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these financial statements are set out in note A3. These policies have been consistently applied to all the periods presented, unless otherwise stated.

ADOPTION OF NEW AND REVISED STANDARDS

Two new standards became applicable for the current reporting period:

- IFRS 9: 'Financial instruments' and
- IFRS 15: 'Revenue from contracts with customers'.

The impact of the adoption of these standards and the new accounting policies are disclosed below.

IFRS 9: 'Financial instruments'

IFRS 9 addresses the classification, measurement and recognition of financial assets and financial liabilities. It replaces the guidance in IAS 39: 'Financial instruments' that relates to the classification and measurement of financial instruments. The standard became effective for reporting periods beginning on 1 April 2018.

Recognition and subsequent measurement of financial instruments

All loans are recognised initially at fair value plus directly attributable transaction costs. The carrying amount of the debt is increased by the amortisation of the finance and transaction costs determined using the effective interest rate in respect of the accounting year and reduced by any payments made in the period. The finance cost recognised in the income statement is allocated to accounting periods over the term of the debt using the effective interest method.

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment.

Payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

The accounting policies adopted by the company for initial recognition and subsequent measurement of financial instruments in the current and previous periods are in line with IFRS 9 requirements. There is therefore no impact on the valuation of financial instruments on initial recognition or subsequent measurement as a result of applying the new accounting standard.

The company did not hold any derivative financial instruments in previous reporting periods and therefore has not previously disclosed an accounting policy in relation to these. A derivative contract was entered into during the period, and the following accounting policy, which is in line with the requirements of IFRS 9, has been adopted. Derivatives are initially recognised at fair value on the date the derivative contract is entered into and are subsequently re-measured at their fair value in each reporting period. Gains or losses arising on revaluation are recorded in the income statement in the period in which they arise.

Expected credit loss model

With the exception of retailers operating in the non-household retail market, provision for impairment of receivables is based on historical recoverability and calculated by applying a range of different percentages to trade receivables of different ages. These percentages also vary between categories of trade receivables. Higher percentages are applied to those categories of trade receivables which are considered to be of greater risk and also to trade receivables of greater age; these receivables have higher expected credit losses. At each reporting date, the company takes into consideration any significant economic changes that may impact its credit loss model and future credit losses.

Since 1 April 2017, the company has supplied wholesale water to retailers operating in the non-household market. Retailers operating in the non-household market have been granted a licence by Ofwat, with the financial resources of the retailer assessed on licence application and monitored on a continual basis. The company uses this assurance and monitors the recoverability of its receivables by assessing cash collection rates since market opening to ensure any uncertain debt is provided for. At each reporting date, the company takes into consideration any significant economic changes that may impact the recoverability of these receivables and future credit losses.

The company has concluded that, given the nature of its financing arrangements, the procedure currently in place to assess the impairment of financial instruments detailed above is deemed sufficient under the expected credit loss model; historical recoverability of trade receivables has shown to be a good indicator of future expected losses, both in the next 12 months and across the lifetime of the instrument. Therefore, no adjustment has been made to provisions for impairment as a result of adopting IFRS 9. The company will take into consideration any significant economic changes that may impact the model and future credit losses at each reporting date.

IFRS 15: 'Revenue from contracts with customers'

The standard became effective for reporting periods beginning on 1 April 2018. IFRS 15 introduces a new revenue recognition model, and replaces IAS 18: 'Revenue' and IAS 11: 'Construction contracts' and related interpretations. The standard requires revenue to be recognised in line with the satisfaction of performance obligations identified within contracts between an entity and its customers, at an amount that reflects the transaction price allocated to each performance obligation. Particular challenges exist within the water industry as formal written contracts do not exist for most transactions with customers. Contracts are instead implied through statute and regulation. Judgement is therefore required in identifying the services contained within the contract and the customer with whom the contract is entered into, which in turn impacts on how the performance obligations are considered and therefore revenue recognised.

The standard has not had an impact on the company's revenue and other income streams detailed in notes 1 and 2.2 of these financial statements or grants and contributions received in respect of property, plant and equipment, as set out on the following page. Therefore, no transitional adjustments are required.

Statutory Financial Statements continued

Accounting policies (continued)

ADOPTION OF NEW AND REVISED STANDARDS (CONTINUED)

IFRS 15: 'Revenue from contracts with customers' (continued)

Revenue recognition

The company's core revenue stream is derived from the supply of clean water. The IFRS 15 definition of a contract is met since the UK government has contracted with the company on behalf of customers by granting the company its water supply licence. The underlying performance obligation is the development and maintenance of the network and ensuring its continued availability to customers. Under IFRS 15, revenue is measured at the transaction price and is recognised as the customer receives the benefit of the water supply through consuming the water:

- for metered customers, the amount which the company has a right to receive is determined by the volume of water consumed, hence there is no change to the IAS 18 revenue recognition pattern for measured supplies; and
- for unmetered customers, the amount which the company has a right to receive is determined by the passage of time during which a customer occupies a property to which water is supplied by the company, hence there is no change to the IAS 18 revenue recognition pattern for unmeasured supplies.

The company has contracts with third parties operating in the non-household retail market for the supply of clean water (wholesale supply). The underlying performance obligation is the development and maintenance of the network, and ensuring its continued availability to retailers on behalf of non-household consumers. Therefore revenue should be recognised as water is consumed. Under IFRS 15 revenue is required to be recognised as the amount which the company has a right to receive. For non-household retailers, the amount which the company has a right to receive is determined by non-household consumption volume data, hence there is no change to the IAS 18 revenue recognition pattern for non-household wholesale revenue.

IFRS 15 requires that revenue is recognised if it is probable that it will be received considering the customer's ability and intention to pay that amount of consideration when it is due. The company is under a statutory obligation to maintain water services to domestic properties within the areas defined in its water supply licence. As a result, the company may provide water services to customers who are unlikely to pay for these services. Under IFRS 15, such revenue is not recognised. As the company did not recognise such revenue under IAS 18, this does not impact on the company's revenue recognition policy.

Other income, including mast rentals and billing and collections services, involves readily identifiable contracts with customers with clearly defined performance obligations to which prices are allocated. Revenue is recognised as the contracts are completed and the performance obligations satisfied. This is in line with the IAS 18 revenue recognition pattern for these income streams.

Grants and contributions

The company receives income (typically from property developers) under the Water Industry Act 1991 as a result of providing new connections to its existing network, and for diverting and extending its existing network. These types of grants and contributions are not government grants within the scope of IAS 20: 'Accounting for government grants and disclosure of government assistance' as the contributions are received from developers. Whilst there may not be a written contract with the customer, the legal duties of a company under the Water Industry Act 1991 would seem to constitute a legally enforceable contract based on the transaction prices set out in the company's charges scheme, tariff documents and invoices so these grants and contributions fall within the scope of IFRS 15.

Connection charges are billed to developers for the provision of a connection to an existing water main, laying a pipe to the boundary of customers' properties and connecting to their supply pipe. Connection charges have previously been recognised in revenue in the income statement in the period that they became receivable. There has been no change in the treatment of these connection charges on application of IFRS 15, as the performance obligation has been identified as the connection of a service pipe to the main. Once the connection is made, the performance obligation is fulfilled and the income recognised immediately in the income statement.

Grants and contributions received in respect of property, plant and equipment where the performance obligation is deemed to be satisfied over time (consisting of contributions for diversions, requisitioned mains/extensions and infrastructure charges) have previously been treated as deferred income and released to cost of sales over the useful economic life of the property, plant and equipment to which they related once these assets had been commissioned. There has been no change in the treatment of these on application of IFRS 15, however the release to the income statement (2019: £2,508,000; 2018: £1,667,000), previously netted off against cost of sales and administrative expenses, has been represented in revenue.

The company may be contracted by developers in its statutory supply area to relocate a pipe which is already in the ground, this is known as a diversion. The company may also be contracted by developers in its statutory supply area to provide a new water main or new sewer, this is known as a requisition/extension. Contributions received in respect of diversions and requisitioned mains/extensions are treated as deferred income and released to revenue over time as the company considers that the obligation to provide these services is highly interrelated with the ongoing obligation to provide water services; therefore the performance obligation is considered to be satisfied over the period that the property, plant and equipment constructed are in service.

Infrastructure charges are charges levied on developers for network reinforcement which is not site specific, i.e. to fund expenditure which will contribute towards wider network reinforcement work away from the development site. Infrastructure charges are treated as deferred income and released to revenue over time as there is an implied ongoing performance obligation to improve and maintain the wider network in order to provide ongoing supply of water services.

Financing components

The company does not expect to have any contracts where the period between the transfer of the promised goods or services to the customer and the payment terms exceeds one year. Consequently, under IFRS 15 the company is not required to adjust any of its transaction prices for the time value of money; this does not represent a change to the previous treatment of revenue.

Statutory Financial Statements continued

Accounting policies (continued)

STANDARDS AND INTERPRETATIONS WHICH ARE NOT YET EFFECTIVE

The following standard is not yet effective and has not been early adopted by the company:

IFRS 16: 'Leases'

IFRS 16 addresses the definition of a lease, recognition and measurement of leases and establishes principles for reporting information to users of financial statements about the leasing activities of both lessees and lessors. A key change arising from IFRS 16 is that most operating leases will be accounted for on balance sheet for lessees. The standard replaces IAS 17: 'Leases', and related interpretations. The standard is effective for reporting periods beginning 1 January 2019. Following a review of lease arrangements by the company's finance and commercial team, management has concluded that IFRS 16 will have a material impact on the recognition, measurement, presentation and disclosure of the company's lease arrangements in its financial statements with effect from 1 April 2019.

As at the reporting date, the company has non-cancellable operating lease commitments of £15,785,000, (refer to note 23). Of these commitments, approximately £67,000 relate to short-term or low-value leases, which will be recognised on a straight-line basis as an expense in the income statement.

For the remaining lease commitments, the company expects to recognise right-of-use assets of approximately £15,200,000, deferred tax liabilities of approximately £2,600,000, lease liabilities of approximately £15,200,000 and deferred tax assets of approximately £2,600,000 on 1 April 2019.

At 31 March 2020, overall net assets are expected to be approximately £100,000 lower, and net current assets will be approximately £3,700,000 lower, due to the presentation of a portion of the liability as a current liability in the statement of financial position.

The company expects that profit after tax will decrease by approximately £100,000 for the year ending 31 March 2020 as a result of adopting IFRS 16.

Operating cash flows will increase and financing cash flows will decrease by approximately £3,700,000 because repayment of the principal portion of the lease liabilities will be classified as a cash flow from financing activities.

The company intends to apply the simplified transition approach and will not restate comparative amounts for the year prior to first adoption. Right-of-use assets will be measured at the amount of the lease liability on adoption.

There are no other standards that are not yet effective and that would be expected to have a material impact on the entity in the current or future reporting periods and on foreseeable future transactions.

DISCLOSURE EXEMPTIONS

As permitted by FRS 101, the company has taken advantage of the following disclosure exemptions available under that standard in the preparation of these financial statements:

- Paragraph 38 of IAS 1: 'Presentation of financial statements' comparative information requirements in respect of:
  - paragraph 79(a)(iv) of IAS 1: 'Presentation of financial statements';
  - paragraph 73(e) of IAS 16: 'Property, plant and equipment'; and
  - paragraph 118(e) of IAS 38: 'Intangible assets' (reconciliations between the carrying amount at the beginning and end of the period)
- The following paragraphs of IAS 1: 'Presentation of financial statements':
  - 16 (statement of compliance with all IFRS); and
  - 38B-D (additional comparative information);
- Paragraph 17 of IAS 24: 'Related party disclosures' (key management compensation)
- The requirements in IAS 24: 'Related party disclosures' to disclose related party transactions entered into between two or more members of a group

CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

The preparation of financial statements in conformity with FRS 101 requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial information are disclosed on the following page. Additionally, judgements in relation to identifying the services contained within a contract and the customer with whom a contract is entered into, which in turn impacts on how performance obligations are considered, and therefore the recognition of revenue, are disclosed in the IFRS 15: 'Revenue from contracts with customers' section of the Accounting policies (refer to **pages 137 to 139**) and in note 1.

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The company makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below and on the following page.

Measured income accrual

The company records an accrual for measured consumption of water that has not yet been billed (refer to note 13). The accrual is estimated using a defined methodology based upon weighted average water consumption by tariff, which is calculated based upon historical information.

Provision for impairment of trade receivables and contract assets

The company makes an estimate of the recoverable value of trade receivables and contract assets and records a provision for impairment based on experience (refer to note 13). This provision is based on, amongst other things, a consideration of actual collection history. At each reporting date, the company takes into consideration any significant economic changes that may impact its credit loss model and future credit losses. The actual level of receivables collected may differ from the estimated levels of recovery, which could impact operating results positively or negatively.

Statutory Financial Statements continued

Accounting policies (continued)

CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (CONTINUED)

Defined benefit pension plan

The company has an obligation to pay pension benefits to certain employees. The cost of these benefits and the present value of the obligation depend on a number of factors, including: life expectancy, inflation, salary increases, asset valuations and the discount rate on corporate bonds. Management estimates these factors in determining the net pension obligation in the statement of financial position. The assumptions (refer to note A5) reflect historical experience and current trends, and may differ from actual results due to changing market and economic conditions and longer or shorter lives of participants. There are no restrictions to the realisability of the surplus relating to the defined benefit section of the pension plan; therefore no adjustment has been made to the retirement benefit surplus recognised in accordance with International Financial Reporting Interpretations Committee 14: 'The limit on a defined benefit asset, minimum funding requirements and their interaction'.

Useful economic lives of property, plant and equipment

The annual depreciation charge for property, plant and equipment is sensitive to changes in the estimated useful economic lives and residual values of the assets. The useful economic lives and residual values are re-assessed annually. They are amended when necessary to reflect current estimates, based on management's judgement and experience, which include the knowledge and research of the company's dedicated asset management teams. Refer to note 8 for the carrying amount of property, plant and equipment and note A3 for the useful economic lives for each class of assets.

CRITICAL ACCOUNTING JUDGEMENTS IN APPLYING THE ENTITY'S ACCOUNTING POLICIES

Cost capitalisation

The company capitalises expenditure on its infrastructure assets to property, plant and equipment where such expenditure enhances or increases the capacity of the network, or relates to material replacements of network components. Any expenditure classed as maintenance is expensed in the period it is incurred. Distinguishing between enhancement and maintenance expenditure is a subjective area, particularly when projects have both elements within them. Refer to note 8 for the carrying amount of property, plant and equipment.

Notes to the financial statements

1. REVENUE

1.1 Disaggregation of revenue from contracts with customers

	2019 £000	2018 £000
Timing of revenue recognition – at a point in time		
Unmeasured supplies	**116,829**	122,737
Measured supplies	**128,249**	121,298
Non-household wholesale revenue	**54,582**	54,402
Connection charges	**9,317**	7,687
Chargeable services	**84**	178
	309,061	306,302
Timing of revenue recognition – over time		
Requisitioned mains/extensions	**569**	571
Diversions	**827**	39
Infrastructure charges	**956**	907
Other	**156**	150
	2,508	1,667
	311,569	307,969

All revenue is derived in the United Kingdom.

1.2 Assets and liabilities related to contracts with customers

The company has recognised the following assets and liabilities related to contracts with customers:

	31 March 2019 £000	31 March 2018 £000	1 April 2017 £000
Net trade receivables	**28,010**	27,206	32,256
Contract assets			
Unbilled accrual for metered customers – household customers	**32,392**	28,722	29,459
Unbilled accrual for metered customers – non-household customers	**-**	-	10,954
Amounts owed by group undertakings relating to contract assets	**-**	-	5,413
Contract liabilities			
Payments received in advance – water supplies	**36,147**	32,750	35,409
Deferred income – water supplies	**3,122**	4,426	4,521
Deferred income – other	**2,049**	2,125	1,666
Deferred grants and contributions	**117,894**	100,515	95,441
Payments received in advance – grants and contributions	**35,685**	22,655	12,991

Significant changes in contract assets and liabilities

At 31 March 2019, the company had been reimbursed £30,494,000 (2018: £9,256,000) for its costs incurred in relation to the HS2 rail project, which will cross the Affinity Water supply area. During the year, in line with the company's accounting policy for grants and contributions received in respect of property, plant and equipment, which include contributions received for diversions, £10,510,000 relating to costs for assets that have been commissioned was reclassified from payments in advance – grants and contributions to deferred grants and contributions (as at 31 March 2018, no assets had been commissioned and therefore no amounts were included in deferred grants and contributions). At 31 March 2019, £19,984,000 (2018: £9,256,000) of payments received were included in payments in advance – grants and contributions.

Statutory Financial Statements continued

Notes to the financial statements (continued)

1. REVENUE (CONTINUED)

1.2 Assets and liabilities related to contracts with customers (continued)

Recognition of trade receivables, contract assets and contract liabilities

For metered customers, a receivable is recognised when the customer is billed for the usage. At this point, the consideration is unconditional because only the passage of time is required before the payment is due. Where the company has provided the service before payment is due, an accrual for the consumption of water that has not yet been billed is recognised in the income statement and the company discloses this as a contract asset in the statement of financial position (see table on the previous page). Where the company has not provided the service before payment is due, deferred income is recognised and the company discloses this as a contract liability in the statement of financial position (see table on the previous page).

For unmetered customers, the customer pays a fixed amount determined by the transaction prices set out in the company's charging scheme and tariff documents. If the payments received exceed the amount the company has the right to receive, the company recognises a payment received in advance and discloses this as a contract liability in the statement of financial position (see table on the previous page).

Some non-household retailers are billed in advance monthly for wholesale charges determined by billing/volume reports created by the market operator. The company recognises deferred income in relation to these accounts and has presented this as a contract liability within payables. Where the company has not provided the service before payment is due, deferred income is recognised and the company discloses this as a contract liability in the statement of financial position (see table on the previous page).

Developers are billed for connection charges and contributions towards diversions and requisitioned mains/extensions in advance of work being performed by the company. The company recognises payment as being received in advance and discloses these as contract liabilities in the statement of financial position (see table on the previous page).

Developers are billed for infrastructure charges once the connection has been completed; a trade receivable is immediately recognised at this point as the consideration is unconditional. These receivables are included in net trade receivables in the table on the previous page.

The company does not incur any costs to obtain or fulfil contracts that would be recognised as an asset under IFRS 15.

Revenue recognised in relation to contract liabilities

The following table sets out how much of the revenue recognised in the current reporting period relates to carried forward contract liabilities and how much relates to performance obligations that were satisfied in a prior year:

	2019 £000	2018 £000
Revenue recognised that was included in the contract liability balance at the beginning of the year		
Payments received in advance – water supplies	**32,750**	34,070
Deferred income – water supplies	**5,059**	4,521
Deferred income – other	**2,209**	399
Deferred grants and contributions	**2,508**	1,667
Payments received in advance – grants and contributions	**7,669**	6,497
Revenue recognised from performance obligations satisfied in previous years		
Unbilled accrual for metered customers – household customers	**339**	1,178

1. REVENUE (CONTINUED)

1.2 Assets and liabilities related to contracts with customers (continued)

Revenue expected to be derived from unsatisfied performance obligations

IFRS 15 requires the disclosure of the aggregate amount of revenue which is expected to be derived from performance obligations which are unsatisfied as at the end of the reporting period, i.e. the aggregate amount of future revenues from existing ongoing contracts. The company has applied the practical expedient, set out in paragraph 121(a) of IFRS 15, not to disclose this amount in relation to water charges as the performance obligation is part of a contract that has an original expected duration of one year or less.

At 31 March 2019, £117,894,000 (2018: £100,515,000) of grants and contributions is expected to be derived from performance obligations which were unsatisfied at the end of the reporting period.

Variable consideration

The unbilled accrual for measured income is a contract asset under IFRS 15 and is deemed to be variable consideration. Historical information has proved to be an accurate indicator of current consumption and therefore the company deems it reasonable to conclude that the measured income accrual is materially correct.

2. OPERATING PROFIT

2.1 Operating costs

The following items have been charged/(credited) to either cost of sales or administrative expenses in the income statement:

	2019 £000	2018 £000
Staff costs (note 5.1)	**67,027**	63,042
Profit on disposal of property, plant and equipment	**(1,058)**	(558)
Loss on disposal of infrastructure assets	**1,714**	1,928
Abandonment of fixed assets	**-**	803
Purchase of bulk water and water supplied under statutory entitlement	**6,911**	7,586
Water abstraction charges	**4,122**	3,981
Business rates	**15,922**	16,178
Chargeable services direct expenditure	**372**	134
Depreciation of infrastructure assets (note 8)	**12,275**	11,226
Depreciation of other property, plant and equipment (note 8)	**45,956**	41,451
Amortisation of intangible assets (note 9)	**9,651**	9,276
Impairment of trade receivables and contract assets (note 13)	**6,128**	8,884
Research and development	**192**	193
Operating lease rentals – land and buildings	**1,547**	1,547
Operating lease rentals – other	**2,659**	2,478
Auditor's remuneration (note 2.3)	**805**	400
Cost of inventories used	**351**	1,511

Statutory Financial Statements continued

Notes to the financial statements (continued)

2. OPERATING PROFIT

2.2 Other income

	2019 £000	2018 £000
Timing of revenue recognition – at a point in time		
Commission and rentals	**17,896**	17,379

The majority of other income relates to commission earned by the company from billing and collecting charges in respect of sewerage and infrastructure within its area on behalf of Thames Water Utilities Limited and Anglian Water Services Limited (refer to note 24).

2.3 Auditor's remuneration

During the year the company obtained the following services from its auditor and its associates:

	2019 £000	2018 £000
Fees payable to the company's auditor and its associates for the audit of the financial statements	**142**	137
Fees payable to the company's auditor and its associates for other services:		
Audit of the company's associates	**104**	101
Audit-related assurance services		
– regulatory reporting	**55**	55
– Thames Water and Anglian Water annual returns	**9**	9
– audit related assurance service - other	**34**	33
Other assurance services including services related to bond issue	**6**	61
Other non-audit services	**455**	4
Total auditor's remuneration	**805**	400

3. PROFIT ON DISPOSAL OF SUBSIDIARY

In January 2019, the company transferred its investment of £10,000 in 100% of the £1 ordinary shares of Affinity Water Programme Finance Limited to Affinity Water Capital Funds Limited, the company's intermediate parent company for £35,000.

4. PROFIT ON DISPOSAL OF NON-HOUSEHOLD RETAIL BUSINESS

Affinity Water Limited used the Exit Regulations laid out by the Department for the Environment, Food and Rural Affairs ('Defra') to transfer its existing non-household retail base to Affinity for Business (Retail) Limited, a member of the wider Affinity Water group, on 1 April 2017. The company received £27,000,000 in consideration for the non-household debt book and associated customer base, and recognised a £10,958,000 gain on disposal. No other assets were transferred as part of the sale.

5. EMPLOYEES

5.1 Employee benefit expense (including executive directors)

	2019 £000	2018 £000
Wages and salaries	**62,546**	60,120
Social security costs	**6,124**	5,797
Defined benefit pension costs (note 11)	**5,783**	4,713
Defined contribution pension costs (note A5)	**3,170**	2,276
Other pension administration costs	**1,285**	1,213
Staff costs	**78,908**	74,119
Staff costs capitalised	**(11,881)**	(11,077)
Staff costs recognised in the income statement	**67,027**	63,042

5.2 Average number of people employed

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

By activity	2019 Number	2018 Number
Operations	**830**	816
Customer service	**272**	290
Administration	**262**	251
	1,364	1,357

5.3 Directors' remuneration

The Directors' emoluments were as follows:

	2019 £000	2018 £000
Aggregate emoluments	**1,561**	3,753

Aggregate amounts receivable under long-term incentive schemes were £nil (2018: £1,662,000), not included within aggregate emoluments above.

Neither the company nor its immediate parent entities has any listed shares and so the directors have not been offered any share incentives.

The directors who were appointed by Infracapital Partners II, North Haven Infrastructure Partners LP and Veolia Water UK Limited up until the sale on 19 May 2017, and by Allianz Capital Partners, HICL Infrastructure plc (formerly HICL Infrastructure Company Limited) and DIF from that date, did not receive any emoluments from the company, or any company within the Affinity Water group.

Statutory Financial Statements continued

Notes to the financial statements (continued)

5. EMPLOYEES (CONTINUED)

5.3 Directors' remuneration (continued)

Highest paid director

The highest paid director's emoluments were as follows:

	2019 £000	2018 £000
Aggregate emoluments	**666**	1,712

Amounts receivable by the highest paid director under long-term incentive schemes were £nil (2018: £1,228,000), not included within aggregate emoluments above.

The company made £53,000 of contributions to a pension plan in respect of the highest paid director's qualifying services during the year. The highest paid director did not hold any share options during the year.

Further information regarding directors' remuneration during the year can be found within the remuneration report on **pages 103 to 116**.

6. FINANCE INCOME AND COSTS

	2019 £000	2018 £000
Finance income		
Bank interest income	**806**	237
Net interest receivable on RPI linked inflation swap	**2,955**	-
Net income from post-employment benefits	**2,829**	1,971
	6,590	2,208
Finance costs		
Interest payable on borrowings held at amortised cost from parent company	**(160)**	(160)
Interest payable on borrowings held at amortised cost from subsidiary undertakings	**(37,293)**	(35,962)
Accretion payable in respect of interest on loans from subsidiary undertakings	**(9,483)**	(12,807)
Accretion payable on financial instrument	**(1,679)**	-
Other	**(516)**	(567)
	(49,131)	(49,496)
Fair value loss on financial instrument	**(2,389)**	-
Net finance costs	**(44,930)**	(47,288)

7. TAX EXPENSE

7.1 Tax expense included in the income statement

	2019 £000	2018 £000
Current tax:		
– UK Corporation tax on profits for the year	**4,338**	6,054
– Adjustment in respect of prior years	**(417)**	(3,353)
Total current tax	**3,921**	2,701
Deferred tax		
– Origination and reversal of temporary differences	**(952)**	(346)
– Adjustment in respect of prior years	**134**	3,948
Total deferred tax	**(818)**	3,602
Tax expense	**3,103**	6,303

Tax expense assessed for the period is higher (2018: lower) than the standard rate of corporation tax in the UK for the year ended 31 March 2019 of 19% (2018: 19%). The differences are explained below:

	2019 £000	2018 £000
Profit before tax	**13,672**	35,938
Tax calculated at the standard rate of tax in the UK of 19% (2018: 19%)	**2,598**	6,828
Tax effects of:		
– Adjustments in respect of prior years	**(283)**	595
– Non-taxable profit on disposal of the non-household retail business	**-**	(2,082)
– Expenses not deductible for tax purposes	**788**	962
Tax expense	**3,103**	6,303

7.2 Tax (credit)/expense included in the statement of comprehensive income

	2019 £000	2018 £000
Deferred tax:		
Origination and reversal of temporary differences on retirement benefit surplus	**(1,487)**	4,928

7.3 Factors that may affect future tax charges

In September 2016, changes were enacted to the main rate of corporation tax in the UK to reduce it from 19% to 17% effective from 1 April 2020.

Statutory Financial Statements continued

Notes to the financial statements (continued)

7. TAX EXPENSE (CONTINUED)

7.4 Reconciliation of current and deferred tax charge

	2019 £000	2019 %	2018 £000	2018 %
Profit before tax	**13,672**	**-**	35,938	-
Tax on profit on ordinary activities at standard UK tax rate of 19% (2018: 19%)	**2,598**	**19.00%**	6,828	19.00%
Tax effect of:				
– Depreciation in excess of capital allowances	**2,327**	**17.00%**	1,809	5.00%
– Pension movements	**(833)**	**(6.10%)**	(678)	(1.90%)
– Increase in provisions	**56**	**0.40%**	126	0.40%
– Expenses not deductible for tax purposes	**190**	**1.40%**	51	0.10%
– Non-taxable profit on sale of trade and assets to Affinity for Business (Retail) Limited	**-**	**-**	(2,082)	(5.80%)
– Adjustment to tax charge in respect of prior years	**(417)**	**(3.10%)**	(3,353)	(9.30%)
Reported current tax charge and effective rate	**3,921**	**28.60%**	2,701	7.50%
Depreciation in excess of capital allowances	**(1,647)**	**(12.00%)**	(840)	(2.30%)
Increase in provisions	**(50)**	**(0.40%)**	(113)	(0.30%)
Pension movements	**745**	**5.50%**	607	1.70%
Adjustments to tax charge in respect of prior years	**134**	**1.00%**	3,948	10.90%
Reported deferred tax charge and effective rate	**(818)**	**(5.90%)**	3,602	10.00%
Total tax charge and effective rate	**3,103**	**22.70%**	6,303	17.50%

Taxable profits were reduced last year by a one-off non-taxable profit on the sale of the company's non-household retail business. The trade and assets were sold to another group company; therefore the profit was not subject to tax.

All significant adjustments to taxable profits for the year ended 31 March 2019 are timing differences, meaning that tax payments are deferred to later years rather than being permanently reduced. The largest of these adjustments is in respect of tax allowances on the company's capital expenditure, most of which is eligible for tax relief at a rate of either 8% or 18% per annum. These capital allowances provide tax relief in place of accounting depreciation, which is not tax deductible.

Capital allowances at a rate of 100% are available for investment in research and development, and water and energy saving technology. These allowances are yet to be finalised and are, therefore, not reflected in the current year's tax provision. The current tax credit and deferred tax charge in respect of prior years are mainly due to capital allowances on prior year investment.

8. PROPERTY, PLANT AND EQUIPMENT

	Land, buildings and operational structures £000	Potable water distribution mains £000	Raw water pipes £000	Fixed plant £000	Vehicles and mobile plant £000	Assets in course of construction £000	Total £000
Cost or deemed cost							
At 1 April 2018	294,990	781,075	19,223	713,680	54,748	152,030	**2,015,746**
Additions	-	-	-	-	-	104,135	**104,135**
Transfers	2,899	30,313	3,588	83,530	12,868	(133,198)	**-**
Disposals	(38)	(1,835)	(18)	-	(624)	-	**(2,515)**
At 31 March 2019	297,851	809,553	22,793	797,210	66,992	122,967	**2,117,366**
Accumulated depreciation							
At 1 April 2018	(87,853)	(42,951)	(1,066)	(483,710)	(24,800)	-	**(640,380)**
Charge for the year	(4,381)	(11,665)	(610)	(36,930)	(4,645)	-	**(58,231)**
Disposals	37	139	1	-	624	-	**801**
At 31 March 2019	(92,197)	(54,477)	(1,675)	(520,640)	(28,821)	-	**(697,810)**
Net book amount							
At 1 April 2018	207,137	738,124	18,157	229,970	29,948	152,030	**1,375,366**
Movement in year	(1,483)	16,952	2,961	46,600	8,223	(29,063)	**44,190**
At 31 March 2019	205,654	755,076	21,118	276,570	38,171	122,967	**1,419,556**

All land and buildings are held as freehold.

Statutory Financial Statements continued

Notes to the financial statements (continued)

9. INTANGIBLE ASSETS

	Goodwill £000	Computer software development costs £000	Total £000
Cost			
At 1 April 2018	14,961	69,031	**83,992**
Additions	-	6,199	**6,199**
Disposals	-	(2,738)	**(2,738)**
At 31 March 2019	14,961	72,492	**87,453**
Accumulated amortisation			
At 1 April 2018	-	(32,637)	**(32,637)**
Charge for the year	-	(9,651)	**(9,651)**
Disposals	-	2,738	**2,738**
At 31 March 2019	-	(39,550)	**(39,550)**
Net book amount			
At 1 April 2018	14,961	36,394	**51,355**
Movement in year	-	(3,452)	**(3,452)**
At 31 March 2019	14,961	32,942	**47,903**

Goodwill includes £8,283,000 relating to the unification of the Affinity Water group's regulated businesses on 27 July 2012. The remaining balance of £6,678,000 relates to goodwill arising from the acquisition of the trade and assets of North Surrey Water Limited on 1 October 2000.

Affinity Water Limited is the only cash generating unit ('CGU') due to the fact it constitutes the smallest identifiable group of assets that generate cash inflows for the entity, by means of supplying drinking water to customers. The recoverable amount has been determined using the RCV of Affinity Water Limited at 31 March 2019. Per management's assessment it has been determined that the headroom is such that no reasonable change in any key assumptions is expected to result in impairment of the goodwill recognised.

Included in the computer software asset category above is £7,984,000 of capitalised intangible assets under construction, which is not amortised. £4,385,000 of intangible projects under construction were completed in the year, and amortisation was charged as at the point in time that the software became fit for purpose and ready to use.

There were no individually material computer software development costs in the year ended 31 March 2019 (2018: £4,933,000 of expenditure in relation to a new work management information system).

10. INVESTMENTS

	2019 £000	2018 £000
Investments in subsidiaries (refer to note A6)	**100**	60

The directors believe that the carrying value of the investments is supported by their underlying net assets.

11. RETIREMENT BENEFIT SURPLUS

Defined benefit section

The net pension expense before taxation recognised in the income statement in respect of the defined benefit plan is:

	2019 £000	2018 £000
Total current service cost of the Affinity Water Pension Plan	**(4,132)**	(4,800)
Contributions from participating employer	**97**	87
Past service cost	**(1,748)**	-
Pension expense charged to operating profit	**(5,783)**	(4,713)
Net pension interest income credited to finance income (note 6)	**2,829**	1,971
Net pension expense charged before taxation	**(2,954)**	(2,742)

The opening and closing retirement benefit surpluses included in the statement of financial position are summarised as follows:

	2019 £000	2018 £000
At 1 April	**105,558**	72,997
Principal employer contributions	**7,337**	6,313
Net current service cost (per above)	**(4,035)**	(4,713)
Past service cost	**(1,748)**	-
Net interest income	**2,829**	1,971
Net re-measurement (loss)/gain	**(8,747)**	28,990
At 31 March	**101,194**	105,558

Re-measurement gains and losses are recognised directly in the statement of comprehensive income and are summarised as follows:

	2019 £000	2018 £000
Re-measurement gains on plan assets	**2,485**	316
Re-measurement (losses)/gains on plan liabilities	**(11,232)**	28,674
	(8,747)	28,990

The past service cost includes the impact of the court ruling in October 2018 to remove historical gender inequalities in relation to GMP.

Further analysis and underlying valuation assumptions of the defined benefit plan are provided in note A5.

Statutory Financial Statements continued

Notes to the financial statements (continued)

12. INVENTORIES

	2019 £000	2018 £000
Raw materials and consumables	**2,716**	1,631

Inventories are stated after provisions for impairment of £538,000 (2018: £538,000).

13. TRADE AND OTHER RECEIVABLES

	2019 £000	2018 £000
Non-current:		
Other receivables	**2,215**	-
Current:		
Trade receivables	**55,806**	54,970
Less: provision for impairment of trade receivables	**(27,796)**	(27,764)
	28,010	27,206
Amounts owed by group undertakings	**207**	483
Interest receivable from external parties	**4,044**	-
Other receivables	**4,563**	3,209
Unbilled accrual for metered customers	**32,392**	28,722
Prepayments and accrued income	**5,547**	5,446
	74,763	65,066

The carrying amounts of trade and other receivables approximate to their fair value.

13.1 Provision for impairment of trade receivables and contract assets

Trade receivables and contract assets do not carry interest and are stated net of a provision for impairment, as follows:

	Trade receivables		Unbilled accrual for metered customers		Total	
	2019 £000	2018 £000	2019 £000	2018 £000	2019 £000	2018 £000
At 1 April	**27,764**	27,626	**306**	253	**28,070**	27,879
Provision for receivables impairment charged to income statement	**6,127**	8,791	**1**	93	**6,128**	8,884
Receivables written off during the year as uncollectable	**(6,095)**	(7,299)	**-**	-	**(6,095)**	(7,299)
Provision transferred to Affinity for Business (Retail) Limited	**-**	(1,354)	**-**	(40)	**-**	(1,394)
At 31 March	**27,796**	27,764	**307**	306	**28,103**	28,070

There was no impairment provision in relation to the amounts owed by group undertakings relating to contract assets at 1 April 2017.

See note A4 for details on the calculation of the impairment provision.

13. TRADE AND OTHER RECEIVABLES (CONTINUED)

13.2 Ageing analysis of trade receivables

The aged analysis of receivables at the reporting date is as follows:

	2019 £000	2018 £000
Aged less than one year	**15,396**	15,972
Aged between one year and two years	**11,191**	10,081
Aged greater than two years	**1,423**	1,153
	28,010	27,206

14. CASH AND CASH EQUIVALENTS

	2019 £000	2018 £000
Cash at bank and in hand	**21,187**	22,751
Term deposits	**90,344**	92,091
	111,531	114,842

The carrying amounts of cash and cash equivalents approximate to their fair value.

15. SHARE CAPITAL, SHARE PREMIUM AND CAPITAL CONTRIBUTION RESERVE

Alloted and fully paid up	Number of shares (thousands)	Ordinary shares of £0.10 each (£000)	Share premium (£000)	Capital contribution reserve (£000)	Total (£000)
At 31 March 2018 and 31 March 2019	265,058	26,506	1,400	30,150	**58,056**

All shares rank pari passu in all respects.

Statutory Financial Statements

Statutory Financial Statements continued

Notes to the financial statements (continued)

16. TRADE AND OTHER PAYABLES

	2019 £000	2018 £000
Non-current		
Amounts falling due after more than one year:		
Deferred grants and contributions	**10,458**	6,456
Amounts falling due after more than five years:		
Deferred grants and contributions	**105,301**	92,835
	115,759	99,291
Current		
Amounts falling due within one year:		
Trade payables	**13,506**	15,319
Amounts due to group undertakings	**250**	245
Interest payable to subsidiary companies	**13,761**	13,701
Interest payable to external parties	**63**	55
Social security and other taxes	**1,618**	1,588
Other payables	**8,448**	7,673
Capital accruals	**13,149**	10,045
Deferred grants and contributions	**2,135**	1,224
Payments received in advance	**71,832**	55,405
Other accruals and deferred income	**35,347**	40,092
	160,109	145,347
	275,868	244,638

The carrying amounts of trade and other payables approximate to their fair value.

17. BORROWINGS

	2019 £000	2018 £000
Borrowings measured at amortised cost:		
Loan from Affinity Water Finance (2004) PLC financed by bond issue	**253,922**	254,346
Loan from Affinity Water Programme Finance Limited financed by bond issue	**-**	814,613
Loan from Affinity Water Finance PLC financed by bond issue	**823,747**	-
Loan from intermediate parent company	**3,550**	3,550
3.5% irredeemable consolidated debenture stock	**-**	-
4% irredeemable consolidated debenture stock	**8**	8
4% irredeemable debenture stock	**1**	1
4.25% irredeemable debenture stock	**-**	-
5% irredeemable debenture stock	**24**	24
5.25% irredeemable debenture stock	**1**	1
	1,081,253	1,072,543

17. BORROWINGS (CONTINUED)

On 13 July 2004, the company's subsidiary Affinity Water Finance (2004) PLC issued a £200,000,000 bond at an interest rate of 5.875% and repayable in July 2026. On 16 July 2014 Affinity Water Finance (2004) PLC completed a tap issue of £50,000,000 on the same terms as the existing £200,000,000 bond.

The net proceeds of the bond and tap issue were lent to the company on the same terms.

On 4 February 2013, the company's former subsidiary Affinity Water Programme Finance Limited issued £80,000,000 Class A Guaranteed Notes maturing in September 2022 with a coupon of 3.625%, £250,000,000 Class A Guaranteed Notes maturing in March 2036 with a coupon of 4.500%, £150,000,000 Class A Guaranteed RPI linked Notes maturing in June 2045 with a coupon of 1.548% and £95,000,000 Class B Guaranteed RPI linked Notes maturing in June 2033 with a coupon of 3.249%.

On 29 October 2015, Affinity Water Programme Finance Limited completed a tap issue of its 1.548% RPI linked Notes maturing in June 2045 of £40,000,000 on the same terms as the existing 2045 Notes.

On 19 February 2016, Affinity Water Programme Finance Limited issued £10,000,000 Class B Guaranteed RPI linked Notes maturing in June 2033 with a coupon rate of 1.024%.

On 22 August 2016, Affinity Water Programme Finance Limited exchanged £65,800,000 of its 3.625% Guaranteed Notes due 2022 for a new issue of 3.278% Guaranteed Notes due 2042. An additional £19,200,000 of 3.278% Guaranteed Notes due 2042 were issued at the same time.

On 22 November 2017, Affinity Water Programme Finance Limited issued £60,000,000 Class A Guaranteed Notes maturing in November 2033 with a coupon of 2.699% and £60,000,000 Class A Guaranteed CPI linked Notes maturing in November 2042 with a coupon of 0.230%.

On 22 January 2019, the assets and liabilities of Affinity Water Programme Finance Limited were transferred to the company's subsidiary Affinity Water Finance PLC.

The net proceeds of the bond issues and the tap issue were lent to the company on the same terms.

On 4 February 2013, the company borrowed an amount of £3,550,000 from Affinity Water Capital Funds Limited, the company's intermediate parent company. The final repayment date of this loan is 31 March 2036, with interest terms having been set at 4.500%.

The company has unconditionally and irrevocably guaranteed the due and punctual payment of all sums from time to time payable by Affinity Water Finance (2004) PLC and Affinity Water Finance PLC in respect of the bonds issued by these companies. These guarantees constitute direct, general and unconditional obligations of the company which will at all times rank at least pari passu with all other present and future unsecured obligations. The bonds issued are also guaranteed by Affinity Water Holdings Limited, the company's immediate parent undertaking.

The fair value of the bonds on-lent from the financing subsidiaries at 31 March 2019 is £1,426,572,000 (2018: £1,391,218,000). The fair value of Class A bonds has been derived from 'level 1' fair value measurements: quoted prices (unadjusted) in active markets for identical liabilities. The fair value of Class B bonds had been derived from 'level 2' fair value measurements: directly observable market inputs other than Level 1 inputs.

The company is subject to a number of covenants in relation to its borrowings, which, if breached, would result in its loans becoming immediately repayable. These covenants specify certain limits in terms of key ratios such as net cash flow to debt interest and net debt to RCV. At the year end the company was not in breach of any financial covenants.

Statatory Financial Statements continued

Notes to the financial statements (continued)

18. DERIVATIVE FINANCIAL INSTRUMENT

	2019 £000	2018 £000
Non-current		
Fair value of RPI linked inflation swap	**2,389**	-
Accretion on RPI linked inflation swap	**1,608**	-
	3,997	-

An RPI linked inflation swap with a nominal value of £135.0m, which is linked to the maturity of the Class A fixed rate £250.0m bond (July 2026), was entered into in August 2018.

19. DEFERRED TAX LIABILITIES

19.1 Analysis of deferred tax assets and deferred tax liabilities

	2019 £000	2018 £000
Deferred tax assets:		
– Deferred tax asset to be recovered after more than 12 months	**(500)**	(588)
	(500)	(588)
Deferred tax liabilities:		
– Deferred tax liability to be settled after more than 12 months	**179,461**	181,854
	179,461	181,854
Deferred tax liabilities - net	**178,961**	181,266

The gross movement on the deferred tax account is as follows:

	2019 £000	2018 £000
At 1 April 2018 / 1 April 2017	**181,266**	172,736
(Credited)/charged to the income statement	**(818)**	3,602
(Credited)/charged to other comprehensive income	**(1,487)**	4,928
At 31 March 2019 / 31 March 2018	**178,961**	181,266

19. DEFERRED TAX LIABILITIES (CONTINUED)

The movement in deferred tax assets and liabilities during the year is as follows:

19.2 Deferred tax liabilities

	Accelerated capital allowances £000	Retirement benefit obligations £000	Total £000
At 1 April 2017	161,309	12,409	173,718
Charged to the income statement	2,601	607	3,208
Charged to other comprehensive income	-	4,928	4,928
At 31 March 2018	163,910	17,944	**181,854**
Charged to the income statement	(1,651)	745	**(906)**
Charged to other comprehensive income	-	(1,487)	**(1,487)**
At 31 March 2019	162,259	17,202	**179,461**

19.3 Deferred tax assets

	Provisions £000
At 1 April 2017	(982)
Charged to the income statement	394
At 31 March 2018	(588)
Charged to the income statement	**88**
At 31 March 2019	**(500)**

Statutory Financial Statements continued

Notes to the financial statements (continued)

20. PROVISIONS FOR OTHER LIABILITIES AND CHARGES

	Insurance £000	Other £000	Total £000
At 1 April 2017	1,792	670	2,462
Charged to the income statement	1,854	-	1,854
Utilised in the year	(1,084)	-	(1,084)
At 31 March 2018	2,562	670	3,232
Charged to the income statement	3,163	2,162	5,325
Utilised in the year	(1,488)	-	(1,488)
At 31 March 2019	4,237	2,832	**7,069**

Insurance

Insurance represents the amount of the company's liability in respect of individual claims. This is based upon data provided by loss adjusters to insurers and is calculated on settlement experience.

Included within this provision is an amount of £2,215,000, which would be recoverable from the company's insurer and is, therefore, disclosed as a non-current other receivable on the company's statement of financial position.

Other provisions

Other provisions include £2,162,000 in relation to a corporate reorganisation, which is expected will be utilised by 31 March 2020 and therefore presented as a current liability in the statement of financial position, and £670,000 (2018: £670,000) in relation to unfunded pension liabilities for a former non-executive director, which it is expected will be utilised by January 2051.

21. DIVIDENDS

	2019 £000	2018 £000
First interim paid of 1.89p per share (2018: 2.45p)	**5,000**	6,500
Second interim paid of 0.60p per share (2018: 8.30p)	**1,600**	22,000
No third interim dividend paid (2018: 6.79p)	**-**	17,998
No fourth interim dividend paid (2018: 4.53p)	**-**	12,000
	6,600	58,498

22. NOTES TO THE STATEMENT OF CASH FLOWS

22.1 Cash generated from operations

		2019 £000	2018 £000
Profit before tax		**13,672**	35,938
Adjustments for:			
Depreciation of property, plant and equipment (note 8)		**58,231**	52,677
Amortisation of grants and contributions		**(2,508)**	(1,667)
Amortisation of intangible fixed assets (note 9)		**9,651**	9,276
Profit on disposal of non-household retail business		**-**	(10,958)
Profit on disposal of subsidiary		**(25)**	-
Profit on disposal of property, plant and equipment		**(1,058)**	(558)
Loss on disposal of infrastructure assets		**1,714**	1,928
Abandonment of fixed assets		**-**	803
Post-employment benefits		**(1,554)**	(1,600)
Net finance costs (note 6)		**44,930**	47,288
Changes in working capital:			
– Inventories		**(1,085)**	(201)
– Trade and other receivables		**(7,868)**	24,616
– Trade and other payables:	- provision element	**3,837**	770
	- other	**(257)**	(20,623)
Cash generated from operations		**117,680**	137,689

22.2 Reconciliation of liabilities arising from financing activities

	At 1 April 2018 £000	Cash flow £000	Non-cash flows £000	At 31 March 2019 £000
Loan from Affinity Water Finance (2004) PLC financed by bond issue	254,346	-	(424)	**253,922**
Loan from Affinity Water Programme Finance Limited financed by bond issue	814,613	(826,133)	11,520	**-**
Loan from Affinity Water Finance PLC financed by bond issue	-	826,133	(2,386)	**823,747**
Loan from intermediate parent company	3,550	-	-	**3,550**
Debenture stock	34	-	-	**34**
Total liabilities arising from financing activities	**1,072,543**	**-**	**8,710**	**1,081,253**

Non-cash flows relate to loan indexation and amortisation of bond issuance costs.

Statutory Financial Statements

Statutory Financial Statements continued

Notes to the financial statements (continued)

23. COMMITMENTS

23.1 Capital commitments

Capital expenditure contracted for at the end of the reporting period but not yet incurred is as follows:

	2019 £000	2018 £000
Property, plant and equipment	**18,616**	17,678
Intangible assets	**1,041**	1,699
	19,657	19,377

23.2 Commitments under operating leases

The future aggregate minimum lease payments under non-cancellable operating leases are as follows:

	2019		2018	
	Land and buildings £000	**Other £000**	Land and buildings £000	Other £000
No later than one year	**1,547**	**2,302**	1,547	2,253
Later than one year and no later than five years	**6,187**	**3,558**	6,187	4,134
Later than five years	**2,191**	**-**	3,738	-
	9,925	**5,860**	11,472	6,387

24. BILLING ON BEHALF OF THAMES WATER AND ANGLIAN WATER

The company bills and collects charges in respect of sewerage and infrastructure within its area on behalf of Thames Water Utilities Limited and Anglian Water Services Limited. No amounts are included in these financial statements in respect of uncollected sewerage and sewerage infrastructure charges at 31 March 2019 (2018: £nil).

25. EVENTS AFTER THE REPORTING PERIOD

There were no significant events that took place after the reporting period.

26. ULTIMATE PARENT COMPANY AND CONTROLLING PARTY

The immediate parent undertaking of the company is Affinity Water Holdings Limited, a company registered in England and Wales.

Affinity Water Holdings Limited is wholly owned by Daiwater Investment Limited, a company registered in England and Wales. Daiwater Investment Limited is the parent undertaking of the largest group to consolidate the statutory financial statements of the company. These financial statements are also consolidated in the financial statements of Affinity Water Holdco Finance Limited, the smallest group to consolidate the financial statements of the company.

Copies of the group financial statements of Daiwater Investment Limited and Affinity Water Holdco Finance Limited for the year ended 31 March 2019 may be obtained from the Company Secretary, Tamblin Way, Hatfield, Hertfordshire, AL10 9EZ.

The directors consider Daiwater Investment Limited as the ultimate holding and controlling company in the United Kingdom.

The directors consider the following entities to be the company's ultimate controllers, as they are in a position to exercise material influence over the company's policy and affairs:

- Allianz Infrastructure Luxembourg I Sarl
- DIF Management Holding BV
- DIF Management UK Limited
- HICL Infrastructure plc
- InfraRed Capital Partners (Management) LLP

Allianz Capital Partners is the Allianz Group's in-house investment manager for alternative equity investments. The investment focus is on infrastructure and renewables as well as private equity funds. Allianz Capital Partners' investment strategy is targeted to generate attractive, long-term and stable returns while diversifying the overall investment portfolio for the Allianz Group insurance companies.

DIF is an independent and specialist fund management company, which invests in infrastructure assets that generate long-term stable cash flows, including public-private partnerships, regulated infrastructure assets and renewable energy projects in Europe, North America and Australia.

HICL Infrastructure plc is a long-term investor in infrastructure assets which are predominantly operational and yielding steady returns. HICL has a portfolio of infrastructure investments, which are positioned at the lower end of the risk spectrum, in three target market segments: public-private partnerships, regulated assets and demand-based assets. The Investment Adviser to HICL is InfraRed Capital Partners Limited, a leading international investment manager focused on infrastructure and real estate.

Statutory Financial Statements continued

Notes to the financial statements – appendices

A1. GENERAL INFORMATION

The company owns and manages the water assets and network in an area of approximately 4,515km^2 split over three supply regions, comprising eight separate water resource zones, in the South East of England. The company is the sole supplier of drinking water in these areas.

The company is a private company and is incorporated and domiciled in the United Kingdom. The address of its registered office is Tamblin Way, Hatfield, Hertfordshire, AL10 9EZ.

Refer to note 26 for details of the company's parent company and ultimate parent company.

A2. SEGMENTAL REPORTING

In the same way that financial information is reported on a monthly basis to the Board, the company's chief operating decision maker, during the current and previous financial year on a combined basis, the company presents its results under a single segment for financial reporting purposes.

A3. ACCOUNTING POLICIES

Consolidation

The company is a majority owned subsidiary of Daiwater Investment Limited, which is the parent undertaking of the largest group to consolidate the statutory financial statements. It is included in the consolidated financial statements of Daiwater Investment Limited, which will be made publicly available. Therefore the company is exempt by virtue of section 400 of the Companies Act 2006 from the requirement to prepare consolidated financial statements.

Property, plant and equipment

Property, plant and equipment are held at historical cost less accumulated depreciation and impairment charges.

Infrastructure assets comprise a network of mains and associated underground pipe-work. Infrastructure assets are held at deemed cost established through an event-driven valuation on transition to FRS 101 in 2015/16 and subsequent additions are recorded at historical cost less accumulated depreciation and impairment charges.

For accounting purposes the network is segmented into components based on the material used to construct the pipe concerned. The estimated useful economic lives of infrastructure pipes are based on management's judgement and experience, which includes the knowledge and research of the company's dedicated asset management teams. Where management identifies that the actual useful economic life of an asset significantly differs from the estimate used to calculate its depreciation, the depreciation charge is adjusted prospectively.

Expenditure on infrastructure assets relating to increases in capacity, enhancements or material replacements of network components is capitalised where it can be reliably measured and it is probable that incremental future economic benefits will flow to the company. The carrying amount of the replaced part is derecognised. Costs of day-to-day servicing of network components are recognised in the income statement as they arise.

Cost of other property, plant and equipment includes own work capitalised comprising the direct costs of materials, labour and applicable overheads.

Property, plant and equipment are depreciated to their estimated residual values over their estimated useful lives using the straight-line method, with the exception of freehold land which is not depreciated. Assets in the course of construction are not depreciated until commissioned.

The estimated useful lives are:

Infrastructure assets		
Potable water distribution mains		50-150 years
Raw water pipes		50-150 years
Other property, plant and equipment		
Buildings		40-60 years
Operational structures		5-85 years
Fixed plant:	– short life	3-10 years
	– other	10-30 years
Vehicles and mobile plant		3-10 years

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in operating profit.

Property, plant and equipment (continued)

The company is required to evaluate the carrying value of its property, plant and equipment for impairment whenever circumstances indicate, in management's judgement, that the carrying value of such assets may not be recoverable. An impairment review in such circumstances requires management to make subjective judgements concerning the future cash flows, growth rates and discount rates of the asset under review.

Intangible assets

Goodwill

Goodwill represents the excess of the fair value of purchase consideration over the fair value of the net assets acquired. Fair value adjustments based on provisional estimates are amended within one year of the acquisition, if required, with a corresponding adjustment to goodwill.

Goodwill is not amortised but is reviewed for impairment at least annually. Impairment reviews are also carried out if there is an indication that impairment may have occurred, or, where otherwise required, to ensure that intangible assets are not carried above their estimated recoverable amounts. Goodwill is allocated to the CGU that derives benefit from the goodwill for impairment testing purposes. Impairments are recognised immediately in the income statement.

Computer software development costs

Costs associated with maintaining computer software programmes are recognised as an expense as incurred. Development costs that are directly attributable to the design and testing of identifiable and unique software products controlled by the company are recognised as intangible assets only if they meet the criteria of IAS 38: 'Intangible Assets'.

Other development expenditures that do not meet these criteria are recognised as an expense as incurred.

Computer software development costs recognised as assets are amortised on a straight-line basis over their estimated useful lives, which does not exceed five years. Amortisation charged on assets with finite lives is recognised in the income statement in operating costs.

Intangible assets are reviewed for impairment where indicators of impairment exist. Impairments are recognised immediately in the income statement.

Statutory Financial Statements continued

Notes to the financial statements – appendices (continued)

A3. ACCOUNTING POLICIES (CONTINUED)

Grants and contributions

Grants and contributions received in respect of property, plant and equipment where the performance obligation is deemed to be satisfied over time (consisting of contributions for diversions and requisitioned mains/extensions, and infrastructure charges), are treated as deferred income and released to revenue over the useful economic life of the property, plant and equipment to which they relate once these assets have been commissioned.

The company may be contracted by developers in its statutory supply area to relocate a pipe which is already in the ground; this is known as a diversion. The company may also be contracted by developers in its statutory supply area to provide a new water main or new sewer; this is known as a requisition/extension. Contributions received in respect of diversions and requisitioned mains/extensions are treated as deferred income and released to revenue over time as the company considers that the obligation to provide these services is highly interrelated with the ongoing obligation to provide water services; therefore the performance obligation is considered to be satisfied over the period that the property, plant and equipment constructed are in service.

Infrastructure charges are charges levied on developers for network reinforcement which is not site specific, i.e. to fund expenditure which will contribute towards wider network reinforcement work away from the development site. Infrastructure charges are treated as deferred income and released to revenue over time as there is an implied ongoing performance obligation to improve and maintain the wider network in order to provide ongoing supply of water services.

Grants and contributions received in respect of property, plant and equipment where the performance obligation is deemed to be satisfied at a point in time (comprising payments for connection charges) are recognised immediately in the income statement, once the performance obligation is fulfilled.

Connection charges are billed to developers for the provision of a connection to an existing water main, laying a pipe to the boundary of customers' properties and connecting to their supply pipes. Connection charges are recognised in revenue in the income statement in the period that they became receivable; the performance obligation has been identified as the connection of a service pipe to the main. Once the connection is made, the performance obligation is fulfilled and the income recognised immediately in the income statement.

Each of these types of grants and contributions (contributions for diversions and requisitioned mains/extensions, infrastructure charges, and connection charges) is not a government grant within the scope of IAS 20: 'Accounting for government grants and disclosure of government assistance' as the contributions are received from developers. Whilst there may not be a written contract with the customer, the legal duties of the company under the Water Industry Act 1991 would seem to constitute a legally enforceable contract based on the transaction prices set out in the company's charges scheme, tariff documents and invoices; accordingly these grants and contributions fall within the scope of IFRS 15.

A3. ACCOUNTING POLICIES (CONTINUED)

Investment in subsidiaries

Investments in subsidiaries are held at cost less accumulated impairment losses.

Trade and other receivables

Trade and other receivables are recognised initially at transaction price and subsequently measured at amortised cost using the effective interest method, less expected credit losses.

Expected credit losses are based on historical recoverability and calculated by applying a range of different percentages to trade receivables of different ages. These percentages also vary between categories of trade receivables. Higher percentages are applied to those categories of trade receivable which are considered to be of greater risk and also to trade receivables of greater age. At each reporting date the company takes into consideration any significant economic changes that may impact its credit loss model and future credit losses.

The company applies the IFRS 9 simplified approach for measuring expected credit losses which uses a lifetime expected loss allowance for all trade receivables and contract assets. To measure expected credit losses, trade receivables and contract assets are grouped based on shared credit risk characteristics and overdue days. Contract assets relate to unbilled metered consumption and have substantially the same risk characteristics as trade receivables for the same types of contract. The company has therefore concluded that expected loss rates for trade receivables are a reasonable approximation for loss rates for contract assets.

Inventories

Inventories are valued at the lower of cost or net realisable value after allowance for obsolete and slow-moving items. In accordance with established practice in the water industry, no value has been placed upon the water in reservoirs, mains or in the course of treatment.

Cash and cash equivalents

Cash and cash equivalents include cash at bank and in hand, deposits held at call with banks and other short-term highly liquid investments with original maturities of twelve months or less. Term deposits with original maturities longer than three months can be redeemed early, subject to the interest income being forfeited or reduced to reimburse any cost incurred by the counterparty. These are classed as cash and cash equivalents if the deposit can be redeemed to meet short term cash needs and there is no risk of a significant change in value as the result of an early withdrawal.

Current and deferred tax

The tax expense for the year comprises current and deferred tax. Tax is recognised in the income statement, except to the extent that it relates to items recognised in other comprehensive income or directly in shareholder's funds. In this case, the tax is also recognised in other comprehensive income or directly in shareholder's funds, respectively.

The current tax charge is based on taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The company's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the date of the statement of financial position.

Deferred taxation is provided in full, using the liability method, on taxable temporary differences between the tax bases of assets and liabilities and their carrying amounts in the financial statements. A deferred tax asset is only recognised to the extent that it is probable that sufficient taxable profits will be available in the future to utilise it. Deferred taxation is measured on a non-discounted basis using the tax rates and laws that have been enacted or substantively enacted by the date of the statement of financial position and are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

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 taxes levied by the same taxation authority and the company intends to settle its current tax assets and liabilities on a net basis.

Statutory Financial Statements continued

Notes to the financial statements – appendices (continued)

A3. ACCOUNTING POLICIES (CONTINUED)

Payables

Payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

Payments received in advance and measured and unmeasured deferred income are contract liabilities under IFRS 15 and relate to advance contributions received in respect of connection charges, diversions and requisitioned mains/extensions and customer payments in advance for measured and unmeasured supplies.

Borrowings

All loans are recognised initially at fair value plus directly attributable transaction costs. The carrying amount of the debt is increased by the amortisation of the finance and transaction costs determined using the effective interest rate in respect of the accounting period and reduced by any payments made in the year. The finance cost recognised in the income statement is allocated to accounting periods over the term of the debt using the effective interest method.

An exchange of debt with substantially different terms is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. At the point of refinancing, all costs relating to the previous debt have been written off to the income statement in full.

Financial instruments

Financial instruments such as derivatives are initially recognised at fair value on the date the derivative contract is entered into and are subsequently re-measured at their fair value at each reporting period. Gains or losses arising on revaluation are recorded in the income statement in the period in which they arise.

Provisions

A provision is recognised when the company has a legal or constructive obligation as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation, and the amount can be reliably estimated.

Ofwat assesses companies' operational performance against agreed performance commitments. Each performance commitment contains an ODI, which can carry a financial reward or penalty or both that will be realised as part of the next price review process in the form of revenue or RCV adjustments. The company does not recognise a provision for penalties or rewards in the financial year in which they are incurred or achieved, as the financial impact is realised in future AMPs.

A3. ACCOUNTING POLICIES (CONTINUED)

Revenue recognition

The company's core revenue stream is derived from the supply of clean water. The IFRS 15 definition of a contract is met since the UK government has contracted with the company on behalf of customers by granting the company its water supply licence, where the underlying performance obligation is the development and maintenance of the network and ensuring its continued availability to customers. Under IFRS 15, revenue is measured at the transaction price and is recognised as the customer receives the benefit of the water supply through consuming the water:

- for metered customers, the amount which the company has a right to receive is determined by the volume of water consumed; and
- for unmetered customers, the amount which the company has a right to receive is determined by the passage of time during which a customer occupies a property to which water is supplied by the company.

The company has contracts with third parties operating in the non-household retail market for the supply of clean water (wholesale supply). The underlying performance obligation is the development and maintenance of the network, and ensuring its continued availability to such third party retailers on behalf of non-household consumers. Revenue is recognised at the point in which the company has a right to receive the revenue. For non-household retailers, the amount which the company has a right to receive is determined by non-household consumption volume data.

For metered household customers, a receivable is recognised when the customer is billed for the usage. At this point, the consideration is unconditional because only the passage of time is required before the payment is due. Where the company has provided the service before payment is due, an accrual for the consumption of water that has not yet been billed is recognised in the income statement offset by a contract receivable within assets. The accrual is estimated using a defined methodology based upon weighted average water consumption by tariff, which is calculated based upon historical information.

Unmetered customers pay a fixed amount determined by the transaction prices set out in the company's charging scheme and tariff documents. If the payments received exceed the amount the company has the right to receive (i.e. unearned income), the company recognises a payment received in advance and discloses this as a contract liability within payables.

Some non-household retailers are billed in advance monthly for wholesale charges determined by billing/volume reports created by the market operator. The company recognises deferred income in relation to these accounts and discloses this as a contract liability within payables.

The recognition of revenue from grants and contributions billed to developers is detailed in the grants and contributions accounting policy.

Revenue is recognised if it is probable that it will be received, considering the customer's ability and intention to pay that amount of consideration when it is due. The company is under a statutory obligation to maintain water services to domestic properties within the areas defined in its water supply licence. As a result, the company may provide water services to customers who are unlikely to pay for these services. The company does not recognise revenue where historical evidence indicates that the company will probably never be able to collect the revenue billed.

The company does not expect to have any contracts where the period between the transfer of the promised goods or services to the customer and the payment terms exceeds one year. The company therefore does not adjust any of its transaction prices for the time value of money.

Statutory Financial Statements continued

Notes to the financial statements – appendices (continued)

A3. ACCOUNTING POLICIES (CONTINUED)

Other income

Other income includes all income derived from sources associated with the ordinary activities of the business, other than revenue derived from the regulatory activities of the business. Other income, including mast rentals and billing and collections services, involves readily identifiable contracts with customers with clearly defined performance obligations to which prices are allocated. Income is recognised as the contracts are completed and the performance obligations satisfied. It is stated net of value added taxes.

Interest income

Interest income is recognised using the effective interest method. When a loan receivable is impaired, the company reduces the carrying amount to its recoverable amount, being the estimated future cash flow discounted at the original effective interest rate of the instrument, and continues unwinding the discount as interest income.

Leases

Leases in which substantially all the risks and rewards of ownership are retained by the lessor are classified as operating leases. Operating lease rentals are charged to the income statement on a straight-line basis over the period of the lease.

The company does not hold any finance leases.

Grafham reservoir

Under the Great Ouse Water Act of 1961, the company has an entitlement to water from the Grafham reservoir owned and operated by Anglian Water Services Limited. The company pays Anglian Water a charge for the supply of water, which covers its share of the overall costs of running Grafham reservoir. These costs are recognised as an expense in the income statement as incurred.

Dividend distributions

Dividend distributions to the company's shareholder are recognised as a liability in the company's financial statements in the period in which the dividends are approved.

A3. ACCOUNTING POLICIES (CONTINUED)

Retirement benefits

The company operates a pension plan, the Affinity Water Pension Plan ('AWPP'), as the AWPP's Principal Employer, providing defined benefits based on final pensionable salary. The assets of the plan are held separately from those of the company.

The cost of providing benefits under the defined benefit plan is determined using the projected unit method, which attributes entitlement to benefits to the current period (to determine current service cost) and to the current and prior periods (to determine the present value of defined benefit obligations) and is based on actuarial advice. Past service costs are recognised immediately in the income statement. When a settlement or a curtailment occurs, the changes in the present value of the plan liabilities and the fair value of the plan assets reflect the gain or loss which is recognised in the income statement. Losses are measured at the date that the employer becomes demonstrably committed to the transaction and gains when all parties whose consent is required are irrevocably committed to the transaction.

The retirement benefit surplus or deficit in the statement of financial position comprises the present value of the defined benefit obligation (using a discount rate based on high quality corporate bonds), less any past service cost not yet recognised and less the fair value of plan assets out of which the obligations are to be settled directly. Fair value is based on market price information and in the case of quoted securities is the published bid price.

Re-measurement gains and losses arising from changes in actuarial assumptions are charged or credited to shareholder's funds in other comprehensive income in the period in which they arise.

The amount charged or credited to finance costs is a net interest amount calculated by applying the liability discount rate to the net defined benefit asset or liability.

Fellow group company Affinity for Business (Retail) Limited is a Participating Employer of the AWPP and contributes to the AWPP on behalf of its eligible employees. As the Principal Employer, Affinity Water Limited recognises all the remeasurement gains and losses on the plan assets and liabilities. Affinity Water Limited recognises current service costs net of contributions from Affinity for Business (Retail) Limited.

Contributions to the defined contribution section of the plan are recognised in the income statement in the period in which they become payable.

The company also has an obligation to pay pensions to former non-executive directors of predecessor companies. A provision in respect of the obligation is included within the net pension asset or liability.

Statutory Financial Statements continued

Notes to the financial statements – appendices (continued)

A4. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Risk management

The company's financial instruments comprise borrowings, derivatives, debentures, cash and liquid resources, and various items, such as trade receivables and trade payables that arise directly from operations. The main purpose of these financial instruments is to provide finance for the company's operations. The company finances its operations through a mixture of retained profits, borrowings from its subsidiary companies, borrowings from Affinity Water Capital Funds Limited, its intermediate parent, and debentures.

It is the company's policy, and has been throughout the year under review, that no trading in financial instruments shall be undertaken.

The main risks arising from the company's financial instruments are liquidity risk, credit risk, and interest rate and inflation risk. Treasury policies in relation to these risks are agreed in conjunction with the wider Affinity Water group.

The Board reviews and agrees policies for managing each of these risks (refer to our principal risks and uncertainties section beginning on **page 48** for further information on management of these risks). These policies have remained unchanged during the year.

Day-to-day responsibility for operational compliance with the treasury policies rests with the treasurer. A treasury report is provided quarterly to the Board, which summarises treasury activities and includes details on the company's position in regard to debt and cash at the end of each quarter.

The company's treasury function does not act as a profit centre and does not undertake speculative transactions.

A4. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

Liquidity risk

The objective of the company's liquidity risk management policy is to ensure that the company has banking arrangements and adequate, though not excessive, cash balances, revolving credit facilities and standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business and service objectives.

Liquidity risk is primarily managed by maintaining a level of liquidity such that there are sufficient cash balances and committed loan facilities capable of immediate draw down to cover as a minimum the next 12 months' forecast cash requirement ensuring that over-reliance is not placed on any one counterparty, whether through cash holdings or available facilities.

Liquidity is actively monitored by the company's treasury function and reported to the Board on a quarterly basis through the treasury report.

At 31 March 2019, the company had £272,531,000 (2018: £272,842,000) of available liquidity, which comprised £111,531,000 (2018: £114,842,000) of cash and term deposits and £161,000,000 (2018: £158,000,000) of undrawn committed borrowing facilities.

In August 2018, the group entered into an RPI linked inflation swap, detailed in the interest rate and inflation risk section of note A4. This leads to a net interest receivable cashflow over the life of the swap, offset by an accretion payment on maturity in 2026. There is no liquidity risk prior to 2026 as there is no requirement to pay collateral prior to maturity. On maturity, a final accretion payment will be made based on the mark to market valuation at that date, resulting in a forecast cash payment of £38,027,000, shown in the maturity analysis table. The mark to market valuation is reviewed on a monthly basis and a forecast accretion payment is reviewed annually to ensure sufficient cash balances can be made available if required.

Undrawn borrowing facilities:

	2019 £000	2018 £000
Floating rate:		
– Expiring within one year	**61,000**	58,000
– Expiring in more than one year	**100,000**	100,000
	161,000	158,000

The facilities expiring within one year comprise two standby facilities with different counterparties in the event of a liquidity shortfall: a 364 day revolving Debt Service Reserve Facility of £38,000,000 (2018: £38,000,000), which is intended for the purpose of funding any debt service payments, and a 364 day revolving Operations and Maintenance Reserve Facility of £23,000,000 (2018: £20,000,000), which is intended for the purpose of funding operating and capital maintenance expenditure.

The facilities expiring in more than one year comprise two revolving credit facilities, £60,000,000 (2018: £60,000,000) provided by Barclays Bank PLC and £40,000,000 (2018: £40,000,000) provided by Lloyds Bank PLC. The facilities are intended for the purpose of financing capital expenditure and working capital requirements to the extent that additional funding is required and have a maturity date of 30 July 2020.

Statutory Financial Statements continued

Notes to the financial statements – appendices (continued)

A4. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

Maturity analysis

Additional risk may arise if large cash flows are concentrated within particular time periods. The maturity profile in the following table represents the forecast future contractual principal and interest cash flows in relation to the company's non-derivative financial liabilities with agreed repayment periods on an undiscounted basis.

At 31 March 2019 Non-derivatives	Total £000	1 year or less £000	1-2 years £000	2-3 years £000	3-4 years £000	4-5 years £000	More than 5 years £000
Loans from subsidiaries	**1,649,212**	**38,231**	**38,421**	**38,577**	**52,684**	**38,389**	**1,442,910**
Loan from intermediate parent	**6,266**	**160**	**160**	**160**	**160**	**160**	**5,466**
Borrowings	**1,655,478**	**38,391**	**38,581**	**38,737**	**52,844**	**38,549**	**1,448,376**

At 31 March 2018 Non-derivatives	Total £000	1 year or less £000	1-2 years £000	2-3 years £000	3-4 years £000	4-5 years £000	More than 5 years £000
Loans from subsidiaries	1,692,625	37,998	38,226	38,467	38,718	52,922	1,486,294
Loan from intermediate parent	6,426	160	160	160	160	160	5,626
Borrowings	1,699,051	38,158	38,386	38,627	38,878	53,082	1,491,920

The maturity profile in the following table represents the forecast future net cash flows in relation to the company's derivatives estimated using the forward rates applicable at the year end. No comparatives have been presented as the RPI linked swap was entered into during the year.

At 31 March 2019 Derivatives	Total £000	1 year or less £000	1-2 years £000	2-3 years £000	3-4 years £000	4-5 years £000	More than 5 years £000
RPI linked inflation swap net payment/ (receivable)	**415**	**(3,930)**	**(4,856)**	**(4,758)**	**(4,656)**	**(4,551)**	**23,166**
Total derivatives	**415**	**(3,930)**	**(4,856)**	**(4,758)**	**(4,656)**	**(4,551)**	**23,166**

A4. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

Credit risk

Credit risk arises principally from trading (the supply of services to customers) and treasury activities (the depositing of cash).

The financial assets that are subject to the expected credit loss model are trade and other receivables, contract assets relating to the unbilled accrual for metered customers and cash and cash equivalents. While cash and cash equivalents are also subject to the impairment requirements of IFRS 9, the identified impairment loss is nil.

Contract assets and trade and other receivables

The company applies the IFRS 9 simplified approach for measuring expected credit losses which uses a lifetime expected loss allowance for all trade receivables and contract assets. To measure expected credit losses, trade receivables and contract assets are grouped based on shared credit risk characteristics and overdue days. Contract assets relate to unbilled metered consumption and have substantially the same risk characteristics as trade receivables for the same types of contract. The company has therefore concluded that expected loss rates for trade receivables are a reasonable approximation for loss rates for contract assets.

The company manages its credit risk of trade and other receivables through effective management of customer relationships. Concentrations of credit risk with respect to trade receivables are limited due to the company's customer base consisting of a large number of unrelated households and non-household retailers. The Water Industry Act 1991 (as amended by the Water Industry Act 1999) prohibits the disconnection of a water supply and the limiting of supply with the intention of enforcing payment for certain premises, including domestic dwellings. However allowance is made by Ofwat in revenue limits at each price review for a proportion of receivables deemed to be irrecoverable.

Expected credit losses for household receivables are based on historical recoverability and calculated by applying a range of different percentages to trade receivables of different ages. These percentages also vary between categories of trade receivables. Higher percentages are applied to those categories of trade receivables which are considered to be of greater risk and also to trade receivables of greater age; these receivables have higher expected credit losses. The company's policy is to write-off closed and live accounts that fall under the following categories: bankruptcy, liquidation, debt relief orders, deceased accounts where there is no estate, failed legal action and receivable amounts from customers who have moved out of the property with no forwarding address or are no longer responsible for payment of a water bill; the company concludes that there is no reasonable expectation of recovery under these circumstances. At each reporting date the company takes into consideration any significant economic changes that may impact its credit loss model and future credit losses.

Amounts are also written off on accounts where the company is still supplying the customer and where all reasonable internal and external debt collection activities have been undertaken. Under these circumstances, if the total receivable contains amounts over six years old, the amount over six years old or more is written off. The company's write-off policy on household receivables has remained unchanged and has been consistently applied in the current year compared with the previous year.

Since 1 April 2017, the company has supplied wholesale water to third party retailers operating in the non-household market. Retailers operating in the non-household market have been granted a licence by Ofwat, with the financial resources of the retailer assessed on licence application and monitored on a continual basis. The company uses this assurance and monitors the recoverability of these receivables by assessing cash collection rates since market opening to ensure any uncertain receivables are provided for. At each reporting date, the company takes into consideration any significant economic changes that may impact the recoverability of these debtors and future credit losses.

Statistory Financial Statements continued

Notes to the financial statements – appendices (continued)

A4. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

The company has concluded that, given the nature of its financing arrangements, the procedure currently in place to assess the impairment of financial instruments detailed above is deemed sufficient under the expected credit loss model; historical recoverability of trade receivables has shown to be a good indicator of future expected losses, both in the next 12 months and across the lifetime of the instrument.

At each reporting date management takes into consideration any significant economic changes that may impact the model and future credit losses. Therefore the directors of the company do not believe there is any further credit risk provision required in excess of the expected credit losses of trade receivables (see note 13).

The loss allowance as at 31 March 2019 and 1 April 2018 (on adoption of IFRS 9) was determined as follows for both trade receivables and contract assets (unbilled accrual for metered customers):

At 31 March 2019	Current £000	Less than 1 year £000	1-2 years £000	2-3 years £000	3-4 years £000	More than 4 years past due £000	Total £000
Expected loss rate – metered household receivables	0.9%	8%	26%	42%	62%	100%	
Gross carrying amount – metered household receivables	-	16,759	5,156	3,000	1,893	2,453	29,261
Gross carrying amount – unbilled accrual for metered customers	32,699	-	-	-	-	-	32,699
Provision at expected loss rate	307	1,424	1,325	1,263	1,177	2,453	7,949
Amounts provided at 100%	-	1,484	1,233	1,086	868	1,742	6,413
Loss allowance	307	2,908	2,558	2,349	2,045	4,195	14,362

	Current £000	Less than 1 year £000	1-2 years £000	2-3 years £000	3-4 years £000	More than 4 years past due £000	Total £000
Expected loss rate – unmetered household receivables	-	19%	28%	42%	61%	100%	
Gross carrying amount – unmetered household receivables	-	8,157	4,959	3,086	2,240	3,271	21,713
Provision at expected loss rate	-	1,518	1,395	1,309	1,360	3,271	8,853
Amounts provided at 100%	-	1,122	908	728	667	404	3,829
Loss allowance	-	2,640	2,303	2,037	2,027	3,675	12,682

	Less than 3 months £000	3-6 months £000	6-9 months £000	9-12 months £000	More than 12 months past due £000	Total £000
Expected loss rate – developer services	0%	48%	49%	65%	99%	
Gross carrying amount – developer services	1,939	384	254	39	734	3,350
Loss allowance	-	184	125	25	725	1,059
Total loss allowance						28,103

A4. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

At 1 April 2018	Current £000	Less than 1 year £000	1-2 years £000	2-3 years £000	3-4 years £000	More than 4 years past due £000	Total £000
Expected loss rate – metered household receivables	1.1%	10%	28%	45%	65%	100%	
Gross carrying amount – metered household receivables	-	16,175	5,027	2,941	2,045	3,114	29,302
Gross carrying amount – unbilled accrual for metered customers	29,028	-	-	-	-	-	29,028
Provision at expected loss rate	306	1,617	1,408	1,323	1,329	3,114	9,097
Amounts provided at 100%	-	1,105	1,064	1,004	957	1,100	5,230
Loss allowance	306	2,722	2,472	2,327	2,286	4,214	14,327

	Current £000	Less than 1 year £000	1-2 years £000	2-3 years £000	3-4 years £000	More than 4 years past due £000	Total £000
Expected loss rate – unmetered household receivables	-	20%	31%	45%	62%	100%	
Gross carrying amount – unmetered household receivables	-	7,447	4,921	3,450	2,708	2,193	20,720
Provision at expected loss rate	-	1,490	1,525	1,553	1,679	2,193	8,440
Amounts provided at 100%	-	781	788	797	820	894	4,080
Loss allowance	-	2,271	2,313	2,350	2,499	3,087	12,520

	Less than 3 months £000	3-6 months £000	6-9 months £000	9-12 months £000	More than 12 months past due £000	Total £000
Expected loss rate – developer services	0%	43%	58%	71%	98%	
Gross carrying amount – developer services	7,120	134	27	105	1,097	8,482
Loss allowance	-	57	16	75	1,075	1,223
Total loss allowance						28,070

The closing loss allowances for trade receivables and contract assets as at 31 March 2019 reconcile to the opening loss allowances as shown in note 13.

At 31 March 2019 and 31 March 2018, the maximum exposure to credit risk was represented by the carrying amount of each financial asset in the statement of financial position:

	2019 £000	2018 £000
Cash and term deposits (note 14)	**111,531**	114,842
Trade and other receivables (excluding prepayments)	**70,735**	60,654
	182,266	175,496

Statutory Financial Statements

Statutory Financial Statements continued

Notes to the financial statements – appendices (continued)

A4. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

The company manages its risk from treasury activities by ensuring counterparties meet the minimum credit requirements approved by the Board, which include a maximum peak exposure limit and minimum credit rating. Credit exposure is monitored regularly by the company's treasury function and is reported quarterly to the Board through the treasury report.

The breakdown of cleared cash and cash equivalents exposed to credit risk at each of the external credit ratings* at 31 March 2019 is:

	2019 £000	2018 £000
AAA*	**30,060**	42,009
A-1+*	**5,017**	10,012
A-1*	**61,762**	30,064
A-2*	**-**	17,817
P-1**	**10,005**	10,006
	106,844	109,908

* ratings per Standard & Poor's at 31 March
** rating per Moody's at 31 March

These are all short term ratings.

Interest rate and inflation risk

The company seeks to manage its interest rate risk by maintaining its exposure within a board approved range, primarily through using a mixture of fixed, inflation linked and floating rate borrowings. An RPI linked inflation swap with a nominal value of £135.0m, which is linked to the maturity of the Class A fixed rate £250.0m bond (July 2026), was entered into in August 2018 as this was the most efficient way to switch to a higher proportion of index linked debt. This will lead to net interest receivable cashflow over the life of the swap, which is expected to increase the headroom against our covenant limits, offset by an accretion payment on maturity. Movements in RPI forward rates create fair value profits or losses, which will flow through the income statement.

The company earns an economic return on its RCV, comprising a real return through revenues and an inflation return as an uplift to its RCV. To the extent that nominal debt liabilities finance a proportion of the RCV, there is an asset liability mismatch which potentially exposes the company to the risk of economic loss where actual inflation is lower than that implicitly locked in through nominal debt. The company's index-linked borrowings, which are linked to inflation, form a partial economic hedge of the company's regulatory assets, which are also linked to inflation.

Interest rate and inflation risks are reported quarterly to the Board through the treasury report.

A4. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

Interest rate and inflation risk (continued)

The interest rate profile of the company's debt is as follows:

As at	Fixed rate debt £000	RPI-linked debt £000	CPI-linked debt £000	Total £000
31 March 2019	**673,647**	**346,719**	**60,887**	**1,081,253**
31 March 2018	674,227	338,543	59,773	1,072,543

Sensitivity analysis

Sensitivity analysis has not been performed on movements in interest rates as the company's fixed rate debts had no exposure to interest rates as at 31 March 2019. The following table details the sensitivity of profit before taxation to changes in RPI and CPI on the company's index-linked borrowings and RPI linked inflation swap. The analysis relates to the position at the reporting date and is not indicative of the years then ended, as these factors would have varied throughout the year. Comparative figures exclude the impact of the RPI linked inflation swap as this was entered into during the year to 31 March 2019.

Impact on profit before taxation	2019 £000	2018 £000
1% increase in RPI	**(3,450)**	(3,364)
1% decrease in RPI	**3,450**	3,363
1% increase in CPI	**(614)**	(603)
1% decrease in CPI	**614**	603

Currency risk

The company has no material net exposure to movements in currency rates.

Capital risk management

The gearing policy approved by the Board is a target measured as net debt (as defined in the company's WBS documentation, refer to note 1E of the company's regulatory Annual Performance Report) to RCV, of 80%. This allows sufficient headroom within the company's financial covenants, which are triggered at a level of more than 90%. The company's gearing on this basis was 78.3% at 31 March 2019 (78.6% at 31 March 2018).

Assuming no significant changes to existing credit rating agencies' methodologies or sector risk assessments, the company aims to maintain its existing credit ratings of A3 with Moody's and A- with Standard & Poor's for the Class A bonds issued by its financing subsidiaries. These ratings are used by the industry's economic regulator, Ofwat, to assess the company's ability to comply with its licence requirement to maintain an investment grade credit rating.

The company looks to manage its risk by monitoring and maintaining the relevant key financial ratios used by the credit rating agencies to determine the credit ratings given. Further detail on the precise measures and methodologies used to assess water companies' credit ratings can be found in the methodology papers published by the rating agencies. Gearing and credit ratings are reported quarterly to the Board through the treasury report.

Statutory Financial Statements continued

Notes to the financial statements – appendices (continued)

A5. RETIREMENT BENEFITS

Defined benefit section

The company's pension plan providing benefits based on final pensionable salary is closed to new members (the two precursor plans closing in April 1996 and September 2004). The assets of the AWPP are held separately from those of the company. The plan's corporate trustee (the 'Trustee') is a subsidiary of Affinity Water Capital Funds Limited, an intermediate parent of the company.

The risks of the plan are as follows:

Asset volatility

The plan liabilities are calculated using a discount rate set with reference to high quality corporate bond yields. If plan assets underperform this yield, this will create a deficit.

The assets of the plan include a proportion of equities, which are expected to outperform corporate bonds in the long-term while providing volatility and risk in the short-term. As the plan has matured, the Trustee has commenced reducing the level of investment risk and will be investing more in assets that better match the liabilities of the plan and expected cash outflows based on the plan's maturity profile.

The company believes that due to the strength of its business and the long-term nature of the plan liabilities, a level of continuing equity investment is an appropriate element of the Trustee's long-term strategy to manage the plan efficiently.

Changes in bond yield

A decrease in corporate bond yields will increase plan liabilities, although this will be partially offset by an increase in the value of the plan's bond holdings.

Life expectancy

The majority of the plan's obligations are to provide benefits for the life of its members, so increases in life expectancy will result in an increase in the plan's liabilities.

Inflation risk

The pension obligations are linked to inflation, and higher inflation will lead to higher liabilities (although, in most cases, caps on the level of inflationary increases are in place to protect the plan against extreme inflation). However, the Trustee has increased the level of interest rate and inflation hedging provided by the plan's assets through Liability Driven Investment.

The latest actuarial valuation of the AWPP, determined by an independent qualified actuary, was at 31 December 2017, which concluded that the pension plan was fully funded on a self-sufficiency basis. This actuarial valuation was made on the "attained age" funding method, based on the following assumptions:

RPI inflation:	measured by reference to the Bank of England gilt inflation curve;
CPI inflation:	measured by reference to the RPI inflation curve described above less 1.0% per annum;
Pre-retirement discount rate:	measured by reference to the Bank of England gilt yield curves plus 0.25% per annum;
Post retirement discount rate:	measured by reference to the Bank of England gilt yield curves plus 0.25% per annum;
Salary increases:	measured by reference to the CPI inflation curve described above plus 1.0% per annum;
Deferred pension increases:	measured by reference to the CPI or RPI inflation curves described above with an appropriate adjustment for any caps and collars; and
Pension increases:	measured by reference to the CPI or RPI inflation curves described above with an appropriate adjustment for any caps and collars.

A5. RETIREMENT BENEFITS (CONTINUED)

Defined benefit section – employer contributions

Based on the latest actuarial valuation at 31 December 2017, no further deficit payments are required. The contributions expected to be paid into the AWPP for the year ending 31 March 2020 are £4,908,000 by the company (£7,337,000 in the year ended 31 March 2019) and £5,000,000 taking into account both participating employers (£7,434,000 in the year ended 31 March 2019).

The weighted average duration of the defined benefit obligation is 17.1 years (2018: 16.9 years).

Defined benefit section - financial and demographic assumptions

Adjustments to actuarial valuations have been made based on the following assumptions:

	2019	2018
Discount rate	**2.40% pa**	2.60% pa
Salary growth	**3.15% pa**	3.05% pa
RPI	**3.15% pa**	3.05% pa
CPI	**2.15% pa**	2.05% pa
Life expectancy for a male pensioner from age 65 (years)	**22**	22
Life expectancy for a female pensioner from age 65 (years)	**24**	24
Life expectancy from age 65 (years) for a male participant currently aged 45 (years)	**23**	23
Life expectancy from age 65 (years) for a female participant currently aged 45 (years)	**25**	25

Deferred pensions are revalued to retirement age in line with the CPI assumption of 2.15% per annum (2018: 2.05% per annum) unless otherwise prescribed by statutory requirements or the plan rules.

Statutory Financial Statements continued

Notes to the financial statements – appendices (continued)

A5. RETIREMENT BENEFITS (CONTINUED)

Defined benefit section – sensitivity analysis

	Change in assumption	Impact on defined benefit obligation	Change in assumption	Impact on defined benefit obligation
2019				
Discount rate	**0.5% decrease**	**9.0% increase**	**0.5% increase**	**9.0% decrease**
Salary growth	**0.5% increase**	**1.0% increase**	**0.5% decrease**	**1.0% decrease**
Pension growth rate	**0.5% increase**	**7.0% increase**	**0.5% decrease**	**7.0% decrease**
Life expectancy	**1 year increase**	**4.0% increase**	**1 year decrease**	**4.0% decrease**
2018				
Discount rate	0.5% decrease	8.8% increase	0.5% increase	8.8% decrease
Salary growth	0.5% increase	1.0% increase	0.5% decrease	1.0% decrease
Pension growth rate	0.5% increase	7.5% increase	0.5% decrease	7.5% decrease
Life expectancy	1 year increase	3.0% increase	1 year decrease	3.0% decrease

The above sensitivity analyses are based on a change in an assumption while holding all other assumptions constant. In practice this is unlikely to occur, and changes in some of the assumptions may be correlated. When calculating the sensitivity of the defined benefit asset to significant actuarial assumptions, the same method (present value of the defined benefit asset calculated using the projected unit credit method at the end of the reporting period) has been applied as when calculating the pension asset recognised within the statement of financial position.

Defined benefit section - net retirement benefit surplus

At 31 March, the fair values of the plan's assets recognised in the statement of financial position were as follows:

	Plan assets %	2019 £000	Plan assets %	2018 £000
Equity securities	**5%**	**27,129**	10%	50,819
Debt securities	**25%**	**127,658**	21%	108,319
Diversified growth funds	**10%**	**51,770**	13%	65,540
Property	**0%**	**654**	1%	2,070
Infrastructure	**2%**	**11,726**	2%	11,972
Liability driven investments	**57%**	**296,412**	53%	271,428
Cash and cash equivalents	**1%**	**3,337**	0%	1,795
Total fair value of the plan's assets	**100%**	**518,686**	100%	511,943
Present value of defined benefit obligations		**(417,492)**		(406,385)
Net retirement benefit surplus		**101,194**		105,558

A5. RETIREMENT BENEFITS (CONTINUED)

Defined benefit section - fair value of plan assets

Movements in the fair value of the plan's assets were as follows:

	£000	£000
At 1 April 2018 / 1 April 2017	**511,943**	507,000
Benefits paid	**(16,899)**	(15,192)
Principal employer contributions	**7,337**	6,313
Contributions by plan participants	**615**	662
Interest income	**13,205**	12,844
Re-measurement gains	**2,485**	316
At 31 March 2019 / 31 March 2018	**518,686**	511,943

Defined benefit section - present value of plan liabilities

Movements in the present value of the defined benefit liabilities are as follows:

	£000	£000
At 1 April 2018 / 1 April 2017	**(406,385)**	(434,003)
Benefits paid	**16,899**	15,192
Contributions by plan participants	**(615)**	(662)
Net current service cost	**(4,035)**	(4,713)
Past service cost	**(1,748)**	-
Interest expense	**(10,376)**	(10,873)
Re-measurement (losses)/gains	**(11,232)**	28,674
At 31 March 2019 / 31 March 2018	**(417,492)**	(406,385)

The past service cost relates to the impact of the High Court's ruling on 26 October 2018 that pension trustees are under a duty to amend pension schemes in order to equalise benefits for men and women so as to alter the result produced in relation to Guaranteed Minimum Pensions ('GMPs')

Defined contribution section

At the same time that the defined benefit section became closed to new entrants, the company established a defined contribution section to provide pension benefits to qualifying employees.

The total pension charge for the defined contribution section of the AWPP for the year ended 31 March 2019 was £3,170,000 (2018: £2,276,000). There are no amounts prepaid or outstanding in respect of the defined contribution section at 31 March 2019 (2018: nil).

Statutory Financial Statements continued

Notes to the financial statements – appendices (continued)

A6. SUBSIDIARIES

Name of company	Country of registration/ incorporation	Registered address	Nature of business	Type of holding	Proportion of voting rights and shares held
Affinity Water Finance (2004) PLC	United Kingdom	Tamblin Way, Hatfield, Hertfordshire AL10 9EZ	Financing company	Ordinary shares	100%
Affinity Water Finance PLC	United Kingdom	Tamblin Way, Hatfield, Hertfordshire AL10 9EZ	Financing company	Ordinary shares	100%
Three Valleys Water Limited	United Kingdom	Tamblin Way, Hatfield, Hertfordshire AL10 9EZ	Dormant company	Ordinary shares	100%
Tendring Hundred Water Services Limited	United Kingdom	Tamblin Way, Hatfield, Hertfordshire AL10 9EZ	Dormant company	Ordinary shares	100%
Folkestone and Dover Water Services Limited	United Kingdom	Tamblin Way, Hatfield, Hertfordshire AL10 9EZ	Dormant company	Ordinary shares	100%
White Cliffs Water Limited	United Kingdom	Tamblin Way, Hatfield, Hertfordshire AL10 9EZ	Dormant company	Ordinary shares	100%

The company has an investment of £50,000 in 100% of the £1 ordinary shares of a subsidiary company, Affinity Water Finance (2004) PLC. The principal activity of Affinity Water Finance (2004) PLC, incorporated in the United Kingdom, is to raise finance for the company. It made a profit of £1,000 for the year ended 31 March 2019 (2018: £1,000), relating to bond management fees charged to Affinity Water Limited.

In January 2019, the company transferred its investment of £10,000 in 100% of the £1 ordinary shares of Affinity Water Programme Finance Limited to Affinity Water Capital Funds Limited, the company's intermediate parent company for £35,000.

In January 2019, the company acquired 100% of the £1 ordinary shares of Affinity Water Finance PLC from Affinity Water Capital Funds Limited for £50,000. The principal activity of Affinity Water Finance PLC, incorporated in the United Kingdom, is to raise finance for the company. It made a profit of £2,000 for the period ended 31 March 2019, relating to bond management fees charged to Affinity Water Limited.

The four dormant subsidiaries listed above file accounts at Companies House.

A7. RELATED PARTY TRANSACTIONS

Purchases of goods and services

			2019		2018	
Related party	Nature of Relationship	In respect of	Value £000	Balance £000	Value £000	Balance £000
Veolia Water UK Limited*	Former shareholder	Management and technical support	-	-	20	-
Veolia Environmental Services (UK) Limited*	Former partial common ownership	Waste water disposal	-	-	24	-
VWS (UK) Limited*	Former partial common ownership	Transport and other services	-	-	4	-
Allianz Global Corporate & Speciality	Common ownership	Insurance	**1,569**	**(930)**	1,392	(791)
Allianz Engineering	Common ownership	Insurance	**2**	**(1)**	2	(1)

Sales of goods and services

			2019		2018	
Related party	Nature of Relationship	In respect of	Value £000	Balance £000	Value £000	Balance £000
Veolia Environmental Services (UK) Limited*	Former partial common ownership	Waste water disposal	-	-	12	-
Other Veolia entities*	Former partial common ownership	Transitional services, capability sharing agreement and laboratory services	-	-	7	-

Term deposit

			2019		2018	
Related party	Nature of Relationship	In respect of	Value £000	Balance £000	Value £000	Balance £000
Morgan Stanley Liquidity Funds*	Former common ownership	Term deposit and interest thereon	-	-	4	-

See note 5.3 for disclosure of the directors' remuneration.

Statutory Financial Statements

Regulatory Annual Performance Report

for the year ended 31 March 2019

CONTENTS

The following regulatory Annual Performance Report is prepared to enable the Water Services Regulation Authority (Ofwat) to monitor the financial performance of the regulated water business. This regulatory Annual Performance Report should be read in conjunction with the annual report and financial statements as a whole.

Affinity Water Limited

(Registered Number 02546950)

Colleagues volunteering at an Affinity Day to restore a World War II pillbox

Regulatory annual performance report

Statement on direction and performance

We are pleased to introduce our Regulatory Annual Performance Report for the year ended 31 March 2019. The industry has been under scrutiny recently and we wholeheartedly welcome the opportunity to address the concerns and contribute constructively to discussions on the long-term legitimacy of the industry.

As a Board, we spend a significant amount of time aligning our company plans to the interests of customers, employees and wider stakeholders. We have set challenging targets to become the UK's leading community-focused water company and to ensure that customers have enough water, whilst leaving more water in the environment. Our Board consists of carefully selected individuals with relevant skills and experiences to challenge and support the executives and focus closely on regulatory, customer and sector priorities. We discuss at length how we can make our company more resilient, how we have performed against our targets and our plans to address our shortcomings. For further details of matters considered by the Board during the year, refer to **page 79** of our Corporate Governance Report.

We recognise the need to continue to put customers first and to invest in new infrastructure to ensure we can meet the growing demand for water in the South East of England and manage the long-term impact of climate change in our region. We are committed to reducing leakage and water abstractions, and are encouraging customers to minimise their water usage through our metering programme. Our customers expect us to lead the way and we are committed to doing so. Our CCG, consisting of representatives with experience representing household customers, holds us to account on how we are performing against our performance commitments.

Our shareholders are highly regarded and have experience of long-term asset ownership. They support our plans to invest and enhance our infrastructure to ensure future resilience. We have put in place the finance required for the first half of the next AMP to deliver our expected investment programme and to deliver high levels of service whilst maintaining gearing at a level lower than 80%.

Our Board approved revised dividend and executive remuneration policies during the year, available on the governance pages of our website:

stakeholder.affinitywater.co.uk/our-governance.aspx,

that provide for dividends and executive remuneration proportionate with long-term returns and performance of the company, whilst not impairing its longer term financeability. The performance of the company comprises our financial performance as well as an assessment of performance in the following areas: customer service, operational commitments, community commitments and people.

Our salary and benefit pay policy for executives is based on the market median. Executive annual bonuses are linked to in year delivery of regulatory, customer and Business Plan performance targets, aligned to the company wide bonus scheme. The breakdown of executive bonuses is detailed in our Remuneration Report on **pages 103 to 116**. Executives are also entitled to take part in a Long Term Incentive Plan, which is balanced between financial and strategic targets, including service and performance commitments, over a five year period. The Board is reassured that the pay structure incentivises executives to deliver long-term sustainable performance for customers and communities, employees and shareholders.

This annual report and financial statements includes full and transparent disclosure of our performance in the year and the Board are confident that the plans put in place ensure a stable future for our company.

On behalf of the Board:

Tony Cocker
Chairman

Certificates of compliance

To: Water Services Regulation Authority, Centre City Tower, 7 Hill Street, Birmingham B5 4UA

SUFFICIENCY OF FINANCIAL RESOURCES CERTIFICATE

This is to certify that on 25 June 2019 the Board of Affinity Water Limited ('the Appointee') resolved that in its opinion:

1. the Appointee will have available to it sufficient financial resources and facilities to enable it to carry out, for at least the next 12 months, the Regulated Activities (including the investment programme necessary to fulfil the Appointee's obligations under the Appointment); and
2. the Appointee will, for at least the next 12 months, have available to it
   (a) management resources; and
   (b) methods of planning and internal control

   which are sufficient to enable it to carry out the Regulated Activities (including the investment programme necessary to fulfil the Appointee's obligations under the Appointment); and
3. all contracts entered into with any Associated Company include all necessary provisions and requirements concerning the standard of service to be supplied to the Appointee, to ensure that it is able to meet all its obligations as a water undertaker.

In giving this certificate the main factors which the directors have taken into account are:

- the net worth of the company as shown in the financial statements and the budget for the forthcoming year supported by long-term plans for both operating and investment expenditure;
- the financing arrangements available to the company and management of associated risks (refer to notes 16 and A4 of the company's statutory financial statements and the principal risks and uncertainties section of the company's strategic report beginning on **page 48** for further details);
- the results of the stress-testing performed in relation to the company's viability statement for the year ended 31 March 2019 (refer to **pages 58 to 61**), which is subject to external assurance (refer to our Data Assurance Report, which is published on our stakeholder website: **stakeholder.affinitywater.co.uk** for further details);
- the adequacy of the senior management team and management resources, including the ability of the senior management team to focus their teams on delivering on a number of complex and high-profile projects during 2018/19 without any obvious detriment to the other services provided to its customers and the review of succession planning being performed by the Remuneration Committee along with the company's Human Resources Team;
- the suite of internal control procedures across both operational and financial matters, supported by delegated authority procedures, an Internal Audit team reporting to the Audit Committee, and the availability of specialist planning teams who are deployed to major projects and utilise the resources of acknowledged external specialists in such matters;

Regulatory annual performance report continued

Certificates of compliance (continued)

SUFFICIENCY OF FINANCIAL RESOURCES CERTIFICATE (CONTINUED)

- the company is subject to considerable external assurance review, both fiscal and operational (refer to our Data Assurance Report, which is published on our stakeholder website: **stakeholder.affinitywater.co.uk** for further details);
- an examination of the contracts with Associated Companies;
- with the exception of the company's contract to supply wholesale water and the service agreement with Affinity for Business (Retail) Limited, there are only limited contractual arrangements with associated companies; and
- any transactions with Associated Companies are disclosed in the transactions with associated companies note in section 4 of the company's Regulatory Annual Performance Report for the year ended 31 March 2019 (refer to **page 240**), which is subject to external assurance (refer to our Data Assurance Report, which is published on our stakeholder website: **stakeholder.affinitywater.co.uk** for further details).

In this certificate, the terms "Appointment", "Associated Company" and "Regulated Activities" have the meanings given in the Appointee's Instrument of Appointment.

Tony Cocker

Chairman
25 June 2019

COMPLIANCE WITH CONDITION K

Paragraph 3.1 of Condition K of the company's Instrument of Appointment requires the company to ensure at all times, so far as reasonably practicable, that, if a special administration order were made, it would have available to it sufficient rights and assets (other than financial resources) to enable a special administrator to manage the affairs, business and property of the appointed business of the company.

The company hereby certifies that at 31 March 2019 it was in compliance with paragraph 3.1 of Condition K.

STATEMENT OF DISCLOSURE OF TRANSACTIONS WITH ASSOCIATED COMPANIES

With respect to the disclosure of transactions with associated companies, the directors declare that to the best of their knowledge:

- all appropriate transactions with associated companies have been disclosed;
- transactions with associated companies are at arms length (except where agreed with Ofwat) with no cross-subsidy occurring; and
- no directors have acted as both purchaser and supplier in any transaction with an associate company.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

In addition to their responsibilities to prepare financial statements in accordance with the Companies Act 2006, the directors are also responsible under Condition F of the Instrument of Appointment granted by the Secretary of State for the Environment to the company as a water undertaker as amended by the Variation and Modifications dated 27 July 2012 under what is now the Water Industry Act 1991 for keeping appropriate accounting records which are consistent with the Regulatory Accounting Guidelines ('RAGs') published by Ofwat.

In the case of each of the persons who are directors of the company at the date when this report was approved, so far as each of the directors is aware there is no relevant audit information of which the company's auditor is unaware; and each of the directors has taken all the steps that he/she ought to have taken as a director in order to make himself/herself aware of any relevant information and to establish that the company's auditor is aware of that information.

Relevant audit information means information needed by the company's auditor in connection with preparing its report. This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

Regulatory annual performance report continued

Statement of risk and compliance

PURPOSE OF THIS STATEMENT

The purpose of this statement is:

- to confirm that the company has complied with all its relevant statutory, licence and regulatory obligations;
- to confirm that the company is taking appropriate steps to manage or mitigate the risks it faces; and
- to explain any significant matters relevant to the company's performance in 2018/19, as presented in section 3 of this regulatory Annual Performance Report on **pages 225 to 227**.

The statement explains the company's approach to regulatory compliance and assurance and sets out its statement of compliance. It should be read alongside the company's annual report and financial statements for the year ended 31 March 2019, which include a summary of the company's financial and operational performance for 2018/19 on **pages 40 to 46** and set out how the company manages risk and uncertainty from **page 48**.

REGULATORY COMPLIANCE AND ASSURANCE

The company's approach to achieving and assuring compliance with its licence and regulatory obligations is based on a sound system of internal controls and governance. The company's Board and Audit Committee members carry out a range of activities to inform themselves about the company's compliance. The company's Director of Regulation is responsible for monitoring regulatory compliance and is supported in discharging this responsibility by employees in the Regulation, Legal and Internal Audit teams.

The company continues to employ an external reporter (the 'Reporter') to scrutinise, challenge and give independent advice on the procedures the company uses to collect and report the information underpinning this compliance statement. As a result of the Reporter's scrutiny, the Reporter has identified the following areas for consideration. The Reporter considers that they are not material risks to regulatory compliance or reporting of performance this year but are areas the company will consider addressing to mitigate compliance and performance risks in the longer term:

- Meter replacements reported in table 4Q1 – The Reporter considers that there are some weaknesses in the company's processes for reporting meter replacements, which means that the true level of activity is under-reporte d if a meter is renewed more than once in a year.
- Property numbers and void households reported in tables 4A and 4Q1 – The Reporter considers that there are systemic issues with reporting from the company's billing system, HiAffinity. As a result, there are some areas where the Reporter's assurance was limited to confirming that the summary figures in reports had been transposed accurately where it was not possible to interrogate the raw data, namely in relation to residential property numbers and vulnerability reporting for social tariffs.
- Total population served reported in table 4Q1 – The Reporter noted that the company uses a different approach to deriving household and business population served when the Reporter considers that good practice would suggest a consistent approach should be used, preferably the approach for deriving business population.

The Reporter's report is available on the company's stakeholder website: **stakeholder.affinitywater.co.uk/reports-publications.aspx**.

REGULATORY OUTPUTS

The Board has reviewed the performance of the company against its regulatory outputs set at the Final Determination for PR14. This regulatory Annual Performance Report identifies differences between the outputs that the company has delivered in the year and those that were assumed in its Final Determination for PR14.

COMPLIANCE STATEMENT

As a Board, we confirm that:

- we have a full understanding of, and are meeting, our statutory and regulatory obligations;
- we have taken steps to understand and meet customers' expectations;
- we are satisfied that we have sufficient processes and internal systems of control to meet our obligations; and
- we have appropriate systems and processes in place to allow us to identify, manage and review our risks.

On behalf of the Board:

Tony Cocker
Chairman

Patrick O'D Bourke
Independent non-executive director

Regulatory annual performance report continued

Independent Auditors' report to the Water Services Regulation Authority (the WSRA) and the Directors of Affinity Water Limited

Report on the Annual Performance Report

Opinion on Annual Performance Report

In our opinion, Affinity Water Limited's Regulatory Accounting Statements within the Annual Performance Report have been prepared, in all material respects, in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA (RAG 1.08, RAG 2.07, RAG 3.11, RAG 4.08 and RAG 5.07) and the accounting policies (including the company's published accounting methodology statement, as defined in RAG 3.11, appendix 2) set out on **pages 209 to 212**.

What we have audited

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

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

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

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)"), including ISA (UK) 800, and applicable law, except as stated in the section on Auditors' responsibilities for the audit of the Annual Performance Report below, and having regard to the guidance contained in *ICAEW Technical Release Tech 02/16 AAF 'Reporting to Regulators on Regulatory Accounts'* issued by the Institute of Chartered Accountants in England & Wales.

Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the Regulatory Accounting Statements within the Annual Performance Report section of our report. We have fulfilled our ethical responsibilities under, and are independent of the company in accordance with, UK ethical requirements under the FRC Ethical Standard. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Report on the Annual Performance Report (continued)

Emphasis of matter – special purpose basis of preparation

In forming our opinion on the Regulatory Accounting Statements within the Annual Performance Report, which is not modified, we draw attention to the fact that the Annual Performance Report has been prepared in accordance with Condition F, the Regulatory Accounting Guidelines, the accounting policies (including the company's published accounting methodology statement, as defined in RAG 3.11, appendix 2) set out in the statement of accounting policies and under the historical cost convention. The nature, form and content of the Regulatory Accounting Statements are determined by the WSRA. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the WSRA's purpose. Accordingly we make no such assessment.

The Annual Performance Report is separate from the statutory financial statements of the company and has not been prepared under the basis of International Financial Reporting Standards as adopted by the European Union ("IFRSs"). Financial information other than that prepared on the basis of IFRSs does not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in statutory financial statements prepared in accordance with the Companies Act 2006.

The Regulatory Accounting Statements on **pages 198 to 239** have been drawn up in accordance with Regulatory Accounting Guidelines with a number of departures from IFRSs. A summary of the effect of these departures from Generally Accepted Accounting Practice in the company's statutory financial statements is included in the tables within section 1.

The Regulatory Accounting Statements are prepared in accordance with a special purpose framework for the specific purpose as described in the Responsibilities for the Annual Performance Statement and the audit section below. As a result, the Regulatory Accounting Statements may not be suitable for another purpose.

Conclusions relating to going concern

ISAs (UK) require us to report to you when:

- the directors' use of the going concern basis of accounting in the preparation of the Regulatory Accounting Statements is not appropriate; or
- the directors have not disclosed in the Regulatory Accounting Statements any identified material uncertainties that may cast significant doubt about the company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the Regulatory Accounting Statements are authorised for issue.

We have nothing to report in respect of the above matters.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the company's ability to continue as a going concern. For example, the terms on which the United Kingdom may withdraw from the European Union are not clear, and it is difficult to evaluate all of the potential implications on the company's trade, customers, suppliers and the wider economy.

Reporting on other information

The other information comprises all of the information in the Annual Performance Report other than the Regulatory Accounting Statements within the Annual Performance Report and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the Regulatory Accounting Statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the Regulatory Accounting Statements within the Annual Performance Report, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the Regulatory Accounting Statements within the Annual Performance Report or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the Regulatory Accounting Statements within the Annual Performance Report or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

Regulatory annual performance report continued

Independent Auditors' report to the Water Services Regulation Authority (the WSRA) and the Directors of Affinity Water Limited (continued)

Responsibilities for the Annual Performance Report and the audit

Responsibilities of the Directors for the Annual Performance Report

As explained more fully in the Statement of Directors' Responsibilities set out on **page 191**, the directors are responsible for the preparation of the Annual Performance Report in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA and the company's accounting policies (including the company's published accounting methodology statement, as defined in RAG 3.11, appendix 2).

The directors are also responsible for such internal control as they determine is necessary to enable the preparation of the Annual Performance Report that is free from material misstatement, whether due to fraud or error.

In preparing the Annual Performance Report, 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.

Auditors' responsibilities for the Audit of the Annual Performance Report

Our objectives are to obtain reasonable assurance about whether the Annual Performance Report as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditors' 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 this Annual Performance Report.

A further description of our responsibilities for the audit of the Regulatory Accounting Statements within the Annual Performance Report is located on the FRC's website at: **www.frc.org.uk/auditorsresponsibilities**. This description forms part of our auditors' report.

We have not assessed whether the accounting policies are appropriate to the circumstances of the company where these are laid down by Condition F. Where Condition F does not give specific guidance on the accounting policies to be followed, our audit includes an assessment of whether the accounting policies adopted in respect of the transactions and balances required to be included in the Annual Performance Report are consistent with those used in the preparation of the statutory financial statements of the company.

The company has presented the allocation of operating costs and assets in accordance with the accounting separation policy set out in Sections 2 and 4 and its accounting methodology statement published on the company's website in June 2019.

We are not required to assess whether the methods of cost allocation set out in the Methodology Statement are appropriate to the circumstances of the company or whether they meet the requirements of the WSRA, which would have been required if we were to express an audit opinion under International Standards on Auditing (UK).

Section 1 – Regulatory financial reporting

Responsibilities for the Annual Performance Report and the audit (continued)

Use of this report

This report is made, on terms that have been agreed, solely to the company and the WSRA in order to meet the requirements of Condition F of the Instrument of Appointment granted by the Secretary of State for the Environment to the company as a water and sewage undertaker under the Water Industry Act 1991 ("Condition F"). Our audit work has been undertaken so that we might state to the company and the WSRA those matters that we have agreed to state to them in our report, in order (a) to assist the company to meet its obligation under Condition F to procure such a report and (b) to facilitate the carrying out by the WSRA of its regulatory functions, and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the WRSA, for our audit work, for this report or for the opinions we have formed.

Our opinion on the Regulatory Accounting Statements within the Annual Performance Report is separate from our opinion on the statutory financial statements of the company for the year ended 31 March 2019 on which we reported on 26 June 2019, which are prepared for a different purpose. Our audit report in relation to the statutory financial statements of the company (our "Statutory audit") was made solely to the company's member in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our Statutory audit work was undertaken so that we might state to the company's member those matters we are required to state to them in a statutory audit report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume responsibility for any other purpose or to any other person to whom our Statutory audit report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

Opinion on other matters prescribed by Condition F

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

- proper accounting records have been kept by the appointee as required by paragraph 3 of Condition F; and
- the Regulatory Accounting Statements are in agreement with the accounting records and returns retained for the purpose of preparing the Annual Performance Report.

PricewaterhouseCoopers LLP

Chartered Accountants and Statutory Auditors
Uxbridge

26 June 2019

Regulatory annual performance report continued

Section 1 – Regulatory financial reporting (continued)

1A - INCOME STATEMENT FOR THE 12 MONTHS ENDED 31 MARCH 2019

		Adjustments			
	Statutory £000	Differences between statutory and RAG definitions £000	Less: non-appointed £000	Total adjustments £000	Total appointed activities £000
Revenue	**311,569**	**(9,076)**	**-**	**(9,076)**	**302,493**
Operating costs	(270,888)	(1,551)	(3,885)	2,334	(268,554)
Other operating income	17,896	(3,352)	12,929	(16,281)	1,615
Operating profit	**58,577**	**(13,979)**	**9,044**	**(23,023)**	**35,554**
Other income	25	13,979	-	13,979	14,004
Interest income	3,761	-	-	-	3,761
Interest expense	(49,131)	-	-	-	(49,131)
Other interest expense	2,829	-	-	-	2,829
Profit before tax and fair value movements	**16,061**	**-**	**9,044**	**(9,044)**	**7,017**
Fair value gains/(losses) on financial nstruments	(2,389)	-	-	-	(2,389)
Profit before tax	**13,672**	**-**	**9,044**	**(9,044)**	**4,628**
UK Corporation tax	(3,921)	-	(1,718)	1,718	(2,203)
Deferred tax	818	-	-	-	818
Profit for the year	**10,569**	**-**	**7,326**	**(7,326)**	**3,243**
Dividends	**(6,600)**	**-**	**(6,600)**	**6,600**	**-**
Tax analysis					
Current year	4,338	-	1,718	(1,718)	2,620
Adjustments in respect of prior years	(417)	-	-	-	(417)
UK Corporation tax	**3,921**	**-**	**1,718**	**(1,718)**	**2,203**

1A - INCOME STATEMENT FOR THE 12 MONTHS ENDED 31 MARCH 2019 (CONTINUED)

The table below summarises the differences between statutory and RAG definitions:

	Revenue recognition £000	Third party non-price control revenue £000	Income from providing developer information and administration of new connections £000	Connection charges income £000	Amortisation of deferred grants and contribution £000	Loss on disposal of fixed assets £000	Meter reading commission £000	Rental and sundry income £000	Total £000
Revenue	2,527	222	(1,099)	(8,218)	(2,508)	-	-	-	(9,076)
Operating costs	(2,527)	-	-	-	-	756	220	-	(1,551)
Other operating income	-	-	-	-	-	(756)	(220)	(2,376)	(3,352)
Other income	-	(222)	1,099	8,218	2,508	-	-	2,376	13,979
Total	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**

£2,527,000 of the difference between statutory and RAG defined revenue relates to the disapplication in the Regulatory Accounts of the provision of IFRS 15, which states that revenue should only be recognised when it is probable that the economic benefits associated with the transaction will flow to the entity (refer to the revenue recognition accounting policy note on **page 209**). A further £222,000 relates to the reclassification of third party non-price control revenue, which is presented within other income in the Statutory Accounts. These differences are offset by the reclassification of £8,218,000 of connection charges income, £1,099,000 of income from providing developer information and the administration of new connections, and £2,508,000 of amortisation associated with deferred grants and contributions, which are presented within other income in the Regulatory Accounts.

The difference between statutory and RAG defined operating costs consists of the revenue recognition adjustment described in the previous paragraph of £2,527,000 offset by the reclassification of a £756,000 net loss on disposal of fixed assets, which is presented within other operating income in the Regulatory Accounts. In addition, £220,000 of meter reading commission included within other operating income is offset against operating costs in the Regulatory Accounts.

The difference between statutory and RAG defined other operating income consists of the reclassification of the net loss on disposal of fixed assets from operating costs described in the previous paragraph of £756,000 and the reclassification of £2,376,000 of rental and sundry income, which is presented within other income in the Regulatory Accounts. £220,000 of meter reading costs included within other operating income in the statutory accounts were offset against operating costs in the Regulatory Accounts.

The difference between statutory and RAG defined other income consists of the reclassification of £8,218,000 of connection charges income, £1,099,000 of income from providing developer information and the administration of new connections, £2,508,000 of amortisation associated with deferred grants and contributions and £2,376,000 of rental and sundry income, offset by £222,000 of third party non-price control revenue described in previous paragraphs.

Regulatory annual performance report continued

Section 1 – Regulatory financial reporting (continued)

1B - STATEMENT OF COMPREHENSIVE INCOME FOR THE 12 MONTHS ENDED 31 MARCH 2019

		Adjustments			
	Statutory £000	Differences between statutory and RAG definitions £000	Less: non-appointed £000	Total adjustments £000	Total appointed activities £000
Profit for the year	10,569	-	7,326	(7,326)	3,243
Actuarial gains/(losses) on post employment plans	(8,747)	-	-	-	(8,747)
Other comprehensive income	1,487	-	-	-	1,487
Total comprehensive income for the year	**3,309**	-	**7,326**	**(7,326)**	**(4,017)**

1C - STATEMENT OF FINANCIAL POSITION AS AT 31 MARCH 2019

		Adjustments			
	Statutory £000	Differences between statutory and RAG definitions £000	Less: non-appointed £000	Total adjustments £000	Total appointed activities £000
Non-current assets					
Fixed assets	1,419,556	-	-	-	1,419,556
Intangible assets	47,903	-	-	-	47,903
Investments – loans to group companies	-	-	-	-	-
Investments – other	100	-	-	-	100
Financial instruments	-	-	-	-	-
Retirement benefit assets	101,194	-	-	-	101,194
Total	**1,568,753**	-	-	-	**1,568,753**
Current assets					
Inventories	2,716	–	–	–	2,716
Trade and other receivables	76,978	-	605	(605)	76,373
Financial instruments	-	-	-	-	-
Cash and cash equivalents	111,531	-	5,370	(5,370)	106,161
Total	**191,225**	-	**5,975**	**(5,975)**	**185,250**
Current liabilities					
Trade and other payables	(144,825)	19,984	(2,958)	22,942	(121,883)
Capex creditor	(13,149)	-	-	-	(13,149)
Borrowings	-	-	-	-	-
Financial instruments	-	-	-	-	-
Current tax liabilities	(4,205)	-	(2,291)	2,291	(1,914)
Provisions	(4,297)	2,135	-	2,135	(2,162)
Total	**(166,476)**	**22,119**	**(5,249)**	**27,368**	**(139,108)**
Net current assets/(liabilities)	**24,749**	**22,119**	**726**	**21,393**	**46,142**
Non-current liabilities					
Trade and other payables	-	-	-	-	-
Borrowings	(1,081,253)	(1,608)	-	(1,608)	(1,082,861)
Financial instruments	(3,997)	1,608	-	1,608	(2,389)
Retirement benefit obligations	-	-	-	-	-
Provisions	(4,907)	-	-	-	(4,907)
Deferred income – grants and contributions ('G&C's')	(115,759)	(22,119)	-	(22,119)	(137,878)
Deferred income – adopted assets	-	-	-	-	-
Preference share capital	-	-	-	-	-
Deferred tax	(178,961)	-	-	-	(178,961)
Total	**(1,384,877)**	**(22,119)**	-	**(22,119)**	**(1,406,996)**
Net assets	**208,625**	-	**726**	**(726)**	**207,899**

Regulatory annual performance report continued

Section 1 – Regulatory financial reporting (continued)

	Statutory £000	Adjustments: Differences between statutory and RAG definitions £000	Adjustments: Less: non-appointed £000	Adjustments: Total adjustments £000	Total appointed activities £000
Equity					
Called up share capital	26,506	-	-	-	26,506
Retained earnings and other reserves	182,119	-	726	(726)	181,393
Total equity	**208,625**	**-**	**726**	**(726)**	**207,899**

The £19,984,000 difference between statutory and RAG defined trade and other payables consists of the reclassification of payments received for costs incurred in relation to the HS2 rail programme, which will cross the Affinity Water supply area. In line with our accounting policy for grants and contributions received in respect of property, plant and equipment, which include contributions received for diversions, in the company's statutory financial statements income received is treated as deferred income and released to cost of sales over the useful economic life of the property, plant and equipment to which it relates once these assets are commissioned (as at 31 March 2019, £10,510,000 had been commissioned and £10,510,000 of associated payments received have been recognised in deferred income with the remaining £19,984,000 of payments received included within payments in advance in trade and other payables). Given assets constructed by the company under the HS2 programme may not be commissioned for several years, adopting this accounting policy in the Regulatory Accounts will lead to a mismatch of costs incurred and payments received in relation to these costs in the total expenditure ('totex') tables in sections 2 and 4 of these Regulatory Accounts (tables 2B, 4B and 4D). Therefore the payments received in relation to HS2 within statutory payments in advance have been reclassified to deferred income – G&C's in the Regulatory Accounts and £21,238,000 of payments received in the year are included in the totex tables to offset the expenditure incurred in the year. The payments received in the year have also been included in the diversions line within the analysis of capital contributions and land sales table (table 2E).

The £2,135,000 difference between statutory and RAG defined provisions within current liabilities relates to the reclassification of current deferred G&C's to deferred income – G&C's.

The £1,608,000 difference between statutory and RAG defined borrowings and financial instruments relates to the reclassification of accretion on the RPI linked inflation swap from financial instruments to borrowings.

The £22,119,000 difference between statutory and RAG defined deferred income – G&C's relates to the reclassifications detailed in the previous paragraphs.

1D - STATEMENT OF CASH FLOWS FOR THE 12 MONTHS ENDED 31 MARCH 2019

	Statutory £000	Adjustments: Differences between statutory and RAG definitions £000	Adjustments: Less: non–appointed £000	Adjustments: Total adjustments £000	Total appointed activities £000
Operating profit	**58,577**	**(13,979)**	**9,044**	**(23,023)**	**35,554**
Other income	25	13,979	-	13,979	14,004
Depreciation	67,882	-	-	-	67,882
Amortisation – G&C's	(2,508)	-	-	-	(2,508)
Changes in working capital	(9,210)	-	728	(728)	(9,938)
Pension contributions	(8,988)	-	-	-	(8,988)
Movement in provisions	11,271	-	-	-	11,271
Profit on sale of fixed assets	631	-	-	-	631
Cash generated from operations	**117,680**	**-**	**9,772**	**(9,772)**	**107,908**
Net interest paid	(39,757)	-	-	-	(39,757)
Tax paid	-	-	(1,793)	1,793	1,793
Net cash generated from operating activities	**77,923**	**-**	**7,979**	**(7,979)**	**69,944**
Investing activities					
Capital expenditure	(107,229)	-	-	-	(107,229)
Grants and contributions	30,746	-	-	-	30,746
Disposal of fixed assets	1,093	-	-	-	1,093
Other	756	-	-	-	756
Net cash used in investing activities	**(74,634)**	-	-	-	**(74,634)**
Net cash generated before financing activities	**3,289**	-	**7,979**	**(7,979)**	**(4,690)**
Cashflows from financing activities					
Equity dividends paid	(6,600)	-	(6,600)	6,600	-
Net loans received	-	-	-	-	-
Cash inflow from equity financing	-	-	-	-	-
Net cash generated from financing activities	**(6,600)**	-	**(6,600)**	**6,600**	**-**
Increase/(decrease) in net cash	**(3,311)**	-	**1,379**	**(1,379)**	**(4,690)**

The difference between statutory and RAG defined operating profit consists of the reclassification of £8,218,000 of connection charges income, £1,099,000 of income from providing developer information and the administration of new connections, £2,508,000 of amortisation associated with deferred grants and contributions and £2,376,000 of rental and sundry income all of which are shown in other income, offset by the reclassification of £222,000 of third party non-price control revenue, which is presented within other income in the Statutory Accounts.

Regulatory annual performance report continued

Section 1 – Regulatory financial reporting (continued)

1E - NET DEBT ANALYSIS AT 31 MARCH 2019

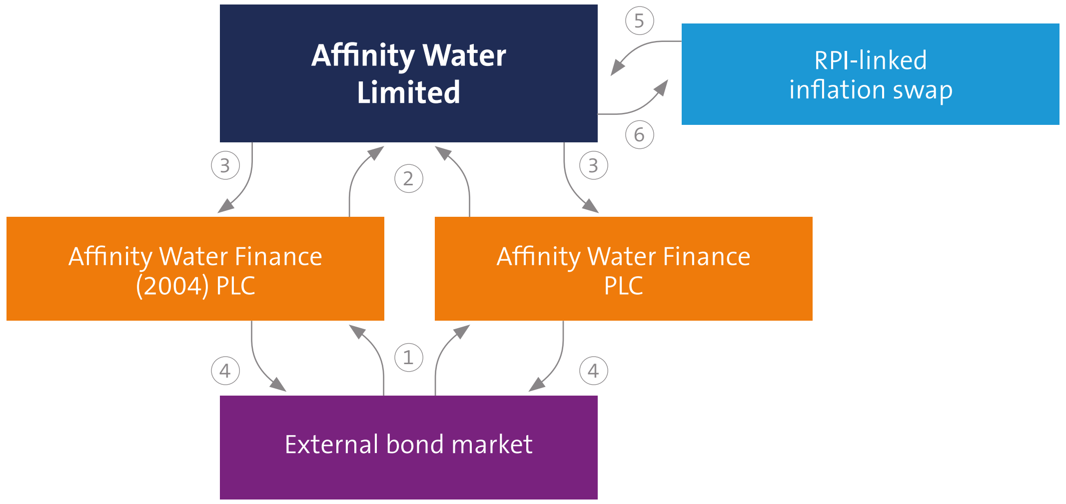
	Fixed rate £000	Floating rate £000	Index linked £000	Total £000
Borrowings (excluding preference shares)	538,647	-	544,214	**1,082,861**
Preference share capital				-
Total borrowings				**1,082,861**
Cash				**(106,161)**
Short term deposits				-
Net debt				**976,700**
Gearing				79.66%
Adjusted gearing				78.26%
Full year equivalent nominal interest cost	23,087	-	23,129	**46,215**
Full year equivalent cash interest payment	23,087	-	10,109	**33,195**
Indicative interest rates:				
Indicative weighted average nominal interest rate (%)	4.37	-	4.31	**4.34**
Indicative weighted average cash interest rate (%)	4.37	-	1.88	**3.12**
Weighted average years to maturity	15.29	-	18.42	**16.87**

There are no differences between total borrowings presented in the above table and total borrowings presented in table 1C.

Adjusted gearing is calculated using the definition of net debt set out in the company's WBS documentation, as presented in the following table.

	Fixed rate £000	Floating rate £000	Index linked £000	Total £000
Borrowings (excluding preference shares)	538,647	-	544,214	**1,082,861**
Preference share capital				-
Less: capitalised bond issue costs				**(17,975)**
Less: loan from intermediate parent company				**(3,550)**
				1,061,336
Add: accrued interest on borrowings				**9,717**
Total borrowings				**1,071,053**
Cash				**(111,531)**
Short term deposits (including non-appointed cash)				-
Net debt				**959, 522**

Affinity Water Limited has two financing subsidiaries which have issued bonds listed by the UK Listing Authority. Affinity Water Finance (2004) PLC has issued an external bond of £250.0m and Affinity Water Finance PLC has issued external bonds totalling £764.2m, the proceeds of which have been lent on to and are guaranteed by Affinity Water Limited, as shown in the diagram below. Please refer to **pages 95 and 96** for more information on our financing arrangements.



1. Affinity Water Finance (2004) PLC and Affinity Water Finance PLC have raised debt from the external sterling bond market in the form of several bond issuances.
2. The financing subsidiaries have on-lent the debt to Affinity Water Limited on the same terms.
3. Affinity Water Limited pays interest payments annually to the financing subsidiaries and will repay the principal debt upon maturity of the bond.
4. Affinity Water Finance (2004) PLC and Affinity Water Finance PLC pay interest payments annually to the bondholders, and will repay the principal debt upon maturity of the bond.
5. Affinity Water Limited receives a fixed interest payment annually for the RPI linked inflation swap.
6. Affinity Water Limited pays index linked interest payments annually for the RPI linked inflation swap and will make a final accretion payment based on the mark to market valuation at maturity.

Regulatory annual performance report continued

Section 1 – Regulatory financial reporting (continued)

1F – FINANCIAL FLOWS FOR THE 12 MONTHS ENDED 31 MARCH 2019 (2012-13 FINANCIAL YEAR AVERAGE RPI)

	%			£		
12 months ended 31 March 2019	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity
Regulatory return on equity	5.96	3.27	5.96	23,612	12,962	12,962
Actual performance adjustment 2010-2015	(0.29)	(0.16)	(0.29)	(1,165)	(640)	(640)
Adjusted return on regulatory equity	5.67	3.11	5.67	22,447	12,322	12,322
Regulatory equity	396,328	396,328	217,516	-	-	-
Financing						
Gearing	-	1.49	2.71	-	5,890	5,890
Variance in corporation tax	-	(1.75)	(3.20)	-	(6,952)	(6,952)
Group relief	-	-	-	-	-	-
Cost of debt	-	(0.61)	(1.12)	-	(2,431)	(2,431)
Hedging instruments	-	-	-	-	-	-
Financing total	**5.66**	**2.23**	**4.06**	**22,447**	**8,829**	**8,829**
Operational Performance						
Totex out / (under) performance	-	(2.12)	(3.86)	-	(8,394)	(8,394)
ODI out / (under) performance	-	(1.76)	(3.20)	-	(6,972)	(6,972)
Retail out / (under) performance	-	(0.60)	(1.10)	-	(2,385)	(2,385)
Other exceptional items	-	-	-	-	-	-
Operational performance total	**-**	**(4.48)**	**(8.16)**	**-**	**(17,751)**	**(17,751)**
Total earnings	5.66	(2.25)	(4.10)	22,447	(8,922)	(8,922)
RCV growth from RPI	3.06	3.06	3.06	12,110	12,110	6,647
Total shareholder return	8.72	0.81	(1.04)	34,557	3,188	(2,275)
Net dividend	4.00	-	-	15,853	-	-
Retained value	4.72	0.81	(1.04)	18,704	3,188	(2,275)
Dividends reconciliation						
Gross dividend	4.00	-	-	15,853	-	-
Interest receivable on intercompany loans	-	-	-	-	-	-
Net dividend	4.00	-	-	15,853	-	-

The regulatory return on equity of 5.96% as determined in PR14 decreases to 5.67% after adjusting for AMP5 performance adjustments. It increases to 8.38% after adjusting for the company's actual capital structure (2.71%, as reported in the gearing line of this table). The PR14 determination was carried out on a notional capital structure with 62.5% net debt to RCV gearing, the actual average level of gearing of 79.66% creates an adjustment of +2.71%. This is offset by an adverse adjustment of -1.12% resulting from the company's actual cost of debt underperforming against the 2.75% allowed in the PR14 determination after taking into account the movement in RPI during the year (2.44%). The variance in corporation tax (calculated as the difference between the amount allowed for corporation tax in the PR14 determination and actual tax payable, before any fair value adjustments, after taking into account adjustments for capital allowances and prior year adjustments, refer to the reconciliation on **page 243**) further offsets the favourable adjustment by -3.20%.

The 4.06% regulatory return on equity adjusted for financing is reduced to -4.10% when considering the impact of operational performance. Totex underperformance in the year results in a -3.86% reduction (refer to table 4B), ODI underperformance in the year (refer to table 3A) results in a -3.21% reduction and the performance of the retail business unit (refer to table 2C) creates a -1.10% adverse adjustment. After factoring in RCV growth due to indexation, the total shareholder return for the year is -1.04%.

No dividend was paid out by the regulated business, which equates to a 0.00% return on equity which compares to the -1.04% covered above.

1F – FINANCIAL FLOWS FOR THE PRICE REVIEW TO DATE (2012-13 FINANCIAL YEAR AVERAGE RPI)

	%			£		
Average 2015-2019	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity
Regulatory return on equity	6.08	3.50	6.08	23,598	13,622	13,622
Actual performance adjustment 2010-2015	(0.21)	(0.12)	(0.21)	(812)	(466)	(466)
Adjusted return on regulatory equity	5.88	3.38	5.88	22,786	13,156	13,156
Regulatory equity	388,064	388,064	223,933	-	-	-
Financing						
Gearing	-	1.40	2.42	-	5,414	5,414
Variance in corporation tax	-	(0.84)	(1.45)	-	(3,244)	(3,244)
Group relief	-	-	-	-	-	-
Cost of debt	-	0.01	0.02	-	48	48
Hedging instruments	-	-	-	-	-	-
Financing total	**5.88**	**3.95**	**6.87**	**22,786**	**15,374**	**15,374**
Operational Performance						
Totex out / (under) performance	-	(0.65)	(1.12)	-	(2,517)	(2,517)
ODI out / (under) performance	-	(0.75)	(1.30)	-	(2,911)	(2,911)
Retail out / (under) performance	-	(1.06)	(1.84)	-	(4,129)	(4,129)
Other exceptional items	-	1.55	2.67	-	6,008	6,008
Operational performance total	**-**	**(0.91)**	**(1.59)**	**-**	**(3,549)**	**(3,549)**
Total earnings	5.88	3.04	5.28	22,786	11,825	11,825
RCV growth from RPI	2.50	2.50	2.50	9,706	9,706	5,601
Total shareholder return	8.38	5.54	7.78	32,492	21,531	17,426
Net dividend	4.00	7.56	13.11	15,522	29,357	29,357
Retained value	4.38	(2.02)	(5.33)	16,970	(7,826)	(11,931)
Dividends reconciliation						
Gross dividend	4.00	7.56	13.11	15,522	29,357	29,357
Interest receivable on intercompany loans	-	-	-	-	-	-
Net dividend	4.00	7.56	13.11	15,522	29,357	29,357

Regulatory annual performance report continued

Section 1 – Regulatory financial reporting (continued)

1F – FINANCIAL FLOWS FOR THE PRICE REVIEW TO DATE (2012-13 FINANCIAL YEAR AVERAGE RPI) (CONTINUED)

Figures for prior years of AMP6 used in the calculation of the above table have been restated from those submitted in the company's 2017/18 financial flows data submission due to a reallocation of meter reading costs from the appointed to the non-appointed business. This reallocation is explained further in the company's Accounting Separation Methodology Statement, which can be found on the company's stakeholder website:

stakeholder.affinitywater.co.uk/reports-publications.aspx

The change did not impact on retained value reported for the prior years of AMP6 but reduced retail underperformance, and increased variance in corporation tax, total shareholder return, gross and net dividend.

Following the publication of Ofwat's finalised RAGs for the 2018/19 reporting year, the figures for 2017/18 used in the calculation of the above table have also been updated from those submitted in the company's 2017/18 financial flows data submission to include £24.0m (in 2012/13 prices) of proceeds from the disposal of the company's non-household retail business to Affinity for Business (Retail) Limited in the new "other exceptional items" line.

The figures for 2017/18 used in the calculation of the above table have further been updated for the ODI penalty resulting from the restatement of our 2017/18 leakage figure (refer to the narrative under table 3A).

The gross dividend figure for 2016/17 used in the calculation of the above table includes a dividend of £7.8m (in 2012/13 prices) directly from proceeds from the disposal of the company's non-household retail business to Affinity for Business (Retail) Limited. Under the transfer scheme and wholesale contract entered into with Affinity for Business (Retail) Limited, the company was contractually entitled to receipts from Affinity for Business (Retail) Limited broadly equivalent to the dividends paid. Therefore, this dividend has not been paid out of the Affinity Water group. Excluding the impact of this dividend, the difference between the net dividend paid and the calculated total shareholder return for the price review to date is -4.46%.

STATEMENT OF ACCOUNTING POLICIES

Basis of preparation

These accounts have been prepared in accordance with the relevant RAGs.

Accounting policies used are the same as those adopted in the statutory accounts, except as set out below.

Regulatory accounts are prepared to enable Ofwat to monitor the financial performance of the regulated water business. Note tables 2H, 4E, 4K, 4M, 4N, 4O, 4R, 4S, 4T, 4U and 4W have not been presented as they are not applicable for water supply only companies.

Standards and interpretations which are not yet effective

IFRS 16 is not yet effective and has not been early adopted by the company. The expected impact of adopting this standard is set out on **page 140** of our statutory financial statements for the year ending 31 March 2019.

Revenue recognition

Revenue represents the fair value of income receivable in the ordinary course of business from the regulated activities of the business in the year exclusive of value added tax. The company recognises revenue when the amount of revenue can be reliably measured, when it is probable that future economic benefit will flow to the entity and when specific criteria have been met.

The company's core revenue stream is derived from the supply of clean water. The UK government has contracted with the company on behalf of customers by granting the company its water supply licence, where the underlying performance obligation is the development and maintenance of the network and ensuring its continued availability to customers. Revenue is recognised as the customer receives the benefit of this through consuming the water:

- for metered customers, the amount which the company has a right to receive is determined by the volume of water consumed; and
- for unmetered customers, the amount which the company has a right to receive is determined by the period of time during which a customer occupies a property to which water is supplied by the company.

The company has contracts with third parties operating in the non-household retail market for the supply of clean water (wholesale supply). The underlying performance obligation is the development and maintenance of the network, and ensuring its continued availability to third party retailers on behalf of non-household consumers. Revenue is recognised at the point in which the company has a right to receive the revenue. For non-household retailers, the amount which the company has a right to receive is determined by non-household consumption volume data.

For metered household customers, a receivable is recognised when the customer is billed for the usage. At this point, the consideration is unconditional because only the passage of time is required before the payment is due. Where the company has provided the service before payment is due, an accrual for the consumption of water that has not yet been billed is recognised within trade and other receivables (refer to the measured income accrual section below).

Unmetered customers pay a fixed amount determined by the transaction prices set out in the company's charging scheme and tariff documents. If the payments received exceed the amount the company has the right to receive, the company recognises a payment received in advance within trade and other payables.

Some non-household retailers are billed in advance monthly for wholesale charges determined by billing/volume reports created by the market operator. The company recognises deferred income in relation to these accounts and discloses this within trade and other payables.

The company does not expect to have any contracts where the period between the transfer of the promised goods or services to the customer and the payment terms exceeds one year. The company therefore does not adjust any of its transaction prices for the time value of money.

Charges on income arising from court, solicitor and debt recovery agency fees are recognised in revenue.

Regulatory annual performance report continued

Section 1 – Regulatory financial reporting (continued)

STATEMENT OF ACCOUNTING POLICIES (CONTINUED)

Measured income accrual

The measured income accrual is an estimation of the amount of mains water unbilled at the year end. The accrual is estimated using a defined methodology based upon weighted average water consumption by tariff, which is calculated based upon historical information. No changes have been made to the methodology in calculating the measured income accrual during the year. The measured income accrual is recognised within revenue.

Revenue for the year ended 31 March 2018 included a measured income accrual of £29,028,000. The value of billing recognised in the year ended 31 March 2019 for consumption in the prior year was £29,367,000. This resulted in an increase of £339,000 in the current year's revenue due to the under-estimation of the prior year's revenue. This represented 0.11% of 2018/19 revenue and is within acceptable tolerance for accounting estimates.

Adjustments from statutory to regulatory accounts

The Regulatory Accounts disapply the provision of IFRS 15 which states that revenue should only be recognised if it is probable that it will be received, considering the customer's ability and intention to pay that amount of consideration when it is due. For regulatory reporting purposes, companies are required to assume that where an amount is billed it is probable that cash will be collected, thereby deviating from the IFRS 15 requirement in that there is no judgement applied to the probability of collection. Therefore, in the Regulatory Accounts the company does not derecognise revenue where historical evidence indicates that the company will probably never be able to collect the revenue billed.

No further differences exist between the revenue recognition policies in the statutory accounts and in the Regulatory Accounts.

Charging policy

Water charges are payable in full from the date of connection or change of customer on all properties at which it is recorded that water is being used or required. Exceptions to this, where the company waives water charges at its discretion on being informed by customers, include where the customer is in a care home; in long-term hospitalisation; in prison; overseas long-term; or in the event of the death of the customer.

Definition and treatment of properties

The company classifies unoccupied bulk owner properties as 'occupied' if they are empty for less than 26 weeks for short-term situations such as refurbishment or change of tenancy. These properties are billed in full and then a percentage is deducted from the amount owed to recognise that some properties will have been empty. Where properties are unoccupied for more than 26 weeks, the agreement with the bulk owner provides that the local authority will notify the company so that the property can be formally recorded as 'empty' on the company's billing system and, therefore, will not be billed.

The company no longer raises bills addressed to 'The Occupier' when there is no consumption detected at the property. The company's assumption is that these properties are not occupied. The company makes further enquiries and when it receives information that the property has become occupied the status of the account is amended, the customer's name applied to the account and billing commences.

In each of the above cases, if a bill is sent, the company would recognise it within revenue in the Regulatory Accounts.

All new properties are metered. Charges accrue from the date at which the meter is installed. The developer is billed between the date of connection and first occupancy and this is recognised as revenue. If the developer is no longer responsible for the property and no new occupier has been identified the property management process referred to above is followed to identify the new occupier. Until the new occupier has been identified the property is treated as unoccupied and is not billed.

STATEMENT OF ACCOUNTING POLICIES (CONTINUED)

Capitalisation policy

Expenditure on infrastructure assets relating to increases in capacity, enhancements or material replacements of network components is capitalised where it can be reliably measured and it is probable that incremental future economic benefits will flow to the company. Expenditure generally will only meet the criteria for capitalisation when it relates to specific planned works. Where this work does not involve a mains pipe exceeding a diameter of 300mm (considered qualitatively material due to its strategic importance in the generation of future economic benefits), replacement is considered quantitatively material when the pipe involved is at least 2km long and uses a new material for that location, which enhances the section of network being re-laid.

Costs of day-to-day servicing of network components are recognised in the income statement as they arise.

The company does not capitalise any borrowing costs in its statutory accounts, as the costs do not meet the criteria for capitalisation set out in IAS 23: 'Borrowing costs'.

Bad debt

At each reporting date, the company evaluates the collectability of trade receivables and records a provision for impairment based on experience. The provision for impairment is charged to operating costs to reflect the company's assessment of the risk of non-recovery of trade receivables.

The provision for impairment is calculated by applying a range of different percentages to trade receivables of different ages. These percentages also vary between categories of receivable. Higher percentages are applied to those categories of receivables which are considered to be of greater risk and also to trade receivables of greater age. The value of the provision for impairment is sensitive to the specific percentages applied. The specific percentages applied are updated annually to reflect the latest collection performance data from the company's billing system. All trade receivables greater than five years old are fully provided for. Actual amounts recovered may differ from the estimated levels of recovery which could impact on operating results.

The company applies the IFRS 9 simplified approach to measuring expected credit losses which uses a lifetime expected loss allowance for all trade receivables and contract assets. To measure the expected credit losses, trade receivables and contract assets have been grouped based on shared credit risk characteristics and the days past due. The contract assets relate to unbilled metered consumption and have substantially the same risk characteristics as the trade receivables for the same types of contracts. The company has therefore concluded that the expected loss rates for trade receivables are a reasonable approximation of the loss rates for the contract assets.

The company's policy for provision for impairment has remained unchanged and has been consistently applied in the current and prior years. There has not been a significant increase in the provision from £28,070,000 at 31 March 2018 to £28,103,000 at 31 March 2019.

The company's policy is to write-off closed and live accounts that fall under the following categories: bankruptcy, liquidation, debt relief orders, deceased accounts where there is no estate, failed legal action and receivable amounts from customers who have moved out of the property with no forwarding address or are no longer responsible for payment of a water bill.

Regulatory annual performance report continued

Section 1 – Regulatory financial reporting (continued)

STATEMENT OF ACCOUNTING POLICIES (CONTINUED)

Bad debt (continued)

Accounts are written off following all internal recovery activity and subsequent external debt collection agency activity, except as follows:

- Closed accounts under £15 are written off without any internal recovery activity.
- Closed accounts under the name of 'the Occupier' are written off without any internal recovery action.
- Closed accounts under £50 are written off following all internal recovery activity where there is a forwarding address for the customer.
- Closed accounts under £100 are written off following all internal recovery activity where there is no forwarding address for the customer.

Amounts are also written off on accounts where the company is still supplying the customer and where all reasonable internal and external debt collection activities have been undertaken. Under these circumstances, if the total debt contains amounts over six years old, the amount over six years old or more is written off.

The company's write-off policy has remained unchanged and has been consistently applied in the current year compared with the previous year. The amount of debt written off has decreased from £7,299,000 in 2017/18 to £6,095,000 in 2018/19 primarily due to an initiatives programme to drive improved cash collection against some of our oldest debt as well as identifying and crediting invoices raised against empty properties.

There has not been a significant increase in trade receivables during the year (£27,703,000 at 31 March 2019; £26,900,000 at 31 March 2018).

Grants and contributions

Grants and contributions received in respect of property, plant and equipment (including infrastructure charges, and contributions for diversions and requisitioned mains/extensions), where the performance obligation is deemed to be satisfied over time, are treated as deferred income and released to revenue over the useful economic life of the property, plant and equipment to which they relate once these assets have been commissioned.

For contributions received in respect of diversions and requisitioned mains/extensions, the assets constructed are considered to have no economic value without the promise to provide ongoing supply of water services; therefore the performance obligation is considered to be satisfied over the period that the property, plant and equipment constructed are in service.

Infrastructure charges are charges levied on developers for network reinforcement which is not site specific, i.e. to fund expenditure which will contribute towards wider network reinforcement work away from the development site. There is an implied ongoing performance obligation to improve and maintain the wider network in order to provide ongoing supply of water services.

Grants and contributions considered to be given in compensation for expenses incurred with no future related costs, including charges billed to developers for new connections ('connection charges'), are recognised in revenue in the income statement in the period that they became receivable; the performance obligation has been identified as the connection of a service pipe to the main. Once the connection is made, the performance obligation is fulfilled and the income recognised immediately in the income statement.

These grants and contributions are not government grants within the scope of IAS 20: 'Accounting for government grants and disclosure of government assistance' and fall within the scope of IFRS 15, as, whilst there may not be a written contract with the customer, the legal duties of a company under the Water Industry Act 1991 would seem to constitute a legally enforceable contract with the transaction prices set out in the company's charges scheme, tariff documents and invoices.

STATEMENT OF DIRECTORS' REMUNERATION AND STANDARDS OF PERFORMANCE

Executive directors' remuneration comprises a package of base salary together with an annual performance-related bonus and a long-term incentive plan. Executive directors' bonuses paid by the company are linked to the standards of performance of the company and are therefore in accordance with RAG 3.11. The elements of the 2018/19 remuneration arrangements for executive directors were established by the company's Remuneration Committee in 2018/19.

The following table provides a summary of the key elements of the remuneration package for executive directors:

Purpose and link to strategy	Policy and approach	Maximum potential value (as percentage of base pay)	Performance metrics	Changes for 2019/20
Base salary				
To provide competitive fixed remuneration that will attract and retain key employees and reflect their experience and position in the company.	To target around market median, dependent on experience in the role.	N/A	N/A	No changes were made to the policy for 2019/20 and AMP7 up to the date of approval of this annual report and financial statements.
Other taxable benefits				
To provide market competitive benefits.	Private health care insurance cover, life assurance and income protection are provided, together with a fully expensed company car (or car allowance).	N/A	N/A	No changes were made to the policy for 2019/20 and AMP7 up to the date of approval of this annual report and financial statements.
Annual bonus plan				
The annual bonus plan is designed to provide a direct link between executive and company performance and the level of bonus awarded, although award and payment remain discretionary.	Maximum bonus potential is set at a market competitive level. The bonus is based on budgeted non-financial and financial targets aligned to the company's commitments for AMP6 and AMP7, plus individual targets (AMP6 only).	Up to 100% of base salary for the CEO and up to 75% of base salary for the CFO. Simon Cocks will not be eligible for the annual bonus in 2018/19 following his resignation as an executive director on 21 May 2018.	50% of the total bonus is determined on the achievement of the financial performance target, which is based on net cash outflow before taxation and financing. 25% of the total bonus is determined on the achievement of operational and customer and community performance targets. 20% of the total bonus is determined on the achievement of personal objectives. 5% of the total bonus is determined on the achievement of the company's health and safety target.	No change in 2019/20. In AMP7 there will be a rebalance of the bonus with 40% relating to financial performance and 40% performance on customer service and stakeholder commitments. The personal element of the bonus will continue to be 20%. No payment will be awarded if achievement is below the target/plan for that metric. There is also the introduction of a check that stops pay-out of the bonus if either the customer or the financial elements of the bonus fall below a set level. Reduce the discretion of the Remuneration Committee to award any bonus outside the performance delivery.
2019/20 AMP7 readiness bonus				
The AMP7 readiness bonus is designed to provide a direct link between executive and company performance in 2019/20 in relation to achieving AMP7 readiness and the level of bonus awarded, although award and payment remain discretionary.	The bonus is based on non-financial and financial targets for 2019/20 aligned to the company's plans for achieving AMP7 readiness.	Up to 60% of base salary.	Total bonus is determined on the achievement of company operational and financial performance targets directly linked to the individual director's responsibilities in relation to four AMP7 readiness business priorities (cost, culture, community and leakage).	N/A - this is a one-off bonus plan for 2019/20.

Regulatory annual performance report continued

Section 1 – Regulatory financial reporting (continued)

STATEMENT OF DIRECTORS' REMUNERATION AND STANDARDS OF PERFORMANCE (CONTINUED)

Purpose and link to strategy	Policy and approach	Maximum potential value (as percentage of base pay)	Performance metrics	Changes for 2019/20
Pension related benefits				
To provide competitive post-retirement benefits.	Executives joining the company after 2004 are invited to participate in the company's defined contribution pension scheme. No current executives joined prior to this date. Under the defined contribution scheme, the executive contributes at a rate of 7% of salary and the company contributes at 20%.	In lieu of being a member of the company's retirement benefit schemes, Simon Cocks received a taxable allowance of approximately 24% of base pay until 21 May 2018.	N/A	No changes were made to the policy for 2019/20 and AMP7 up to the date of approval of this annual report and financial statements.
LTIP				
To incentivise executives to achieve long-term shareholder value whilst achieving high levels of customer experience performance, although both award and payment are discretionary.	Base awards are granted as a percentage of salary and are paid out in cash at the end of a three year performance period, with 33% of the amount earned paid at the end of year three, 33% paid at the end of year four and 33% paid at the end of year five subject to the achievement of performance conditions. The scheme is based on three year targets that are aligned to strategic delivery at AMP7. Base awards include clawback and malus provisions, as detailed in the remuneration report on **pages 103 to 116**. The awards do not automatically vest on change of control of the business.	Up to 150% of base salary for the CEO and 125% of base salary for the CFO.	The award is determined on the performance of the company over the three years. 50% of the scheme pay-out is based on financial targets and 50% is based on strategic outcomes including service and performance commitments.	No changes for 2019/20. Changes for AMP7 are detailed below: Further rebalance of performance commitments, with 40% of the scheme pay-out based on financial targets including cash generated from operations and investment targets, 50% based on customer service and stakeholder commitments including the CMEX and DMEX position, water quality, helping vulnerable customers, leakage, consumption, mains bursts, abstraction and environmental innovation and 10% based on employee commitments including ESAT, employee engagement and safety. No award will be made for a metric if performance is below target/plan.
Compensation for the forfeit of variable remuneration from previous employer				
To provide compensation of forfeited remuneration from previous employers.	The Committee may make additional cash awards if deferred pay is forfeited by an executive director on leaving a previous employer. Such awards would take into account the nature of awards forfeited (i.e. cash or shares), time horizons, attributed expected value and performance conditions.	N/A	N/A	No changes were made to the policy for 2019/20 and AMP7 up to the date of approval of this annual report and financial statements.

STATEMENT OF DIRECTORS' REMUNERATION AND STANDARDS OF PERFORMANCE (CONTINUED)

Tony Cocker was appointed as Chairman of the company on 30 January 2018 for an initial period of three years. Tony Cocker receives a fixed annual fee for his services, reflecting the time commitment and responsibilities of the role.

	Base salary/fees[1] £000		Taxable benefits[2] £000		Pension related benefits[3] £000		Annual bonus £000		LTIP[4] £000		Other[5] £000		Total £000	
	18/19	17/18	18/19	17/18	18/19	17/18	18/19	17/18	18/19	17/18	18/19	17/18	18/19	17/18
Non-executive														
Current														
Patrick O'D Bourke	48	48	-	-	-	-	-	-	-	-	-	-	48	48
Chris Bolt	45	45	-	-	-	-	-	-	-	-	-	-	45	45
Trevor Didcock	43	43	-	-	-	-	-	-	-	-	-	-	43	43
Susan Hooper	48	46	-	-	-	-	-	-	-	-	-	-	48	46
Chris Newsome	8	-	-	-	-	-	-	-	-	-	-	-	8	-
Former														
Simon Cocks	15	-	-	-	-	-	-	-	-	-	-	-	15	-
Chairman														
Current														
Tony Cocker	195	42	-	-	-	-	-	-	-	-	-	-	195	42
Former														
Dr Philip Nolan	-	183	-	-	-	-	-	-	-	-	-	860	-	1,043
Executive														
Current														
Stuart Ledger	203	96	6	3	41	10	48	57	-	-	-	41	298	207
Pauline Walsh	326	-	10	-	53	-	108	-	-	-	169	-	666	-
Former														
Duncan Bates	-	57	-	4	-	15	-	-	-	434	-	500	-	1,010
Simon Cocks	50	350	2	14	11	80	-	268	-	1,228	132	1,000	195	2,940
	981	910	18	21	105	105	156	325	-	1,662	301	2,401	1,561	5,424

[1] 2017/18 fees for Chris Bolt have been restated to reflect additional amounts paid in 2018/19 relating to his services in respect of 2017/18 following a benchmarking exercise of independent non-executive directors and chairs undertaken by Deloitte LLP during the year identified inconsistencies between fees paid to the independent non-executive directors.

[2] Taxable benefits comprise company car allowance, living accommodation benefit and healthcare insurance.

[3] Pension related benefits for Stuart Ledger and Pauline Walsh comprise £41,000 and £53,000 respectively of contributions paid to money purchase schemes (2017/18: £10,000 and £nil); there were no amounts outstanding at year end. Pension related benefits for Simon Cocks include an allowance of £11,000 in lieu of being a member of the company's retirement benefit schemes (2017/18: £80,000). The same pension related benefits in 2017/18 for former director Duncan Bates included an allowance of £15,000.

[4] Prior year LTIP remuneration includes the 2014/15 LTIP amount paid which vested fully on 31 March 2018, and the 2015/16, 2016/17 and 2017/18 LTIP amounts paid which vested fully following the sale of the group on 19 May 2017.

[5] Other remuneration in 2018/19 for Pauline Walsh relates to discretionary payments made in connection with commencement of qualifying services during the year, including compensation for the forfeit of a variable remuneration arrangement with her previous employer. Other remuneration in 2018/19 for Simon Cocks relates to a discretionary bonus in relation to completion of targets associated with his transition from an executive to a non-executive role during the year. Other remuneration in 2017/18 for Dr Philip Nolan consists of remuneration received in relation to the arrangement described on **page 81** of the prior year remuneration policy report. Other remuneration in 2017/18 for both Simon Cocks and Duncan Bates consists of remuneration received in relation to the successful completion of the sale of the group on 19 May 2017, funded by former shareholders. Other remuneration for Stuart Ledger in 2017/18 relates to discretionary payments made in connection with commencement of qualifying services during the year, representing compensation for the forfeit of a variable remuneration arrangement with his previous employer.

Regulatory annual performance report continued

Section 1 – Regulatory financial reporting (continued)

STATEMENT OF DIRECTORS' REMUNERATION AND STANDARDS OF PERFORMANCE (CONTINUED)

Achievement against performance related measures (annual bonus)

The annual bonus scheme is designed to provide a direct link between executive and company operational, customer and financial performance, and the level of bonus awarded, although award and payment remain discretionary. The table below shows the percentage of maximum annual bonus potential awarded in relation to the 2018/19 year for Pauline Walsh and Stuart Ledger for each of the performance measures. No amounts in relation to these bonuses have been deferred.

Performance measure		Link to strategy (refer to page 20)	2018/19 target	Weighting for 2018/19 (as a % of base salary)		2018/19 achievement (as a % of base salary)	
				Pauline Walsh	Stuart Ledger	Pauline Walsh	Stuart Ledger
Financial measure	Cash generated by operations: net cash outflow before taxation and financing[1]	Value creation imperative	£44.3m	50.00%	37.50%	0.00%	0.00%
Operational measures	Leakage: volume of water lost through leaks on the network (Ml/d)	Customer outcome	167.7 or less	3.57%	2.68%	0.00%	0.00%
	Water availability: volume of water lost from distribution due to unplanned outages at production sites (Ml/d)	Customer outcome	38 or less	3.57%	2.68%	3.27%	2.68%
	Water quality: number of water quality compliance failures	Customer outcome	44 or less	3.57%	2.68%	0.00%	0.00%
	Unplanned interruptions: number of properties without water for over 12 hours due to an unplanned interruption to supply	Customer outcome	320 or less	3.57%	2.68%	3.27%	2.68%
	Water Saving Programme: per capita consumption	Customer outcome	150.3 or less	3.57%	2.68%	3.27%	2.68%
Customer and community measures	SIM[2] : score	Customer outcome	81.33	7.15%	5.35%	0.00%	0.00%
Safety and health measure	Accident frequency rate (annual target): number of lost time injuries per 100,000 hours worked	Responsibility and accountability imperative	0.22 or less	5.00%	3.75%	4.58%	3.75%
Personal performance[3]				20.00%	15.00%	16.50%	12.00%
Total % of base salary				**100.00%**	**75.00%**	**30.89%**	**23.79%**
Base salary						**£350,000[4]**	**£204,000**
Bonus paid						**£108,000**	**£48,000**

Further information regarding directors' remuneration during the year and future policy can be found within the remuneration report on **pages 103 to 116**.

[1] This "non-GAAP" measure is calculated as the total of the following line items per the statement of cash flows (refer to **page 119**): cash generated from operations; purchases of property, plant and equipment; capital contributions; proceeds on disposal of property, plant and equipment; and purchase of intangibles.

[2] SIM is the industry's measure of customer experience. One element is quantitative (the volume of unwanted contact and complaints we receive) and the other is qualitative (the quality of the experience derived from an independent quarterly survey).

[3] The Remuneration Committee exercised discretion in determining the level of bonus awarded in relation to the personal performance element of the executive directors' annual bonus within the pre-agreed base salary percentage cap. The Committee considered achievement of personal objectives set at the start of the year in exercising its discretion together with events occurring during the year.

[4] Pauline Walsh's annual bonus was calculated as a percentage of 11 months of her base salary.

Section 2 – Price review and other segmental reporting

ACCOUNTING POLICY FOR PRICE CONTROL SEGMENTS

The tables in this section have been prepared in accordance with RAG 2.07, as detailed in the company's Accounting Separation Methodology Statement, which can be found on the company's stakeholder website:

stakeholder.affinitywater.co.uk/reports-publications.aspx

The methodology statement explains the basis for the allocations of costs and assets and has been updated for changes to the requirements in the year and to address Ofwat's concerns in relation to cost allocation set out in its 2018 Company Monitoring Framework assessment report published in January 2019. Changes to the methodology are explained within the company's Accounting Separation Methodology Statement on the company's website. Wherever possible, direct costs and assets have been directly attributed to business units. Where this is not possible, appropriate cost allocations have been applied and assets have been allocated to business units based on an assessment of the principal user, as described in the methodology.

2A - SEGMENTAL INCOME STATEMENT FOR THE 12 MONTHS ENDED 31 MARCH 2019

	Retail		Wholesale			
	Household £000	Non-household £000	Water resources £000	Water network+ £000	Water Total £000	Total £000
Revenue – price control	27,340	-	-	272,567	272,567	299,907
Revenue – non price control	-	-	-	2,586	2,586	2,586
Operating expenditure	(27,111)	-	(16,016)	(157,545)	(173,561)	(200,672)
Depreciation – tangible fixed assets	(15)	-	(1,673)	(56,543)	(58,216)	(58,231)
Amortisation – intangible fixed assets	(715)	-	-	(8,936)	(8,936)	(9,651)
Other operating income	1,650	-	71	(106)	(35)	1,615
Operating profit before recharges	**1,149**	**-**	**(17,618)**	**52,023**	**34,405**	**35,554**
Recharges in respect of 'principal use' assets						
Recharges from other segments	(732)	-	(127)	-	(127)	(859)
Recharges to other segments	-	-	-	859	859	859
Operating profit	**417**	**-**	**(17,745)**	**52,882**	**35,137**	**35,554**

Regulatory annual performance report continued

Section 2 – Price review and other segmental reporting (continued)

2B - TOTEX ANALYSIS FOR THE 12 MONTHS ENDED 31 MARCH 2019 – WHOLESALE WATER

	Water resources £000	Water network+ £000	Total £000
Operating expenditure			
Power	3,071	18,862	21,933
Income treated as negative expenditure	-	-	-
Abstraction charges / discharge consents	3,962	-	3,962
Bulk supply / bulk discharge	1,154	5,723	6,877
Other operating expenditure			
Renewals expensed in the year (Infrastructure)	-	17,299	17,299
Renewals expensed in the year (Non-Infrastructure)	-	-	-
Other operating expenditure excluding renewals	5,893	99,278	105,171
Local authority and Cumulo rates	1,936	13,684	15,620
Total operating expenditure excluding third party services	**16,016**	**154,846**	**170,862**
Third party services	**–**	**2,699**	**2,699**
Total operating expenditure	**16,016**	**157,545**	**173,561**
Capital expenditure			
Maintaining the long term capability of the assets - infra	-	15,348	15,348
Maintaining the long term capability of the assets – non-infra	9,217	45,361	54,578
Other capital expenditure – infra	-	6,552	6,552
Other capital expenditure – non-infra	4,854	21,654	26,508
Infrastructure network reinforcement	-	5,660	5,660
Total gross capital expenditure (excluding third party)	**14,071**	**94,575**	**108,646**
Third party services	**-**	**122**	**122**
Total gross capital expenditure	**14,071**	**94,697**	**108,768**
Grants and contributions			
Less: Grants and contributions	7,004	31,828	38,832
Totex	**23,083**	**220,414**	**243,497**
Cash expenditure			
Pension deficit recovery payments	291	2,504	2,795
Other cash items	(156)	(1,492)	(1,648)
Totex including cash items	**23,218**	**221,426**	**244,644**

2C - OPERATING COST ANALYSIS FOR THE 12 MONTHS ENDED 31 MARCH 2019 – RETAIL

	Household £000	Non-household £000	Total £000
Operating expenditure			
Customer services	7,737	-	7,737
Debt management	2,113	-	2,113
Doubtful debts	6,504	-	6,504
Meter reading	1,210	-	1,210
Services to developers	-	-	-
Other operating expenditure	9,547	-	9,547
Total operating expenditure excluding third party services	**27,111**	**-**	**27,111**
Third party services operating expenditure	-	-	-
Total operating expenditure	**27,111**	**-**	**27,111**
Depreciation – tangible fixed assets	15	-	15
Amortisation – intangible fixed assets	715	-	715
Total operating costs	**27,841**	**-**	**27,841**
Debt written off	**6,095**	**-**	**6,095**

Household operating costs and other operating income (£26,191,000; refer to table 2A) are £2,375,000 lower than revenue allowed in the PR14 determination (£28,566,000). This variance is due to achieving cost efficiencies during the year in relation to a reduction in headcount and an improvement in debt recovery associated with an initiatives programme to drive improved cash collection against some of our oldest debt as well as identifying and crediting invoices raised against empty properties, which has led to a reduction in our bad debt charge during the year. Meter reading costs have also decreased reflecting a change in methodology in 2018/19, which has led to the allocation of a proportion of meter reading costs to non-appointed operating costs to reflect the element of sewerage commission received that relates to the company reading customer meters.

Non-household operating costs and other operating income (refer to table 2A) are £3,522,000 less than revenue allowed in the PR14 determination. This is due to exiting the non-household retail market on 1 April 2017.

Regulatory annual performance report continued

Section 2 – Price review and other segmental reporting (continued)

2D - HISTORIC COST ANALYSIS OF TANGIBLE FIXED ASSETS - WHOLESALE AND RETAIL

	Wholesale		Retail		
	Water resources £000	Water network+ £000	Household £000	Non-household £000	Total £000
Cost					
At 1 April 2018	27,306	1,984,005	4,435	-	2,015,746
Disposals	-	(2,515)	-	-	(2,515)
Additions	13,595	90,328	212	-	104,135
Adjustments	-	-	-	-	-
Assets adopted at nil cost	-	-	-	-	-
At 31 March 2019	**40,901**	**2,071,818**	**4,647**	**-**	**2,117,366**
Depreciation					
At 1 April 2018	(11,964)	(627,417)	(999)	-	(640,380)
Disposals	-	801	-	-	801
Adjustments	-	-	-	-	-
Charge for the year	(1,673)	(56,543)	(15)	-	(58,231)
At 31 March 2019	**(13,637)**	**(683,159)**	**(1,014)**	**-**	**(697,810)**
Net book amount at 31 March 2019	**27,264**	**1,388,659**	**3,633**	**-**	**1,419,556**
Net book amount at 1 April 2018	15,342	1,356,588	3,436	-	1,375,366
Depreciation charge for year					
Principal services	(1,673)	(55,471)	(15)	-	(57,159)
Third party services	-	(1,072)	-	-	(1,072)
Total	(1,673)	(56,543)	(15)	-	(58,231)

The net book value includes £122,967,000 in respect of assets in the course of construction.

2E - ANALYSIS OF CAPITAL CONTRIBUTIONS AND LAND SALES FOR THE 12 MONTHS ENDED 31 MARCH 2019 – WHOLESALE

	Fully recognised in income statement £000	Capitalised and amortised (in income statement) £000	Fully netted off capex £000	Total £000
Grants and contributions - water				
Connection charges	8,218	-	-	**8,218**
Infrastructure charge receipts	-	5,584	-	**5,584**
Requisitioned mains	-	2,039	-	**2,039**
Other contributions (price control)	-	-	-	-
Diversions	-	22,991	-	**22,991**
Other contributions (non-price control)	-	-	-	-
Total	8,218	30,614	-	**38,832**
Value of adopted assets	-	1,893	-	1,893

Movements in capitalised grants and contributions	
Brought forward	**109,772**
Capitalised in year	**30,614**
Amortisation (in income statement)	**(2,508)**
Carried forward	**137,878**

Land sales	
Proceeds from disposals of protected land	**859**

£21,238,000 of payments received in 2018/19 for costs incurred in relation to the HS2 rail programme are included in the diversions of the above table.

Regulatory annual performance report continued

Section 2 – Price review and other segmental reporting (continued)

2F - HOUSEHOLD – REVENUES BY CUSTOMER TYPE

	Wholesale charges revenue £000	Retail revenue £000	Total revenue £000	Number of customers	Average household retail revenue per customer £
Unmeasured water only customer	106,261	11,737	117,998	604,280	19.42
Measured water only customer	111,724	15,603	127,327	768,877	20.29
Total	**217,985**	**27,340**	**245,325**	**1,373,157**	**19.91**

2G - NON-HOUSEHOLD – REVENUES BY TARIFF TYPE

	Wholesale charges revenue £000	Retail revenue £000	Total revenue £000	Number of Connections	Average non-household retail revenue per customer £
Non-default tariffs					
Total non-default tariffs	38	-	38	3	-
Default tariffs					
AFW Metered 0-5 Ml, including assessed customers and unmeasured RV customers	30,592	-	30,592	71,913	-
Water supplies 5 to 50 Ml	18,846	-	18,846	2,368	-
Water supplies 50 Ml and over	5,106	-	5,106	87	-
Total default tariffs	**54,544**	-	**54,544**	**74,368**	-
Total	**54,582**	-	**54,582**	**74,371**	-

	Number of customers	Average non–household retail revenue per customer £
Revenue per customer		
Total	**74,371**	-

2I - REVENUE ANALYSIS FOR THE 12 MONTHS ENDED 31 MARCH 2019

	Household £000	Non-household £000	Total £000
Wholesale charge – water			
Unmeasured	106,261	2,489	108,750
Measured	111,724	52,093	163,817
Third party revenue	-	-	-
Wholesale total	**217,985**	**54,582**	**272,567**
Retail revenue			
Unmeasured	11,737	-	11,737
Measured	15,603	-	15,603
Other third party revenue	-	-	-
Retail total	**27,340**	-	**27,340**
Third party revenue – non-price control			
Bulk supplies			2,280
Other third party revenue			306
Principal services – non-price control			
Other appointed revenue			-
Total appointed revenue			**302,493**

	Total £000
Wholesale revenue governed by price control	272,567
Grants & contributions[1]	15,841
Total revenue governed by wholesale price control	**288,408**
Amount assumed in wholesale determination	285,014
Adjustment for in-period ODI revenue	-
Adjustment for WRFIM[2]	(1,952)
Total assumed revenue	**283,062**
Difference	**(5,346)**

£1,761,000 of the variance between allowed and actual revenue under the wholesale price control relates to increased grants and contributions received following increased developer services work during the year. The remaining variance relates to higher measured consumption during the period of exceptionally hot, dry weather in the summer of 2018 and higher non-household volume data than anticipated in the company's Business Plan. Following market reform and the opening of the non-household retail market, new reports of billing/volume data have been created by the market operator in accordance with the operating code of the market. Non-household volume data within these reports include estimates that will not be 'firm' until sometime after the end of any period. This means an inherent additional uncertainty in non-household wholesale revenue recognised while the market and billing/volume data settles over time through to a full and final reconciliation. This issue will improve as the length of the billing record grows.

[1] Relevant capital contributions as defined in the company's final determination for PR14.

[2] This amount consists of a £1,952,000 WRFIM adjustment relating to 2016/17.

Regulatory annual performance report continued

Section 3 – Performance summary

2J – INFRASTRUCTURE NETWORK REINFORCEMENT COSTS FOR THE 12 MONTHS ENDED 31 MARCH 2019

Wholesale water network+ (treated water distribution)	Network reinforcement capex £000	On site/site specific capex (memo only) £000
Distribution and trunk mains	4,313	-
Pumping and storage facilities	1,347	-
Other		
Total	**5,660**	**-**

2K – INFRASTRUCTURE CHARGES RECONCILIATION FOR THE 12 MONTHS ENDED 31 MARCH 2019

	Total £000
Impact of infrastructure charge discounts	
Infrastructure charges	5,584
Discounts applied to infrastructure charges	-
Gross infrastructure charges	**5,584**
Comparison of revenue and costs	
Variance brought forward	-
Revenue	5,584
Costs	(5,660)
Variance carried forward	**(76)**

There is an insignificant variance between revenues and costs arising from providing infrastructure network reinforcement for developers.

No discounts have been applied to infrastructure charges during the year that would require presentation in the above table. The company's policy is to apply a discount if the new connection was a reconnection and had been disconnected within the past five years.

3A - OUTCOME PERFORMANCE TABLE

ID	Performance commitment	Unit (decimal places)	2017-18 performance level - actual	2018-19 performance level - actual	Performance commitment level met?	Out/ under-performance payment – ODIs payable at the end of AMP6 (indicator)	Out/ under-performance payment – ODIs payable at the end of AMP6 (£m)	31 March 2020 forecast – total AMP6 out/ under-performance payment (indicator)	31 March 2020 forecast – total AMP6 out/ under-performance payment (£m)
PR14AF WWSW _W-A1	Leakage	ML/d (1)	177.2	196.1	No	Under-performance payment	(6.9720)	Under-performance payment	(7.9979)
PR14AF WWSW _W-A2	Average water use	l/person/d (1)	151.0	149.2	Yes				
PR14AF WWSW _W-A3	Water available for use	ML/d (1)	1,135.6	1,105.3	Yes				
PR14AF WWSW _W-A4	Sustainable abstraction reduction	ML/d (1)	-32.7	-42.1	Yes			Out-performance payment	1.2648
PR14AF WWSW _W-A5	Abstraction incentive mechanism	N/A (N/A)	-5.106	-4.150	-	N/A	N/A	N/A	N/A
PR14AF WWSW _W-B1	Compliance with water quality standards	% (2)	99.96	99.96	Yes				
PR14AF WWSW _W-B2	Customer contacts for discolouration	Number per 1,000 people (2)	0.27	0.23	Yes				
PR14AF WWSW _W-C1	Unplanned interruptions to supply over 12 hours	Number of properties (0)	7,890	309	Yes			Under-performance payment	(4.9128)
PR14AF WWSW _W-C2	Mains bursts	Number of bursts (0)	2,923	2,530	Yes				
PR14AF WWSW _W-C3	Customers not being notified of planned interruptions	Number of properties (0)	282	68	Yes				
PR14AF WWSW _W-C4	Planned works taking longer than notified	Number of events (0)	484	477	Yes				
PR14AF WHHR _R-A1	Service Incentive Mechanism ('SIM')	Score out of 100 (2)	80.91	81.20	-				
PR14AF WHHR _R-A2	Value for money survey	Score out of 100 (1)	67.7	68.3	-				

Regulatory annual performance report continued

Section 3 – Performance summary (continued)

3A - OUTCOME PERFORMANCE TABLE

The company set itself very challenging performance targets at PR14. The ambition of these targets contributed towards Ofwat awarding the company 'enhanced status' for its AMP6 Business Plan. In most cases in 2018/19 the company met or exceeded these targets. There was one exception where the target was not met, explained below. The company exceeded its target for leakage in the year.

Leakage

We have not met our performance commitment for leakage. As a result we have incurred a penalty through our ODI regime.

A significant contributor was the discovery in the year of a large burst at the outlet of one of our largest treatment works that ran for a large part of the year. We were also affected by 2018 summer's unusually warm and dry weather with increased bursts and pressure issues caused by the high demand. Our ability to target leakage was further complicated by the high night use seen.

In Autumn 2018, we triggered an action plan with additional resources to return leakage to target levels. Although our actions did not result in meeting the 2018/19 target, our current leakage performance has us on track to deliver our 2019/20 target of 162.2Ml/d. Our daily leakage level as at 31 March 2019 was 160.9 Ml/d.

We have learnt the lessons of 2018's long, dry summer and we are using technology and analytical insight in ever more effective ways to reduce leakage. These changes, combined with a revised operating structure and a strengthening of our internal skills and competencies (to reduce our reliance on the supply chain), means we believe we are in a strong position to meet our target of a 18.5% reduction in leakage by 2025.

We have restated our 2017/18 leakage figure as a result of the burst at the outlet of one of our largest treatment works that is believed to have started in 2017/18. The burst caused an increase in leakage which averaged 5.7Ml/d for 2017/18. This means that our restated leakage for 2017/18 underperforms our regulatory target by 4.12Ml/d. As a result, we have incurred a penalty of £1.026m through our ODI regime.

This large leak also caused us to reassess our per capita consumption (average water use per person) performance for 2017/18. This has led us to restate our 2017/18 performance as 151.0 l/p/d, previously reported as 151.7 l/p/d in our Annual Performance Report for the year ended 31 March 2018.

Refer to the operational performance section of the annual report on **pages 44 to 46** for further details of our performance in relation to leakage, as well as sustainable abstraction reductions, compliance with water quality standards, unplanned interruptions to supply over 12 hours, mains bursts and SIM.

To meet our commitment of being open and transparent we provide information in "Our Year in Review", which reports our performance for the year to customers and stakeholders both at a company level and broken down by community against our regulatory targets. For more information please refer to the Our Performance page of our stakeholder website:

stakeholder.affinitywater.co.uk/company-performance.aspx.

Our CCG, which consists of individuals with experience of representing household customers and special interest groups, holds us to account on how we are performing against our performance commitments.

3B - SUB-MEASURE PERFORMANCE TABLE

This table has not been presented, as the company does not have any sub-measures to report.

Section 4 – Non-audited additional regulatory information

3C - ABSTRACTION INCENTIVE MECHANISM ('AIM')

Abstraction site	Decimal places	2018-19 AIM performance (Ml)	2018-19 normalised AIM performance (Nr)	Cumulative AIM performance 2016-17 onwards (Ml)	Cumulative normalised AIM performance 2016-17 onwards (Nr)	Contextual information relating to performance on the AIM
BRIC	1	0.0	0.00	321.6	0.26	AIM calculated for BRIC and NETH combined
NETH	1	0.0	0.00	0.0	0.00	
WELL	1	43.5	0.49	47.5	0.86	
OUGH	1	(463.2)	(0.87)	(519.0)	(1.72)	AIM calculated for OUGH and OFFS combined
OFFS	1	0.0	0.00	0.0	0.00	
DIGS	1	0.0	0.00	23.1	0.05	
FULL	1	0.0	0.00	0.0	0.00	Source switched off permanently due to sustainability reductions as of 1 April 2017
BOWB	1	0.0	0.00	0.0	0.00	Source switched off permanently due to sustainability reductions as of 1 April 2016
HOLY	1	0.0	0.00	13.1	0.01	AIM calculated for HOLY and MUDD combined
MUDL	1	0.0	0.00	0.0	0.00	
MARL	1	0.0	0.00	(102.8)	(0.07)	AIM calculated for MARL and PICC combined. AIM baseline varied as of 1 April 2018 to be the post sustainability reduction annual average licence of the two sources
PICC	1	0.0	0.00	0.0	0.00	
AMER	1	0.0	0.00	(172.9)	(0.18)	AIM calculated for AMER and CHAL combined. CHAL source removed from AIM calculation from 2018/19 onwards following discussion with local EA office. AIM baseline for AMER varied as of 1 April 2018 to be the post sustainability reduction annual average licence of the source
CHAL	1	0.0	0.00	0.0	0.00	
WHIT	1	0.0	0.00	(14.9)	(0.39)	AIM baseline varied as of 1 April 2018 to be the post sustainability reduction annual average licence of the source
CHES	1	0.0	0.00	(154.9)	(0.43)	
HUGH	1	0.0	0.00	(181.3)	(0.60)	Source switched off permanently due to sustainability reductions as of 1 April 2017
PERI	1	(1,809.0)	(0.61)	(5,351.6)	(1.92)	AIM calculated for PERI and RUNL combined
RUNL	1	0.0	0.00	0.0	0.00	
SLIP	1	21.4	2.68	(103.6)	1.56	AIM baseline varied as of 1 April 2018 in accordance with rolling trigger based on licence condition – see AIM 2018/19 annual report
SPRI	1	(176.5)	(0.73)	(744.7)	(1.14)	AIM calculated for SPRI and SBUC combined
SBUC	1	0.0	0.00	0.0	0.00	
SDNG	1	0.0	0.00	(112.9)	(0.44)	
Total	**1**	**(2,383.8)**	**0.96**	**(7,053.3)**	**(4.15)**	

3D - SIM SCORE TABLE

Row	Line description	Units	Decimal places	Score
1	1st survey score	Nr	2	4.24
2	2nd survey score	Nr	2	4.15
3	3rd survey score	Nr	2	4.19
4	4th survey score	Nr	2	4.28
5	Qualitative SIM score (out of 75)	Nr	2	60.28
6	Total contact score	Nr	2	81.59
7	Quantitative SIM score (out of 25)	Nr	2	20.92
8	Total annual SIM score (out of 100)	Nr	2	81.20

Regulatory annual performance report continued

Section 4 – Non-audited additional regulatory information (continued)

ACCOUNTING SEPARATION POLICY

Tables 4B, 4C, 4D, 4F, 4G, 4J and 4L within this section have been prepared in accordance with the company's Accounting Separation Methodology Statement, which can be found on the company's stakeholder website:

stakeholder.affinitywater.co.uk/reports-publications.aspx

The methodology statement explains the basis for the allocations of costs and assets and has been updated for changes to the requirements in the year and to address Ofwat's concerns in relation to cost allocation set out in its 2018 Company Monitoring Framework assessment report published in January 2019. Changes to the methodology are explained within the company's Accounting Separation Methodology Statement on the company's website. Wherever possible, direct costs and assets have been directly attributed to business units. Where this is not possible, appropriate cost allocations have been applied and assets have been allocated to business units based on an assessment of the principal user, as described in the methodology.

4A - NON-FINANCIAL INFORMATION FOR THE 12 MONTHS ENDED 31 MARCH 2019

	Unmeasured	Measured
Retail - household		
Number of void households (000s)	21.384	15.972
Per capita consumption (excluding supply pipe leakage) l/h/d	184.07	136.34
		Water
Wholesale		
Volume (Ml/d)		
Bulk supply export		26.763
Bulk supply import		59.438
Distribution input		953.122

4B - WHOLESALE TOTEX ANALYSIS

	2019 £000	Cumulative £000
Actual totex	244,644	998,310
Less: Items excluded from the menu		
Third party costs	**2,821**	11,981
Pension deficit recovery payments	**2,795**	10,497
Other 'Rule book' adjustments	**(1,523)**	(1,021)
Total costs excluded from the menu	**4,093**	21,457
Add: Transition expenditure		
Transition expenditure	**-**	2,263
Adjusted actual totex	**240,551**	979,116
Adjusted actual totex – base year prices	**207,749**	885,731
Allowed totex based on final menu choice – base year prices	**189,555**	888,075

Totex forecast included in the company's resubmitted AMP7 Business Plan, which took into account transition expenditure reported in the above table, results in an overall overspend over AMP6 as a whole of 2.5%, £30.5m. Although there is a £30.5m overspend on totex compared to the company's allowance, the amount customers would be expected to fund through the sharing mechanism is only £2.8m (in 17/18 prices). This is primarily due to pension deficit cost and offsetting the financing cost of the underspend in the first few years.

Expenditure has been managed on a totex basis over AMP6, rather than a focus on operating expenditure ('opex') and capital expenditure ('capex'). This has enabled greater cost efficiency and the delivery of a better outcome. For example, on IT this has enabled a move away from a traditional capex-led data centre approach to a cloud based infrastructure and software. This has eradicated problems that caused service and operational issues on a daily basis at the start of the AMP and has also enabled sector-leading cyber security to be put in place.

The main variances on cumulative totex in outturn prices of £1,028.3m (£885.7m in 12/13 prices) compared to allowed totex in outturn prices of £1,023.936m (£888.1m in 12/13 prices) to 31 March 2019 (an underspend in outturn prices of £2.7m, £2.3m in base year prices) are discussed in detail below:

Pension cost

The company's PR14 Final Determination allowed £2.7m in outturn prices of pension deficit cost cumulative to 31 March 2019. Actual total AMP6 pension cost cumulative to 31 March 2019 is £8.8m, resulting in an overspend cumulative to 31 March 2019 of £6.1m. The internal plan has been for the company to pay more into its pension plan than the allowance. This has been done to take the plan to a fully funded basis on a self-sufficiency basis. Through working with the trustees and careful management of the plan the self-sufficiency level has been achieved eight years ahead of target. These extra contributions are outside of the cost sharing mechanism and therefore have been made fully at the company's own expense.

Market reform

The cost of preparing for market reform and opening of the non-household retail market has been higher than planned across the industry. An additional £17.4m cumulative to 31 March 2019 has been spent than originally planned to develop the systems, cleanse the data and put in the processes to ensure full compliance. Expenditure in this area did result in full compliance and has enabled the company's performance as a wholesaler to be upper quartile.

Regulatory annual performance report continued

Section 4 – Non-audited additional regulatory information (continued)

Leakage expenditure

One of the company's significant challenges this AMP has been reducing leakage. This has particularly been the case in the current year and some of the expenditure that was incurred to reduce leakage is expected to continue into 2019/20. Investment has been made in new technology to improve leakage detection and additional dedicated resources have been brought in to analyse, find and fix leaks. The exceptional hot summer of 2018 made reducing leakage even more challenging. All this resulted in an additional cost of £24.3m incurred cumulative to 31 March 2019.

Supply chain management

Additional costs of £8.0m cumulative to 31 March 2019 have been incurred in the company's supply chain for operation activities. During 2017/18 the company's main supplier agreed to end their contract with the company. To maintain continuity of service and cause the least disruption to customers, temporary contracts were put in place with suppliers to deliver the services. Management services that were provided by the company's main supplier were insourced. This has led to an increase in costs. In parallel the supply chain strategy for AMP7 and beyond has been developed. The procurement process is being completed and the plan is to have the new supply chain in place and fully-mobilised ahead of the start of AMP7.

Business rates

There has been a saving in business rates of £2.5m cumulative to 31 March 2019 mainly driven by the revaluation review of the rateable values for all business properties in England. Revaluation was done to maintain fairness in the system by redistributing the total amount payable in business rates, reflecting changes in the property market.

Energy

Through procuring and locking into favourable base rate prices for energy usage savings have been realised on our energy costs. An energy optimisation programme has been run over AMP6 to reduce energy usage across production sites. An activity based costing model that been developed to provide more detail on the costs of production and in particular energy costs. In total, savings of £6.4m cumulative to 31 March 2019 have been achieved on energy.

Import (bulk supply)

The company relies on imports from Anglian Water, Grafham reservoir and Thames, Fortis Green to meet supply needs. At times of high demand, these are utilised as the volume of water that can be produced from the company's sites are limited. This imported water is at a much higher marginal cost than the water produced through the company's own sites. Imports increased especially during the summer of 2018/19 to meet the higher peak demands. This has increased costs by £2.2m more than the amount allowed.

Capex efficiencies and timing

Savings have been delivered in our lead programme through unit rate and a targeted approach to mains and trunk mains replacement, which has maintained bursts rates below the reference level. Savings in our central services have also been realised and there has been a delay in our metering programme. £11.6m of the underspend results from within AMP timing and is expected to be spent in 2019/20.

Atypical expenditure

In 2018/19, we incurred £1.8m of atypical expenditure in relation to a one-off reorganisation and £1.2m of costs associated with the substitution of our Cayman Islands financing entity with a UK entity as part of simplifying our group structure, as disclosed in table 4J.

4C - IMPACT OF AMP PERFORMANCE TO DATE ON RCV

	2019 £000
Cumulative totex over/underspend so far in the price control period	**(2,714)**
Customer share of cumulative totex over/underspend	**(1,193)**
RCV element of cumulative totex over/underspend	**(1,645)**
Adjustment for ODI outperformance payment or underperformance payment	**(13,350)**
RCV determined at FD at 31 March	**1,226,099**
Projected 'shadow' RCV	**1,211,104**

Refer to the narrative under table 4B for details of the cumulative totex underspend to 31 March 2019.

The adjustment for ODI underperformance payment relates to underperformance penalties incurred in 2015/16, 2016/17 and 2017/18 in relation to the company's unplanned interruptions to supply over 12 hours performance (£5,632,000 in 2018/19 prices), and in relation to the company's 2017/18 and 2018/19 leakage performance (£9,168,000 in 2018/19 prices), which more than offset an outperformance payment in relation to the company's sustainable abstraction reductions performance in 2017/18 (£1,450,000 in 2018/19 prices).

Regulatory annual performance report continued

Section 4 – Non-audited additional regulatory information (continued)

4D - TOTEX ANALYSIS FOR THE 12 MONTHS ENDED 31 MARCH 2019 – WHOLESALE WATER

	Water resources		Network+				
	Abstraction licences £000	Raw water abstraction £000	Raw water transport £000	Raw water storage £000	Water treatment £000	Treated water distribution £000	Total £000
Operating expenditure							
Power	-	3,071	3,290	-	2,632	12,940	21,933
Income treated as negative expenditure	-	-	-	-	-	-	-
Abstraction charges / discharge consents	3,962	-	-	-	-	-	3,962
Bulk supply	833	321	-	-	5,723	-	6,877
Other operating expenditure							
Renewals expensed in the year (Infrastructure)	-	-	-	-	-	17,299	17,299
Renewals expensed in the year (Non-Infrastructure)	-	-	-	-	-	-	-
Other operating expenditure excluding renewals	534	5,359	1,375	865	16,262	80,776	105,171
Local authority and Cumulo rates	-	1,936	332	-	2,895	10,457	15,620
Total operating expenditure excluding third party services	**5,329**	**10,687**	**4,997**	**865**	**27,512**	**121,472**	**170,862**
Third party services	-	-	-	-	-	2,699	2,699
Total operating expenditure	**5,329**	**10,687**	**4,997**	**865**	**27,512**	**124,171**	**173,561**
Capital expenditure							
Maintaining the long-term capability of the assets – infra	-	-	(8)	-	-	15,356	15,348
Maintaining the long-term capability of the assets – non-infra	-	9,217	218	-	15,615	29,528	54,578
Other capital expenditure – infra	-	-	-	-	-	6,552	6,552
Other capital expenditure – non-infra	-	4,854	106	-	8,450	13,098	26,508
Infrastructure network reinforcement	-	-	-	-	402	5,258	5,660
Total gross capital expenditure (excluding third party)	**-**	**14,071**	**316**	**-**	**24,467**	**69,792**	**108,646**
Third party services	-	-	-	-	122	-	122
Total gross capital expenditure	**-**	**14,071**	**316**	**-**	**24,589**	**69,792**	**108,768**
Less: Grants and contributions	-	7,004	-	-	-	31,828	38,832
Totex	**5,329**	**17,754**	**5,313**	**865**	**52,101**	**162,135**	**243,497**
Cash expenditure							
Pension deficit recovery payments	5	286	21	9	546	1,928	2,795
Other cash items	(2)	(154)	(10)	(4)	(286)	(1,192)	(1,648)
Totex including cash items	**5,332**	**17,886**	**5,324**	**870**	**52,361**	**162,871**	**244,644**

4D - TOTEX ANALYSIS FOR THE 12 MONTHS ENDED 31 MARCH 2019 – WHOLESALE WATER (CONTINUED)

Unit cost information (operating expenditure)

	Water resources		Network+			
	Licensed volume available	Volume abstracted	Volume transported	Average volume stored	Distribution input volume	Distribution input volume
Volume (ML)	461,097	348,462	103,894	-	347,890	347,890
Unit cost (£/ML)	11.56	30.67	48.10	-	79.08	356.93
Population	3,611,113	3,611,113	3,611,113	3,611,113	3,611,113	3,611,113
Unit cost (£/pop)	1.48	2.96	1.38	0.24	7.62	34.39

4F - OPERATING COST ANALYSIS FOR THE 12 MONTHS ENDED 31 MARCH 2019 – HOUSEHOLD RETAIL

	Unmeasured £000	Measured £000	Total £000
Operating expenditure			
Customer services	2,948	4,789	7,737
Debt management	1,014	1,099	2,113
Doubtful debts	2,965	3,539	6,504
Meter reading	-	1,210	1,210
Other operating expenditure	4,192	5,355	9,547
Total operating expenditure excluding third party services	**11,119**	**15,992**	**27,111**
Third party services operating expenditure	-	-	-
Total operating expenditure	**11,119**	**15,992**	**27,111**
Depreciation – tangible fixed assets			
– on assets existing at 31 March 2015	6	9	15
– on assets acquired since 1 April 2015	-	-	-
Amortisation – intangible fixed assets			
– on assets existing at 31 March 2015	72	98	170
– on assets acquired since 1 April 2015	230	315	545
Total operating costs	**11,427**	**16,414**	**27,841**
Capital expenditure	**660**	**906**	**1,566**

Other operating expenditure includes the net retail expenditure for the following retail activities, which are part funded by wholesale activities:

	£000
Household	
Demand-side water efficiency – gross expenditure	1,493
Demand-side water efficiency – expenditure funded by wholesale	(1,146)
Demand-side water efficiency – net retail expenditure	**347**
Customer-side leak repairs – gross expenditure	606
Customer-side leak repairs – expenditure funded by wholesale	-
Customer-side leak repairs – net retail expenditure	**606**

Regulatory annual performance report continued

Section 4 – Non-audited additional regulatory information (continued)

4G - WHOLESALE CURRENT COST FINANCIAL PERFORMANCE FOR THE 12 MONTHS ENDED 31 MARCH 2019

Income Statement

	Total £000
Revenue	275,153
Operating expenditure	(173,561)
Capital maintenance charges	(94,405)
Other operating income	(35)
Current cost operating profit	**7,152**
Other income	12,905
Interest income	3,761
Interest expense	(49,131)
Other interest expense	2,829
Current cost profit before tax and fair value movements	**(22,484)**
Fair value gains/(losses) on financial instruments	(2,389)
Current cost profit before tax	**(24,873)**

4H - FINANCIAL METRICS FOR THE 12 MONTHS ENDED 31 MARCH 2019

	Current year	AMP6 to date
Financial indicators		
Net debt	£976.700m	
Regulated equity	£249.399m	
Regulated gearing	79.66%	
Post tax return on regulated equity	1.95%	
RORE (return on regulated equity)	3.20%	5.20%
Dividend yield	-	
Retail profit margin – Household	(0.20)%	
Retail profit margin – Non household	-	
Credit rating	Baa1 (negative outlook)	
Return on RCV	3.87%	
Dividend cover	-	
Funds from operations (FFO)	£79.882m	
Interest cover (cash)	3.01	
Adjusted interest cover (cash)	1.73	
FFO/Debt	0.08	
Effective tax rate	37.34%	
Free cash flow (RCF)	£79.882m	
RCF/capex	0.74	
Revenue and earnings		
Revenue (actual)	£299.907m	
EBITDA (actual)	£99.235m	
Movement in RORE		
Base return	6.08%	6.14%
Totex out/(under) performance	(2.07)%	(0.61)%
Retail cost out/(under) performance	(0.42)%	(0.62)%
ODI out/(under) performance[1]	(1.50)%	(0.63)%
Financing out/(under) performance	1.23%	0.98%
Other factors[2]	(0.12)%	(0.06)%
Regulatory return for the year	3.20%	5.20%
Borrowings		
Proportion of borrowings which are fixed rate	49.74%	
Proportion of borrowings which are floating rate	-	
Proportion of borrowings which are index linked	50.26%	
Proportion of borrowings due within 1 year or less	-	
Proportion of borrowings due in more than 1 year but no more than 2 years	-	
Proportion of borrowings due in more than 2 years but no more than 5 years	1.30%	
Proportion of borrowings due in more than 5 years but no more than 20 years	63.21%	
Proportion of borrowings due in more than 20 years	35.49%	

[1] The ODI penalty resulting from the restatement of our 2017/18 leakage figure (refer to the narrative under table 3A) has been considered in the calculation of the movement in AMP6 to date RORE caused by ODI out/(under) performance.

[2] Other factors include the removal of earnings before interest and tax less cash tax associated with the non-household retail business from April 2017 onwards included in the PR14 Base RORE. Net proceeds of £27.0m were received by the company in 2017/18 from the disposal of the company's non-household retail business.

Regulatory annual performance report continued

Section 4 – Non-audited additional regulatory information (continued)

4I - FINANCIAL DERIVATIVES FOR THE 12 MONTHS ENDED 31 MARCH 2019

	Nominal value by maturity (net) at 31 March			Total value at 31 March		Total accretion at 31 March	Interest rate (weighted average for 12 months to 31 March 2019)	
	1 to 2 years £m	2 to 5 years £m	Over 5 years £m	Nominal value (net) £m	Mark to market £m	£m	Payable £m	Receivable £m
Financial indicators								
Fixed to index-linked	-	-	135,000	135,000	(2,389)	1,679	2.13	5.88
Total financial derivatives	-	-	135,000	135,000	(2,389)	1,679	2.13	5.88

This table is being presented for the first time, as the company entered into its first ever RPI linked inflation swap in 2018/19. The swap has a nominal value of £135.0m and was the most efficient way to switch to a higher proportion of index linked debt. This will lead to a net interest receivable cash flow over the life of the swap, which is expected to increase the headroom above the company's covenant limits, offset by an accretion payment on maturity.

4J - ATYPICAL AND NON-ATYPICAL EXPENDITURE BY BUSINESS UNIT FOR THE 12 MONTHS ENDED 31 MARCH 2019 - WHOLESALE WATER

	Water resources		Network+				
	Abstraction licences £000	Raw water abstraction £000	Raw water transport £000	Raw water storage £000	Water treatment £000	Treated water distribution £000	Total £000
Operating expenditure (excluding atypicals)							
Power	-	3,071	3,290	-	2,632	12,940	21,933
Income treated as negative expenditure	-	-	-	-	-	-	-
Abstraction charges	3,962	-	-	-	-	-	3,962
Bulk supply	833	321	-	-	5,723	-	6,877
Other operating expenditure							
Renewals expensed in the year (Infrastructure)	-	-	-	-	-	17,299	17,299
Renewals expensed in the year (Non-Infrastructure)	-	-	-	-	-	-	-
Other operating expenditure excluding renewals	531	5,176	1,364	859	15,921	78,415	102,266
Local authority and Cumulo rates	-	1,936	332	-	2,895	10,457	15,620
Total operating expenditure excluding third party services	**5,326**	**10,504**	**4,986**	**859**	**27,171**	**119,111**	**167,957**
Third party services	-	-	-	-	-	2,699	2,699
Total operating expenditure	**5,326**	**10,504**	**4,986**	**859**	**27,171**	**121,810**	**170,656**
Capital expenditure (excl. atypicals)							
Maintaining the long-term capability of the assets – infra	-	-	(8)	-	-	15,356	15,348
Maintaining the long-term capability of the assets – non-infra	-	9,217	218	-	15,615	29,528	54,578
Other capital expenditure – infra	-	-	-	-	-	6,552	6,552
Other capital expenditure – non-infra	-	4,854	106	-	8,450	13,098	26,508
Infrastructure network reinforcement	-	-	-	-	402	5,258	5,660
Total gross capital expenditure (excluding third party)	**-**	**14,071**	**316**	**-**	**24,467**	**69,792**	**108,646**
Third party services	-	-	-	-	122	-	122
Total gross capital expenditure	**-**	**14,071**	**316**	**-**	**24,589**	**69,792**	**108,768**
Less: Grants and contributions	-	7,004	-	-	-	31,828	38,832
Totex	**5,326**	**17,571**	**5,302**	**859**	**51,760**	**159,774**	**240,592**
Cash expenditure (excl. atypicals)							
Pension deficit recovery payments	5	286	21	9	546	1,928	2,795
Other cash items	(2)	(154)	(10)	(4)	(286)	(1,192)	(1,648)
Totex including cash items	**5,329**	**17,703**	**5,313**	**864**	**52,020**	**160,510**	**241,739**
Atypical expenditure							
One-off reorganisation costs	1	75	4	3	140	1,532	1,755
One-off costs associated with the substitution of our Cayman Islands financing entity with a UK entity	2	108	7	3	201	829	1,150
Total atypical expenditure	**3**	**183**	**11**	**6**	**341**	**2,361**	**2,905**
Total expenditure	**5,332**	**17,886**	**5,324**	**870**	**52,361**	**162,871**	**244,644**

Regulatory annual performance report continued

Section 4 – Non-audited additional regulatory information (continued)

4L - ENHANCEMENT CAPITAL EXPENDITURE BY PURPOSE FOR THE 12 MONTHS ENDED 31 MARCH 2019 - WHOLESALE WATER

	Expenditure in report year							Cumulative expenditure on schemes completed in the report year						
	Water resources		Network+					Water resources		Network+				
Enhancement capital expenditure by purpose	Abstraction licences	Raw water abstraction	Raw water transport	Raw water storage	Water treatment	Treated water distribution	Total	Abstraction licences	Raw water abstraction	Raw water transport	Raw water storage	Water treatment	Treated water distribution	Total
NEP - Making ecological improvements at abstractions (Habitats Directive, SSSI, NERC, BAPs)	-	2,657	-	-	-	-	2,657	-	-	-	-	-	-	-
NEP - Eels Regulations (measures at intakes)	-	121	-	-	-	-	121	-	-	-	-	-	-	-
NEP – Invasive Non Native Species	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Addressing low pressure	-	-	-	-	-	1,220	1,220	-	-	-	-	-	1,396	1,396
Improving taste/odour/colour	-	-	-	-	953	10	963	-	-	-	-	201	-	201
Meeting lead standards	-	-	-	-	-	2,052	2,052	-	-	-	-	-	2,099	2,099
Supply side enhancements to the supply/demand balance (dry year critical/peak conditions)	-	-	-	-	-	84	84	-	-	-	-	-	-	-
Supply side enhancements to the supply/demand balance (dry year annual average conditions)	-	727	-	-	5	102	834	-	-	-	-	-	143	143
Demand side enhancements to the supply/demand balance (dry year critical/peak conditions)	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Demand side enhancements to the supply/demand balance (dry year annual average conditions)	-	-	-	-	-	-	-	-	-	-	-	-	-	-
New developments	-	-	-	-	-	9,234	9,234	-	-	-	-	-	2,906	2,906
New connections element of new development (CPs, meters)	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Investment to address raw water deterioration (THM, nitrates, Crypto, pesticides, others)	-	171	-	-	5,535	-	5,706	-	-	-	-	14,668	-	14,668
Resilience	-	705	106	-	1,451	3,826	6,088	-	-	-	-	933	2,438	3,371
SEMD	-	-	-	-	908	(33)	875	-	-	-	-	-	-	-
NEP – Drinking Water Protected Areas (schemes)	-	-	-	-	-	-	-	-	-	-	-	-	-	-
NEP – Water Framework Directive measure	-	-	-	-	-	-	-	-	-	-	-	-	-	-
NEP - Investigations	-	473	-	-	-	-	473	-	-	-	-	-	-	-
Improvements to river flows	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Metering (excluding cost of providing metering to new service connections) - meters requested by optants	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Metering (excluding cost of providing metering to new service connections) - meters introduced by companies	-	-	-	-	-	8,413	8,413	-	-	-	-	-	13,563	13,563
Metering (excluding cost of providing metering to new service connections) - other	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total enhancement capital expenditure	**-**	**4,854**	**106**	**-**	**8,852**	**24,908**	**38,720**	**-**	**-**	**-**	**-**	**15,802**	**22,545**	**38,347**

4V - OPERATING COST ANALYSIS FOR THE 12 MONTHS ENDED 31 MARCH 2019 - WATER RESOURCES

	Impounding Reservoir £000	Pumped Storage £000	River Abstractions £000	Ground-water excluding MAR water supply schemes £000	Artificial Recharge (AR) water supply schemes £000	Aquifer Storage and Recovery (ASR) water supply schemes £000	Other £000	Total £000
Power	6	18	1,078	1,969	-	-	-	3,071
Income treated as negative expenditure	-	-	-	-	-	-	-	-
Abstraction charges / discharge consents	8	24	1,391	2,539	-	-	-	3,962
Bulk supply	2	7	405	740	-	-	-	1,154
Other operating expenditure								
Renewals expensed in year (Infrastructure)	-	-	-	-	-	-	-	-
Renewals expensed in year (Non-infrastructure)	-	-	-	-	-	-	-	-
Other operating expenditure excluding renewals - direct	5	16	918	1,676	-	-	-	2,615
Other operating expenditure excluding renewals - indirect	6	20	1,151	2,101	-	-	-	3,278
Total functional expenditure	**27**	**85**	**4,943**	**9,025**	**-**	**-**	**-**	**14,080**
Local authority and Cumulo rates	4	12	679	1,241	-	-	-	1,936
Total operating costs (excluding 3rd party)	**31**	**97**	**5,622**	**10,266**	**-**	**-**	**-**	**16,016**
Depreciation	3	10	587	1,073	-	-	-	1,673
Total operating costs (excluding 3rd party)	**34**	**107**	**6,209**	**11,339**	**-**	**-**	**-**	**17,689**

4V - OTHER EXPENDITURE FOR THE 12 MONTHS ENDED 31 MARCH 2019 - WHOLESALE WATER

	Water resources	Raw water distribution	Water treatment	Treated water distribution	Total
Item					
Employment costs - directly attributable (£000)	2,003	295	4,518	23,907	30,723
Employment costs - indirectly attributed (£000)	2,066	809	3,211	11,213	17,299
Number FTEs – directly allocated	79	7	145	599	830
Number FTEs – indirectly allocated	19	2	35	144	200
Costs associated with Traffic Management Act (£000)	-	-	-	1,835	1,835
Service charges					
Canal & River Trust service charges and discharge consents (£000)	-	-	-	-	-
Environment Agency service charges/ discharge consents (£000)	3,962	-	-	-	3,962
Other service charges / permits (£000)	-	-	-	-	-
Statutory water softening (£000)	-	-	-	-	-

Regulatory annual performance report continued

Section 4 – Non-audited additional regulatory information (continued)

TRANSACTIONS WITH ASSOCIATED COMPANIES

	Company	Turnover of associate £000	Terms of supply	Value £000
Service received				
Interest paid on loan	Affinity Water Capital Funds Limited*	-	Market rate at time of loan inception	160
Dividends paid	Affinity Water Holdings Limited*	-	No market – amount paid in line with dividend policy	6,600
Interest paid on loan	Affinity Water Finance (2004) PLC*	-	At market rate, on-lent by associate on the same terms	14,263
Interest paid on loan	Affinity Water Programme Finance Limited*	-	At market rate, on-lent by associate on the same terms	30,521
Interest paid on loan	Affinity Water Finance PLC*	-	At market rate, on-lent by associate on the same terms	1,993
Service provided				
Wholesale water charges	Affinity for Business (Retail) Limited	58,512	At market rate from MOSL reports	45,127
Recharges for support services – facilities		58,512	No market – services charged at a fixed annual fee based on actual cost or recharged by time allocation	(3)
Recharges for support services – finance		58,512	No market – services charged at a fixed annual fee based on actual cost or recharged by time allocation	192
Recharges for support services – Information Technology		58,512	No market – services charged at a fixed annual fee based on actual cost or recharged by time allocation	511
Recharges for support services – HR, legal, and other support recharges		58,512	No market – services charged at a fixed annual fee based on actual cost or recharged by time allocation	51
Recharges for meter read costs		58,512	Actual costs to the company recharged	384

* these companies do not have turnover.

The company has applied a materiality threshold of £100,000 for disclosing transactions with individual related parties. No contracts individually exceeded this threshold.

In 2004, Affinity Water Limited borrowed £200,000,000 from its wholly owned subsidiary, Affinity Water Finance (2004) PLC, the loan being the proceeds of the latter's £200,000,000 Class A bonds issued in that year and maturing in July 2026 with an annual coupon of 5.875% and lent on the same terms. On 16 July 2014 Affinity Water Finance (2004) PLC completed a tap issue of £50,000,000 on the same terms as the existing £200,000,000 bond. The net proceeds of both the bond and the tap issue have been lent to the company on the same terms. The amount outstanding at year end, net of amortised debt issuance costs, was £253,922,000 (2018: £254,346,000).

As part of the WBS in February 2013, all existing loans and revolving credit facilities, except for the above £250,000,000 bond, were replaced by the following four new bonds issued on 4 February 2013 by the company's former subsidiary, Affinity Water Programme Finance Limited: £80,000,000 Class A Guaranteed Notes maturing in September 2022 with a coupon of 3.625%, £250,000,000 Class A Guaranteed Notes maturing in March 2036 with a coupon of 4.500%, £150,000,000 Class A Guaranteed RPI linked Notes maturing in June 2045 with a coupon of 1.548% and £95,000,000 Class B Guaranteed RPI linked Notes maturing in June 2033 with a coupon of 3.249%.

On 29 October 2015 Affinity Water Programme Finance Limited completed a tap issue of £40,000,000 on the same terms as its existing £150,000,000 Class A Guaranteed RPI linked Notes.

On 19 February 2016 Affinity Water Programme Finance Limited issued £10,000,000 Class B guaranteed RPI linked Notes maturing in June 2033 with a coupon rate of 1.024%.

On 22 August 2016, Affinity Water Programme Finance Limited exchanged £65,800,000 of its 3.625% Guaranteed Notes due 2022 for a new issue of 3.278% Guaranteed Notes due 2042. An additional £19,200,000 of 3.278% Guaranteed Notes due 2042 were issued at the same time.

On 22 November 2017, Affinity Water Programme Finance Limited issued £60,000,000 Class A Guaranteed Notes maturing in November 2033 with a coupon of 2.699% and £60,000,000 Class A Guaranteed CPI linked Notes maturing in November 2042 with a coupon of 0.230%.

On 22 January 2019, the assets and liabilities of Affinity Water Programme Finance Limited were transferred to the company's subsidiary Affinity Water Finance PLC.

The net proceeds of the bond issues and the tap issue have been lent to the company on the same terms. The amount outstanding at year end, net of amortised debt issuance costs, was £823,747,000 (2018: £814,613,000).

On 4 February 2013, the company borrowed an amount of £3,550,000 from Affinity Water Capital Funds Limited, the company's intermediate parent company. The final repayment date of this loan is 31 March 2036, with interest terms having been set at 4.500%.

There are no loans to group companies.

Regulatory annual performance report continued

Section 4 – Non-audited additional regulatory information (continued)

DIVIDEND POLICY

Our policy, available on the governance pages of our website:

stakeholder.affinitywater.co.uk/our-governance.aspx

is to pay a dividend commensurate with the long-term returns and performance of the business whilst not impairing its longer term financeability. In determining the level of the dividend, the financial performance of the appointed and non-appointed businesses is considered separately.

The base dividend for the appointed business is set in line with our internal business plan approved by the Board following determination of the price controls for each asset management period. The base dividend may not exceed a nominal 5% yield on equity as an annual average over the AMP. This includes any sharing mechanism within the price controls related to our financing structure. The Board assesses performance against this base dividend and accordingly increases or decreases the dividend to be paid as appropriate. This assessment considers the whole asset management period. An assessment is also completed by the Board to determine if the payment or part payment of the dividend reflects and/or would compromise the long-term social, financial and operational commitments made to stakeholders, which include the following areas: customer service, operational commitments, community commitment, and employees and the health of the pension plan.

The policy in respect of the non-appointed business is to pay dividends reflecting the profitability and performance of this business.

The Board tests any proposed dividend payments against legal and regulatory requirements and restrictions, including the management of economic risk and compliance with financial covenants.

The directors declared and paid ordinary dividends of £6,600,000 during the year ended 31 March 2019. This compares to £58,498,000 declared and paid in the year ended 31 March 2018.

No dividends were paid in relation to our appointed business this year, reflecting the anticipated penalty in relation to not achieving our leakage reduction target and financial underperformance in the year. Higher dividends in 2017/18 can also be attributed to proceeds from the disposal of the company's non-household retail business to Affinity for Business (Retail) Limited.

No final dividend is proposed (2018: £nil).

VIABILITY STATEMENT

The company's viability statement, including information on the company's approach to producing this statement, can be found within the strategic report on **pages 58 to 61**. The sensitivities used in stress-testing the base case cash flow forecast were in some instances more severe than the sensitivities specified by Ofwat to be used in stress-testing AMP7 Business Plans.

Stress-testing was performed on a Board approved base case cash flow forecast prepared by management. The Audit Committee considered and provided input into the determination of which of the company's principal risks and combinations thereof might have an impact on the company's financial viability, and reviewed the results of management's stress testing of the company's base cash flow forecasts. The results of management's stress-testing and the viability statement were reviewed by the Board in approving the strategic report.

To address comments in Ofwat's 2018 Company Monitoring Framework assessment report and Ofwat's expectations for 2018/19 reporting set out in their information notice published in April 2019, further information has been provided in the company's viability statement as to how the combined scenarios have been developed, about the outcome of the stress testing on financial ratios, debt covenants and credit ratings and the mitigating actions available. The stress tests have also been applied under three different levels of capital structure in the context of the PR19 price setting mechanism for sharing financial outperformance with customers.

Two additional sensitivities have been used in the stress testing performed for 2018/19:

- 2% increase in cost of debt, as £264.2m of the company's existing bonds mature in the outlook period, and the company has not yet secured financing for all AMP7 expenditure commitments and expected expenditure commitments beyond AMP7; and
- a 100% decrease in cash generated by the company's non-appointed business, reflecting a severe, plausible and reasonable scenario that companies may decide to no longer procure non-appointed services from the company.

The impact of a significant cyber-attack leading loss of customer data or interruption to operations has also been modelled.

VIABILITY STATEMENT (CONTINUED)

Details of the third party assurance obtained over the viability statement, which included assurance over the accuracy of the underlying calculations for the stress testing underpinning the viability statement, can be found within our Data Assurance Report, which is published on our stakeholder website:

stakeholder.affinitywater.co.uk

PwC did not include any matters in their independent auditor's report on **pages 124 to 130** in relation to the viability statement.

CURRENT TAX RECONCILIATIONS

The appointed current tax charge assessed for the period is lower than the standard rate of corporation tax in the UK of 19% for the year ended 31 March 2019. The differences are explained below:

	£000
Profit on appointed activities before tax	**4,628**
Tax calculated at the standard rate of tax in the UK of 19%	879
Tax effects of:	
- Adjustments in respect of prior years	(417)
- Expenses not deductible for tax purposes	196
- Accelerated capital allowances	2,327
- Other timing differences - pension	(833)
- Other timing differences - provisions	56
- Non-taxable profit on disposal of subsidiary	(5)
Appointed current tax charge	**2,203**

Significant variations between the appointed current tax charge and the total current tax charge for the year ended 31 March 2019 allowed in the company's price limits are explained below:

	£000
Appointed current tax charge	**2,203**
Variance in profit before tax excluding profit on disposal of subsidiary	2,810
Non-taxable profit on disposal of subsidiary	5
Adjustments in respect of prior years	417
Variance in assumptions - capital allowances	(4,755)
Other timing differences - pensions	361
Other	78
Total current tax charge allowed in price limits	**1,119**

FACTORS AFFECTING FUTURE TAX CHARGES

In September 2016 changes were enacted to the main rate of corporation tax in the UK to reduce it from 19% to 17% effective from 1 April 2020.

Regulatory annual performance report continued

Tax strategy related to the appointed business

Our approach to tax is based on the values incorporated in the Affinity Water Code of Conduct:

We always act honestly, openly and responsibly, so that we are trusted. We uphold the Affinity Way together by complying with the law and regulatory requirements, making decisions with integrity, and speaking up when we believe that conduct falls short of our principles.

We are transparent in our dealings with government and regulators, fulfilling our obligations honestly and promptly. We don't hide information that should be in the public domain and we don't disclose information that we shouldn't. We are clear and honest about our services, processes, policies, achievements and prospects. We encourage people to speak up whenever they see conduct that falls short of our principles and we take their concerns seriously.

Our tax strategy includes the following:

1. Approach to risk management and governance
2. Attitude to tax planning
3. Level of acceptable risk in relation to UK tax
4. Approach to dealing with HM Revenue and Customs ('HMRC')

APPROACH TO RISK MANAGEMENT AND GOVERNANCE

The Group CFO is ultimately responsible for our tax strategy. Responsibility for day to day tax matters, and for reporting to the Audit Committee and the Board on significant tax risks and developments, is delegated to the Group Tax Manager. Tax strategy is part of our overall risk management and governance framework, which is overseen by the Audit Committee and the Board.

We consider our main tax risk to be the introduction of new legislation or changes in tax practice, which could result in increased tax payments that have not been included in the current regulatory settlement.

ATTITUDE TO TAX PLANNING

We do not use artificial tax avoidance schemes or tax havens to reduce our tax liabilities, and we always comply with what we understand to be both the letter and the spirit of the law. We operate solely in the UK and all our customers are based here. All our profits are reported and taxed in the UK. No funds are held off-shore, and all finance is raised and held within the UK.

Whilst we do not interpret tax legislation aggressively, we try to minimise our tax liability so that our customers are not funding excessive and unnecessary charges through increased bills.

We seek external advice when necessary, in order to ensure that our interpretation of current tax law and practice is correct.

LEVEL OF ACCEPTABLE RISK IN RELATION TO UK TAX

Our approach to tax risk is part of our wider risk management framework, in the context of our regulatory settlement.

DEALING WITH HMRC

We have an open relationship with HMRC, and we advise them of any complex issues so that we can work with them to determine the correct amount of tax due. We actively engage with HMRC and other relevant authorities on proposed changes to tax legislation, either directly or as part of our industry group.

Data assurance summary

The data presented in this regulatory Annual Performance Report has been subject to the company's governance, risk management and internal control framework as set out in the governance section of the annual report and financial statements on page 83.

For further information on our assurance procedures and results, please refer to our Data Assurance Report, which is published on our stakeholder website:

stakeholder.affinitywater.co.uk

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