Annual Report and Financial Statements

For the year ended 31 March 2020

Affinity Water Limited
(Registered Number 02546950)

Glossary of key acronyms and definitions used within this report

AMP – Asset Management Plan
The five-year price control period covered by a company's Business Plan. AMP6 ran from 2015-20. AMP7 runs from 2020-25.

C-MeX – Customer Measure of Experience
A measure of customer service levels being used by Ofwat in AMP7.

CCG – Customer Challenge Group
An independent group of individuals who hold us to account on how we are performing against our Performance Commitments.

CCW – Consumer Council for Water
The regulator tasked with investigating customer complaints relating to service, price and value for money.

CRI – Compliance Risk Index
A measure of water quality compliance designed to illustrate the risk arising from treated water compliance failures.

D-MeX – Developer Measure of Experience
A measure of developer service levels being used by Ofwat in AMP7.

Defra – Department for the Environment, Food and Rural Affairs
The UK government department responsible for water policy.

DWI – Drinking Water Inspectorate
The regulator ensuring compliance with drinking water quality regulations.

EA – Environment Agency
A non-governmental organisation which controls, inter alia, how much water we can abstract from the environment.

Ml/d – Megalitres per day
A measure of consumption. One megalitre is equal to one million litres.

MOSL – Market Operator Service Limited
The independent operator of the non-household retail market in England and Wales.

MZC – Mean Zonal Compliance
A measure of water quality compliance derived from monitoring samples taken from customers' taps.

ODI – Outcome Delivery Incentive
Mechanism for financial rewards or penalties which underpins the Performance Commitments submitted in a company's Business Plan (the "Plan").

Ofwat – Water Services Regulation Authority
The economic regulator of the water industry.

PCC – Per Capita Consumption
The amount of water used by each person, usually measured in litres per person per day ('l/p/d').

PR – Periodic Review
The price determination process undertaken by Ofwat ahead of each new AMP. The PR19 process set the price controls for AMP7.

RCV – Regulatory Capital Value
The economic value of the regulated business, as determined by the price control regime.

RORE – Return on regulated equity
A financial metric used by Ofwat to determine the profitability of the regulated company.

SIM – Service Incentive Mechanism
A measure of customer service levels used by Ofwat in AMP6.

Totex – Total expenditure
The sum of operational expenditure and capital expenditure.

WRMP – Water Resources Management Plan
A long-term plan detailing how a water company will maintain a sustainable balance between future demand and supply of water.

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 have been prepared using the principles of the International Integrated Reporting Framework.

Our Registered Office

Tamblin Way
Hatfield
Hertfordshire
AL10 9EZ

affinitywater.co.uk

Contents

Green Apple Award
in environmental best practice for our partnership approach to biodiversity with Herts and Middlesex Wildlife Trust

Affinity Water at a glance

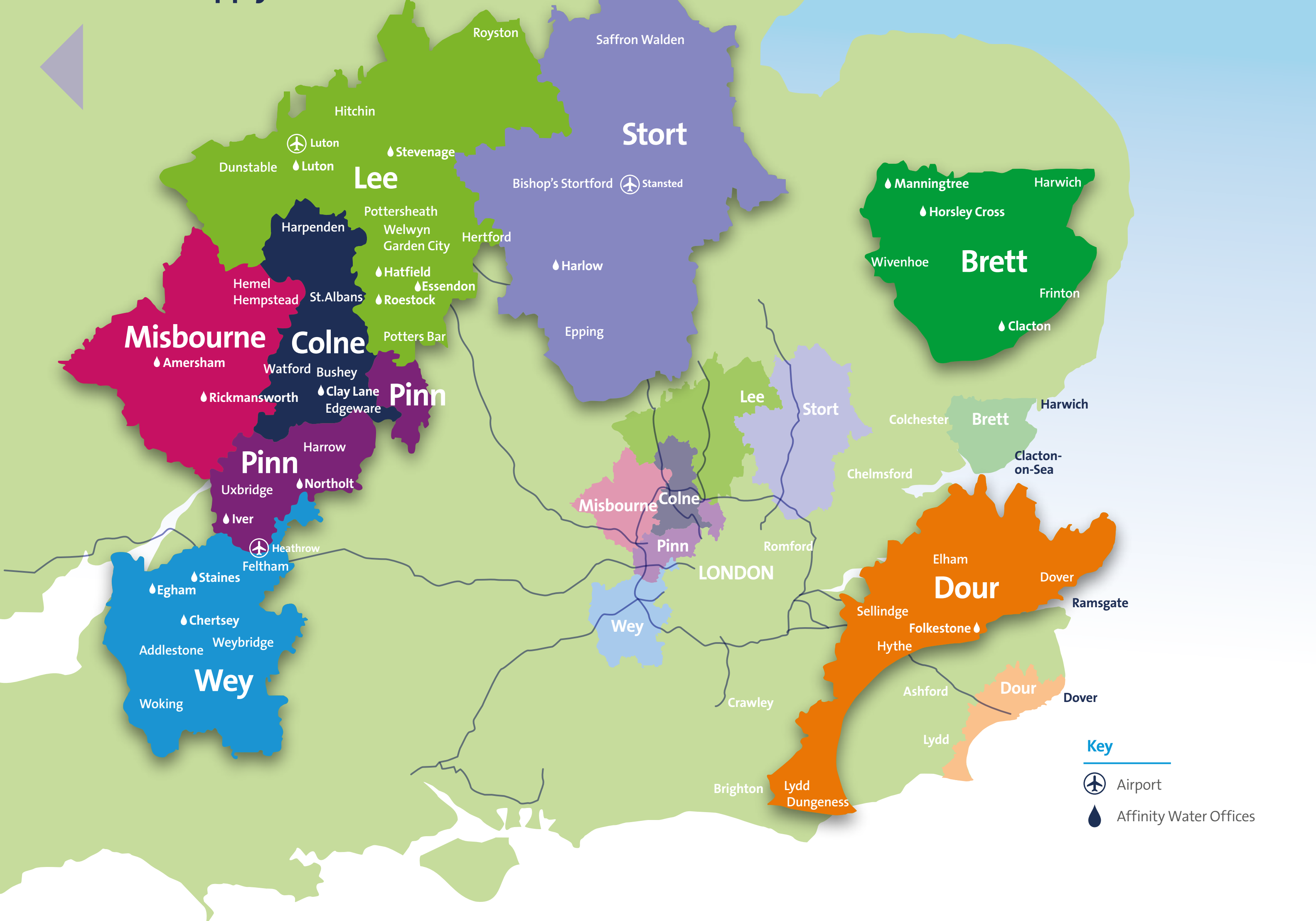
Where we operate

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 4,500km² across three supply regions in the South East of England.

We sub-divide our supply regions 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.

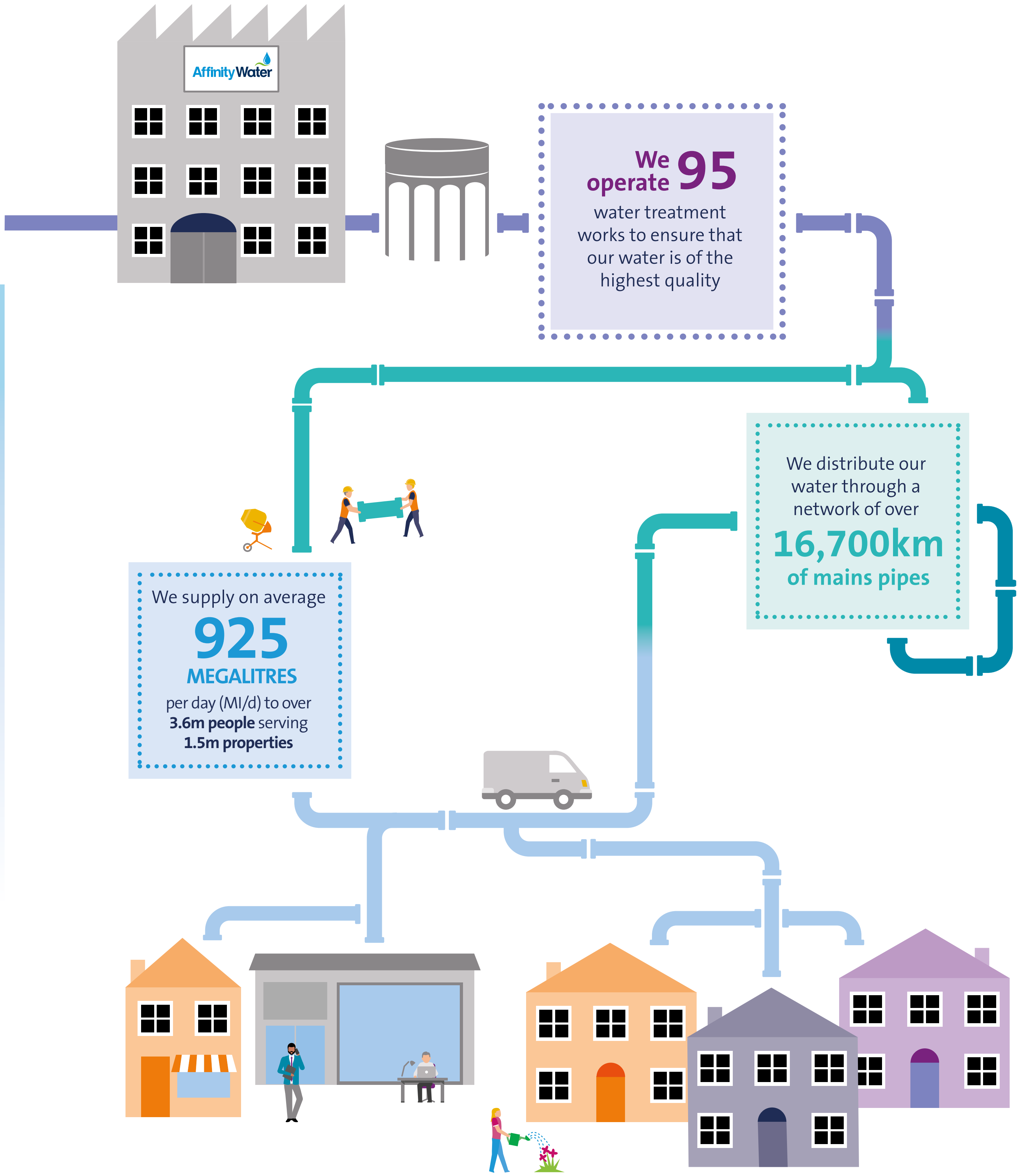
Our vision is to be the UK's leading community-focused water company. It reflects the importance we place on our people working within and for the communities of customers we serve. By understanding and responding to the needs of different community groups, we are accountable to them at a local level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

Our supply area



What we do

Our purpose is to provide high quality drinking water and to take care of our environment for our communities now and in the future.



Affinity Water at a glance continued

Our key facts

Operating profit[1]:
£45.6m
2018/19: £58.6m
Our operating profit for 2019/20 was lower than the prior year mainly due to £4.4m lower revenue and £9.2m higher operating costs, partially offset by £0.6m increased other income

Net cash inflow before tax and financing[2]:
£35.9m
2018/19: £42.3m
Our net cash inflow was lower than the prior year, due to £7.6m lower cash generated from operations and £3.7m lease payments made, partially offset by £4.9m lower net capital expenditure

Dividends paid:
£nil
2018/19: £6.6m
Our dividend policy was revised during the year. Our shareholders are re-investing dividends to enable the substantial investments to improve resilience and protect the environment

Post-tax return on regulated capital value:
3.0%
2018/19: 3.9%
Our post tax return on RCV was lower than the prior year due to lower non-household wholesale revenue and higher operational costs

Gearing:
78.9%
31 March 2019: 78.3%
Our gearing at 31 March 2020 was slightly higher than the prior year, but remained below our internal threshold of 80.0% of RCV both at 31 March 2020 and throughout the financial year. This allows sufficient headroom within our financial covenants

Credit rating:
Class A: A3 / BBB+ / BBB+
Class B: Baa3 / BBB- / BBB-
In March 2020, we obtained an additional credit rating from Fitch. All our ratings remain investment grade despite a downgrade of one notch each for our Class A and Class B debt by Standard & Poor's following our acceptance of Ofwat's Final Determination

Leaving more water in the environment
We recorded leakage of
162.1 Ml/d
achieving our target for 2019/20 and our AMP6 performance commitment which was the industry's largest leakage percentage reduction target for 2015-20

Leaving more water in the environment
We recorded PCC of
153.0 l/p/d
which is an increase of 0.8 l/p/d on the prior year

Supplying high quality drinking water
Mean zonal compliance ('MZC')[1] of
99.97%
for the 2019 calendar year, compared to a target of 99.95% and actual performance in 2018 of 99.96%

Throughout AMP6 we revised our strategy and improvement plan to focus on a number of safety and health initiatives. In 2019/20, we recorded
0.20
lost time injuries per
100,000 hours
compared to 1.02 in 2014/15

Minimising disruption to our customers
We experienced
499
unplanned interruptions to supply over 12 hours compared to a target of 320 and actual performance of 309 in 2018/19

Minimising disruption to our customers
We experienced
2,102 bursts
compared to our target of 3,100 and actual performance in 2018/19 of 2,530

[1] Operating profit for the year ended 31 March 2020 includes the impact of adopting IFRS 16: Leases ('IFRS 16') for the first time. The impact of adopting this new accounting standard had an immaterial impact (£0.1m) on operating profit; therefore, the prior period operating profit has not been restated.
[2] This "non-GAAP" measure is calculated as the net total of the following line items per the statement of cash flows (refer to **page 148**): cash generated from operations; purchases of property, plant and equipment; proceeds on disposal of property, plant and equipment; purchase of intangible assets; and principal elements of lease payments.

[1] MZC is the average 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 DWI.

Affinity Water at a glance continued

Our year at a glance

April

We received the Competent Operator Scheme certificate from the water industry competency assessment body Energy & Utility Skills. The scheme reinforces that each licensed operator is working to the minimum standards of operational good practice and compliance.

Water UK announced five distinctive Public Interest Commitments for the water industry. We are working together with our peers to champion these measures, in line with best practice among leading socially-responsible businesses.

May

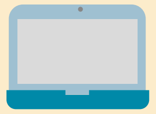
We launched a #whynotwater campaign to encourage a national debate about water conservation to mobilise support and call for action on the issue of water and changes to legislation. See **page 29** for further information.

We sponsored the St Albans Sustainability Festival, with more than 150 events between 11 May and 1 June. We also organised an exhibition in St Albans Museum delivered in partnership with TapChat to inspire the local community to save water in a positive and engaging way.

June

On 7 June we submitted our final WRMP for the period 2020-2080 to the Secretary of State for the Environment (the "Secretary of State"), Food and Rural Affairs, setting out our plan to secure the long-term provision of resilient and sustainable water supplies for customers for that period.

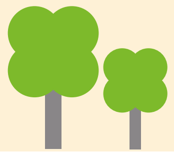
We are using technology in order to detect and manage leaks more efficiently. We embarked on a step test programme to identify leaks and pinpoint them at a street level in order to minimise our repair time.



July

As part of the "Our Finest Dour" project, year 5 and 6 students from two Dover schools spent their summer term learning about the River Dour. This is a three-year National Lottery Heritage Funded project which aims to raise local awareness about the River Dour, its rarity, and its importance for biodiversity.

We conducted a thorough culture survey to drive changes to make the company a better place to work.



August

On 27 August we became a Level 2 accredited Disability Confident Employer which reflects our commitment to support diversity and inclusion in the workplace. The accreditation, a government-led initiative, encourages us to think differently about disability and take action to improve how we recruit, retain and help to develop disabled people.

We submitted our response to Ofwat's Draft Determination on our Business Plan for the AMP7 price control period.

September

We implemented river restoration works, with the aim of improving these environments and enhancing biodiversity across our supply area, enabling the Box Moor Trust to reintroduce water voles to the River Bulbourne.

Following the launch of our customers principles we refreshed our purpose: to provide high quality drinking water and to take care of our environment for our communities now and in the future.

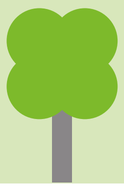
October

We emailed 500,000 customers to raise awareness about our low water resources and the fact that we had experienced three consecutive years of below average rainfall in our Central Region. This formed part of a coordinated campaign for the following six months including website updates, social media posts and further email communication, with the aim of reducing PCC.

November

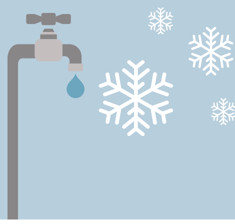
On 28 November 2019 we launched our 'Drought Awareness – Your Views' campaign. We wanted to make sure our customers and stakeholders got the opportunity to tell us their views about possible water restrictions through our website.

We won a Green Apple Environment Award in the "Partnership approach – connecting people and wildlife" category for our achievements in environmental best practice, primarily in biodiversity management.



December

Ofwat published our PR19 final determination,moving us out of their "Significant Scrutiny" category and also highlighting our "open and positive" engagement with them. In our plan we have set ourselves 28 ambitious performance commitments (see **page 35** for more details) that will change and improve the way our customers experience their water supply and the environment in which they live.



January

On 20 January we celebrated World Religion Day. It was an opportunity to understand and explore the diversity of different religions. We shared blogs, organised interviews, and conducted a live Q&A session with people of different backgrounds and faiths.

We completed a four month river restoration project along the River Ver, a chalk stream near St Albans. We have worked with the Environment Agency to revitalise chalk rivers in our supply area bringing them back to their natural state, so they are less likely to suffer from low flows and have a good variety of habitats for wildlife.

February

We held our first Culture Ambassador Forum, representing the views of employees across the business to formulate an action plan to improve our internal culture. See **page 25** for more details.

Standard & Poor's downgraded the ratings of our Class A and Class B Bonds by one notch each following our acceptance of Ofwat's Final Determination.

March

We celebrated International Women's Day by holding an #EachForEqual brunch at our Head Office. 70 employees from all over the business attended and we also live-streamed the event to two of our regional sites for the first time.

We set up a COVID-19 Incident Response Team with the primary focus to maintain the quality and supply of water for our customers and implement business continuity plans. See **page 15** for more details.

Affinity Water at a glance continued

Chair's welcome

I am delighted to present Affinity Water's annual report and financial statements for the year ended 31 March 2020.

We have now completed the final year of our five-year AMP6 Business Plan which included a number of stretching performance commitments. Ofwat acknowledged the level of ambition in that plan and I am pleased to say that we have achieved most of our targets and improved our performance in 2019/20. Please see the review from Pauline Walsh on **page 14** and our operational performance on **pages 36 to 38** for more details.

Clearly the COVID-19 pandemic is having a very significant impact on the daily lives of our customers, communities, and colleagues. In this unprecedented situation, I have been impressed by the response of our whole team. In March 2020, we set up an Incident Response Team with the primary focus to maintain the quality and supply of water for our customers and implement business continuity plans. We very quickly enabled home working for most colleagues, and put in place protocols for field colleagues to do their work safely. As a business we are continuing to supply water, fix leaks, and ensure that our people are safe as they operate everyday as key workers in the community.

We recognise there is a lot of uncertainty for our customers and that many will be impacted financially by COVID-19. We are supporting them, through a variety of channels, with relevant information and updates as they occur, and are offering solutions such as payment breaks, spreading the cost of bills and alternative tariffs. Of course, we are engaging with the government and our regulators as part of managing the situation. At the same time, we are continuing in our plans to invest in our infrastructure and to improve demand management, so that we strengthen the resilience of our supply for current and future customers.

REGULATORY UPDATE

During the year we worked extensively on our AMP7 Business Plan and re-submitted our Water Resources Management Plan ('WRMP').

Ofwat published its Final Determination for AMP7 in December 2019, which gives us clarity on what we need to deliver up to 2025. We welcome Ofwat's support of our investment to protect the environment, improve service and boost resilience. We know that it will be challenging but we are determined to deliver our Plan, both to improve the services we provide to our customers and to improve our environment.

In March 2020, the Secretary of State approved our WRMP, which set out our plan to balance the availability of water supply with the demand for water from our customers for the period to 2080. We welcome this approval and support from the Secretary of State and will work on implementing these plans, in line with our Business Plan. See **page 60** for details on the evolution of the WRMP.

OUR PURPOSE

During 2019/20, we refreshed our purpose, values and aspired culture, ensuring we are ready for AMP7. We conducted internal and external research, gathering insight from stakeholder interviews, focus groups and opinion polling.

Our research showed that customers, employees and stakeholders have a strong appetite for us to place the environment, and, in particular the local environment, at the heart of our business.

Our purpose is to provide high quality drinking water and to take care of our environment for our communities now and in the future. It 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.

Please refer to our CEO's introduction on **page 14** for more details and to **pages 27, 29 and 31** for examples of how we are bringing our purpose, values and culture to life.

AMP7 Final Determination summary

- average bills to fall by 5.5% in real terms in the 2020-25 period;
- total expenditure of £1,441.4m, including:
  - £121m to improve the environment by efficiently delivering our obligations as set out in the Water Industry National Environment Programme ('WINEP');
  - £146m for supply and demand balance schemes and strategic water resource development, including long-term drought resilience; and
  - £57.3m for new meter installations.
- 20% leakage reduction on a three-year average basis; and
- 12.5% reduction in PCC by 2024/25.

OUR STAKEHOLDERS

The Board and Executive team are very committed to engaging our customers, communities, stakeholders, and employees. At the beginning of the year we held our inaugural Stakeholder Assembly. During the year, we had extensive discussions with customers, regulators, and communities on a range of topics including to: inform our decisions in finalising our AMP7 plan and WRMP; help to develop our purpose; inform our plans for a potential drought after two dry winters in 2017/18 and 2018/19 (fortunately averted by a very wet winter!). Our independent CCG was a vital 'critical friend' throughout. This year we also conducted a very thorough culture survey with employees, and appointed Trevor Didcock as our Designated Director for Employee Engagement.

OUR GOVERNANCE

We recognise the importance of demonstrating to customers, investors, communities, regulators and other stakeholders that we operate our business to the highest standards of governance and transparency. See the governance section on **page 96** of this report for more details.

We have had three changes amongst the non-executive directors in the period. Chris Bolt, our Senior Independent Director, stepped down in September 2019 and on behalf of the Board I would like to thank him for his support. We welcomed two new directors; Mark Horsley and Ann Bishop, both have a proven track record in infrastructure, and we look forward to sharing their strategic thinking and implementation skills.

Our Company Secretary, Tim Monod, left the business in November 2019, being replaced by Colin Caldwell as interim Company Secretary until 31 March 2020. I would like to extend my appreciation to both, and also welcome Sunita Kaushal who joined as Company Secretary on 1 April 2020.

I am also pleased to welcome Caroline Warner as the new Chair of our CCG, who took over from Teresa Perchard in April 2020. I would like to express our grateful thanks to Teresa for her hard work and dedication in this role.

DIVIDENDS AND EXECUTIVE REMUNERATION

We reviewed our dividend policy during the year, see **page 4**. Our shareholders are re-investing dividends through the period to enable the substantial investments to improve resilience and protect the environment. Our policy for executive director pay continues to be aligned to the company's strategy of delivering value through high quality customer service and operational performance whilst ensuring the cost of water remains affordable. See the Remuneration report from **page 98** for more details of executive director pay.

Our Board-approved dividend and executive remuneration policies are available on the governance pages of our website: **affinitywater.co.uk/governance-assurance**

LOOKING FORWARD

As we look forward, we know that we have committed to an ambitious plan for the AMP7 with challenging targets to improve customer service and operational performance whilst also investing to protect the environment and enhance resilience. We also know that we have re-invigorated the business considerably in the last two years, with: improved performance at the end of AMP6, a new executive team, strengthened Board, committed long-term investors, an excellent team of colleagues, and a clear purpose.

Tony Cocker,
Company Chair

Strategic Report

Contents

Pond dipping at our Education Centre: taking care of our environment for our communities now and in the future.

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 purpose and how we will achieve this using our four strategic outcomes, summarising achievements made in AMP6, our current year business transformation to ensure AMP7 readiness and our plans going forwards.

The subsequent sections set out the external environment in which we operate before presenting our business model and explaining in detail our purpose and how we create long-term value for our customers and stakeholders.

We draw 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 use them to deliver, through our operating activities, our four strategic outcomes (supplying high quality water you can trust; making sure our customers have enough water, whilst leaving more water in the environment; providing a value for money service; and minimising disruption to you and your community).

We measure our success in relation to each of these four strategic 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 purpose and create value are described in the principal risks and uncertainties section, and are again linked to our business model through our four strategic outcomes.

An assessment of the company's financial viability over the ten-year period to 31 March 2030 is presented in the viability statement, which includes how each of our principal risks and uncertainties have been taken into account in this assessment.

Our section 172(1) statement describes how the directors have had regards to the likely consequences of any decision in the long-term, taking into account the interests of the company's employees, suppliers, customers and other stakeholders, and the impact of the company's operations on its communities and the environment. We integrate non-financial information throughout our annual report and financial statements.

This final section of our strategic report is designed to help readers locate the key information necessary to understand our business with regards to non-financial matters.

SUSTAINABLE DEVELOPMENT GOALS

The United Nations' Sustainable Development Goals are a blueprint to achieve a better and more sustainable future for all. The 17 related goals address the global challenges we face including those related to poverty, inequality, climate, environmental degradation, prosperity, peace and justice. As a water company supplying a vital resource to our communities, we support each of these goals and continue to do so as we respond to COVID-19. We have used the icons below throughout our strategic report to highlight where we feel we are making a contribution towards these goals.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE ('ESG') PRINCIPLES

We recognise the importance of ESG principles in operating an effective and ethical company. This annual report includes information on the environment (**page 28**), recognising that causing damage to the environment we operate in is a key risk for our company (see our principal risks on **pages 39 to 48**). Details of our customers, communities and people are included on **pages 26 and 30** respectively, with details of relevant policies on **page 63**. Our governance report from **page 66** onwards details our compliance with the 2018 Code and includes the Board's consideration of ESG principles including health and safety, employee engagement and culture, diversity and our environment. More details on our ESG principles and relevant policies are included on our website at: **affinitywater.co.uk/responsibility**

Strategic report

Our response to COVID-19

The provision of high quality water and the health and well-being of our people are of utmost importance and as a company we are closely managing the situation through our COVID-19 Incident Response Team.

We are following government health advice to make sure our customers and our colleagues stay safe, and are putting all the necessary measures in place to ensure this advice is followed by everyone.

We understand this is a challenging time for everybody and we have put our robust business continuity plans into action so we can make sure we can still supply our water services to all our customers in the South East.

We want to reassure all our customers that we are focusing our teams on essential work to ensure we have sufficient resources available to continue to supply high quality drinking water. Research from the World Health Organisation shows that the water treatment process, specifically the addition of chlorine which is routinely used for disinfection, neutralises the virus. Customers can therefore trust the virus is not spread through the water from source to tap.

To reduce the risk of spreading the virus themselves, our colleagues are practising the social distancing measures as instructed by the government. Colleagues are not entering customers' properties unless for a water quality, loss of supply or safety issue, and teams have been provided with the appropriate protective equipment to allow them to do this safely; other teams are working from home where possible and we have increased the distance between workspaces in our call centres.

CUSTOMER FINANCIAL SUPPORT

We recognise that many of our customers may be impacted financially by COVID-19. We have a number of schemes in place in response to COVID-19, in addition to those we already offer our customers. The additional schemes include payment breaks, spreading the cost of your bills and alternative tariffs such as our WaterSure scheme. Details of these are included on our website: **affinitywater.co.uk**.

VIABILITY STATEMENT

The impact of COVID-19 on the company's viability is assessed in more detail in the viability statement on **page 49**. The company has estimated the financial impact of COVID-19 and included this in the base case. Stress testing scenarios are applied on top of this COVID-19 base case.

BOARD AND STAKEHOLDER ENGAGEMENT

The Board is continuing to monitor the impact of COVID-19 and this has become a key agenda item at Board meetings. See details included in the section 172(1) statement on **page 54** for the Board's response and our stakeholder engagement in response to COVID-19.

Strategic report continued

Chief Executive Officer's introduction

AMP6 – a strong operational finish for the year and for the five-year period, although operating costs have increased.

I am delighted to report that for the final year of AMP6 we have closed with a strong operational finish, hitting stretching targets and delivering for Affinity Water and our stakeholders. I would like to thank all my Affinity Water colleagues and our partners for their hard work over the AMP. I am very proud of the progress we have made to turn the business around to ready ourselves for the challenges of AMP7.

We have delivered a major transformation programme improving productivity and service levels and undertaking a significant operational expenditure efficiency programme. We clarified and realigned accountabilities including introducing a new assurance directorate to enable better and faster operational decisions. We trained 189 of our employees on business excellence and LEAN methodologies, encouraging a culture of empowerment and continuous improvement. We are applying a "fast learner and follower" approach to innovations and ways of working to accelerate the company forward. More details on our financial performance are included in our Chief Financial Officer's review on **page 17**.

We have worked hard to build improvements in health, safety and mental wellbeing for our colleagues and partners, establishing regular health and safety workstreams, improving our communications, and establishing a culture of honest and open feedback. We made significant improvements across AMP6, reducing our accident frequency rate from 1.02 in 2014/15 to 0.20 in 2019/20.

Externally, we saw key improvements in our metrics. In water quality, we delivered MZC for 2019 of 99.97%, as regulated by the DWI, and this has remained stable.

We continue to maintain our core network assets keeping services running 24 hours a day, 7 days a week and 365 days a year. During AMP6 we invested in local level assets such as pumps, mains upgrades, new mains, and in-service reservoirs to move water efficiently to where we need it.

We reported last year on our failure to achieve our leakage targets for 2017/18 and 2018/19. I am pleased to report that we have turned this round and at the end of this financial year, have achieved the lowest ever levels of leakage for our company, as well as meeting the water industry's largest percentage leakage reduction target (14%) for AMP6. We are now targeting a further 20% leakage reduction by 2025.

Our average annual household bill for 2019/20 was £170.50, equivalent to just 47 pence per day, for a four-person household in our Central region. We are working hard to keep our bills low whilst maintaining a high quality and trusted service.

Pauline Walsh
Chief Executive Officer

AMP7 BUSINESS PLAN

To shape our AMP7 Business Plan, we spoke with over 15,300 customers and stakeholders and analysed more than five million day-to-day customer contacts. From this research we identified four strategic outcomes:

- to supply high quality water everyone can trust;
- to make sure everyone has enough water, while leaving more water in the environment;
- to provide a great service that creates value for all our stakeholders; and
- to minimise disruption to everyone.

At the start of this new regulatory period, we are facing a significant cut in allowed wholesale returns to around 2.4% real in cash terms, compared with 3.6% in AMP6, as well as challenging performance targets. Ofwat's final determination has reduced our exposure to the risk of cost overruns, but not eliminated the risk of performance penalties.

We have clear project plans in place for delivery of our 28 performance commitments, including 17 Outcome Delivery Incentives. We are focused on delivering the £100m operational efficiency challenge required in AMP7 and delivering our investment programme. Further details of these commitments are included on **page 33**. Unlike most businesses we have certainty: we know the prices we can charge and so we know what costs we need to manage and what investments we need to make. While this will be challenging, it give us lots of opportunities.

COVID-19

As I write this, we are in an era of unprecedented uncertainty, as a result of the COVID-19 pandemic. Our business is on the front line and we are continuing to supply water, fix leaks and ensure that our people are safe as they operate everyday as key workers in the community. We are helping and supporting a wide group of customers, with a particular focus on the most vulnerable. We are working through a variety of channels, with relevant information and updates as they occur.

Clearly the COVID-19 pandemic is impacting our work and our plans. We are engaging with government and the regulators to review our ability to deal with this crisis and learn from it. We are determined to stay on track as much as is humanly possible. I would like to take this opportunity to thank every one of our employees for their passion, dedication, and open mindedness to ensure we continue to deliver quality water at all times and stay safe. Further details can be found on **page 13**.

A CLEAR PURPOSE AND STRATEGIC OUTCOMES

During the year we clarified our purpose and it is: to provide high quality drinking water and to take care of our environment, for our communities now and in the future. This fits well within the four strategic outcomes we identified for our customers and stakeholders.

Supplying high quality water everyone can trust
We are the UK's largest water-only company, supplying a population of over 3.6m people with 950 Ml of the highest quality water every day. For AMP7, we have a stringent target for water quality, the CRI. We will ensure that everything we do follows our processes and is right first time.

To improve resilience, we are going to deliver major programmes to treat water for wider distribution across our supply area, where and when it is most needed; and accelerate work on new supply options such as reservoirs and transfers of water from other parts of the country.

Making sure everyone has enough water, while leaving more water in the environment
Our customers and stakeholders have told us that they want to be able to enjoy their environment and to know that it will be there for future generations.

Since 2015 we have reduced our abstraction from environmentally sensitive sites by 42.1 Ml/d and will aim to reduce this by a further 27.3 Ml/d by 2024/25. We are working with our local communities to ensure that chalk streams, which are unique habitats, once again, become an integral part of the British landscape and home to several rare and protected species, such as, the southern damsel fly, otters, kingfishers and the white-clawed crayfish.

Working with neighbouring water companies we are building medium-term plans for water resources and drought planning. Our WRMP is a long-term plan for the period to 2080. Our aim is to balance the availability and supply of water with the demand from our increasing customer base. The full details of our WRMP can be found on our website: **affinitywater.co.uk/water-resources**

Water efficiency is critical to climate change but in our view, is not sufficiently part of the debate. In June 2019, we launched our #WhyNotWater campaign to encourage a national debate to ensure that water conservation is at the heart of our actions and behaviour. Our case study on **page 27** gives more details.

The South East is a severely water stressed region, so we are working with local government to ensure that all new developments are designed to meet the best water usage standards.

We want to help the people in our communities use water more sustainably and are running customer awareness campaigns and fitting water meters. Our aim is to reduce PCC to 132.6 l/p/d by the end of AMP7.

We plan to install over 250,000 meters during AMP7. Meters provide customers with the information and transparency to understand their water use. Research has shown that unmetered customers use 48 l/p/d more, on average, than metered customers.

Strategic report continued

Chief Executive Officer's introduction (continued)

Providing a great service that creates value for all our stakeholders
Providing excellent customer experience is fundamental to maintaining trust and confidence in the water sector. We incurred an ODI penalty in AMP6 for our SIM performance and recognise the need to improve. Our ambition is to be in the top four companies in how our customers rate their service and our brand by 2025. This is a big shift in performance, but we have already seen some improvement in our C-Mex and D-Mex scores. This year we developed five customer principles to measure our performance for AMP7. Please refer to **page 26** for more information.

We recognise the importance of digital communication and launched a new website in October to improve the website experience for our customers. Our self-serve platform "My Account" continues to grow, with over 495,000 customers now registered. We have improved our email capabilities, allowing us to communicate with customers through the channel of their choice.

Our support for financially vulnerable customers, who have a low household income or are claiming benefits, has grown with 64,000 households now supported by our social tariffs. This is likely to increase further as a result of the economic hardship that COVID-19 has caused. These customers receive a reduced fixed rate spread over 12 months. We are introducing a Customer Assistance Fund this year and our projections suggest, that the number of customers receiving support through our social tariff, will increase to 82,000 customers in 2024/25. We continue to work with organisations including Housing Associations, debt support charities and faith groups. This is proving a success as we more than met our target to increase the number of vulnerable customers on our Priority Services Register.

Minimising disruption to everyone
We constantly look at ways to do things differently and better; from changing the way we generate and use energy to driving down the waste in our processes.

Leakage was a big issue that we have addressed in AMP6 and are going to do much more about in AMP7. We have taken measures to improve our leakage detection by investing in new leading-edge technology. We now monitor and compare our distribution input to the demand in each zone across our supply area. Using our leakage software, we can identify areas of water loss. We have reconfigured our flow loggers to report night usage measurements at a district level and have increased the use of leak noise mapping to help identify genuine leakage as opposed to higher water use. We use the data gathered from the extensive use of our flow loggers and leakage software to ensure continuous improvement.

We have introduced step testing which allows our engineers to systematically work through districts and streets, by establishing a monitoring meter, and then opening and closing valves to isolate parts of the network to narrow down areas suffering from loss of water due to leakage.

Customers, rightly, expect us to keep the water on. By 2025 we plan to more than halve the average time that homes experience an interruption to supply.

OUR PEOPLE
Our aim is to attract, develop and retain a highly skilled and customer focused workforce to drive the changes we need to continue to make the company successful.

In determining our purpose and planning for the future we recognise the long-term talent needs and are continually looking at our approach to graduate recruitment, apprenticeship intake, and other training and development opportunities. Our work in communicating with all employees in a more interactive manner is showing a pleasing improvement in employee engagement. We conducted a culture survey and commenced a Culture Ambassador scheme to drive changes to make the company a better place to work. We have started 360° feedback surveys among our operational teams to assess how well they believe the company's leaders are living our purpose and values whilst driving the business transformation programme. See **page 76** for more details.

I am proud of the work our employees have put in over the last year to turn the business around. I would like to thank every one of them. Their efforts have contributed to a strong year end performance and resulted in a company-wide bonus, linked to the achievement of key operational and financial targets.

Chief Financial Officer's review

This year has been impacted financially by some large one-off costs, however during the year we have seen more stability in our underlying base costs.

This is the start of the transformation of our cost base as we deliver the efficiencies to meet the challenging allowances set for the next five years. Towards the end of the financial year the COVID-19 pandemic commenced and this has affected our full year profits. We expect this to continue and have a further effect in 2020/21 and possibly beyond.

Ofwat's final methodology for PR19 confirmed that prices in the industry will in future be indexed to CPI instead of RPI. In March 2020, we transacted our first CPI linked inflation swap, with a nominal value of £25.0m. We have completed and plan to complete further swap transactions to increase the proportion of our borrowing linked to inflation.

Ofwat published its Final Determination for AMP7 in December 2019. In March 2020 we obtained an investment grade credit rating from Fitch (Class A bonds: BBB+ and Class B bonds: BBB-).

In March 2020 Moody's reaffirmed our credit ratings and moved the rating from Review for Downgrade to Negative Outlook. In February 2020, Standard & Poor's downgraded the ratings of our Class A and Class B Bonds by one notch each bringing the Class B bond rating in line with those from Moody's and Fitch.

To meet our commitment of being open and transparent, we published our inaugural "Understanding our finances" report in November 2019. The purpose of this report is to help our customers and other stakeholders understand our business and our finances, including how we fund our operations and how we spend our customers' money. The full report is available on our website: **affinitywater.co.uk/performance**

AMP7 BUSINESS PLAN
We plan to invest £1.44bn totex 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 WRMP for the 60-year period from 2020 to 2080.

Our Plan for AMP7 keeps customers' bills as low as possible. 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 have reduced in real terms by almost 7.0% across AMP6. We plan to reduce our bill by a further 5.5% across AMP7.

Our Plan also ensures our business is financeable. We have assessed this through stress testing our Plan, whilst maintaining the ratios within our covenants at a level consistent with our family credit rating of BBB+. The Plan is built on the financial structure the company has in place and on access to the long-term financing needed for our investment during AMP7.

2019/20 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 149**.

	2020 £m	2019 £m
Revenue	**307.2**	311.6
Operating costs	**(280.1)**	(270.9)
Other income	**18.5**	17.9
Operating profit	**45.6**	58.6
Net finance costs	**(45.5)**	(44.9)
Profit before tax	**0.1**	13.7
Taxation	**(21.8)**	(3.1)
(Loss) / Profit for the year	**(21.7)**	10.6

Stuart Ledger
Chief Financial Officer

Strategic report continued

Chief Financial Officer's review (continued)

Revenue for 2019/20 was £307.2m, being a £4.4m (1.4%) decrease on the prior year (2019: £311.6m). The decrease is primarily due to lower non-household revenue as a result of final settlement reports issued by the market operator, as well as the impact of COVID-19 causing a large number of businesses to temporarily close and therefore use less water in March 2020. Operating costs for the year increased by £9.2m (3.4%) to £280.1m (2019: £270.9m).

The largest cost increases were due to inflation, which was 2.63% for the year to March 2020 and depreciation (excluding right-of-use assets) as a result of the ongoing investment in our mains network and IT software, as more assets have been capitalised and are therefore now being depreciated.

Our operational costs also increased due to higher unit costs as a result of the complexity of jobs being carried out and higher reinstatement costs. The location of mains bursts in our network also had an impact with a number of bursts causing significant damage to customer property and some requiring the use of costly specialist equipment.

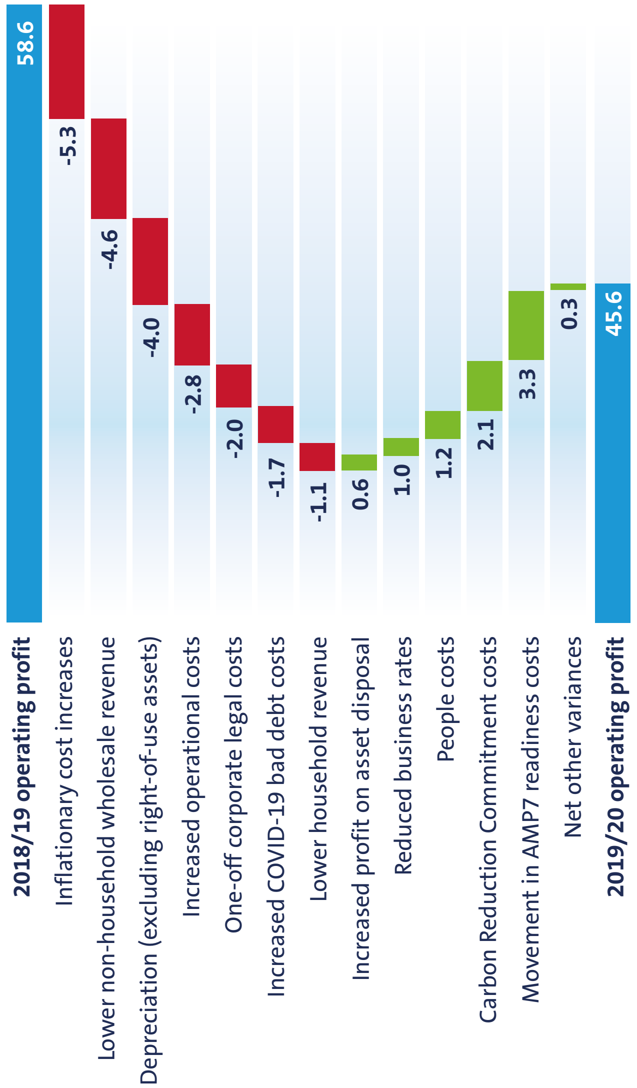
These were partially offset by lower bulk water costs than the prior year due to the wet weather over the winter months allowing us to use our own abstraction sources rather than importing water from other regions.

We also incurred £2.0m of one-off corporate legal consultancy fees during 2019/20 which were not present in the prior year and a £1.7m bad debt charge in relation to COVID-19.

The £3.3m cost of restructuring of our business in the prior year in order to be able to deliver the significant efficiencies planned for AMP7 has not been repeated in the current year. It led to a lower headcount, which more than offset inflationary salary increases, such that overall people costs have reduced by £1.2m.

Our business rates have reduced by £1.0m year on year and we re-sold some of our unused Carbon Reduction Commitment allowances during the year, which along with a reducing cost profile of the scheme has resulted in lower costs compared to 2018/19.

As a result, operating profit fell by £13.0m (22.2%) to £45.6m (2019: £58.6m) as shown in the graph below. The net finance expense of £45.5m was £0.6m 1.2%) higher than last year (2019: £44.9m), primarily as a result of increased accretion on our bonds. For more detail refer to note 5 of the statutory financial statements. Profit before tax for 2019/20 was £0.1m, being a £13.6m (99.3%) decrease on prior year (2019: £13.7m).

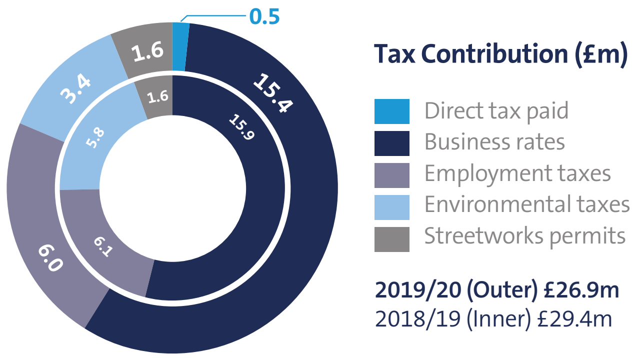


TAXATION

The income tax expense on profit before tax was £21.8m (2019: £3.1m). The effective current tax rate (23,928.8%; 2019: 28.6%) was higher (2019: higher) than the UK corporation tax rate of 19.0% (2019: 19.0%). Further information and a full reconciliation of the current tax charge are set out in note 6.4 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. In March 2020, we were reaccredited with the Fair Tax Mark. Details of the tax strategy for our regulated business can be found on **page 265**, and the group tax strategy of Daiwater Investment Limited, our ultimate holding and controlling company in the UK, can be found on our website: **affinitywater.co.uk/library.**

Our total tax contribution is set out below:



DIVIDENDS

No equity dividends were paid during the year (2019: £6.6m, none of which related to the regulated business) reflecting the shareholders' commitment to re-invest all planned returns from the company's appointed business for the benefit of our customers.

CAPITAL EXPENDITURE

Capital expenditure in the year was £129.9m (2019: £107.2m), and was incurred principally in our mains renewals, trunk main replacement, lead pipe replacement, water treatment (including pesticide treatment) and integrated water savings programmes.

This excluded £17.2m (2019: £17.3m) of infrastructure renewal expenditure, which is treated as an operating cost under FRS 101. The higher capital expenditure in 2019/20 reflected our increased work on the HS2 project, for which we also received higher capital contributions offsetting these costs.

CASH FLOW

Net cash inflow before tax and financing[1] for the year was £35.9m being a 15.1% decrease on last year (2019: £42.3m). The decrease is primarily due to £7.6m lower cash generated from operations partially offset by £4.9m lower net investment in fixed assets (including capital contributions) in the current period (2020: £70.5m; 2019: £75.4m).

AMP6 TOTEX

Our overall totex for AMP6 showed an overspend of £30.3m (2.56%) in outturn prices compared to our allowed expenditure, although the amount we expect customers to fund through the sharing mechanism is only £4.0m (in 19/20 prices). This was primarily due to pension deficit costs higher than allowed in our PR14 Final Determination (we paid more into our pension scheme to take it to a fully funded basis on a self-sufficiency basis). These costs are outside the sharing mechanism and therefore have been fully at the company's expense, and offsetting the financing cost of an underspend in the first few years of AMP6. The main variances on cumulative totex for AMP6 ompared 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 2020 was £972.9m, an increase of £13.4m since last year (2019: £959.5m) primarily due to accretion on the index-linked bonds. Our gearing as measured by net debt to RCV at 31 March 2020 was 78.9% (2019: 78.3%) which remains 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%. 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. The company renewed two revolving credit facilities on 24 June 2020 totalling £100.0m, which use SONIA as the reference rate and have sustainability performance measures included.

[1] This "non-GAAP" measure is calculated as the total of the following line items per the statement of cash flows (refer to **page 148**): cash generated from operations; purchases of property, plant and equipment; proceeds on disposal of property, plant and equipment; purchase of intangible assets; and principal elements of lease payments.

Strategic report continued

Our industry

The industry in which we operate needs to comply with the laws, regulations and standards, and policies published by a number of regulators, including:

Water Services Regulation Authority
Ofwat is our economic regulator.
ofwat.gov.uk

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

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

Department for the Environment, Food and Rural Affairs
Defra is the UK government department responsible for water policy.
gov.uk/government/organisations/department-for-environment-food-rural-affairs

Natural England
Natural England is responsible for the protection of designated sites for nature conservation.
gov.uk/government/organisations/natural-england

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

POLITICAL AND REGULATORY ENVIRONMENT

There was continued public debate about the ownership and operations of the water industry during 2019 with the opposition party's election manifesto seeking water re-nationalisation.

This debate reinforces the need for us to ensure that our customers trust the service we provide and have confidence that we operate in ways that are responsible, transparent and accountable.

In December 2019, Ofwat published its final price control proposals for AMP7. As well as setting limits on customers' water bills, the determinations require greater operating efficiency from water companies along with substantial investment to improve the resilience of the water supply system.

They also feature Performance Commitments to reduce water demand and leakage, augment supply and improve the performance of operations alongside improving customer service and meeting environmental objectives.

We accepted Ofwat's PR19 Final Determination in February 2020 and have mobilised our business to deliver against the substantial challenges embodied in our settlement in order to move into AMP7 with certainty about what we must deliver.

Four water companies within our industry have asked Ofwat to refer their PR19 determinations to the Competition and Markets Authority ('CMA'). The CMA will investigate how well Ofwat's PR19 proposals for the four companies operate in the public interest and what, if any, amendments are needed. Some of the CMA's conclusions may have implications for wider water regulation, not just for the four companies under referral.

ECONOMIC REGULATION

Our business is a regional monopoly and is subject to incentive-based economic regulation by Ofwat. We are subject to a strict revenue control regime, designed to incentivise efficiency in operations and investment decisions. Ofwat operated three separate controls for AMP6 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 since that date have only operated in the retail household and wholesale markets, both of which are monopoly activities.

Our retail household price control continues to operate on a maximum allowed revenue per customer basis.

The wholesale revenue price control is based on incentives related to totex. This control has been further disaggregated into a "water resources" control (abstraction) and a "network plus" control (raw water transport, storage and treatment, and treated water distribution) for AMP7.

Ofwat assesses companies' operational performance against agreed performance commitments. Certain performance commitments contain an ODI, which can carry a financial reward, penalty, or both. There are also reputational consequences for failures against performance commitments.

Our price limits for AMP7 include financial adjustments relating to our performance in the first four years of AMP6. Any price control incentive penalties or rewards in relation to our performance in 2019/20 will be considered as part of the PR19 Reconciliation framework, for which final rules are expected in the latter half of 2020.

From AMP7 onwards, the ODIs will be measured in-period and recognised as a revenue adjustment in the next charging period. In addition to controlling revenues, Ofwat has determined eight ODIs with financial incentives which will be common across all companies. Ofwat "standardised" its measurement to enable it to use comparative information in setting and agreeing target benchmarks.

There are a further 20 ODIs which are bespoke to us. Nine of these carry financial incentives, whilst 11 do not but, if we fail to meet the standards required, are likely to worsen our reputation with stakeholders.

In AMP7 we plan to do more for our customers by:

- reducing the average household bill by 5.5% in real terms;
- delivering our biggest investment programme and reducing operating costs;
- improving customer experience by reaching top quartile performance;
- improving our IT experience; and
- supporting customers in vulnerable circumstances, and those who will benefit from our Priority Services Register.

We will also stretch ourselves further to step up our operational performance through a number of commitments including:

- our leakage reduction target of 20% (142.80Ml/d by 2024/25);
- our PCC reduction target of 12.5% (to 132.6 litres per household per day by 2024/25);
- our water quality target of a CRI score of less than 2.0; and
- our supply interruptions target of only 5 minutes lost per property on average per year.

More information is available on our website: **affinitywater.co.uk/business-plan**

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.

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 strategic 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 Purpose	To provide high quality drinking water and to take care of our environment for our communities now and in the future				
Our Principles	Be proactive	Make it easy	Show you understand	Do what you say you will	Show you care
Our vision	To be the UK's leading community-focused water company				
Our capitals	Our customers and communities	Our environment	Our people	Our assets and sites	Our finances
Long-term plans	Maintain our local environment	Sustain our local communities	Support our local economies		
Strategic outcomes	Supplying high quality water you can trust	Making sure you have enough water, whilst leaving more water in the enviornment	Providing a great service that you vaule	Minimising disruption to you and your community	
Short-term plans	Maintain high water quality; Catchment management; Water treatment	Abstraction reduction; PCC reduction; Leakage reduction	Keep bills low; Support vulnerable customers; Improve customer experience	Reduce supply interruptions; Reduce risk of low pressure; Invest in our assets	
	Provide an appropriate return for our shareholders				

Our purpose, values and culture

In 2019/20, we commenced work on defining our purpose, values and culture. We conducted internal and external research, gathering insight from stakeholder interviews, focus groups and opinion polling.

Our research showed that customers, employees and other stakeholders have a strong appetite for us to place the environment, and in particular the local environment, at the heart of our business. Our purpose is to provide high quality drinking water and to take care of our environment for our communities now and in the future. We aim to achieve our purpose by:

SUSTAINABLE WATER FOR THIS GENERATION AND THE NEXT

- Investing in the infrastructure we need
- Becoming world leading on reducing leakage
- Helping customers use the right amount of water and leading nationally on reduction of consumption.

LOOK AFTER BEAUTIFUL LANDSCAPES EVERYONE CAN ENJOY

- Reducing plastics in watercourses
- Leading on restoring local rivers including campaigning for change where needed
- Securing UNESCO World Heritage status for chalk rivers.

Our independent CCG has helped us to develop our purpose by providing challenges around our community strategy and the journey towards our purpose.

Our purpose links to our vision to be the UK's leading community focused water company both through explicit reference to our communities and the neighbourhoods that we serve but also by creating significant public value. Through investing capital in the environment we will create economic value to the regions we serve.

During Summer 2019 we unveiled our customer principles, which were borne out of the things that research has shown us matter most to our customers (refer to **page 26** for further information on these principles). Using these customer principles as a basis, we further established the values of our ideal internal culture that underpin how we will deliver for our stakeholders in the context of our purpose, giving us our company principles:

Be proactive	Make it easy	Show you understand	Do what you say you will	Show you care

We conducted our inaugural Culture Survey amongst our people in 2019/20, inviting all our senior managers and a cross-section of employees to take part. The results of this survey provided a rich insight into the strengths and weaknesses of our current company culture and enabled us to develop a blueprint for our desired open, empowered and inclusive culture.

We have been working hard during the year to implement the findings of this survey and progress towards our new company culture. We have updated our Code of Conduct, delivered key messaging at Directors' Roadshows and commenced a Culture Ambassador scheme. Culture Ambassadors lead the definition and implementation of initiatives in each department and work together across the company to make Affinity Water an even better place to work.

We appointed Trevor Didcock, one of our Independent Non-Executive Directors, as the Designated Director for Employee Engagement. His role ensures that the voice of the workforce is heard and considered at Board level.

Trevor is also a member of our newly established Diversity and Inclusion Committee set up to bring to life our commitment to build a more inclusive culture and is attending the Culture Ambassador Forums to drive cultural change across the company. For information on the Board's involvement in establishing our purpose, values and culture, and in monitoring values and culture to satisfy itself that behaviour throughout the business is aligned with the company's purpose, refer to **page 76**.

Strategic report continued

How we create value

Our capitals	Our AMP6 achievements	Our AMP7 commitments (see page 33 for a full list of commitments)	Our strategic outcomes
Our customers and communities Relationship and trust between us and our stakeholders. **(page 26)**	We maintained high quality drinking water throughout AMP6 by consistently meeting our MZC target of 99.95% We continued our targeted programme of lead pipe replacement to meet more stringent legal standards	To achieve a CRI score of less than 2.0 To 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 To reduce the number of contacts about water appearance, taste and odour to 0.67 per thousand population per annum by 2024/25	**Supplying high quality water you can trust** KPI: Water quality (**page 36**)
Our environment The natural resources that we rely on. **(page 28)**	We reduced the amount of water we take from the environment by 42.1 Ml/d We encouraged our customers to use less water through our Water Saving Programme, by installing 159,000 meters We invested £500 million in our network to reduce leakage, saving the equivalent of 18.8 Ml/d	To reduce the amount of water we take from the environment by a further 27.3 Ml/d by 2024/25 and reduce abstraction from environmentally sensitive sites when flows or levels are low To reduce leakage from water pipes by 20% on a three year average basis from a 2019/20 baseline To reduce PCC by 12.5% on a three year average basis from a 2019/20 baseline	**Making sure you have enough water, whilst leaving more water in the environment** KPI: Sustainable abstraction reductions (**page 36**) KPI: Leakage (**page 37**) KPI: PCC (**page 37**)
Our people Our experience, skills and competences. **(page 30)**	Average household bills reduced before inflation between 2015 and 2020 We promoted our social tariff (LIFT) to support those least able to pay their bill whilst keeping our bills as low as possible We made ourselves accountable to our communities for our performance	Average annual customer bills will reduce by 5.5% in real terms, and we will deliver over £200.0m of efficiencies to keep bills as low as possible To proactively provide assistance to more of our customers in vulnerable circumstances by understanding and prioritising their needs To improve customer experience by listening to customer needs and investing in the right technologies to deliver great customer interaction and increased engagement	**Providing a great service that you value** KPI: SIM (C-MeX in AMP7) (**page 37**)
Our assets and sites The lifecycle of our assets and investment projects. **(page 32)** **Our finances** Finance available to sustain our business. **(page 34)**	We invested in increased flexibility in our network enabling us to transfer water more effectively around our communities	To reduce supply interruptions to customers to 5 minutes per property per year on average by 2024/25 To reduce the number of properties at risk of receiving low pressure to 1.118 properties per 1,000 properties by 2024/25 To invest £1.44 billion in our wholesale business to maintain core network assets to keep services running 24 hours a day, 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	**Minimising disruption to you and your community** KPI: Mains bursts (**page 38**) KPI: Unplanned interruptions to supply over 12 hours (**page 38**)

Strategic report continued

Our customers and communities

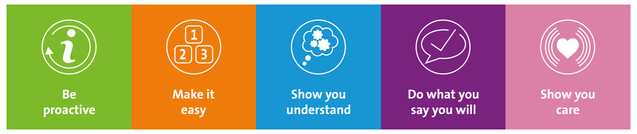
During the year more than **3,500** people from the local community have taken part in volunteering and events on our sites managed by Herts and Middlesex Wildlife Trust

Our people have committed **AROUND 200 DAYS** volunteering to help local community partners and charities through Affinity Days during the year

We have been awarded a **GREEN APPLE AWARD** in environmental best practice for our partnership approach to biodiversity with Herts and Middlesex Wildlife Trust

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.

During Summer 2019 we rolled out our new customer principles, which are set out from the point of view of customers and reflect the things that research has shown us matter most to them.



By continually increasing our focus on customers we have been able to deliver improvements in the following areas:

- in October 2019, we launched an updated website, making it easier to navigate and accessible for all;
- we continued to build more digital enhancements to our self-serve platform "My Account", which continues to grow, with over 495,000 customers now registered;
- we enhanced our email capabilities, allowing us to better communicate with customers through the channel of their choice.

CUSTOMER SATISFACTION

Providing excellent customer experience for customers and developers is fundamental for maintaining trust and confidence in the water sector. Our C-MeX score during the shadow year ended 31 March 2020 was 72.70 against an industry average of 76.65, ranking us 15th out of 17.

Customer satisfaction is of utmost importance to us, so we recognise there are areas we need to improve on in order to climb further up the league table. We have received positive feedback from our customers so know we are able to get there.

Ofwat has also introduced D-MeX, which is designed to incentivise water companies to provide an excellent customer experience to developer services customers.

At March 2020, we achieved a qualitative score of 60.39% and a quantitative score of 88.36% which as a result placed us 16th out of 17 in the industry league table.

SERVING OUR COMMUNITIES

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.

Our Diversity and Inclusion Committee was established in 2019 to help us to better reflect the diversity we see within our communities and within our business as well as providing further insight to ensure our services are inclusive to all.

We continue to promote our Priority Services Register during our interactions with customers. We have developed partnerships with our energy colleagues and have a joint branded leaflet with UK Power Networks to allow customers to sign up to the Priority Services Registers of both organisations. Additionally, we also have a partnership with Money Advice Trust and have a co-branded and unique link to signpost customers to support available via National Debtline.

POSITIVE FEEDBACK FROM OUR CUSTOMERS:

"Fantastic customer service – the lady was very helpful, nothing was too much. Went above and beyond!"

"Your text and web updates have been first class today. My mum has no water but I've registered for the alerts and I let her know every time I get a text and update, it's really good so thank you!"

"Very good service. Call back arranged and this was met. Query was dealt with professionally and quickly. Good customer service. Patience, attentive and good understanding. Thank you"

Our purpose, values and culture in action

#WhyNotWater

Water efficiency is critical to responding to climate change but in our view, it is not sufficiently part of the debate.

In Summer 2019 we launched our #WhyNotWater manifesto and campaign to encourage a national debate to ensure that water conservation is at the heart of our actions and behaviour. Our petition at change.org asked the UK Government to change legislation in order to promote the conservation of water and our natural environment.

We are petitioning for:

1. mandatory water efficiency labelling on appliances;
2. the rights of tenants to use water efficient goods;
3. domestic water efficiency of fixtures and fittings through mandatory certification; and
4. every local plan in a severely water stressed area to include a PCC target of 110 l/p/d.

OUR CAPITALS

We targeted our presence at landlords' forum meetings, various festivals and sports events

To highlight our campaign, we installed an ice block in the grounds of St Albans Cathedral, representing how much water four average households use in one month

KEY STAKEHOLDERS

- Defra
- The UK Government
- Employees
- Customers
- Communities
- River groups
- Wildlife Trusts

ACTIONS AND OUTPUTS

- Campaign urging policy makers to help us create water efficient communities and lobbying our customers and other stakeholders to support it
- Series of podcasts with industry experts endorsing our campaign and advocating for change that help to engage with hundreds more customers
- Our petition reached its target number of signatures and local authorities are now adopting the 110 l/p/d target

Strategic report continued

Our environment

We provided
125,000+
free water saving devices in the year to help our customers to reduce consumption

51
SWIFT BOXES
installed on company sites in the year to encourage this rapidly declining species

14.3KM
of river improved across our catchments during the year

All three of our supply regions have been designated as areas of "serious water stress"[1] by the Secretary of State, with significant increases in population numbers across our supply areas expected.

We recognise the importance of resilience and long-term planning in adapting to increased water stress and have been working hard to reduce abstraction, leakage and customer consumption.

LEAVING MORE WATER IN 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 aquifers, we do not have significant storage for untreated water. We therefore need to react to environmental changes quickly and ensure we operate in a way that leaves more water in the environment.

13 CLIMATE ACTION

Climate change is believed to be making periods of prolonged dry weather more intense. We saw this during 2019/20 where we had periods of low water resources, followed by high levels of rainfall. It is important that we can adapt to the challenges that climate change will bring and continue to use water more wisely.

Our Drought Management group monitors our groundwater levels closely, and works with environmental non-governmental organisations, regulators and catchment groups recognising and communicating instances of environmental drought to our customers.

It is essential that we continue to work hard to reduce leakage on our network; our customers expect us to lead the way and we are committed to doing so. See more details on our leakage performance on **page 37**.

SUSTAINABLE WATER FOR THIS GENERATION AND THE NEXT

Our WRMP sets out our plan to secure the long-term provision of resilient and sustainable water supplies for customers, whilst emphasising that our customers will have enough water while leaving more water in the environment. We plan to:

- install more water meters;
- increase engagement with customers on their consumption;
- increase the supply of water through improvements to our network and increasing cost efficient water imports; and
- improve our resilience to droughts.

Our full WRMP is available in on our website: **affinitywater.co.uk/water-resources**

LOOK AFTER BEAUTIFUL LANDSCAPES EVERYONE CAN ENJOY

We are working with stakeholders to address the environmental challenges of protecting our precious local rivers and habitats while encouraging behavioural change.

14 LIFE BELOW WATER

Most of the world's chalk streams are in the South East of England with many flowing through our supply area. They can be particularly at risk of drying up if the water table in the chalk bedrock is lowered by drought progression or locally by abstraction, especially where these rivers have previously been modified.

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.

[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.

Our purpose, values and culture in action

Improving water quality through catchment management

We ran an innovative scheme incentivising farmers to grow cover crops over the 2019/20 winter period.

We used a reverse-auction platform for farmers to bid competitively for funding to deliver the eco-system services we required.

Our aim was to work in partnership with landowners and other experts to improve water quality by reducing the amount of bare soil during the winter months, which can have a range of benefits including nitrate and carbon capture, flood risk management, soil health improvement and increased biodiversity.

KEY STAKEHOLDERS

- Farmers
- The environment
- Delivery partners

OUR CAPITALS

Over 500 hectares of cover crops replacing bare soil over the winter

12 farm businesses committed to growing cover crops in partnership with the Farming and Wildlife Advisory Group

ACTIONS AND OUTPUTS

- Reduced the amount of nitrate leaching into nearby groundwater by an estimated 25 tonnes
- Increased water infiltration and reduced sediment erosion in current and future climate change scenarios
- Improved aesthetics of the countryside for the benefit of the communities who live there

Strategic report continued

Our people

48 PEOPLE
appointed as Culture Ambassadors and
12 PEOPLE
appointed as Diversity and Inclusion Ambassadors

We have
131 PEOPLE
trained in mental Health Support, Knowledge and Awareness

We have
189 PEOPLE
trained in the principles of Lean Methodology and business transformation

Our people play a critical role in creating long-term value. 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.

TRAINING AND DEVELOPMENT

4 QUALITY EDUCATION

We have created a strong culture of learning and development, through significant investment in training and building a culture of coaching and mentoring to release the potential of our people. During the year, we invested in programmes that focus on business transformation, management development and responsive working practices, all which will help to improve customer satisfaction. We also continue to train our apprentices to become fully qualified Production Technicians by 2021.

SAFETY AND HEALTH

The safety, health and wellbeing of our people and suppliers are priorities we take very seriously and we are committed to operate our business without harm. We have launched a new programme aimed at making safety personal and have set ourselves a challenging target to embed our safety culture in everything we do. Our people are encouraged to spot unsafe behaviour and take ownership to stop it. We have improved our monthly safety brief to all employees, re-established health and safety meetings with our trade unions and worked with contractors to raise standards through inspection programmes.

Resultantly, our accident frequency rate reduced to 0.20 lost time injuries per 100,000 hours worked for the year ended 31 March 2020 (31 March 2019: 0.23).

OUR SUPPLIERS

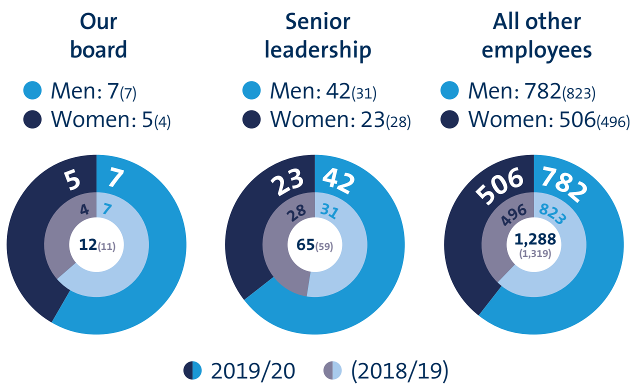
Our suppliers and contractors provide us with essential services which we rely on to deliver our short and long-term plans. We improved our payment practices between April 2019 and April 2020 with a reduction in our average time to pay invoices (from 39 to 35 days) and late payments (from 40% to 38%) 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.

DIVERSITY AND EQUALITY

In 2019/20, we held a #EachForEqual brunch, a "world religion day" to improve understanding of various religions, amended our additional "Christmas" day holiday to be taken for a cultural day of employees' choice and committed to developing software that will enable us to report on ethnicity pay in our next Gender Pay (Diversity Pay) report.

5 GENDER EQUALITY

We published our Gender Pay report of April 2019 data on our website: **affinitywater.co.uk/responsibility** which showed a 3.5% reduction in our mean gender pay gap from 22.5% in April 2018 to 19.0% in April 2019. Initial work on our April 2020 reporting indicates a widening of 1.4% to 20.4%. The gender breakdown of our directors and employees as at 31 March is shown below:



Senior Leaderships include the Executive Management Team and their direct reports

Our purpose, values and culture in action

Diversity and Inclusion Committee

We are committed to building a more inclusive culture and ensuring equal opportunities for all. As part of our #BalanceforBetter campaign in 2019 and the signing of the Energy and Utility Skills Inclusion Commitment, we have committed to attracting and retaining more diverse talent in our sector. This was the catalyst for the creation of an internal Diversity and Inclusion ('D&I') Committee, steering an agenda of change across the company.

Our Committee members bring a wealth of perspectives and ideas from across our teams including senior leaders and Board representation. They have a broad working remit, currently working on monitoring and understanding our gender and ethnicity pay gaps as well as establishing networks for the LGBTQ+ community and parents returning from maternity or paternity leave.

OUR CAPITALS

We have developed our people and provided an opportunity for them to become D&I Ambassadors

By better reflecting the communties we serve, we can provide a better service to our customers

KEY STAKEHOLDERS

- Employees
- Executive Management Team
- Our Board

ACTIONS AND OUTPUTS

- Committee members have been recruited
- Regular meetings established and key work areas identified
- We offer all employees an additional day of annual leave which can be taken at any time during the year to encourage celebration of any religion, festival, tradition or culturally significant occasion

Strategic report continued

Our assets and sites

We engaged with
27,250
PEOPLE
to explore water in our environment through education and creative challenges

We produced
16,400
TONNES
of sludge cake at two of our water treatment works sites which is then taken and used for agricultural purposes

Since its inception in 1992, our Asset Performance Lab has processed more than
6,000
pipe samples, allowing us to determine deterioration rates and inform future investment

We continuously invest in our network, both in our above ground assets which collect water from groundwater or river sources and deliver it to our 95 treatment works, and our below ground network of assets which takes water from treatment works and delivers it to homes and commercial premises through more than 16,700km of mains.

The security of our assets and sites is extremely important to us and we worked hard over AMP6 to ensure all of our sites are now compliant with the Security and Emergency Measure Directive obligations.

INNOVATION ON OUR NETWORK

9 INDUSTRY, INNOVATION AND INFRASTRUCTURE

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.

MAINTAINING OUR ASSETS

Maintaining the health of our assets is essential to ensure we can operate 24 hours a day, 365 days a year, and to make sure we promptly respond to emergency failures. 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. The information is used to tailor our future asset investment and identify weaknesses in the network.

Sustained progress throughout the year continued to be realised across our mains renewals programme, with 311.8km of distribution mains and a further 44.2km of trunk mains replaced during AMP6. Significant progress was also made in our Lead Replacement programme: works to remove lead communications pipes from all educational establishments across our entire supply area, where children 11 years or younger are present, were completed before the end of AMP6.

During 2019/20, we refurbished one of our key water treatment works, redesigning the abstraction intake point, clearing the granular activated carbon filters and sludge tanks, and cleaning the ozone generators in order to improve water quality, increase production capacity, and enable them to operate more efficiently, which will result in an annual cost saving.

The High Speed 2 ('HS2') project is a major national infrastructure project to develop the UK's new high speed rail network, with the proposed route passing through our supply area. We have worked hard to overcome complex design and construction challenges while limiting the impact of the planned outages on the wider network.

PRODUCTION AND SUPPLY

13 CLIMATE ACTION

We continued our work to seek chemical optimisation to promote energy efficiency whilst supporting the environment through trialled source reduction. We aim to reduce our energy usage and carbon emissions across all our sites as part of the formulation of our energy strategy for the next 20 years, supporting our AMP7 Business Plan and our WRMP.

We have embedded network control alongside production control. Smart network event detection enables early warning and action as incidents occur within the network field, thus promoting effective and efficient response to improve customer experience.

Our AMP7 performance commitments

Our Business Plan for AMP7 includes a total of 28 stretching performance commitments that will ensure we deliver our four strategic outcomes:

Outcome	Commitments	Financial / reputational
Supplying high quality water you can trust	Reduce the number of contacts about appearance, taste and odour to 0.67 per thousand population by 2024/25	Financial
	Meet water quality standards on compliance failures by scoring less than 2 annually in DWI's new water quality measure CRI	Financial
Making sure you have enough water, while leaving more water in the environment	20% leakage reduction on a 3-year average from the 2019/20 baseline	Financial
	12.5% reduction in PCC on a 3-year average from the 2019/20 baseline	Financial
	Complete river restoration and habitat enhancement projects under the Water Framework Directive	Financial
	Reduce water abstraction by 27.3 Ml/d by 2024/25	Financial
	Complete 8 environmental pilot projects working in partnership with our local communities	Financial
	Delivery of schemes within the WINEP programme	Reputational
	Reduce abstraction from environmentally sensitive sites to nil when flows or levels are low	Financial
Providing a great service that you value	Improve the overall customer experience provided to our household customers	Financial
	Improve the overall experience provided to developer services customers including property developers, self-lay providers and NAVs	Financial
	Proactively provide assistance to more of our customers in vulnerable circumstances by understanding and prioritising their needs	Reputational
	90% of customers in vulnerable circumstances receiving financial help are satisfied with the service from us	Reputational
	90% of customers in vulnerable circumstances receiving financial help found us easy to deal with	Reputational
	90% of customers in vulnerable circumstances receiving non-financial help are satisfied with the service from us	Reputational
	90% of customers in vulnerable circumstances receiving non-financial help found us easy to deal with	Reputational
	Maintain the BSI standard for inclusive service provision throughout 2020-2025, ensuring our services are accessible, easy and supportive for all	Reputational
	Achieve a score of at least 7.8 out of 10 for customer satisfaction in a Value for Money survey	Reputational
	Identify at least 50 household property gap sites per year	Financial
	Proactively reducing the number of household properties falsely classed as empty on our billing system to 2.10% in 2024/25	Financial
Minimising disruption to you and your community	Reduce supply interruptions to customers to 5 minutes in 2024/25	Financial
	No more than 320 properties affected by a supply interruption per year of more than 12 hours duration – this includes planned interruptions	Financial
	Improve IT resilience by a 29% reduction in the impact of disruption to customers and employees by 2024/25	Reputational
	Reduce the properties at risk of receiving low pressure to 1.118 per thousand properties by 2024/25	Financial
	Reduce the average time each property experiences low water pressure to less than 8 hours 42 minutes in 2024/25	Reputational
	To have no customers at risk of experiencing severe restrictions in a 1-in-200 drought on average over 25 years	Reputational
	Reduce the number of mains repairs to 142.3 per thousand kilometres of network	Financial
	To keep outage of production capacity below 2.34% between 2020-2025	Financial

Strategic report continued

Our finances

£10,267
donated to the Money Advice Trust, a registered charity which is currently supporting our financially vulnerable customers

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

64,000
households supported by our social tariffs and
31,000
households on our Priority Services Register

We plan to invest £1,441.4m totex during AMP7. As we are a business with a long-term outlook and expenditure commitments, we need to match this with long-term sources of debt finance.

We consider the most cost effective way to raise long-term debt to be through the debt capital markets. 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. See **pages 103 to 104** for further details of our financing arrangements.

We expect to undertake our next major refinancing exercise in July 2026 when our £250.0m fixed rate bond matures. The maturity profile of all our borrowings is set out in note A4 to our statutory financial statements.

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 2020, we had cash balances of £85.6m (2019: £96.5m) and short-term deposits held as investments of £25.2m (2019: £15.0m).

Interest rate exposure is primarily managed by using a mixture of fixed rate, floating rate, and index-linked borrowings (refer to note A4 to our statutory financial statements).

At the year-end, 61.7% of our gross borrowings were at fixed rates (2019: 62.3%), 32.6% (2019: 32.1%) at rates indexed to RPI and 5.7% (2019: 5.6%) at rates indexed to CPI. Taking into account our index-linked inflation swaps, the proportion of borrowings at fixed rates decreased to 47.0%, the proportion indexed to RPI increased to 45.0% and the proportion indexed to CPI increased to 8.0%. To the extent that additional funding is required, as well as our cash balances, we have access to £100.0m of bank facilities (2019: £100.0m), which were undrawn at 31 March 2020 (2019: undrawn), to finance capital expenditure and working capital requirements.

In addition, we have access to a further £61.0m of liquidity facilities (2019: £61.0m), 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.

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 Business Plan at a reasonable price (refer to the table on **pages 24 to 25**).

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, for which we are not responsible but which are billed to the water majority of our household customers and which we collect on behalf of other companies, can exacerbate underlying affordability concerns.

Our purpose, values and culture in action

Prince's Trust 'Team' Programme

The Prince's Trust 'Team' Programme is a 12-week personal development programme aimed at 16 to 25 year olds who are not in employment, education or training, allowing them to engage with various employers through a range of 'World of Work' days offering an insight into different industries and enabling them to be more 'work ready'.

Our Education and HR teams hosted a day in November, giving the young people a tour of one of our key water treatment works, running a team building activity and providing work skills sessions to help them understand more about CVs and interviews.

OUR CAPITALS

Our Education Centre and one of our water treatment works were used to facilitate the day

Six of our colleagues shared their skills and experience to equip the young people with the skills needed to enter the workplace

OUR STAKEHOLDERS

- The Prince's Trust
- Education Services team
- HR team
- Production and supply teams

ACTIONS AND OUTPUTS

- Positive impact on the lives of five young people who would otherwise have limited opportunity to receive a water industry specific work experience
- Opportunity to develop professional skills and make a real difference to society for six of our people
- Positive feedback received from participants and separate appraisal from the Prince's Trust team leader

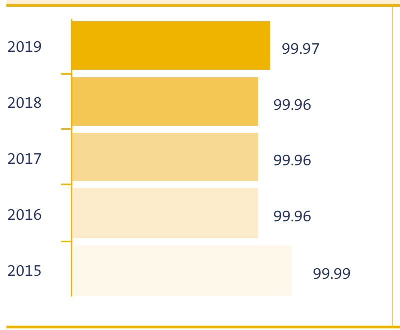
Strategic report continued

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 2019/20 is analysed in the tables below.

For more information on our performance for 2019/20 in relation to all the performance commitments we made in our AMP6 Business Plan refer to **pages 240 to 247** in our regulatory Annual Performance Report.

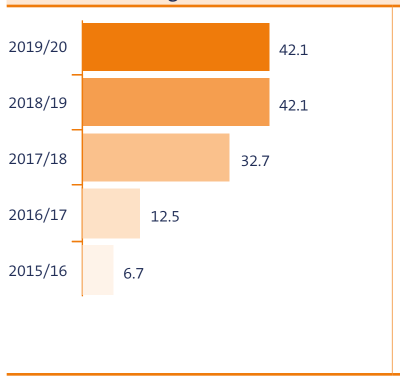
KPI: Water quality - MZC (%)
Actual: **99.97** Target: **99.95**



In the calendar year 2019 there were 50 exceedances of standards from 190,000 compliance samples taken from our sites and consumer properties (2018: 64 exceedances from 180,000 compliance samples).

Of these, 18 exceedances (2018: 19 exceedances) contributed to the MZC calculation. Another measure of our performance is the number of serious and significant incidents. During 2019 one event notified to the DWI was classified as serious or significant (2018: seven events).

KPI: Sustainable abstraction reductions
Cumulative average annual reduction in water abstracted from our river catchments (Ml/d)
Actual: **42.1** Target: **42.1**

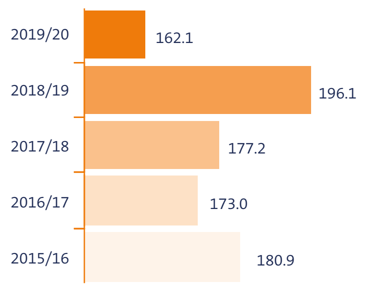


We delivered a 42.1 Ml/d reduction in abstraction as at 31 March 2020, achieving our sustainability reductions in line with our AMP6 Business Plan.

During AMP6 we 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 also completed projects on six chalk streams in our Central region as part of our river restoration and habitat enhancement programme, using a collaborative approach to deliver this work under our Revitalising Chalk Rivers partnership with the EA.

KPI: Leakage - Average annual water leakage from our network (Ml/d)
Actual: **162.1** Target: **162.2 or less**

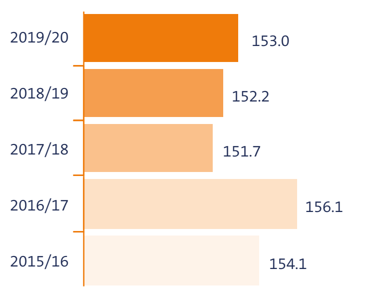


We attach a high priority to meeting leakage reduction targets, as we want to demonstrate that we are playing our part when we are asking customers to save water, and also to overcome the loss of resources to improve conditions on local catchments.

We recovered from the disappointing leakage position reported for 2018/19. Most of this leakage was from a long-running large pipeline burst, but there were other failings in the way we manage and control leakage that we addressed during 2019/20 by:

- adopting a greater skills-based approach to leakage supported by improved analytics;
- introducing software that improves leakage monitoring and our response time;
- making contractor recruitment competence-based, less reliant on lower skilled workforces and integrated into our own teams;
- breaking down long-running high leakage areas into smaller zones through step testing in order to identity areas of water loss;
- utilising new technology to help our teams and complement our current large estate of permanent and mobile acoustic loggers; and
- putting in place a new policy for customer supply pipe leakage that increases provision of free repair if the leak size justifies this decision.

KPI: PCC- Average water use (l/p/d)
Actual: **153.0** Target: **147.4 or less**



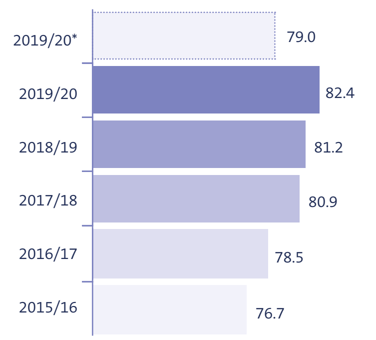
During 2019/20 we recorded PCC of 153.0 l/p/d, which is an increase of 0.8 l/p/d (0.5%) on the prior year (2019: 152.2 l/p/d), and have incurred a penalty of £1.75m through our ODI regime.

During the year, a new team was created to focus efforts on reducing PCC, resulting in the development of a defined PCC strategy and programme. Data insight work was undertaken to understand the water savings from meter installations and our Home Water Efficiency Checks across different customer demographics, shaping the delivery plan for 2020/21.

We improved communications with our customers through our My Account online portal, which now shows customers their personal water use in litres per day as well as average usage in their area in order to drive behaviour change.

We also continue to collaborate with the wider industry through regional working groups, Water UK and UKWIR to improve our understanding of current and future household consumption.

KPI: SIM - (Score)
Actual: **82.4** Target: **82.3**



In 2019/20, SIM was no longer measured and was replaced with the 'shadow reporting year' C-MeX metric.

Ofwat has tracked a "proxy" SIM score for the year ended 31 March 2020 but this is based on C-MeX and is not consistent with the SIM score in prior years. Our "proxy" SIM score is 79.0.

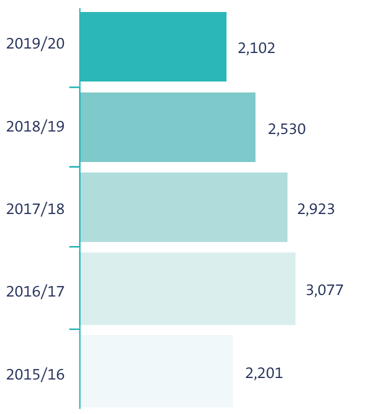
We have continued to calculate an internal SIM score, using a methodology consistent with prior years in order to monitor performance improvement. Our internal SIM score is 82.4, which is an increase on the prior year and shows continued steady improvement across AMP6.

*Ofwat has tracked a "proxy" SIM score for the year ended 31 March 2020 which is not consistent with the SIM score in prior years.

Strategic report continued

Operational performance (continued)

KPI: Mains bursts - (Number)
Actual: **2,102** Target: **3,100 or less**

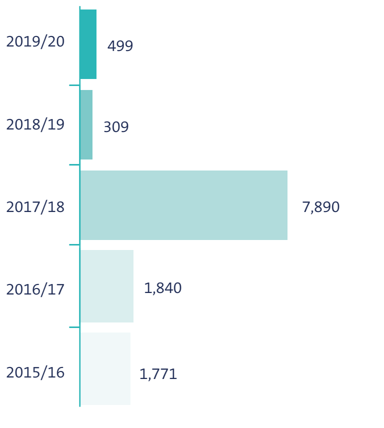


We have achieved our target every year of AMP6, achieving our lowest number of bursts this year, benefitting from settled weather conditions.

Moving into AMP7, our mains burst reporting target has changed to mains repairs per 1,000 km of mains, the target for which equates to a significant reduction over that for 2015-20. We anticipate this will require significant monitoring and work to continue to ensure we look for ways to reduce bursts and their effects on customers.

Work will continue to be focused on reducing night pressure, reducing the volatility of our network and providing analysis where and when bursts occur to inform our mains renewals programme, identifying areas in most need of investment.

KPI: Unplanned interruptions to supply over 12 hours - (Number of properties)
Actual: **499** Target: **320 or less**

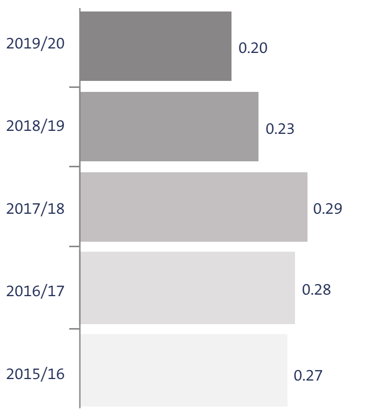


We failed to meet our target this year for unplanned interruptions greater than 12 hours, however we have not incurred an ODI penalty. This is still a disappointing result as we have worked hard to focus our resources on speedy remedy to such events and to learn from the reasons for delays in restoring customers supplies where it has occurred. 312 of the properties affected arose from a single burst incident in a difficult town-centre location.

For the next five-year AMP period our targets for supply interruptions will focus on reducing both the number and duration of all supply interruption events that last for three hours or longer.

Throughout this year we have been working in preparation for this new measure, improving response times, local resources and alternative techniques for repairs and restoration of supplies. Improvements of this nature will continue along with route-cause analysis of events in order to meet a reducing target over the next five years.

KPI: Accident frequency rate - (Number of lost time injuries per 100,000 hours worked)
Actual: **0.20** Target: **0.22 or less**



We continued to work towards improvements in both health and safety, with a particular focus on occupational and mental health. During 2019/20, we recorded five work related lost time injuries ('LTI's'), having an accident frequency rate of 0.20 LTIs per 100,000 hours worked, compared to six LTIs in 2018/19 with an accident frequency rate of 0.23.

We made significant improvements at the start of AMP6, as seen by the reduction of our accident frequency rate from 1.02 in 2014/15 (our baseline figure at the start of AMP6) and have continued to reduce this further in the past two years. **See page 30** for more details on our approach to health and safety.

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.

Our Executive Management Team now also carries out regular assessments of emerging risks, including horizon scanning and monitoring of early warning indicators. 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 96**.

EMERGING RISKS

We have defined emerging risks as potential future events or circumstances which could significantly and negatively impact achievement of our strategic objectives and whose likelihood and impact cannot yet be accurately determined.

As part of our overall risk management framework, we carry out regular horizon scanning and analysis of various early warning indicators in order to identify newly emerging risks and determine if any previously identified emerging risks are increasingly likely to become real current operational risks. Where this is the case, such risks will be subject to the same rigorous process described above to evaluate and manage them.

The Executive Management Team has carried out an exercise to identify and review current and emerging risks. Along with the strategic risks, these will be reviewed at least quarterly by the Executive Management team and at least twice-yearly by the Board.

COVID-19

A national health pandemic, including COVID-19 has been included as a principal operating risk. We have assessed this risk, and the other principal risks, on the assumption that the impact of COVID-19 only lasts for a relatively short part of AMP7. The potential longer term impacts of COVID-19 are assessed in the viability statement on **page 49**.

CLIMATE CHANGE

Climate change is one of the greatest challenges for the industry as a whole and this challenge appears likely to increase in the coming years. Sustainability and resilience in the light of this challenge is important in maintaining the trust of our customers and regulators. Climate change can have short and long-term impacts on our assets, our operations and, therefore, the services we provide.

The most recent significant example was the extreme weather much of the UK experienced in March 2018. Whilst we dealt with that situation very effectively and efficiently, we took the opportunity to review and revise our business continuity and emergency response arrangements. Those arrangements have served us well thus far in coping with the COVID-19 pandemic.

We have identified climate change as an underlying cause of many of the principal risks listed below, in particular numbers 2, 6 and 7.

We have also, therefore, documented in our risk registers, where appropriate, controls in place to mitigate as far as possible the potential effects of climate change in elevating those risks.

We will continue to monitor climate change and its impacts on our operations as well as the effectiveness and efficiency of our mitigating controls, with the objective of ensuring our ongoing sustainability and resilience.

On a positive note, we fully embrace the part we have to play in combatting the effects of climate change. As part of an industry-wide project, we have committed to achieving net zero carbon emissions by 2030.

Strategic report continued

Principal risks and uncertainties (continued)

PRINCIPAL RISKS

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.

We have identified 13 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 are included in the table on the following pages.

MAIN CHANGES SINCE 2018/19

We have removed the following three risks which were included in our 2018/19 report:

- Brexit;
- Failure to achieve a favourable PR19 outcome; and
- Failure to achieve approval of our WRMP

The specific ongoing impacts of Brexit are reflected in some of the operational risks listed below. The other two risks were concerned with regulatory outcomes of our business planning activities which have now been concluded.

This year we have added the following three risks to our report:

- Environment;
- Managing change; and
- National health pandemic

These risks were already captured in our operational risk registers and, for different reasons, they have increased in magnitude during 2019/20 such that they now warrant additional management focus.

We have further strengthened our environmental focus and have reflected this in our purpose, giving equal weighting to delivering high-quality water and looking after the environment. We feel, therefore, that it is appropriate to recognise the environmental risks posed by us and to us.

Our business has gone through significant internal and external change in the past year and we fully expect this to continue for the foreseeable future, not least due to the COVID-19 pandemic. This unprecedented level of change could result in employees becoming disengaged and leaving the company; employees experiencing mental health illnesses; business processes becoming ineffective or inefficient, even if just for short periods of time.

Towards the end of our financial year the COVID-19 pandemic took hold in the UK. So far, our business continuity arrangements have allowed us to continue to provide the vast majority of our services to customers whilst ensuring the health and wellbeing of our employees. Currently, uncertainty remains with regards to how long the pandemic will last; whether a vaccine can be developed and by when; and what the long-term impacts on our business might be.

TABLE KEY

a	Risks included in the sensitivity stress testing for the viability statement (refer to **pages 49 to 53**)
b	Risk included in the scenario stress testing for the viability statement (refer to **pages 49 to 53**)
◀▶	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 Health & Safety management system, which is externally verified and certified to ISO 45001. This encompasses policies, procedures, guidance and risk assessment protocols.

We provide our employees with appropriate arrangements (including training and competency) to enable them to take personal responsibility for their own safety, occupational health and well-being, and that of others. This also includes regular safety related communications; safety briefs; tool box talks; safety stand down days and promoting safety leadership evaluations and safety conversations taking place across the organisation.

We have an established governance framework where Health & Safety related matters and performance are tracked and monitored, spanning Operational, Executive Management Team and Board levels.

We have an audit and inspection regime and incident review protocols in place to ensure key learnings are captured and any necessary strengthening of controls is actioned appropriately.

We also have a programme of Health Surveillance assessments, wellbeing initiatives and an employee assistance programme to help ensure the welfare and wellbeing of our people are effectively managed.

2. Failure to meet our obligations to provide a sufficient supply of high-quality drinking water (b) ▼

Risk: We have a legal requirement to maintain a continuous supply of high-quality water for customers, this being critical to public health in general and to the overall success of our business.

Failure to achieve this could result in consumers losing confidence in their drinking water, and legal and reputational risks for our business.

Interruptions to supply (or supply restrictions) caused by drought, water resource restrictions, changes in quality of water supplies, extreme weather events (extremely cold or prolonged hot weather), flooding events, terrorist attacks, cyber events, civil unrest, disease 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.

Mitigation: We manage this risk through;

- competent staff and processes which are reviewed continuously as part of our Quality management System and through Lean A3 improvement processes
- 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;
- 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, removing single points of failure, implementing treatment upgrades 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 threats materialise, 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.

Strategic report continued

Principal risks and uncertainties (continued)

OPERATIONAL RISKS (CONTINUED)

2. Failure to meet our obligations to provide a sufficient supply of high-quality drinking water (b)

Risk (continued):
The risk with respect to availability of water remains relatively high for us, as we operate in an area of serious water stress. This, coupled with high demand (PCC) from our consumers, housing and other development in the south-east, the construction of the HS2 railway, and other potential large capital infrastructure projects have the potential to further increase this risk.

Furthermore, climate change and 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 (continued):
We have good working relationships with our neighbouring water companies from whom we import and to whom we export water. We continue to demonstrate collaborative methods of working to ensure that we collectively meet our customers' needs.

During 2019 we set up a Water Quality Steering Group composed of EMT members and senior leaders to focus on improvements to ensure that we deliver our AMP7 water quality performance commitments. Many of the actions are around behavioural changes in our teams and encouraging accountability for improvement. Progress is regularly reported to the EMT.

Our drinking water safety plans ('DWSP') provide a comprehensive risk assessment and risk management approach to our supply chain from catchment to tap, supported by our distribution and operations management strategy. We use these plans to inform our investment and maintenance programmes.

DWSP are prepared for full submission to the DWI in October each year and changes are submitted monthly. 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') assesses 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 2019, we carried out 190,000 tests on our water and our MZC, the measure used by the DWI, was 99.97%.

3. Failure to attract, develop and retain good quality employees (a)

Risk: It is vital that we introduce talented individuals into the organisation in line with resource planning needs. If we are unable to fill vacant positions at the right time with the right level of skills, it will severely impact the ability of the company to achieve its business objectives.

Mitigation: We have a dedicated recruitment team which uses direct resourcing methods and works with identified recruitment suppliers to ensure good quality candidates are sourced. The use of the company's website is crucial in providing a strong Employee Value Proposition that will attract talent. A review of external marketing sites is to take place in 2020/21 including a review of Glassdoor feedback as this can impact perception of the company. A project is underway to provide consistency on role definition, create job families and provide salary banding for roles.

We undertook a review of culture during 2019 and we are using the findings to contribute to a transformation programme to deliver greater employee engagement and improvements in a number of areas including performance levels; employee incentivisation and reward; employee development; and career opportunities for individual growth. We have appointed Culture Ambassadors to represent their business areas and provide feedback and support on the culture change journey. A revised Personal Best process, for appraisal / performance management, has been introduced to attain high performance levels and achieve our business objectives.

4. 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 place on 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.

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, demonstrates our commitment to security best practices and ensures 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.

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 the 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 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. This work is ongoing throughout 2020/21.

5. 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.

Strategic report continued

Principal risks and uncertainties (continued)

OPERATIONAL RISKS (CONTINUED)

6. Failure to deliver our business plan, commitments and service to customers 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.

In addition, 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.

It is also 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 complaints, and our reputation.

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.

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 continue to actively manage 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.

We adopt a continuous improvement strategy with regards to customer service. Our Customer Experience Action Group meets monthly and is attended by representatives from around the company. This is also supported by weekly Customer Stand-Up sessions to ensure collaboration on continuous improvements to the services we deliver to our customers.

We have implemented a company-wide Business Excellence programme to drive a culture of continuous improvement of all business processes. Specific to customer service, we are mapping all customer journeys and are critically reviewing all customer communications with regards to tone of voice, use of different media, etc. We are also focusing more than ever on brand and reputation.

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 2019/20, our partner surveyed 106,612 customers with whom we had experienced some interaction. Of those surveyed, 88% expressed themselves as "satisfied" or "very satisfied". We analyse all complaints and have increased our focus on root cause analysis which feeds into the continuous improvement cycle.

We participated in pilot exercises for both C-MeX and D-MeX throughout 2019/20. We have made extensive preparations to ensure that we are able to deliver excellent performance against both these measures throughout AMP7.

Since March 2020, we have encountered various challenges associated with the COVID-19 pandemic. We have already seen increases in household customer water consumption and expect that this may impact achievement of our PCC performance commitment for 2020/21. However, we believe we have sufficient mitigation in place to cope with the pandemic and that we will continue to successfully deliver against the vast majority of our commitments. We have already seen an increase in our customer satisfaction scores since the beginning of the lockdown period.

7. Environment a

Risk: There is a risk that, in the course of operating our business, an incident occurs which inadvertently causes damage to the environment., for example through accidental release of stored chemicals or fuels.

Such an incident could cause pollution or other environmental damage, thus impacting ecology or the wider environment.

We are also exposed to the possibility of damage to our landholdings and assets caused by external factors such as eco system decline; nearby land-use; carbon climate; third-party pollution events; etc. Any of these could lead to increased operational costs; damage to our reputation; prosecution; loss of customer trust; operational disruption, etc.

Mitigation: We are committed to protection of the environment, prevention of pollution and compliance with environmental legislation, regulations and other requirements that are applicable to us.

To deliver on our commitment, we have set ourselves a range of objectives to protect and enhance the environment by:

- minimising the amount of waste generated, and not recycled, from our activities;
- optimising our energy use and reducing our greenhouse gas and other emissions where possible;
- controlling the risks and impacts of pollution;
- using trained and competent people;
- working with our supply chain to address risks and minimise environmental impacts;
- investigating incidents and events to learn from them; and
- working with our communities, regulators and government agencies to manage our impact on the environment.

We have committed to a significant programme (£81.5m) of expenditure on environmental enhancements during AMP7.

Other mitigations in place include: our National Environment Programme; landholdings management plans; corporate social responsibility schemes; catchment management programme; carbon reduction strategy; and education programmes.

The EA has announced that it is to extend the scope of its Environmental Performance Assessment (EPA) to include water-only companies. We recently commented on a consultation with the EA on this and are in discussions with them with regards to the rollout.

8. Managing change a

Risk: There is a risk that the enormity of changes we have made and will continue to make to our organisational structure, our business processes, IT infrastructure, how we interact with our customers, etc. is such that we are unable to implement the required overall transformation of our business necessary to deliver our business plan obligations.

This could occur for various reasons including:
- change fatigue on the part of our employees, contractors or key strategic suppliers;
- insufficient capacity to introduce multiple concurrent changes in a controlled manner; and
- inadequate programme / project management.

Mitigation: As previously mentioned, we are in the midst of a major cultural transformation programme to ensure, amongst other things, that we have a culture in which our people are comfortable with and embrace the significant changes which are necessary in order to make the step changes necessary to deliver our business plan obligations.

We have a well-established and rigorous project methodology in place governing how we deliver our programmes and projects. Our Investment Committee reviews all proposed projects prior to initiation and monitors their delivery to ensure successful outcomes. New projects are approved by reference to available finances, people and other resources as appropriate. Individual members of our Executive Management Team sponsor each project and are ultimately accountable and responsible for delivery to planned budget, time and scope.

Strategic report continued

Principal risks and uncertainties (continued)

OPERATIONAL RISKS (CONTINUED)

9. National health pandemic a

Risk: Our ability to effectively and efficiently deliver the services that our customers expect could be significantly impacted by an outbreak of a pandemic disease.

At the time of writing, we are in the midst of the Coronavirus COVID-19 crisis affecting the whole country and many other countries around the world. As the provider of an essential service, we are expected to continue to maintain the supply of high quality drinking water to all of our customers.

Mitigation: We have emergency response plans and business continuity plans in place, designed to ensure that we continue to perform our business-critical processes in the event of an actual or potential disruption. These plans have been invoked in order to respond to the COVID-19 crisis and have been found to be robust, allowing us to continue to perform the vast majority of the services which we provide to customers. In particular, supply of high quality drinking water has been maintained in all of our customer communities. We have temporarily ceased only a few non-essential processes such as customer appointments which require home visits, unless in the case of an emergency. Where possible, our employees have been instructed to work from home. In order to protect our employees and subcontractors, we have changed the way in which we perform some of our operational processes and in all cases we have taken steps to ensure we follow the Government's social distancing requirements.

At the time of writing we are developing our plans for returning to "business as usual" as and when the time is right to do so. This includes consideration of whether those processes which have been adapted for the current situation need to return to their previous state or whether they can and should continue to be delivered in their adapted state.

10. Adverse changes to the regulatory framework, or social or political climate a

Risk: Changes to the regulatory framework by Ofwat or the government may have an adverse effect on our operational or financial performance. We are also 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 WRMP and some objections to compulsory water metering. These pressures may lead to a reduction in revenue or have a reputational impact.

During the year this risk heightened: the final position for PR19 agreed with Ofwat contains substantial challenges.

While nationalisation itself has fallen down the political agenda following the December 2019 General Election, political risk remains high due to continued scrutiny of the industry.

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.

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

We regularly engage with stakeholders across the political spectrum to understand and mitigate political risk.

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.

We have enhanced our approach to compliance during the year through the development of a comprehensive Compliance Obligations Register and introduction of a twice-yearly self-certification process.

FINANCIAL RISKS

12. Failure to secure appropriate financing for our business activities a

Risk: Our business has an on-going liquidity requirement, driven by the operational costs 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 finalised 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 34** 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 the demanding 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 £14.2m of debt maturing in AMP7 and a spread of maturity beyond this. We expect to undertake our next major refinancing exercise in July 2026 when our £250.0m fixed rate bond matures. 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.

Strategic report continued

Principal risks and uncertainties (continued)

FINANCIAL RISKS (CONTINUED)

13. 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 CPIH 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 and in March 2020, we transacted a CPI swap increasing the proportion of debt linked to inflation to 53.0%. 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. The plan is in 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 been unsuccessful 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.

Viability statement

The Board's consideration of the company's longer-term viability and prospects is an extension of our business planning process. This includes financial budgeting and forecasting, and a robust risk management process.

The directors also assessed the company's long-term prospects in the context of our WRMP, which sets out our plan to secure the long-term provision of resilient and sustainable water supplies for customers from 2020 to 2080. Our plan was approved by the Secretary of State in March 2020. The financial projections presented to the Board, to enable assessment of the company's long-term prospects, reflect the expected level of investment implied by this plan and recovery of this investment from customers.

The directors have assessed the company's financial viability over a shorter ten-year period to 31 March 2030 (the "lookout period"). The forecasts used in the assessment of financial viability, therefore, project beyond the current price control period taking into account both our AMP7 Final Determination and our WRMP. The level of reliability of the assumptions used reduces in the second half of the lookout period; however, the directors continue to consider the ten-year period to be appropriate given the long-term nature of the business.

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 39 to 48** 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 to the company's base case forecast.

Stress-testing was performed on a Board approved base case cash flow forecast (the "base case cash flow forecast") reflecting a capital structure consistent with the de-gearing scenario agreed with the company's shareholders detailed in our AMP7 Business Plan with projected gearing reducing from 76.7% to 75.3% over AMP7, and increasing to 75.5% over AMP8, projected revenues for the period to 31 March 2025 as allowed by Ofwat's final determination of price controls and anticipated expenditure for AMP7, and an extrapolation of the AMP7 Final Determination for AMP8. AMP8 expenditure also includes anticipated expenditure to further develop strategic regional water resource solutions, as detailed in our WRMP.

The base case has also taken into consideration the impact of COVID-19 in the first year of AMP7, using the assumption that the pandemic has a one-off impact impacting revenue and bad debt projections and has reprofiled capital expenditure, however has not been considered to have a material impact on our operating costs. Any longer term financial implications of COVID-19 are then considered to be covered as part of our stress test scenarios.

The projections for the ten-year lookout period apply the AMP7 mechanism for sharing financial outperformance with customers. They also include the impact of the company's net ODI penalties relating to AMP6 performance in AMP7 and potential net ODI penalties resulting from AMP7 performance in AMP7 and AMP8. No ODI penalties or rewards are forecast for AMP8 in the base case cash flow forecast and no additional ODI penalties are assumed as a direct result of COVID-19.

The base case cash flow forecast also assumes a further £100.0m of debt is raised via the capital markets. Additionally, a further £24.0m of funds will be raised utilising the RCF facility priced at LIBOR+1.3% margin. The £100.0m bond tap includes a premium of approximately £30.0m so only increases net debt by approximately £70.0m, allowing for additional gearing headroom.

A further refinancing exercise is forecast to take place in July 2026 when our £250.0m fixed rate bond matures (refer to **page 103** for details of our bond maturities). An all-in interest rate of 5% has been projected for this refinancing, which is consistent with the assumptions used in assessing the financeability of our AMP7 Business Plan.

Strategic report continued

Viability statement (continued)

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 were 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 applied to stress-test the base case cash flow forecast.

S1: 10% increase in totex;
S2: 1% decrease in all three inflation metrics (RPI, CPI and CPIH);
S3: 1% decrease in inflation, impacting revenue only;
S4: replacing the base inflation forecast with a negative 1% forecast, while maintaining a 1% increase in expenditure;
S5: 5% increase in unpaid water customer bills represented by a 5% reduction in revenue;
S6: 1% decrease in inflation impacting revenue only, 5% increase in totex and 5% increase in unpaid water customer bills;
S7: 100% decrease in cash generated by the company's non-appointed business; and
S8: 2% increase in cost of debt.

The sensitivities applied in relation to totex, 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 totex is of a sufficient magnitude to capture the financial impact of exceptional items, such as regulatory fines and legal costs (refer to principal risks 1,4 and 11); costs associated with extreme weather events (refer to principal risk 2); costs associated with a water quality event (refer to principal risk 2); and costs not taken into account by Ofwat in setting our price controls (i.e. unfunded costs).

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 (refer to principal risk 13), such as those experienced in 2008/09 and projected as a result of COVID-19. 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 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 stress test has been applied across all years, on top of the increased bad debt forecast in year 1 as a result of COVID-19 included in the base case. 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 (refer to principal risk 6).

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

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.

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.

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 stated in previous paragraphs, a key assumption is that, even if downgraded, the company's credit rating remains investment grade.

The sensitivity applied in the previous year in relation to a one-off exceptional event has been reconsidered by directors. In the prior year, the scenario used had a £60.0m impact on cash flow in the year the event occurred, with a £10.0m cash flow impact over the following four years. The directors do not believe that this scenario represents a plausible downside due to the mitigations and insurances in place and this stress test has therefore not been used in the current year.

For the principal risks identified in the principal risk table on **pages 39 to 48** 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 (refer to principal risk 2 and **page 32** for further details of this risk and our mitigating activities);
- a major water quality issue (refer to principal risk 2 and **page 32** for further details of this risk and our mitigating activities);
- a severe drought incident within our supply region as considered in our Drought Management Plan (refer to principal risk 2 and **page 28** for further details of this risk and our mitigating activities); or
- a significant cyber-attack leading to a major loss of customer data or interruption to operations (refer to principal risk 4 for further details of this risk and our mitigating activities).

The directors consider that the sensitivity applied in relation to totex is of a sufficient magnitude to capture the financial impact of these exceptional items.

All covenants are met under the base case scenario. Some stress testing scenarios result in a trigger level being reached without mitigating actions, as detailed in the table on the next page. With the mitigating actions, the directors expect that the company will meet its covenants and maintain headroom against those covenants over the lookout period. An investment grade credit rating is expected to be maintained under all scenarios with the mitigation actions in place (based on Moody's current assessment process).

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.

Strategic report continued

Viability statement (continued)

As set out in the table below, without mitigation trigger levels would be breached for the interest cover ratio under the sensitivities S1 and S6, and S9 for the gearing ratio in one or more years over the viability period. Without mitigation, the company would default on scenarios S1, S7 and S9 in one or more years. The majority of the triggers and breaches arise in year 1 as the impact of the scenarios on top of the COVID-19 base case cause levels to be reached, however mitigating actions can be implemented to reduce these levels.

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				Mitigation	With mitigation			
Base	Met	Met	Met	Met	N/A	Met	Met	Met	Met
1	Met	Not Met	Trigger	Met	Required	Met	Met	Met	Met
2	Met	Met	Met	Met	N/A	Met	Met	Met	Met
3	Met	Met	Met	Met	N/A	Met	Met	Met	Met
4	Met	Met	Met	Met	N/A	Met	Met	Met	Met
5	Met	Met	Met	Met	N/A	Met	Met	Met	Met
6	Not Met	Not Met	Trigger	Met	Required	Met	Met	Met	Met
7	Met	Met	Met	Met	N/A	Met	Met	Met	Met
8	Met	Met	Met	Met	N/A	Met	Met	Met	Met

S1 – without mitigation, a 10% increase in totex would result in a trigger level being reached for the interest cover ratio in years 1 and 4 of the viability period but the covenant would be met in all other years.

S6 – without mitigation, a 1% decrease in inflation impacting revenue only, 5% increase in total expenditure and a 5% increase in unpaid water customer bills would result in a trigger level being reached on the interest cover ratio in years 1, 4 and 5.

If the scenarios were to arise, the company could implement the following mitigating actions:

- transfer defaulted debt at market value to another group company outside of the WBS ringfence. This would reduce the bad debt charge within the ringfenced company without impacting the cash flows within the group;
- issue a further short term RPI linked swap to reduce the interest charge. This would yield a higher impact to the interest charge than a longer term swap;
- reduce further operating costs;
- buy back a portion of the 5.875% class A fixed rate bond, the company's most expensive debt, reducing the overall interest charge; and
- restrict dividend payments in AMP8.

In any further extraordinary situations in addition to the above mitigating actions, the company's investment programmes would be re-prioritised and management would intervene to reduce operating costs to reduce cash outflows in critical years.

Together with the results of the stress-testing (summarised in the table on the previous page), 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 planned mitigating actions, as detailed in the principal risk section;
- the company is financially and operationally "ring-fenced" from the rest of the Affinity Water group by way of the WBS (refer to **pages 99 to 104** for further details); and
- under the regulatory model, 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, with the mitigating actions implemented if required, the company will continue to operate and meet its liabilities, as they fall due, over the lookout period.

Strategic report continued

Section 172(1) statement

OUR STAKEHOLDERS

We held our inaugural Stakeholder Assembly on 11 April 2019, bringing together people from 48 organisations including local government, environmental groups, regulators and developers and representing a broad range of interests, to better understand what matters most to our stakeholders and how we can further involve them in our decision-making. We focused on the following four areas: the environment, supply and demand, water efficiency and vulnerability with the aim of gathering information to inform our current and future strategy.

In the table on the next page we present a description of the company's and the Board's engagement activities with each key stakeholder group.

The information obtained through these engagement activities enables the Board to weigh up all relevant factors when deciding on a course of action that best leads to the long term success of the company. This can sometimes mean that certain stakeholders are adversely affected, as we seek to operate in an ethical and responsible manner in relation to all our stakeholders.

The Board considers, both individually and together, that it has acted in the way it considers, in good faith, would be most likely to promote the success of the company for the benefit of its members and as a whole having regard to its stakeholders and the following matters set out in section 172(1) (a-f) of the Companies Act 2006:

a. the likely consequences of any decision in the long term;
b. the interests of the company's employees;
c. the need to foster the company's business relationships with suppliers, customers and others;
d. the impact of the company's operations on the community and the environment;
e. the desirability of the company maintaining a reputation for high standards of business conduct; and
f. the need to act fairly between members of the company.

This statement explains how the Board satisfies itself that relationships with each key stakeholder group are managed effectively and that there is sufficient visibility of relevant stakeholder engagement activities in the boardroom to inform decision-making and delivery of strategy.

THE BOARD'S APPROACH TO SECTION 172(1) AND DECISION MAKING

It is the responsibility of the Chair to enable discussions at Board meetings that lead to decisions being made which are sufficiently informed by section 172 factors. Board minutes record decisions made and actions agreed in the context of these factors. The Board approved a refreshed five-step approach to company stakeholder engagement in 2019/20:

- **Step 1 "Engagement strategy":** set vision and level of ambition for future engagement, and review past engagement
- **Step 2 "Stakeholder mapping":** define criteria for identifying and prioritising stakeholders, and select engagement mechanisms
- **Step 3 "Preparation":** focus on long-term goals to drive the approach, determine logistics for the engagement, and set the rules
- **Step 4 "Engagement":** conduct the engagement itself, ensuring equitable stakeholder treatment while remaining focused on priorities
- **Step 5 "Action plan":** identify opportunities from feedback and determine actions, revisit goals,and plan next steps for follow-up and future engagement.

The Board's role in stakeholder engagement is to:

- ensure that our purpose, strategy and culture are set in the light of views actively sought from relevant stakeholders;
- set an expectation that all key decisions made take into consideration the views of relevant stakeholders;
- require executive directors and other senior managers to engage with relevant stakeholders in a way that ensures views are understood and taken into consideration when making key decisions;
- encourage executive directors and other senior managers to evolve stakeholder engagement in a way that meets all statutory and regulatory requirements but also embraces the principles on which these are based; and
- undertake direct stakeholder engagement that complements day-to-day stakeholder engagement by management.

In 2019/20, the Board's Schedule of Reserved Matters and each Board Committee's terms of reference were reviewed by the Board and updated to ensure that consideration of section 172 factors was appropriately addressed.

SECTION 172(1) IN ACTION

In the table below, we present a description of the company's and the Board's role in engagement activities with each key stakeholder group.

Stakeholder	Expected outcomes from engagement	How the company engages	The Board's role in engagement activities
Customers and future customers, including household and non-household customers, and market participants such as retailers and self-lay providers, developers and NAVs	Customers rely on water as an essential service while our business model is based on the payment of water bills by customers We aim to be a positive contributor to, and able to earn fair returns from, a reliable service that is trusted by and represents value for money for customers. Transparent conversations and engagement with the CCG will support delivery of our purpose and environmental ambitions	• Daily contact • Customer research programme • Tracker polls • Public meetings • Consultations for WRMP, Drought Management Plan and Business Plan • Education programme • Our website, including our specific COVID-19 page • Media/social media • Through our CCG	**Information reported to the Board:** • The Board receives monthly performance summaries of key customer metrics, including SIM, C-MeX, customer satisfaction, written complaints, developer services and wholesale operations service desk performance. It also received in 2019/20 the results of research conducted with customers and other stakeholders in relation to establishing our purpose and additional customer engagement for PR19 focused on household bills for AMP7 and AMP8 **Direct engagement mechanisms:** • There is a clear reporting line to the CEO and accountability for arrangements regarding handling customer complaints • In 2019/20 Board members met with the CCG Chair, in particular in relation to the CCG's price review assurance • The regional Chair of CCW attended the November Board meeting and the UK Chair of CCW met with Tony Cocker **Customer protection:** The Board considers the company's policies around the protection of customer data through its review of the strategic risk register (refer to **page 43** for further information) and specifically reviewed compliance with GDPR at the October Board meeting
Communities, non-governmental organisations and civil society, especially environmental organisations and campaigners	These groups bring distinctive perspectives and influence on key environmental and social issues on behalf of customers and the public Engagement will result in us being a progressive, well-regarded company that delivers its purpose and with which communities and civil society want to work in pursuit of common goals	• Stakeholder Assembly • Joint Forums • Public meetings • Consultation meetings for price review development • Public festivals • Catchment partnerships • Drought Awareness stakeholder consultation • Water resources monthly email updates • Our Education Services • Volunteering days	**Information reported to the Board:** • The Board receives monthly updates on community projects and our Education Services. It also received feedback from key stakeholder consultations in 2019/20, including on drought awareness **Direct engagement mechanisms:** • Our Board-approved Community Engagement Strategy and activities are focused around three core areas: - Protecting rivers and habitats - Investing in science, technology, engineering and mathematics ('STEM') and future skills - Developing community partnerships In 2019/20, we refreshed our community strategy through restating our social purpose and defining the programme of work that will help us meet the growing expectations of our stakeholders and add value to our communities • Board members attended key community events in 2019/20, including our inaugural Stakeholder Assembly and our #WhyNotWater campaign launch event in our Colne community (refer to **page 27** for further information)

Strategic report continued

Section 172(1) statement (continued)

SECTION 172(1) IN ACTION (CONTINUED)

Stakeholder	Expected outcomes from engagement	How the company engages	The Board's role in engagement activities
Regulators, including Ofwat, MOSL, EA, DWI, Defra, HSE, Natural England and CCW Government – central and local government and MPs, highways authorities, Highways England and TfL	Our licence to operate and the framework in which we operate is determined by the government and regulators Engagement will ensure that we are a responsible company which delivers on its purpose	• Industry working groups including committees, panels and forums • Responding to consultations and requests for information • Ongoing dialogue on strategic planning • Events at our sites • Meetings with the Secretary of State for Environment Food and Rural Affairs, and the EA • Regular meetings and calls, including meetings with all key MPs in our supply area • Discussions on our key worker status and priorities in response to COVID-19	**Information reported to the Board:** • The Board receives monthly updates on regulatory and relevant political developments, and regulatory consultations and requests for additional information. In 2019/20 the Board reviewed and approved key correspondence with regulators, including responses to Ofwat's PR19 draft and final determinations and Defra's information request on our revised draft WRMP **Direct engagement mechanisms:** • In 2019/20 Board members attended meetings with and gave presentations to Ofwat representatives as part of the PR19 process • Non-executive directors attended regular events with Ofwat, including prior to their appointment • Our CEO met with the Secretary of State for Environment Food and Rural Affairs on drought matters in 2019/20 • The Regional Chair – London and South East of CCW attended one of our Board meetings in 2019/20
Shareholders	Our shareholders have an important role to play and a direct interest in the strong and effective governance and stewardship of our business We aim to provide a reasonable return on their investment	• Board meetings attended by shareholders / nominated directors • Monthly financial and operational updates • Regular meetings and calls	• We explain how the Board engages with our shareholders and involves them in decision-making in our publication: "Consulting with our shareholders", available on the governance pages of our website, and further detail on this is set out on **page 79** • In 2019/20 the Board engaged directly with shareholders in formulating responses to Ofwat's draft and final PR19 determinations, and in setting budgets for 2020/21 • The Board also reviewed and discussed shareholder objectives in 2019/20 (refer to **page 79** for further information)

Stakeholder	Expected outcomes from engagement	How the company engages	The Board's role in engagement activities
The workforce, including both employees and the wider workforce	Our success depends on the shared talents, skills and values of the people who work for our company, and our ability to attract and retain a talented future workforce Successful engagement will mean we are an inclusive employer that successfully retains and attracts people with the talent and skills to achieve our business objective	• Daily contact • Senior leadership forums • Monthly one-to-one meetings • Annual Culture Survey • Culture Ambassadors selected by their departments • Culture Ambassador forums to gain feedback and progress culture development initiatives • Diversity and Inclusion Steering Group to drive a stronger agenda of inclusiveness • Appointment of a Designated Director for Employee Engagement involved directly in these initiatives and reporting issues and progress to the Board • Internal communications • Daily COVID-19 updates and an internal COVID-19 website for employees	**Information reported to the Board:** • In 2019/20, the Board received a presentation on the output from our inaugural Culture Survey, to which 60% of our employees (randomly selected) responded. The results were debriefed to all employees and Culture Ambassadors were asked to put themselves forward to represent their departments in a rollout of cultural improvement 48 employees became Cultural Ambassadors and these are engaged in the rollout through quarterly Culture Ambassador Forums, regular communication and support in the creation and execution of changes relevant to their departments • Information on productivity, attrition levels, learning participation, training and development plans, wellbeing and output from exit interviews is reported monthly to the Board • Whistleblowing incidents are reported to the Board. All incidents are taken extremely seriously and are thoroughly investigated, working with external reviewers if required **Direct engagement mechanisms:** • In 2019/20, the Board appointed Trevor Didcock to take on responsibility for employee liaison in accordance with the Code. The overriding purpose of the role is to ensure that the voice of the workforce is heard and considered at Board level. A key secondary purpose is to improve the transparency of Board activities, discussion and decision-making and in so doing improve alignment between the Board and the workforce. Trevor attends quarterly Culture Forums with cultural ambassadors from within the business that provide training to ambassadors, reporting and discussion of corrective action taken. Trevor is also a member of our Diversity and Inclusion Committee, established in 2019/20 to bring to life our commitment to build a more inclusive culture, allowing all members of our workforce to bring their true selves to work. Details on company culture are reported to the Board on a monthly basis following discussions between the Executive Management Team and the CEO. In AMP7, feedback will be sought at meetings attended by Trevor with the workforce and reported to the Board in order for it to consider the effectiveness of this employee engagement mechanism • Our Executive Management Team, including our executive directors, conducted a series of Directors' Roadshows at each of our sites in 2019/20 to hear face to face some of the challenges being faced by our employees. Actions to address the resultant findings have been taken to ensure we achieve an improvement in employee engagement going forwards • All of our workforce are entitled to be trade union members. Our CFO is a member of the Joint Negotiation and Consultative Committee ('JNCC') which, together with employee trade union representatives and other company nominated representatives, meets quarterly to consult on workforce practices and policies and negotiate workforce pay **Workforce policies and practices:** • Refer to **page 63** for our key workforce policies, **page 77** for further detail on workforce policies and practice and workforce concerns, and the governance report for details of what the Board about gender equality and reducing our gender pay gap • In February 2020, the Board approved our Code of Conduct, revised to capture the company's purpose to ensure that our business conduct, both internally and externally, is clearly aligned with our values • The Board received regular updates on the COVID-19 pandemic, see the key decisions made in 2019/20 on **page 60** for more details

Strategic report continued

Section 172(1) statement (continued)

SECTION 172(1) IN ACTION (CONTINUED)

Stakeholder	Expected outcomes from engagement	How the company engages	The Board's role in engagement activities
Supply chain	We rely on our supply chain for delivery of operations and capital projects, and partners provide investment and support delivery as well as acting as a source of innovatio and new ways of working Successful engagement will mean we are a good company to work with, to partner and do business with, ensuring that we and our partners maximise the greatest mutual value	• Integration of contractors into our teams • Sharing of reporting and management systems for collaborative and shared learning • Quarterly forums with all our Maintenance and Repair and Traffic Management suppliers, to discuss "lean" processes and improvements • Regular meetings and calls with our largest suppliers • Monthly performance meetings with our largest suppliers • Discussions with suppliers on how we perform key essential work in response to COVID-19	**Board's involvement in the agreement of supplier terms:** • We have a standard set of purchase order terms and conditions and a Supply of Goods and Services Agreement published on our website: **affinitywater.co.uk/policies**, which is reviewed and amended (where necessary) by our Procurement and Legal teams who report to our executive members of the Board • We have a Contracts Committee, attended by executive members of the Board, which approves the award of material contracts • In 2019/20 a subset of the wider Board was involved in formulating a strategy for contracting our key Maintenance and Repair suppliers for AMP7, including determining key principles, contract scopes and tender evaluation criteria • The Board considers the company's policies around compliance with the Modern Slavery Act and GDPR as they relates to suppliers through the approval of the company's Modern Slavery Statement and review of the appropriateness of mitigation detailed in the strategic risk register in relation to the principal risk: "Information security, protection of personal data and data quality failure" **Information reported to the Board:** • The Board receives information on a monthly basis on street works and service strikes performance. Half yearly payment practice information is also reported to the Board to enable it to consider our performance and how it compares to industry peers • The Safety, Health, Environment and Drinking Water Quality ('SHEDWQ') Committee also reviews and monitors, on behalf of the Board, safety and health matters arising from our activities and operations, including in relation to our supply chain (refer to **page 58** for further information on the work of the SHEDWQ Committee, established in 2019/20) • The Board considers the risk of supply chain failure through its consideration of the strategic risk register **Direct engagement mechanisms:** • Executive directors attend meetings with key members of the supply chain based on a supplier strategy included in AMP7 readiness work formulated by a steering group of executive members of the Board, the work of which is regularly fed back to the whole Board and addresses zero harm

Stakeholder	Expected outcomes from engagement	How the company engages	The Board's role in engagement activities
The environment	We need to manage the impact of taking water from sensitive habitats and to maintain flows in local rivers whilst also ensuring a continuous supply of high quality water for customers in line with our purpose Successful engagement will mean we protect water sources and the quality of water supplied and minimise our impact on the environment	• WRMP • AMP7 Business Plan • Catchment management • River restoration	**Governance arrangements:** • The Board is composed of individuals who have appropriate knowledge, skills, experience and background to take decisions informed by an awareness and understanding of environment related threats and opportunities (refer to the biographies of our directors on **pages 70 to 75**). In particular, the Board benefits from the presence of Susan Hooper on the Board who is a director of Chapter Zero, an organisation dedicated to providing education, insight and support on climate change to non-executive Board directors. Our shareholder directors are focused on environmental issues, as part of our shareholders' wider environmental, social and governance ('ESG') programmes and alignment to the UN's Sustainable Development Goals ('SDGs') • The SHEDWQ Committee reviews and monitors, on behalf of the Board, environmental matters arising from our activities and operations, including monitoring performance against targets (refer to **page 58** for further information on the work of the SHEDWQ Committee, established in 2019/20) • Environmental considerations are embedded into our principal risks and the management of these risks, in particular the principal risk "failure to meet our obligations to supply high-quality drinking water", which are monitored by the Board • In 2019/20 the Board approved a revised approach to managing compliance-related risks, which include developments in environmental legislation (refer to **page 98** for further information on our Compliance Obligations Register) • The Board receives monthly information on our performance in relation to key environmental metrics, including in relation to water quality, leakage, sustainable abstraction reductions, average water use and water available for use, to enable it to monitor the success of strategies implemented **Local environment:** • The Board reviewed customer feedback when approving our company purpose and considered customers' views on the environment, including our treatment of chalk streams. The Board approved the proposal to secure UNESCO World Heritage Status for chalk rivers. See **page 23** for more details **Climate change:** • The Board considers climate change in two principal ways: - the potential impacts of climate change are addressed through long-term planning as part of the statutory WRMP (available on our website: **affinitywater.co.uk/water-resources**, addressed in Technical Reports 1.2 and 1.3). A Board sub-committee on the WRMP oversaw this work and was advised by external technical experts; and - the Board discusses how the environment and climate change have informed company strategy through its work on PR19 submissions and the WRMP. Additionally, in 2019/20, the Board conducted several special sessions on corporate purpose, which focused heavily on environmental issues • In 2019/20 our CEO met with Number 10 officials regarding the UK's bid to host the United Nations' 2020 Climate Change Conference (COP26) submit and on drought. We pledged our support for the UK's bid to host COP26 through a joint letter with some of Britain's biggest businesses, which called on the government to do everything in its power to bring this key event to the UK

Strategic report continued

Section 172(1) statement (continued)

SECTION 172(1) IN ACTION (CONTINUED)

Stakeholder	Expected outcomes from engagement	How the company engages	The Board's role in engagement activities
Providers of finance and credit rating agencies	It is imperative that we maintain effective relationships and ongoing dialogues with our banks and credit rating agencies to ensure access to financial services as well as capital markets Successful engagement means we will be a responsible company that delivers reliable returns and is transparent in our reporting	• Annual review meetings with credit rating agencies • Regular meetings and calls with banks • Financial reports • Engaged with banking groups and credit rating agencies on the impact of COVID-19	**Information reported to the Board:** • A treasury report is provided to the Board on a quarterly basis, which includes details of the company's borrowings, its lenders and deposit counter-parties. It also includes treasury counterparty credit risk and our credit ratings **Direct engagement mechanisms:** • The CFO, on behalf of the Board, and the treasurer met with lenders and credit rating agencies during the year • Refer to note A4 of the statutory financial statements for further information on our risk management processes and the Board's role in these

Following a review of direct engagement mechanisms in 2019/20, the Board identified the following priorities for 2020/21:

- engagement with a wide range of stakeholders to ascertain levels of environmental ambition to deliver the company's purpose in preparation of the next WRMP;
- pan-regional engagement with partners to understand views on strategic resource options;
- engagement to explain our purpose in light of a changing legislative and regulatory framework;
- activities and partnerships with stakeholders in the context of COP26; and
- engagement with our CCG relating to delivery of purpose and environmental ambitions.

KEY DECISIONS MADE IN 2019/20

We set out below key decisions made in 2019/20 and the Board's consideration of section 172 factors in making these.

Refer to **page 80** for further information on matters considered by the Board in 2019/20.

Approved our final WRMP	The Board approved our final WRMP in 2019/20. This was the culmination of a process which comprised at each stage extensive consultation with customer focus groups and other external stakeholders, including the EA, Ofwat, Natural England, local authorities, the Group Against Reservoir Development ('GARD') and the Canal & River Trust. The Board worked closely with our CCG from the start of the revised draft WRMP further consultation process through to the formation of a CCG sub-group. The CCG sub-group reviewed the findings and feedback from our further consultation and engagement. In approving the final WRMP, the Board considered the strong and consistent support from customers for the options proposed in our revised draft WRMP and the supportive response from our regulators of the work done on the revised draft WRMP, who also asked us to provide further detail in our final WRMP19 in relation to some topics such as our demand management programme. Their response asked for ambition and robust information and emphasised the importance of on-going studies on strategic options for additional water storage in collaboration with other water companies. Our final WRMP built on our revised draft WRMP taking into account further consultation responses. The plan ensures that our customers will have enough water in the future, whilst also leaving more water in the environment. The Board also ensured that our plan represented the most cost effective and sustainable long-term solution, and met all legal requirements and relevant guidelines set by our regulators.
Approved our response to Ofwat's Draft Determination on our March 2019 AMP7 Business Plan resubmission	The Board was fully engaged in the design, development and preparation of representations on Ofwat's Draft Determination (our "Represented Plan"), owning the strategy and providing strategic direction to management. Following publication of the Draft Determination, the Board met formally and informally on a number of occasions specifically to discuss and set the strategy for and oversee the development of our Represented Plan. Our response took on board most of Ofwat's Draft Determination interventions and focused on proposals and recommendations for change in a few critical areas where we believed the risks would be too great for the business and for our customers. In particular, we highlighted concerns over financeability but believed that the proposed plan in our response would enable us to remain financeable and deliver the best outcomes for our customers and our communities. The Board reviewed the additional customer research programme completed as part of the evidence for our Represented Plan as well as further customer engagement in line with our commitment to test the final AMP7 and AMP8 household bill before the publication of the Draft Determination. The CCG Chair attended Board meetings to present the CCG's feedback. As part of the approval of our Represented Plan, the Board agreed with our shareholders to reduce gearing over AMP7 through investing all the planned earnings from the non-appointed business (after servicing any debt above Affinity Water Limited) along with retaining all the earnings from the appointed business. This is in addition to the returns generated by the appointed business being used to fund significant investments to secure supplies for our customers today and in the future. Refer to **page 263** for further details of our dividend policy, which was revised as part of the Board's approval of our Represented Plan.

Strategic report continued

Section 172(1) statement (continued)

KEY DECISIONS MADE IN 2019/20 (CONTINUED)

Accepted Ofwat's Final Determination on our Represented Plan	Our Board engaged with Ofwat in an open and constructive manner throughout the PR19 process, including the acceptance of the Final Determination in February 2020. We believe our Final Determination will be challenging to deliver, but we do accept the need to improve performance for our customers and for the environment and we are determined to transform our business to achieve this.
Approved our purpose, values and culture, and mechanism for monitoring culture	In approving our purpose, the Board considered the output from research with customers, employees and other stakeholders (refer to **page 23** for further information). The Board further considered our Customer Experience Principles, which are set out from the point of view of customers (refer to **page 26** for further information). In light of the results of our inaugural Culture Survey, to which 60% of our employees responded (refer to **page 30** for further information), the Board approved a mechanism for monitoring culture involving cultural ambassadors and Culture Forums with these ambassadors attended by Trevor Didcock (refer to **page 30** for further information). The Board's review of the results of the Culture Survey further led to the Board deciding that the Director of HR role on the Executive Management Team should be expanded to take responsibility for monitoring culture.
Approved the annual budget and ten-year base case cash flow forecast	The 2020/21 annual budget and ten-year base case cash flow forecast were approved by the Board following a comprehensive review of our strategic priorities and risks to our business in light of Ofwat's Final Determination. Our budget process took both a bottom-up approach, which engaged all cost centre managers in the business, and a top-down approach, which engaged our shareholders and considered Ofwat's Final Determination in light of shareholder objectives. The Board considers our plans challenging but that they will position the company well against our longer-term value creation vision whilst honouring our commitments to stakeholders. The material risks and how we are managing these are set out on **page 39**.
Approved the 2020/21 workforce pay settlement	In 2019/20, the Board reviewed progress of pay negotiations with trade unions. The Board considered the importance of creating value for shareholders while balancing the need for investment in the workforce. Employees were consulted through their trade unions of which all employees are entitled to be a member of. The Board concluded that it was in the best interests of the company to support the Chief Executive Officer's decision to approve the proposed pay increase in order to increase employee engagement, retention rates and productivity, leading to increased value creation.
Approved the company's response to COVID-19	The Board received regular updates on the company's response to COVID-19, having weekly calls at the start of the pandemic to assess the implications and agree the company strategy in response to the change in working environment. The Board reviewed the emergency plan and agreed it was crucial to continue to meet the demands of the public whilst ensuring the upmost safety of employees. The Board reviewed updates on financial implications, regulations and risk assessments and reviewed plans for a phased return to work.

Non-financial information statement

We aim to comply with the non-financial reporting requirements contained in sections 414CA and 414CB of the Companies Act 2006. We integrate this information throughout our annual report and financial statements and so the table below is designed to help locate key elements on non-financial matters. Where we include more details on a policy on our website, the link has been included in the table below.

Reporting requirement	Information necessary to understand our business and its impact	Policies, guidance and standards which govern our approach[1]
Social matters	• Our customers and communities (**page 26**) • Our suppliers (**page 30**) • Our industry (**page 20**)	• Customer Experience Principles (**page 26**) • Volunteering ("Affinity Days") (**page 26**) • Donation to Money Advice Trust (**page 34**) • Our CCG (**affinitywater.co.uk/ccg**) • Purchase Order Terms and Conditions and Supply of Goods and Services Agreement (**page 58**)
Environmental matters	• Our environment (**page 28**) • Greenhouse gas emissions statement (**page 129**)	• Environmental Policy (**affinitywater.co.uk/environment**) • WRMP (**page 28**)
Employees	• Our people (**page 30**)	• Workforce Pay Policy (**page 77**) • Health and Safety Policy (**page 30**) • Code of Conduct (**page 80**) • Gender pay gap report (**page 30**) • Company Principles (**page 23**) • Diversity Policy (**page 30**)
Respect for human rights	• Diversity and equality (**page 30**)	• Modern Slavery and Human Trafficking Statement and Modern Slavery and Human Trafficking Policy (**page 78**) • Privacy Policy and Guidelines (**page 43**)
Anti-corruption and anti-bribery	• Workforce policies and practice and workforce concerns (**page 77**)	• Anti-bribery and Corruption Policy (**page 80**) • Whistleblowing Policy (**page 78**) • Systems of risk management, planning and internal controls (**page 96**)
Description of principal risks	• Principal risks and uncertainties (**page 39**) • Viability statement (**page 49**)	• Systems of risk management, planning and internal controls (**page 96**) • "Three lines of defence" assurance processes (**page 97**) • Compliance Obligations Register (**page 98**)
Description of business model	• Our business model (**page 22**) • How we create value (**page 24**)	• Board statement on direction and performance (**page 204**)
Non-financial key performance indicators	• Operational performance (**page 36**) • Outcome performance table (**page 242**)	• Non-financial performance measured against performance commitments agreed with Ofwat (**page 21**)

Approval of the strategic report
By order of the Board

Tony Cocker
Chairman
24 June 2020

[1] Some policies and standards are only published internally

Governance

CONTENTS

The Boardroom at our Head Office: during the year, we refreshed our purpose, values and aspired culture

Governance

Introduction from the Chair

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 2019/20, except in terms of:

- Board, Audit Committee and Remuneration Committee composition*
- Appointment of a senior independent director ('SID')**
- Prior approval of directors' external appointments ***
- Pension contributions for executives ****

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 Code requirement with regard to board, Audit Committee and Remuneration Committee composition was not met for the period from 3 September 2019 when Chris Bolt stepped down as an independent non-executive director ('INED') to 19 December 2019 when Mark Horsley was appointed to the Board as an INED.*

** *The Code requirement with regard to the appointment of a SID was not met for the period from 3 September 2019 when Chris Bolt stepped down as a director to 1 March 2020 when Trevor Didcock, an INED was appointed as the replacement SID.*

*** *The Code requirement with regard to prior approval of directors' external appointments was not met for the period April 2019 – February 2020 however a formal process for Board approval of external appointments has been in place since that date.*

**** *The Code requirement to align executive pension contributions with those of the workforce was not in place during the year however the company is putting in measures to ensure compliance by the end of March 2021.*

Our governance arrangements also incorporate:

- Our instrument of appointment and Ofwat's 2019 board leadership, transparency and governance principles;
- 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 Companies Act 2006; and
- the OECD Principles of Corporate Governance (2004).

I am delighted to present our Corporate Governance Report for 2019/20 on behalf of the Board. 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 by Ofwat and the FRC.

Our Governance Code, available on our website: **affinitywater.co.uk/governance-assurance**, 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 long-term 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. Both the revised Code principles and Ofwat objectives have been incorporated into the Board's governance framework.

Our ambition is reflected in our articulated purpose "to provide high quality drinking water and take care of our environment for our communities now and in the future". Significant work was undertaken during the year in particular to ensure the company's purpose, strategy and values were clear and transparent, and reflective of the needs of our stakeholders in line with Principle A, Provisions 1 and 2 of the Code alongside the 'Purpose, values and culture' objective of Ofwat's revised principles. The Board has been heavily engaged with the CEO leading extensive, in-depth, research with our customers, employees and stakeholders, the results of which were used by the Board to clarify, refresh and re-articulate our purpose. Refer to **page 76** for further details in the culture and purpose statement.

Our shareholders have an important role to play and a direct interest in the strong and effective governance and stewardship of our business.

Since May 2017, our business has been owned by a consortium of long-term private investors committed to our success. We explain how we engage with our shareholders and involve them in decision making in our publication: "Consulting with our Shareholders" and further detail on this is set out on **page 79**. We continue to meet Ofwat's expectations for INEDs 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 INEDs 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, and continue to build a more inclusive culture.

As a Board, we are responsible for fostering the right culture, and work with the EMT to reinforce the right behaviours to allow 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. During 2019/20, we appointed Trevor Didcock as the Designated Director for Employee Engagement, and he became a member of our newly established Diversity and Inclusion Committee. Please refer to **page 77** for more information on his role. The Board has also strengthened the role of the Nomination Committee to support this approach. More detail on our diversity commitments, inclusivity and commitment to supporting social mobility can be found on **page 30**.

The Board had a busy and varied agenda in 2019/20. Key focus areas included engagement in, and approval of, the PR19 submissions to Ofwat for AMP7, the decision to accept Ofwat's final determination, preparations for the delivery of AMP7 commitments, and review and approval of the revised WRMP. The Board monitored the ongoing operational and financial performance, including metrics for health and safety, customers, the environment, and financial results. Most recently, we have engaged actively in the EMT's management of the implications of the COVID-19 pandemic.

We continued to focus on governance across the business, on overseeing the company's risk management and internal control systems, and taking a long-term view to ensure the sustainability of our business and managing risks. Further detail of how risk assessment activities were carried out can be found on **page 39** of our strategic report. We strengthened our oversight through the establishment of the SHEDWQ Committee.

Our governance is designed to ensure that we take account of the views of all our stakeholders, so our decision-making is fair and collaborative, while maintain our long-term strategy. Our activities to engage with each of our stakeholder groups are set out in our Section 172 statement on **pages 54 to 62**. Our work on our purpose was informed by, and enhanced, our engagement with stakeholders during the year. The Board's activities and items considered at meetings can be found on **page 80** 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.

This Report has been prepared in accordance with the principles of the UK Corporate Governance Code 2018 (the "Code") and Ofwat's revised governance principles. The Report reflects the principles within the Code and provides details on the activities and governance processes of the Board and its Committees.

Tony Cocker

Company Chair

CODE COMPLIANCE

The Code has been applied to the 2019/20 reporting period based on the application of its Principles, to enable our shareholders and other stakeholders to evaluate how these Principles have been applied to our approach to governance. Our reporting in relation to each Principle of the Code is as follows:

Board leadership and company purpose

Details of each Board Director are set out on **pages 70 to 75** including his or her skill set and experience and how the Board has ensured that the company's purpose, values and strategy are aligned to company culture. The activities undertaken by the Board to monitor culture are also described in the Purpose and Culture Statement, together with mechanisms that the Board has put in place to effectively engage with the company's key stakeholders, including the company's workforce. Refer to **page 76**.

Division of responsibilities

In line with the Code, the division of responsibilities between the Chair and CEO is set out clearly on our website: **affinitywater.co.uk/governance-assurance** and was revised, updated and approved by the Board in March 2020. The differing roles and responsibilities of the Chair, CEO, executive directors and non-executive directors are set out on **pages 70 to 75**.

Composition, succession and evaluation

An overview of the process for appointment, induction and evaluation of directors' skills, experience, independence and knowledge of the company to discharge their duties and responsibilities effectively, alongside further details of the Nomination Committee, in the year is provided on **pages 90 to 93**.

Audit, risk and internal control

The report of the Audit Committee details the corporate reporting, risk management and internal control measures that are monitored by the Audit Committee and overseen by the Board. Refer to **pages 105 to 111**.

Remuneration

The Remuneration report provides full details on directors' remuneration. Refer to **pages 112 to 126**.

Governance continued

Board leadership, transparency and governance

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

The revised 2019 Ofwat board leadership, transparency and governance – principles have been incorporated into the Board's governance framework. The objectives of these principles 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 engender trust in the regulated company and ensure accountability for its actions.
- **Board structure and 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.

We believe that we already met many of the objectives and principles, however, further work was undertaken during the year to ensure the company's purpose, strategy and values were clear, transparent and reflective of the needs of our stakeholders. See the purpose and culture statement on **page 76** for more information.

QUICK LINKS:

A copy of Ofwat's 2019 Board leadership, transparency and governance – principles can be found at **ofwat.gov.uk**

CODE PRINCIPLE
BOARD LEADERSHIP AND COMPANY PURPOSE

OFWAT OBJECTIVE
ESTABLISHING THE COMPANY'S PURPOSE, VALUES AND CULTURE IN DELIVERING LONG-TERM SUCCESS

BOARD LEADERSHIP

The role of our Board is to promote the long-term sustainable success of the company, generating value for our shareholders, taking account of our customers and other stakeholders, while contributing to wider society. The Board has reaffirmed the company's purpose, values and strategy and satisfied itself that these and its culture are aligned and ensured that management operates the business accordingly.

The directors understand their duties, both collectively and individually as set out in sections 171-177 of the Companies Act 2006. As such, they act in a manner consistent with their statutory duties and uphold the highest standards of integrity, supporting the Chair in instilling the appropriate values, behaviours and culture in the boardroom and beyond, in line with Principle B of the Code.[1]

[1] Principle B of the Code states 'The board should establish the company's purpose, values and strategy, and satisfy itself that these and its culture are aligned. All directors must act with integrity, lead by example and promote the desired culture'.

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 100**.

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
- S SHEDWQ Committee

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

Former directors

Name	Former Role	Period of service
Chris Bolt	Independent non-executive director	26 February 2015 to 3 September 2019

Governance

Governance continued

Board leadership, transparency and governance (continued)

BOARD OF DIRECTORS (CONTINUED)

TONY COCKER

Company Chair R N

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

Role
• Chair of the Board
• Chair of the Nomination Committee

Responsible for leading and managing the Board, its effectiveness and governance. Ensures Board members are aware of and understand the views of our stakeholders. Sets the tone from the top, implements strategic changes required for AMP7, and drives progress for board alignment to the purpose, values and strategy.

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

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

Effective challenge
Tony fosters constructive board relations based on trust, mutual respect and open communication, and ensures this engagement happens both inside and outside the boardroom environment. He facilitates effective contribution of all non-executive directors and ensures challenges are discussed and where required, further conversations are invited before decisions are made, if applicable.

There is a majority of independent members on the Board, Nomination and Remuneration Committees to demonstrate objective judgement and to challenge the Chair in his role.

Other 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 a non-executive director of SSE plc.

PAULINE WALSH

Chief Executive Officer ('CEO') S 2 3

Appointment to the Board
1 May 2018

Role
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.

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.

Effective challenge
In this leadership role, the CEO ensures that a strong culture of transparency, challenge, integrity and responsibility is reflected across the organisation and continues to drive forward the strategy. Challenges are encouraged and discussed, both at Board and EMT level, and provide the non-executive Board members with confidence and assurance.

Other interests
Up until November 2019, Pauline was a non-executive director at Buccleuch, a business which is focused on the sustainable development of vast land resources and deploying renewable energy technologies.

STUART LEDGER

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

Appointment to the Board
9 October 2017

Role
As CFO, Stuart fulfils two roles; the executive role and Board member role. Stuart manages the financial affairs of the business and supports the CEO in the implementation and achievement of the strategic objectives. He helps to drive transformation of the operational performance of the business and ensures excellence in reporting to shareholders and other stakeholders.

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

Skills
Stuart has significant experience in utilities and has held a number of senior finance roles, most recently CFO 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.

Effective challenge
In his dual role as executive and Board member, Stuart is uniquely placed to share specific insights into areas of his expertise while also providing the Board with an informed, and crucially, independent contribution as a Board member on all key issues on the Board agenda. Switching between both roles is essential to providing an effective and challenging approach while engaging with the Board and senior executives. Stuart's experience in both energy and water provide him with a solid understanding of issues facing the Board and help to facilitate clear engagement and challenge where appropriate.

Other 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 the charity, Rett UK.

JAROSLAVA KORPANEC

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

Appointment to the Board
19 May 2017

Role
As a non-executive director, Jaroslava represents the shareholding of Allianz attending Board, Audit, Remuneration and Nomination committee meetings.

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.

Effective challenge
As a non-executive director shareholder representative for Allianz Capital Partners, Jaroslava's presence at each of the Board and Board Committee meetings ensures there is visibility of company strategy, knowledge and understanding, and clear engagement with executive directors and the Chair. This level of engagement and transparency produces strong relationships and a platform to challenge robustly.

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

Governance continued

Board leadership, transparency and governance (continued)

BOARD OF DIRECTORS (CONTINUED)

ANTHONY ROPER

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

Appointment to the Board
25 July 2018

Role
As a non-executive director, Tony represents the shareholding of HICL and attends Board, Audit and Nomination Committee meetings. Qualifications Tony has a BA and D.Phil from Oxford University, and a Master of Business Administration ('MBA').

Qualifications
Tony has an 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.

Effective challenge
Tony's presence at the Audit and Nomination committee meetings as a non-executive director ensures there is visibility of company strategy, knowledge and understanding, and clear engagement with executive directors and the Chair. This level of engagement and transparency produces strong relationships and a platform to challenge robustly.

Other interests
Tony is the Chairman of both Aberdeen Standard European Logistics Income plc and SDCL Energy Efficiency Income Trust plc, two UK investment trusts.

ANGELA ROSHIER

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

Appointment to the Board
19 May 2017

Role
As a non-executive director, Angela represents the shareholding of DIF, attending Board, Remuneration and SHEDWQ committee meetings.

Qualifications
Angela has an MA from the University of Cambridge and an 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.

Effective challenge
As a non-executive director and representative shareholder of DIF, Angela ensures there is visibility of company strategy, knowledge and understanding, and that there is a clear engagement with executive directors and the Chair. Angela provides independent oversight and constructive challenge to the executive directors.

Other 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.

PATRICK O'D BOURKE

Independent non-executive director A N

Appointment to the Board
24 July 2013

Role
- Chair of the Audit Committee

As an INED, Patrick attends Board, Audit and Nomination Committee meetings.

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

Skills
From 2011 to 2019, Patrick was Group Finance Director of John Laing Group plc. He 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.

Effective challenge
As an INED, Patrick's role is to challenge, question and monitor the CEO and senior management while bringing an independent perspective to decision-making. His recent experience as a group Finance Director places him in a strong position to do this and is able to act as a "critical friend" in the best interests of the company's stakeholders and ensure he holds senior management to account.

Other interests
In February 2020, Patrick joined the Board of Calisen plc as a non-executive director and Chair of the Audit and Risk Committee.

TREVOR DIDCOCK

Independent non-executive director A R S

Appointment to the Board
30 November 2015

Role
- Director of Employee Engagement
- Senior Independent Director ('SID')
- Diversity and Inclusion Committee

In addition to his role as an INED, and director of employee engagement, as the SID, Trevor also supports the Chair to help in the delivery of his objectives.

Qualifications
Trevor has a BSc (Hons) in Mechanical Engineering from the University of Nottingham, and an 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.

Effective challenge
In his capacity as the SID, Trevor acts as an alternative contact for the shareholders and other stakeholders should they have a concern that is unresolved by the Chair, CEO or CFO. His experience in a number of industry sectors as a CIO and Group IT Director ensures he has the skills, knowledge and broad Board level experience to challenge effectively and hold senior management to account. As part of the new culture changes, he acts as a key communicator between the Board and the company workforce ensuring challenges are voiced at Board level and ensuring actions are implemented at senior management level.

Other 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.

Governance continued

Board leadership, transparency and governance (continued)

BOARD OF DIRECTORS (CONTINUED)

SUSAN HOOPER

Independent non-executive director R N

Appointment to the Board
30 November 2015

Role
• Chair of the Remuneration Committee

As an INED and Chair of the Remuneration Committee, Susan plays a key role in helping to determine appropriate levels of remuneration for the chair, executive directors and senior management and submitting to the Board for approval.

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

Skills and career experience
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.

Effective challenge
In her role as an INED, Susan provides constructive challenge, strategic guidance, offers specialist advice and holds management to account. Her experience on Boards as a Managing Director and CEO provides her with the experience, knowledge and understanding of the effectiveness of challenge and responsibilities of this role when holding management to account.

Other 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.

MARK HORSLEY

Independent non-executive director A R

Appointment to the Board
19 December 2019

Role
As a newly appointed INED, Mark brings to the Board his extensive experience working within the energy sector. His previous senior roles enable him to offer specialist advice, strategic guidance, while constructively challenging in order to hold management to account against agreed performance objectives, As a member of the Audit Committee, Mark's fundamental participation is to satisfy himself on the integrity of information and that financial controls and systems of risk management are robust and defensible.

Qualifications
Mark has an MBA from Durham University.

Skills and career experience
Mark has over 40 years' experience in the energy sector. He joined Northern Gas Networks, the North of England's gas distributer, as CEO in 2011. Mark was previously Equity Partner and Head of Power Distribution at EC Harris, an international built asset consultancy, Strategy and Central Programmes Director at Scottish Power and President and Chief Operating Officer at CE Electric UK, where he began his career as an apprentice.

Effective challenge
As a newly appointed INED, Mark brings a fresh perspective to the Board, its Committees and the strategies set, in particular for the new AMP7 and decision-making and can effectively challenge, question and monitor the decision making process of both management and the Board. His experience as a CEO and COO places him in a strong position to do this and he is able to act as a "critical friend" in the best interests of the company's stakeholders and ensure he holds senior management to account.

Other interests
Mark has a passion for innovation and its role in consistently improving ways of working and driving positive change. He held the role of Chairman of the Energy Networks Association from 2004 to 2006 and was Chairman of the Energy Innovation Centre from 2014 - 2017. Mark has been a non-executive director at the EIC since 2017.

CHRIS NEWSOME

Independent non-executive director A S

Appointment to the Board
9 October 2017

Role
• Chair of the SHEDWQ Committee

As Chair of the Safety, Health, Environment and Drinking Water Quality Committee, Chris ensures the Committee reviews and monitors these areas, including mental health and wellbeing, and personal security matters from the company's activities and operations, and makes recommendations to the Board on the strategic direction.

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

Skills
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.

Effective challenge
As a newly appointed INED, Chris brings a fresh perspective to the Board, its Committees and the strategies set, in particular for the new AMP7 and decision-making, and can effectively challenge, question and monitor the decision-making process of both management and the Board. His experience, knowledge and understanding of regulated industries and in particular, the water industry, places him in a strong position to do this, and enables him to act as a "critical friend" in the best interests of the company's stakeholders, while providing scrutiny and hold to account the performance of management and executive directors against agreed objectives.

Other 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 Past President and Board Member of the Institute of Asset Management, a director of UK Water Partnership Limited and board adviser for Barhale Limited.

ANN BISHOP

Independent non-executive director R N

Appointment to the Board
25 March 2020

Role
Through participation in the Nomination Committee, Ann will help to lead the process for board appointments, succession planning and ensure a diverse pipeline is developed. As a member of the Remuneration Committee, Ann will help determine appropriate levels of remuneration for the Chair, executive directors and senior management.

Qualifications
Ann has a BA (Hons), MA Cantab from Sidney Sussex College Cambridge University

Skills and career experience
Ann was the founder and managing director of a management consultancy company, working with clients facing the challenges of regulation, deregulation, competition and restructuring. She has over 30 years' experience in the regulated sectors working with investors, the chair, chief executives, board members and senior executive teams, helping to develop and implement policy and strategy. Ann has advised across regulated industries since privatisation, through price reviews and industry reform and has a good understanding of the water, regulated energy networks, telecoms and rail industries across the world.

Effective challenge
Ann brings a strong background of experience advising regulated industries combined with expertise from her extensive roles as chair, deputy and non-executive director, providing Ann with the experience to challenge effectively, question and monitor the decision-making process of both management and the Board. Ann brings expertise and specialism in the complex space between regulators and regulated companies, and extensive experience of building and rebuilding strong, successful and sustainable relationships, enabling her to act as a "critical friend" in the best interests of the company's stakeholders and ensure she holds senior management to account.

Other interests
From 2010 to date Ann has been Governor of Leeds Beckett University (formerly Leeds Metropolitan University), a member of the Finance, Staffing and Resources Committee, the Governance and Nominations Committees, and from 2017 to date, chair of Senior Staff Remuneration Committee. From 2019 to date, Ann has been Chair of the Customer Engagement Group for UK Power Networks. Ann is also a member of the London First Infrastructure Commission, and a member of the Ofwat Expert Panel. Ann is currently an Ambassador of Wellbeing of Women, and from 2000-2010, was non-executive director and deputy chair for Opera North.

Governance continued

Board leadership, transparency and governance (continued)

PURPOSE STATEMENT

The Board strongly believes that a clear purpose drives improved engagement with colleagues, customers, stakeholders, and regulators, and improved business performance. Consequently, the Board welcomed the push from the FRC, Ofwat, and others and fully acknowledges that the company's commitment to its purpose needs to be meaningful and implemented with full engagement with all stakeholders, and that the Board is expected to ensure a robust process is in place to enable it to report on the approach to stakeholder interests and processes to action feedback received.

As mentioned in the Chair's welcome, during 2019/20, we defined our purpose, values, and culture, through conducting internal and external research, gathering data from stakeholder interviews, focus groups, and opinion polling. Plans to develop and implement a company purpose were strongly welcomed and supported by all of our stakeholders, and as such,we believe that we have forged stronger relationships with, and support from, our external stakeholders, including those regulating our business. The Board and executives worked together closely throughout the development of the purpose, reviewing data from each element of research, before approving the company purpose.

The draft purpose was presented to employees and discussed at all levels of the business and across all our sites, to give our employees the opportunity to provide clear feedback in an engaged and collaborative environment. This transparent and inclusive engagement has, in turn, strengthened our culture. The focus of action was to: create a purpose that was a core driver of company values to lead to high levels of engagement across the business, high levels of creativity and a transformational approach and willingness to partner across functional boundaries within the company; elicit greater engagement with and loyalty from our employees; and engage with consumer focus groups within our communities.

A programme to follow up with employees on the purpose and our principles is supported by Trevor Didcock in his role as Director of Employee Engagement, which is helpful in assuring employees that the Board has visibility of the purpose and culture at work throughout the business.
As mentioned in the CEO's introduction, our purpose was confirmed as being "to provide high quality drinking water and take care of our environment for our communities now and in the future".

Purpose in action
On the basis of this purpose, the Board discussed with senior management a plan for engagement with a wide range of stakeholders to ascertain levels of environmental ambition and key opportunities to deliver the purpose in preparation of WRMP24. Topics included protection of chalk streams, abstraction reductions, river restoration projects, cross-regional strategic resource options, and changing legislative and regulatory frameworks. Activities and partnerships were also implemented with stakeholders in the context of COP26 and the UN Conference on Biodiversity to achieve advances in public policy relevant to our purpose.

Stakeholder Engagement Reporting

	How the Board is kept informed
Communities	Community meetings and working in partnership with local communities on key issues
Workforce	Reviewing and developing plans that promote an inclusive growth culture based on our Purpose and Principles
Customers	Social media, surveys and focus groups, dedicated account teams, customer care initiatives and customer satisfaction surveys
NGOs	Dialogue, policy work, memberships of business and industry associations.
Partnerships	Engagement and transparency with our suppliers, consultants, and our industry counterparts

Next steps and metrics
Development of metrics is taking place to track whether we are making progress towards achieving our purpose, including tracking internal and external perception of delivery and will include all stakeholders. The Board will oversee the metrics and has aligned its annual planner and deep dive programme to ensure its engagement. Due to the COVID-19 pandemic, the branding and public launch of the company purpose and ambition have been delayed but are on the horizon.

WORKFORCE POLICIES AND PRACTICE AND WORKFORCE CONCERNS

The Board recognised that a strong culture and commitment from across the organisation was essential to support and align the new purpose to the company values and strategy. The Code requires that a mechanism is adopted by organisations to enable meaningful, regular engagement between the Board and the workforce.

The Board fulfilled this requirement through the creation of the role of Designated Director for Employee Engagement and Trevor Didcock, an INED, was appointed to this role in September 2019 to ensure Board engagement with the workforce and monitoring of the culture. The role does not substitute for effective executive engagement or act as a "lightning rod" for workforce issues, but instead supports the engagement process, providing a direct link with the Board to empower the workforce and facilitate constructive dialogue and greater influence. This has resultantly strengthened Board decision-making and aligned the Board and workforce around strategic and operational objectives.

The Diversity and Inclusion Committee Governance Structure
Trevor also sits on the Committee for Diversity and Inclusion which had its inaugural meeting on 25 September 2019, and was also attended by Pauline Walsh, CEO. The purpose of the Diversity and Inclusion Committee is to bring to life our commitment to build a more inclusive culture, allowing all members of our workforce to bring their true selves to work, and is supported by 12 Diversity and Inclusion Ambassadors across the business. Feedback is sought at these meetings and reported to the Board in order to consider the effectiveness of this employee engagement mechanism, as well as action clear outcomes. Trevor also attends the quarterly Cultural Forums, with 48 nominated Culture Ambassadors across the business, reporting back to the Board on discussions, outcomes and any corrective action taken or required.

The Board recognises that it is critical to create effective two-way communication and to be open about the subject matters for discussion, while being aware of the importance of balancing commercial sensitivity with transparency. The mechanism for engagement with the workforce through the Culture Forum is considered to be effective as it enables broad topics of engagement to be discussed and provides strong, two-way communication and feedback. Matters for workplace engagement include:

- Workforce engagement processes and campaigns;
- Employee wellbeing processes; and
- Diversity and Inclusion including gender pay gap and ongoing implementation and review of the culture change programme.

A governance framework has been devised to measure feedback and ensure workforce concerns are voiced and all engagement is clearly reported and actioned.

Governance continued

Board leadership, transparency and governance (continued)

KEY BOARD POLICIES

Whistleblowing
A robust 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. Since June 2019, the Board has taken the lead for any whistleblowing matters, in line with Principle E, Provision 6 of the Code, and reviewed and approved the company's Whistleblowing Policy in January 2020.

Human Rights and Modern Slavery
As a highly regulated business with operations limited to the South East of England, the Board is cognisant of human rights issues[1] and upholds a zero tolerance approach to modern slavery and human trafficking across the business and when contracting with our supply chain. The Board approves both the Modern Slavery and Human Trafficking Policy and company's annual statement on Modern Slavery and Human Trafficking. Both documents are adhered to by our employees and our suppliers who provide support for major capital programme delivery, operational support as well as services and supplies. The documents are published on our website: **affinitywater.co.uk/responsibility.**

Conflicts of interest
Directors are required to notify the Chair 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 their roles as directors of the company, and any other roles which they may hold. The Conflicts of Interest Policy is reviewed annually.

[1] 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.

SHAREHOLDER ENGAGEMENT

During the financial year, the Board has been cognisant of its duty and commitment to disclose how stakeholder interests, and section 172 matters have been considered by the Board and its Committees in discussions and decision making. See **page 54** for the section 172 statement.

Relationship with our shareholders
The Board has an open and transparent approach with shareholders having clear access to the Chair, senior executives and non-executive directors in accordance with Principle D of the Code. The Board regularly facilitates effective face-to-face dialogue with shareholders to allow all members of the Board, in particular the INEDs, to develop an understanding of shareholders' views. There are three directors who represent our owners on the Board, and this ensures that the views of the shareholders are taken into account in decision making, and facilitates opportunities for our shareholders to hold open and transparent dialogue with the non-executive directors, as well as gain assurance on the Board's stewardship of their investment.

There are a limited number of matters requiring shareholder consultation before decisions are made, and these are set out in a governance framework document "Consulting with our Shareholders" at **affinitywater.co.uk/governance-assurance**, available on the governance pages of our website. Mechanisms are in place to ensure shareholders are kept in touch with key activities and developments, including:

- shareholders may attend Leaders' Forums and regulatory working group meetings on business and regulatory strategy;
- in addition to formal general meetings, regular engagement with our shareholders takes place with the Chair and the SID, to understand shareholder views on governance and strategic matters;
- the executive management hold ad hoc meetings with shareholders as required, with key company notices and external communications 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;

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 205** for further details).

Each shareholder has also provided an undertaking to the company affirming their commitment to governance principles pursuant to Condition P of the instrument of appointment.

Governance continued

Board leadership, transparency and governance (continued)

BOARD ACTIVITY FOR 2019/20

The table below outlines some of the matters considered by the Board during the year and the Board's role in governance of these areas. Meeting agendas predominantly cover recurring matters.

Environment To review our sustainability strategy, associated policies and monitor progress; our SHEDWQ considers our impact on the environment as well as the safety of our operations within our communities and at our sites, alongside monitoring the impact of our operations on the environment	• Reaffirmed the environment as at the core of our purpose • Reviewed and 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 PCC • Reviewed and submitted the revised draft WRMP representing the most cost effective and sustainable long-term solution • Reviewed environmental performance standards and commitments
Assets To review key proposals to increase resilience of systems and assets with focus on key areas such as leakage and supply interruptions; approve expenditure and plans for capital projects to increase resilience.	• Reviewed progress in delivering the AMP6 capital programme, including the spend on IT infrastructure • Reviewed how the scope and deliverability of the AMP7 investment programme aligned to the revised draft WRMP
Customers and Communities To review the development and execution of the customer service, communications and media strategies. Additional customer engagement and focus take place through the Customer Challenge Group.	• Reaffirmed our customers as central to our purpose • Reviewed terms of reference for the Chair and Committee members of the CCG to ensure they were robust and reflected the position for AMP7 • Reviewed customer satisfaction data, in relation to our performance against SIM and Water UK service levels set for developer service • Reviewed the CCG's annual report and met with the Chair of the group to discuss its PR19 assurances submitted to Ofwat
People To provide oversight and review the implementation of the people and culture strategy, including the employee survey, corporate values through our newly implemented principles and values; To champion diversity and inclusion and our approach to health, safety and wellbeing across the organisation; Our people strategy receives additional focus through the Remuneration and SHEDWQ.	• Reviewed health, safety and wellbeing activities and considered health and safety incidents of employees and contractors reinforcing the company's commitment to "zero harm" • Reviewed and discussed executive team succession plans and the needs of the business and the ongoing progress of our talent pipeline to address business challenges in AMP7 • Reviewed and discussed the results of the employee engagement survey • Reviewed and approved the introduction of new workforce engagement mechanisms to ensure an accurate representation of employees' views is provided to the Board; Trevor Didcock was appointed as the non-executive director designated for engagement with our workforce • Reviewed and updated the Board Diversity Policy • Reviewed and approved new Principles aligned to our culture and the company's newly defined Purpose • Approved the appointment of new EMT members and new INEDs

BOARD ACTIVITY FOR 2019/20 (CONTINUED)

Finance To provide oversight and approval of related financial policies ensuring compliance with the company's Instrument of Appointment where applicable; to review and seek assurance of operating expenditure; additional governance scrutiny is provided by the Audit Committee	• Approved entering into of index-linked swaps • Reviewed the AMP7 Business Plan and approved the 2019/20 budget • Reviewed and approved the half and full-year results • Reviewed and approved the company's Treasury Policy • Reviewed funding requirements and market risk exposures including the impact of Brexit • Reviewed monthly performance against budget and forecast
Regulatory Matters and PR19 To review key performance indicators on a quarterly basis; approve key regulatory submissions to Ofwat, the DWI and EA; agree and implement changes to the company's Instrument of Appointment	• Regular review and monitoring of the draft Business Plan and its submission for AMP7 • Reviewed and assessed ongoing preparations for the final determination, December 2019 • Approval of the AMP7 Business Plan
Risk Management To review all internal control and risk management; the Audit Committee provides the main focus on these areas prior to Board review and approval	• Reviewed the risk profile of the organisation including the principal risks, the risk appetite and operational risks • Reviewed the effectiveness of risk management systems including financial, operational and compliance controls • Reviewed and discussed assurance of all data • Reviewed and discussed developments in cyber-crime and activities undertaken to enhance effectiveness of security controls
Governance To ensure the governance framework is implemented across its Committees, to undertake formal annual reviews of its own performance, that of its Committees and individual directors, and the division of responsibilities and to update and implement any regulatory or legal governance changes to the governance framework. The Nomination Committee assists the Board by providing focus on governance reviews of Board structure, succession planning and appointments to the Board, while the Board retains responsibility for, and endorses, final decisions in these areas and for all its Committees	• Reviewed the terms of reference for the Board and its Committees (Audit, Remuneration, Nomination and SHEDWQ Committees) • Reviewed and amended policies relating to modern slavery and human trafficking, anti-bribery and corruption, whistleblowing, Board diversity and our code of conduct • 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 Board leadership, transparency and governance – principles ensuring the Board and Board Committees have clarity, understanding and traction with these commitments • Reviewed and amended the company's Memorandum and Articles to bring us in line with the Code and the annual re-appointment of all Board directors • Reviewed section 172 commitments at all Board and Board Committee meetings • Annual evaluation of the Chair and Audit Committee effectiveness • Held an AGM to approve the annual report and financial statements

Governance continued

Board leadership, transparency and governance (continued)

CODE PRINCIPLE
DIVISION OF RESPONSIBILITIES

OFWAT OBJECTIVE
THE BOARD OF THE APPOINTEE'S LEADERSHIP AND APPROACH TO TRANSPARENCY AND GOVERNANCE, ENGENDERS TRUST IN THE APPOINTEE AND ENSURES ACCOUNTABILITY FOR ITS ACTIONS

Our Chair, 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 equipped to carry out long-term strategic and sustainable decision-making in the interests of and engendering the trust 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 for the approval of the strategic objectives. Responsibility for the implementation and development of the strategies and overall commercial objectives is delegated to the CEO who is supported by the Executive Management Team.

SENIOR INDEPENDENT NON-EXECUTIVE DIRECTOR

Chris Bolt served as the SID until he stepped down as a director on 3 September 2019. The Board appointed Trevor Didcock as the SID on 1 March 2020. The SID' role is to work closely with the Chair, providing support and a sounding board for the Chair. The SID will:

- act as an intermediary for other directors as and when necessary;
- be 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 Chair, the CEO or CFO);
- meet, at least annually, with the non-executives to review the Chair's performance and succession planning for the Chair's role; and
- attend enough meetings with major shareholders to obtain a balanced understanding of their issues and concerns.

Although appointment of a replacement SID following Chris Bolt stepping down on 3 September 2019 was not made until 1 March 2020, 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 during 2018/19, details of which can be found in the annual report and financial statements for the year ended 31 March 2019 on **page 82**.

In line with Code Provision 21, an internal Board assessment was conducted during 2019/20, details of which can be found on **page 95**. An evaluation of the Chair's performance was carried out by the SID.

THE COMPANY SECRETARY

Sunita Kaushal was appointed as Company Secretary with effect from 1 April 2020, following on from Colin Caldwell who had been appointed to the role on an interim basis with effect from Tim Monod's departure on 6 November 2019.

As a governance professional, the Company Secretary is called on to advise the Board on all governance matters, ensuring the Board operates in accordance with relevant laws and governance principles in the long-term interests of the organisation. In order to be the 'conscience of the company', the Company Secretary ensures best practice in governance and that ethical practices are taking place across the company. In this role, the Company Secretary remains independent-minded and is not under the influence of senior management, the Chair or any other individual director.

The Company Secretary delivers strategic leadership, and acts as a vital bridge between the executive management and the Board, facilitating the delivery of organisational objectives. She ensures 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 Chair and respective Committee Chairs to develop and agree a forward agenda for the year ahead for 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.

GOVERNANCE INFORMATION

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:
affinitywater.co.uk/governance-assurance

Matters Reserved for the Board

The details of matters that the Board has reserved for its own decision are set out in the "Schedule of Matters Reserved for the Board" which was reviewed and updated to reflect the Code and Ofwat's Principles

A copy of the matters reserved for the Board can be found at:
affinitywater.co.uk/governance-assurance

Board Committee Terms of Reference

All Board Committees have terms of reference which are reviewed annually or when changes in law or regulatory requirement is required.

A copy of the Board Committee terms of reference can be found at:
affinitywater.co.uk/governance-assurance

Assurance of Board Documentation

The Company Secretary is pivotal to ensuring that the Board receives accurate information on the Company's performance to enable the Board to operate effectively and fulfil their fiduciary director duties.

Governance continued

Board leadership, transparency and governance (continued)

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 considered to have significant calibre and experience for their views to carry sufficient weight in Board decisions, and INEDs are able to bring their invaluable commercial specialisms and regulatory experience into play at Board meetings.

The composition of the Board at 31 March 2020 is illustrated in the diagram below:

Key
- Chair
- Executive Director
- Independent Non-Executive Director
- Non-Executive Director

Board composition at 31 March 2020	Directors	Independent (including Chair)	Male	Female
	12	7	7	5

In line with Principle A of the Code, the overarching role of the Board is to promote the long-term sustainable success of the company, generating value for our shareholders and contributing to the wider society. Underpinning this is the company's purpose, and a Board strategy to deliver it, linked to the company values and behaviours that shape the company culture and the way our business is conducted.

Executive responsibility for delivery of the objectives set by the Board is delegated to the Executive Directors. The Board delegates certain roles and responsibilities to its principal Board Committees. The Committees report to the Board on matters discussed and actions to be 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.

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: **affinitywater.co.uk/governance-assurance**.

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 SHEDWQ Committee, which assist the Board in discharging its duties. Composition of these Committees at 31 March 2020 is listed in the table below.

Audit Committee	Remuneration Committee	Nomination Committee	SHEDWQ Committee
Patrick O'D Bourke (Chair)	Susan Hooper (Chair)	Tony Cocker (Chair)	Chris Newsome (Chair)
Chris Newsome	Tony Cocker	Patrick O'D Bourke	Trevor Didcock
Mark Horsley	Mark Horsley	Susan Hooper	Angela Roshier
Tony Roper	Jaroslava Korpanec	Jaroslava Korpanec	Pauline Walsh
Jaroslava Korpanec	Angela Roshier	Tony Roper	Tony Roper
	Trevor Didcock	Ann Bishop	
	Ann Bishop		

Each Committee operates in accordance with terms of reference approved by the Board and published on our website.

INDEPENDENCE AND DIVERSITY

The composition of our Board Committees at 31 March 2020, in terms of independence and gender, is shown in the table below.

Composition at 31 March 2020	Members	Independent (including Chair)	Male	Female
Audit Committee	5	3	4	1
Remuneration Committee	7	3	3	4
Nomination Committee	6	3	3	2
Community Committee	5	3	3	2

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 diversity across the whole company and are focussed on promoting a broader diversity and implementing a culture that is inclusive.

During the year the company met Ofwat's expectation that INEDs 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 Chair, to comprise non-executive directors determined by the Board to be independent' from 3 September 2019 when Chris Bolt stepped down as a director to 19 December 2019 when Mark Horsley was appointed, the Board is comfortable that the composition was appropriate for a company owned by private investors. The composition of the Board over the past year has continued to evolve as part of the Board effectiveness and governance review, with two additional INED appointments made, to strengthen our skills and to ensure we meet Code Provision 24 with regard to the number of non-executive directors on our Board. No single director or group of directors can dominate the Board's decision making.

Governance continued

Board leadership, transparency and governance (continued)

BOARD AND COMMITTEE ATTENDANCE

It is vital that directors have sufficient time to engage with the company and to discharge their responsibilities effectively. Since February 2020, the Board has committed to ensure, prior to appointment to the Board, disclosure by individual directors of significant commitments with an indication of time involved, in line with Code Provision 15 replacing the previous Chair led arrangements. All additional and subsequent appointments are disclosed and discussed with the Chair followed by formal approval of the Board prior to being undertaken by the individual director. In addition to formal Board and Committee meetings, directors are encouraged to participate in informal briefings from management. The expected time commitment of our Chair and INEDs is recorded in their respective letters of appointment.

The table sets out attendance at scheduled meetings for the year ended 31 March 2020:

	Board	Audit Committee	Remuneration Committee	Nomination Committee	SHEDWQ Committee
Number of meetings	**12**	**4**	**4**	**4**	**5**
Company Chair					
Tony Cocker	12/12	-	4/4	4/4	-
Independent non-executive directors					
Chris Bolt**	5/12	2/4	2/4	-	1/5
Patrick O'D Bourke	12/12	4/4	-	4/4	-
Trevor Didcock	12/12	1/4	2/4	-	5/5
Susan Hooper	9/12	-	4/4	4/4	5/5
Mark Horsley*	5/12	1/4	1/4	-	-
Chris Newsome	11/12	2/4	-	-	5/5
Ann Bishop	1/12	-	1/4	-	-
Executive directors					
Stuart Ledger	11/12	-	-	-	-
Pauline Walsh	11/12	-	-	-	4/5
Non-executive directors					
Jaroslava Korpanec	12/12	2/4	4/4	3/4	-
Tony Roper	12/12	4/4	-	4/4	5/5
Angela Roshier	11/12	1/4	4/4	-	4/5

* denotes new Board appointment part way through the financial year
** denotes role as a non-executive director ended part way through the financial period (3 September 2019)
\- denotes non-membership of that Committee during the year

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 2020:

	Board	Audit Committee	Remuneration Committee	Nomination Committee	SHEDWQ Committee
Number of meetings	**7**	**1**	**0**	**0**	**0**
Company Chair					
Tony Cocker	7/7	-			
Independent non-executive directors					
Chris Bolt*	4/7	1/1			
Patrick O'D Bourke	6/7	1/1			
Trevor Didcock	6/7	0/1			
Susan Hooper	4/7	-			
Mark Horsley	-	-			
Chris Newsome	6/7	-			
Executive directors					
Stuart Ledger	7/7	-			
Pauline Walsh	7/7	-			
Non-executive directors					
Jaroslava Korpanec	7/7	-			
Tony Roper	7/7	1/1			
Angela Roshier	6/7	0/1			

* denotes role as a non-executive director ended part way through the financial period (3 September 2019)
\- denotes non-membership of that Committee during the year

Governance continued

Board leadership, transparency and governance (continued)

BOARD COMMITTEES

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 Chair and its members are entitled to be present at the Audit, Remuneration, Nomination and SHEDWQ 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: **affinitywater.co.uk/governance-assurance**.

Each Board Committee reviewed its terms of reference during the year to ensure that these were in line with best practice and the latest Ofwat principles.

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	Stepped down 3 September 2019
Trevor Didcock	Independent	Stepped down 1 July 2019
Jaroslava Korpanec	Shareholder appointed	Appointed 12 February 2020
Mark Horsley	Independent	Appointed 19 December 2019
Chris Newsome	Independent	Appointed 18 November 2019
Tony Roper	Shareholder appointed	
Angela Roshier	Shareholder appointed	Stepped down 12 February 2020

The Audit Committee is key to ensuring that an organisation has robust and effective processes relating to financial reporting, internal controls, risk management and ethics. The Committee is also the main oversight body for the internal and external Auditors. The Committee is central to the company's governance structure and ensures the interests of customers, shareholders and other stakeholders are protected, and that responsible business practices are adhered to. The Committee's terms of reference (see **affinitywater.co.uk/governance-assurance**) are structured to ensure it achieves compliance with governance best practice and are reviewed annually to ensure the effectiveness of the Audit Committee.

The Committee is chaired by Patrick O'D Bourke, an INED who has relevant and up to date financial experience, with the Committee as a whole having competency relevant to regulated utilities and infrastructure businesses. The CEO, CFO, Head of Audit, Risk and Compliance, Financial Controller, external Auditor and other parties are invited to attend meetings as appropriate.

The Committee considers matters identified by the external Auditor in its report to the Committee. It updates the Board on how it has discharged its responsibilities through a report from the Committee Chair at each Board meeting following the Audit Committee meeting. When reporting to the Board, the Audit Committee identifies any matters it considers where action or improvement is needed and makes recommendations as to the steps to be taken.

The Audit Committee also has a role in ensuring that shareholder interests are properly protected in relation to financial reporting and internal control. In carrying out this role, the Audit Committee considers the clarity of its reporting and prepares a separate report describing the work of the Audit Committee in discharging its responsibilities. The Chair of the Committee attends the AGM to answer questions on the separate section of the annual report and financial statements describing the Committee's activities and matters within the scope of the Committee's responsibilities.

The Committee reviews the provision of non-audit services by the external Auditor and has primary responsibility for making a recommendation on the appointment, re-appointment and removal of the external Auditor. It also 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 annual internal evaluation of the Committee took place during the year via a questionnaire with the ability for free text answers. The Committee assessed its performance against a range of criteria aligned to the Committee's terms of reference.

The assessment made comparisons with the 2018 assessment to provide a consistent year-on-year benchmark.

The assessment confirmed year on year improvement across the range of assessment criteria, 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 controls; and
- improve the provision of concise, timely information.

The duties of the Audit Committee and activities in the year are contained in the Audit Committee report on **pages 105 to 111**.

The composition of the Committee did not meet Code Provision 24 or Ofwat's expectations for there to be a majority of independent members for the period from 3 September 2019 when Chris Bolt stepped down as a director to 19 December 2019 when Mark Horsley was appointed. It is now compliant with the Code and Ofwat's expectations for INED membership.

Remuneration Committee

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

Remuneration Committee members	Independence	Notes
Susan Hooper (Chair)[1]	Independent	
Chris Bolt	Independent	Stepped down 3 September 2019
Tony Cocker[2]	Independent	
Trevor Didcock	Independent	Appointed 1 July 2019
Mark Horsley	Independent	Appointed 19 December 2019
Jaroslava Korpanec	Shareholder appointed	
Angela Roshier	Shareholder appointed	
Ann Bishop	Independent	Appointed 25 March 2020

The composition of the Committee met Ofwat's expectations for there to be a majority of independent members, as well as the requirements of the Code, for the financial year.

[1] In line with Code Provision 32, Susan Hooper has been Chair of a Remuneration Committee for 'at least 12 months'
[2] In line with Code Provision 32, the Chair is regarded as independent on appointment as Chair

Governance continued

Board leadership, transparency and governance (continued)

BOARD COMMITTEES (CONTINUED)

Remuneration Committee (continued)

The Committee is chaired by Susan Hooper. 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 Chair, INEDs, executive directors and other members of the EMT. 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.

The Remuneration Committee also reviews workforce remuneration and related policies to ensure the reward, incentives and conditions available are taken into account when deciding the pay of executive directors and senior management. The terms of reference have been amended to align responsibilities with the Code. Reporting on remuneration, how it delivers company strategy and long-term success, and alignment with employee remuneration is now part of the Committee's responsibilities. The Committee feeds back to the Board on workforce reward, incentives and conditions providing support to the Board with regard to monitoring policies and practices and alignment to the company's culture and long-term strategy.

There is transparency when communicating to the workforce how decisions on executive pay reflect the wider company pay policy, and 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.

Further information on the work of the Remuneration Committee during the year is contained in the full Remuneration Report on **pages 112 to 126**.

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	
Jaroslava Korpanec	Shareholder appointed	
Tony Roper	Shareholder appointed	
Ann Bishop	Independent	Appointed 25 March 2020

The composition of the Committee met the Ofwat principles and Code Provision for Nomination Committees to comprise a majority of INEDs.

The Committee is Chaired by Tony Cocker. He does not lead any Nomination Committee meetings relating to the appointment of his successor, and in these circumstances, the Committee is chaired by an INED agreed by the remaining Committee members.

The Committee's responsibilities include:

ensuring plans are in place for orderly succession to both Board and senior management positions, and overseeing the development of a diverse pipeline for succession	reviewing Board performance, paying specific attention to the structure, size and composition of the Board including skills, independence, knowledge, ethnicity, and diversity
continually assessing the skills, experience, and capabilities required on the Board, taking account of the company's strategic priorities and the future challenges affecting the business	annually making recommendations to the Board regarding the re-appointment of any non-executive director, having considered the time required for the role and identifying his or her continued contribution to the Board, having particular regard to his or her key skills and expertise
leading the process for appointments, considering, and recommending to the Board persons who are appropriate for appointment as executive and non-executive directors to maintain an appropriate mix of skills and experience within the company and on the Board	making recommendations concerning the membership of Board Committees and the appointment of the SID and the Director for Employee Engagement
In identifying suitable candidates, using open advertising or external advisers, considering candidates from a wide range of backgrounds, and considering candidates on merit and against objective criteria with due regard to the benefits of diversity on the Board, taking care that appointees have sufficient time available to devote to the position	working with the Human Resources and Culture team to take an active role in setting, monitoring, and meeting diversity objectives and strategies for the company as a whole
overseeing the induction, training, and the continuing professional development of Board members	overseeing the Board Diversity policy

In line with Ofwat's expectations regarding succession planning and the Code requirement that Board appointments should be made on merit against objective criteria, the Committee considered the capabilities and skills needed on the Board to enhance its ability to support and challenge the Executive during 2019/20 in delivering the stretching targets in AMP7 - in particular ensuring that Board as a whole has a good mix of:

- asset knowledge and experience; operational and field experience;
- in depth understanding of regulatory approaches from Ofwat;
- customer engagement and retail experience;
- innovation; and
- finance and risk and experience of audit.

The Committee oversaw the preparation of the description and the selection of Russell Reynolds, an independent external research company unrelated to Affinity Water, to conduct a search. In addition to the element of specific skills, knowledge and experiences highlighted above, the criteria in the role specification included: a strategic and analytical leader who would contribute to the collaborative, inclusive, and engaged style of the Board; wholly independent; and an understanding of the need for legitimacy in the eyes of key stakeholders, notably in terms of customers' interest and the environment.

Governance continued

Board leadership, transparency and governance (continued)

BOARD COMMITTEES (CONTINUED)

Nomination Committee (continued)

Russell Reynolds identified candidates for consideration and interview, and the Committee interviewed shortlisted candidates and made final recommendations to the Board. The Committee believes that the appointments of Mark Horsley and Ann Bishop have enhanced our capabilities significantly in a number of the key areas identified above. In addition, both bring experience to support the transformational change and early engagement on PR24.

During 2019/20, the Nomination Committee oversaw the recruitment of Colin Caldwell as Interim Company Secretary; recommended the appointment of Trevor Didcock as SID; oversaw the recruitment of Sunita Kaushal as Company Secretary and General Counsel; reviewed the induction programme for Mark Horsley and overall programme of site visits; and reviewed and recommended changes to Committee membership.

In the current financial year, the Nomination Committee will further develop its consideration of skills and capabilities, and will implement a broader skills matrix for directors that will map the existing skill set against those required to execute strategy and navigate future challenges effectively. The Committee will then assess this skills matrix periodically in the context of discussions on tenure, director and Committee evaluations and long-term succession strategies. The Nomination Committee recommended and Board re-approved the Board Diversity Policy. 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-balanced 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 balance within the organisation.

It will be considering setting targets for the next financial period and beyond.

During 2020/21, the Board will be considering objective setting for a specific male and female quota for its members and will align its Board Diversity Policy to reflect these changes. Currently, the Nomination Committee is not following a specific male or female quota for Board members. Nevertheless, all appointments are based on the diversity of contribution and required competencies, irrespective of gender, ethnicity, 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 30** of the strategic report for the split between males and females within the business and how we are improving diversity across the talent pool.

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 diverse and 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. In addition, together with other UK water companies, the company has signed up to be the first sector to achieve 100% commitment to the Social Mobility Pledge - along with investment in skills. This is part of the water sector's wider aim to promote opportunity in local communities and increase talent and diversity within companies.

SHEDWQ Committee

During the year a new Board Committee, the SHEDWQ Committee, was established[1]. During the year, membership of the SHEDWQ Committee was as follows:

SHEDWQ Committee members	Independence	
Chris Newsome (Chair)	Independent	
Chris Bolt	Independent	Stepped down 1 July 2019
Trevor Didcock	Independent	Appointed 1 July 2019
Angela Roshier	Shareholder appointed	
Tony Roper	Shareholder appointed	Appointed 1 July 2019
Pauline Walsh	Executive	

The Committee's role includes:
- reviewing and monitoring, on behalf of the Board, safety and health, including employee well-being, 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 related to the above are being managed effectively.

BOARD COMPOSITION, SUCCESSION AND EVALUATION

CODE PRINCIPLE
COMPOSITION, SUCCESSION AND EVALUATION

CODE OBJECTIVE
THE BOARD OF THE APPOINTEE 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.

Board appointments

Appointments to the Board are subject to a formal, rigorous and transparent procedure and the Board and Nomination Committee maintain an effective succession plan for Board and senior management roles. Appointments and succession plans are based on merit and objective criteria[2] in line with Principle J of the Code, as set out on **page 92**. The Board promotes diversity of gender, social and ethnic backgrounds, and of cognitive and personal strengths.

Induction

Non-executive directors (including the Chair) 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.

[1] The SHEDWQ held its first meeting on 17 June 2019, however, it was not a formerly constituted Board Committee at this time.
[2] Which protect against discrimination for those with protected characteristics within the meaning of the Equalities Act 2010

Governance continued

Board leadership, transparency and governance (continued)

BOARD COMPOSITION, SUCCESSION AND EVALUATION (CONTINUED)

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

- 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.

TRAINING AND CONTINUING PROFESSIONAL DEVELOPMENT

Our Board members are conscious of the need to keep themselves properly informed 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. As part of the individual directors' element of the board evaluation process, directors are asked to identify any skills or knowledge gaps they would like to address.

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, and are conscious of the need to keep themselves properly briefed and informed to deepen their understanding of the business.

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. **See page 90** for the Committee's responsibilities and training aspirations.

EFFECTIVENESS REVIEW

Our Board evaluation was conducted internally this year; our last externally facilitated review of the effectiveness of the Board and its Committees was undertaken in December 2018 and was conducted by Boardroom Dialogue Limited.

The internal effectiveness review followed the external review headings: role of the board, leadership of the board and quality engagement, information and support, induction and development, succession planning and stakeholder management.

The process was managed by the Company Secretary and was based on questions that have been scored and benchmarked year-on-year and included the opportunity for free text.

The questions assessed both the performance of the Board, and each of its principal Committees, as well as that of the Chair and each of the non-executive directors.

The Board is planning to facilitate an external effectiveness review before the end of 2020. Following on from the recommendations and work commenced from the externally facilitated review in 2018, the table highlights progress made during this financial year on key areas picked up from the 2018 Board effectiveness review:

2018/19 areas of assessment	Progress 2019/20
Balance for debate: more opportunities for non-executive director-only interactions.	Regular scheduled one to one meetings and director only interactions with the Chair. More informal opportunities for meetings also scheduled across the year
Culture oversight of stakeholder engagement.	Development of a stakeholder map updating the Board annually on the strength of the relationship with each stakeholder has commenced; greater visibility of the Board by the workforce with the Designated Director of Employee Engagement acting as its representative.
Succession planning and talent management succession planning for the Board and senior management team.	The Nomination Committee conducted a review of key capabilities and skills required for succession planning for both the Board and senior management team and is implementing a skills matrix assessment to evaluate the needs of the business and Board composition

Trevor Didcock, as the SID, in discussion with the other non-executive directors, led the annual review of the Chair's performance, in line with the Code Provision 12, resulting in a positive review.

The Board continues to monitor progress in implementing the recommendations from 2018 and looks to continuously improve its engagement, development and stakeholder management while being mindful of both the Code and Ofwat's principles.

RE-APPOINTMENT OF DIRECTORS

The company's Articles were amended during the year to provide for the re-election of all directors at AGMs in line with Principle J, Provision 18 of the Code and includes providing justification as to why directors should be re-elected.

The terms of appointment for our directors are available on our website: **affinitywater.co.uk/governance-assurance**

Governance continued

Board leadership, transparency and governance (continued)

CODE PRINCIPLE
AUDIT, RISK AND CONTROL

OFWAT OBJECTIVE
THE BOARD OF THE APPOINTEE'S LEADERSHIP AND APPROACH TO TRANSPARENCY AND GOVERNANCE, ENGENDERS TRUST IN THE APPOINTEE AND ENSURES ACCOUNTABILITY FOR THEIR ACTIONS

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 2006).

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.

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 16 to 63** 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 comprehensive 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.

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.

We have an established framework for identifying, evaluating and managing the principal and emerging 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 39** of the strategic report for further information.

We follow the principles of the 'three lines of defence' model, as promoted by the Institute of Internal Auditors and other professional and commercial organisations, as the basis of the company's assurance process. Assurance is achieved as follows:

First line Management control: Controls are exercised by operational managers who own and manage risks day to day. Controls are designed into systems and processes under the guidance of operational management.

Second line Risk management and peer review: This comprises risk management and compliance functions established by management to help build and/or monitor the first line of defence controls, ensuring that they are properly designed, in place and operating as intended.

Third line Internal Audit: Internal Audit provides the Board and senior management with assurance based on a high level of independence and objectivity within the organisation. Internal Audit provides assurance, on a test basis, as to the effectiveness of governance, risk management, and internal controls operated as part of the first and second lines of defence.

Internal Audit prepares an annual plan of reviews, taking into account risks identified on risk registers, and carries out a number of audits each year. Not all areas are reviewed every year. The Internal Audit plan is approved by the Audit Committee, which also monitors its delivery over the course of the financial/regulatory year.

External Assurance: We also make use of third-party organisations to provide the Board with external assurance that information prepared by management is accurate and compliant.

This particularly applies to major items such as the annual report and financial statements and the tariff setting process. The main parties used to provide this assurance are PricewaterhouseCoopers LLP ('PwC'), who provide assurance on financial data, and Atkins Limited (our 'Reporter'), who provide assurance on engineering and technical data. These contracts are periodically re-tendered and providers may change.

Governance continued

Board leadership, transparency and governance (continued)

RISK MANAGEMENT AND INTERNAL CONTROL (CONTINUED)

During 2019/20, we commissioned an external review of how we manage our various operational and regulatory legal obligations. The outcome of this review was largely positive but some aspects of our approach to compliance were considered to need strengthening. We had already begun enhancing our compliance processes and this work has been accelerated. In particular, we have introduced a Compliance Obligations Register to hold all details of applicable legislation, statutory instruments and regulations.

The register has a scoring system linked to risk and relevance to aid prioritisation of compliance work, as well as identifying the EMT member responsible for each compliance requirement, details of first and second line controls, and internal and external audits conducted or planned. We also now mandate twice-yearly compliance self-declaration returns to be completed by EMT members to ensure that we continue to maintain a high degree of focus on this area.

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 will work on areas of compliance that need strengthening.

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; and
- reports from the EMT, the Audit Committee, external Auditor and other assurance providers, and the Internal Audit function in relation to internal control and risk management systems.

CODE PRINCIPLE
REMUNERATION

OFWAT OBJECTIVE
THE BOARD OF THE APPOINTEE'S LEADERSHIP AND APPROACH TO TRANSPARENCY AND GOVERNANCE ENGENDERS TRUST IN THE APPOINTEE AND ENSURES ACCOUNTABILITY FOR THEIR ACTIONS

Our Remuneration Report can be found on **pages 112 to 126**.

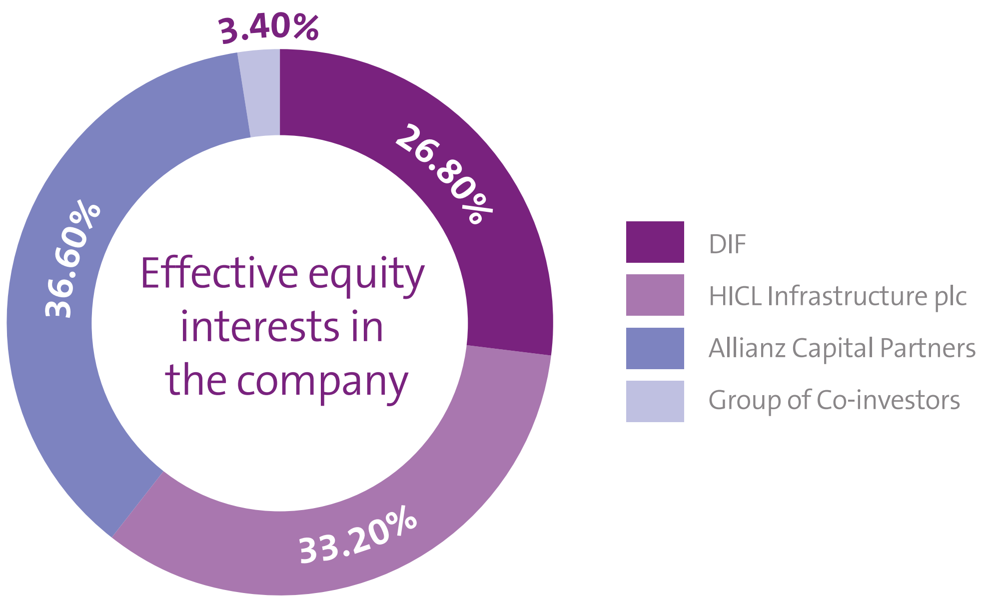
By order of the Board

Tony Cocker
Chair
24 June 2020

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 acquisition, 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 Holding I Pte. Limited
- DIF Management Holding BV
- DIF Management UK Limited
- HICL Infrastructure plc
- InfraRed Capital Partners (Management) LLP[1]

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 INEDs, 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.

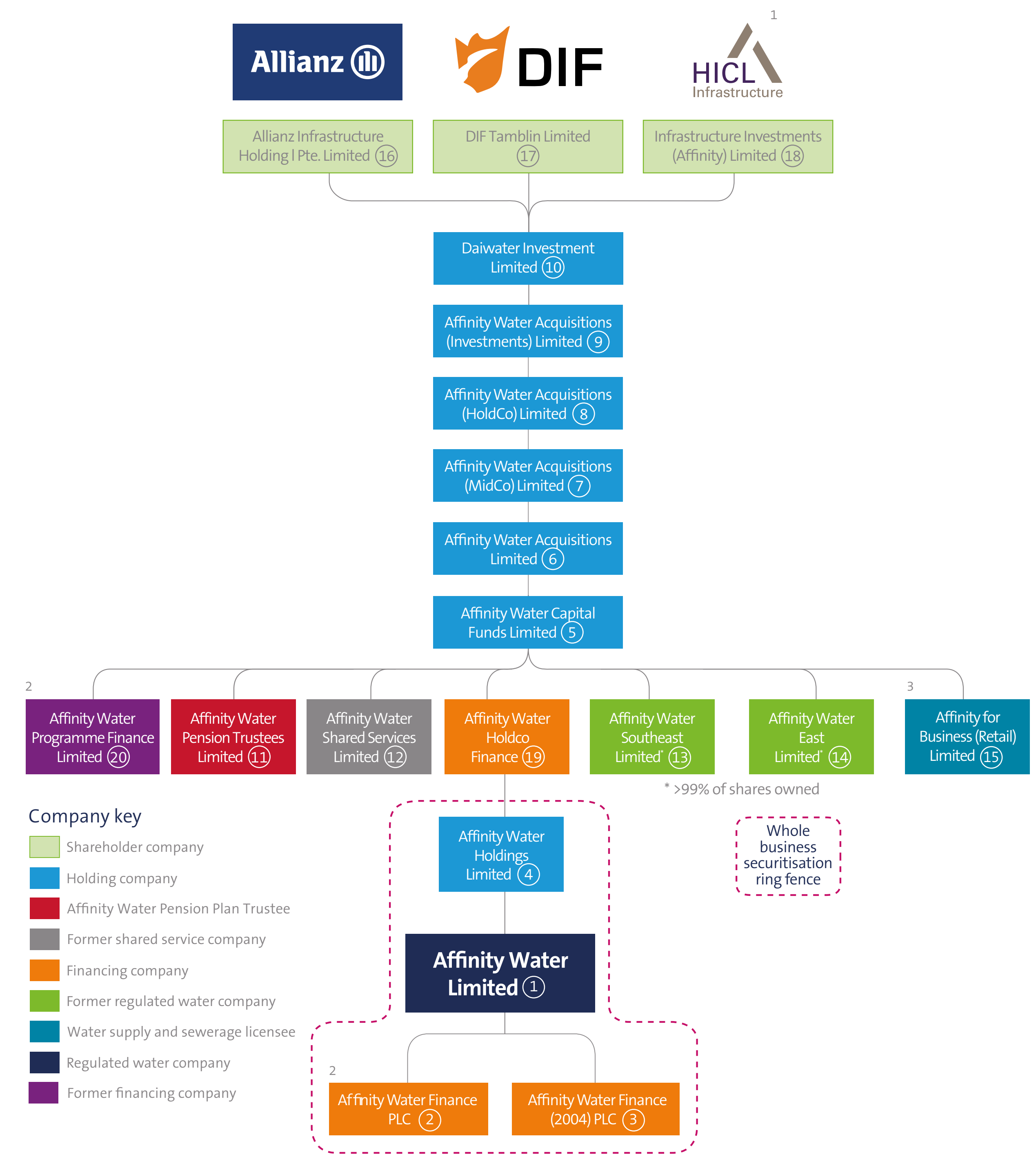
[1] Sun Life Financial Inc has exchanged contracts to acquire an 80% interest in the InfraRed business from InfraRed Capital Partners (Management) LLP. Following completion, which is subject to regulatory consents and other customary closing conditions and which is expected to occur in Summer 2020, Sun Life Financial Inc will become an ultimate controller.

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 2020. 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 70 to 75**.



[1] HICL Infrastructure sold down 3.4% of its 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.
[3] Affinity for Business (Retail) Limited was sold to Castle Water Limited effective on 1 April 2020. The entity has been renamed Castle Water (Southern) 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, 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. 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 consortium in 2012 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 consortium 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 by investors 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	As at 31 March 2020, Affinity for Business (Retail) Limited was a subsidiary of Affinity Water Capital Funds Limited operating as a water and wastewater retailer in the non-household retail market. The entity was sold to Castle Water Limited effective from 1 April 2020 and renamed Castle Water (Southern) Limited.	England and Wales
16	Allianz Infrastructure Holding I Pte. Limited	A company which holds indirectly Allianz Capital Partners' investment in the group.	Singapore
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 plc's investment in the group, together with the co-investment by certain local authority pension funds.	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 EMTN programme. Its assets and liabilities were transferred to Affinity Water Finance PLC in 2019. The company is dormant and will be liquidated in 2020/21.	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 £250.0m; 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 2020 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

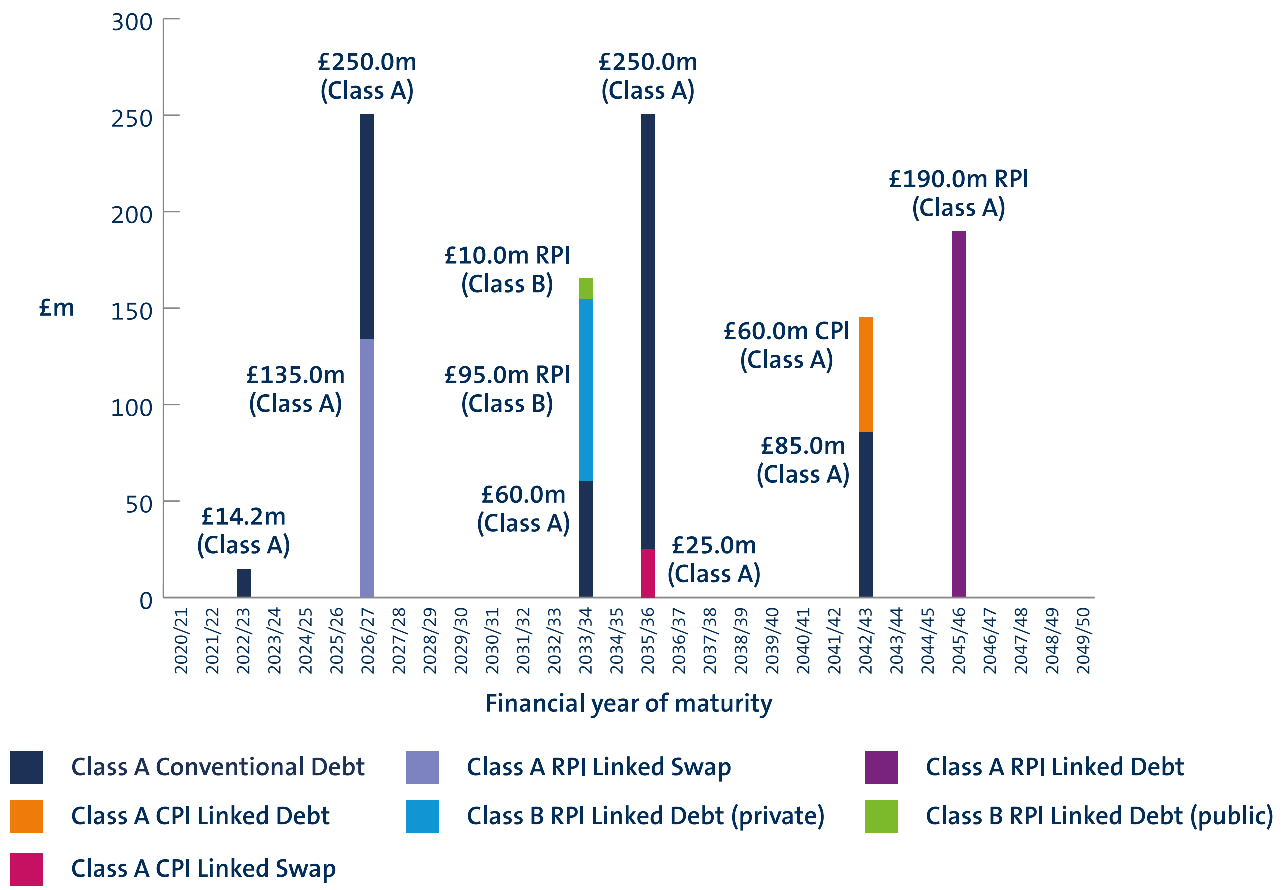
Governance

Governance continued

Ownership and financing (continued)

OUR FINANCING (CONTINUED)

The following chart shows the maturity profile of our bonds and related index linked swaps at 31 March 2020:



The credit ratings for our subsidiaries' bonds assigned by the rating agencies, Moody's, Standard & Poor's and Fitch, at 31 March 2020 were as follows:

Bonds	Moody's	Standard & Poor's	Fitch
Class A	A3	BBB+	BBB+
Class B	Baa3	BBB-	BBB-
Corporate family rating	Baa1	Not applicable	Not applicable

Moody's credit ratings were last affirmed in March 2020.

Standard & Poor's downgraded the ratings of our Class A and Class B Bonds by one notch each in February 2020 following our acceptance of Ofwat's Final Determination.

In March 2020, we obtained an additional credit rating from Fitch Ratings.

Audit Committee report

PATRICK O'D BOURKE

Audit Committee members

- Patrick O'D Bourke
- Chris Bolt*
- Trevor Didcock*
- Mark Horsley*
- Jaroslava Korpanec*
- Chris Newsome*
- Tony 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 Chair, refer to **page 86**. The biographies of the remaining current Committee members are presented on **pages 70 to 75**.

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; and
- Regulatory reporting obligations.

* Chris Bolt stepped down from the Audit Committee on 3 September 2019 and was replaced by Mark Horsley on 19 December 2019. Trevor Didcock stepped down from the Audit Committee on 1 July 2019 and was replaced by Jaroslava Korpanec on 12 February 2020. Chris Newsome was appointed to the Audit Committee on 18 November 2019. Angela Roshier stepped down from the Audit Committee on 12 February 2020.

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 financial information published by the company. Some of the Committee's responsibilities are targeted at the regulated information in the annual report and financial statements 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:

affinitywater.co.uk/governance-assurance

The Committee also has responsibility for overseeing the relationship with our external Auditor (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 2019/20 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 2019/20 financial statements were consistent with those identified by the external Auditor in its report on **pages 136 to 143**. 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 five times. As part of one of these meetings, the Committee met without management present, with both internal and external auditors.

The table below and continued on the next page presents a summary of business considered during 2019/20:

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 2019 half-yearly report and its audit of the March 2020 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 risk assurance work completed in respect of the company's PR19 submissions.
Internal audit	Agreed a programme of work for the Internal Audit function, including a programme of compliance audit work. 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 2019/20 Assurance Plan required under Ofwat's Company Monitoring Framework.
Financial and other reporting	Reviewed the September 2019 half-yearly financial results and the March 2020 annual report and financial statements. Reviewed changes to statutory reporting in relation to the adoption of IFRS 16: 'Leases' ('IFRS 16') in 2019/20. Reviewed the March 2020 regulatory Annual Performance Report to ensure that the information met Ofwat's reporting requirements and addressed issues relating to the March 2019 regulatory Annual Performance Report identified by Ofwat in correspondence received following PR19 submissions. Advised the Board on whether the annual report and financial statements, taken as a whole, were fair, balanced and understandable, and provided the information necessary for shareholders to assess the company's position and performance, business model and strategy. Reviewed the assessment of the company's long-term prospects, viability statement and stress test scenarios, including the potential impact of COVID-19 on the company's forecasts.

OVERVIEW OF THE ACTIONS TAKEN BY THE AUDIT COMMITTEE TO DISCHARGE ITS DUTIES (CONTINUED)

General	Reviewed its terms of reference. 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: • tax matters; • the company's insurance programme and renewal; • 2020/21 tariffs and charging scheme, including governance around this process and charging arrangements for new connections services; • non-financial regulatory reporting management plan and requirements for 2019/20; • progress in relation to management's action plan to improve the reporting of leakage performance following the restatement of our 2017/18 leakage figure in 2018/19 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; • performance against AMP6 performance commitments and the results of associated assurance processes; • the renewal of the company's contract with its Reporter; • a compliance issue in relation to the operation of 18 lagoons at the company's water treatment works; • a review of the company's operational and regulatory compliance obligations by a third-party consultant; • business continuity planning; • gifts and hospitality activity and arrangements in place for governance of this compliance area; • governance arrangements for compliance work carried out by the Markets Oversight Committee; • new corporate, governance, statutory and regulatory reporting requirements for 2019/20; • company purpose; • the company's whistleblowing arrangements; • the status of the company's information security against ISO 27001 controls; • the replacement of the company's Enterprise Resource Planning system, which supports the company's core financial, HR and procurement activities; • a planned surveillance visit by National Quality Assurance ('NQA') in 2019/20 to verify the compliance of the company's management system by reference to ISO 9001:2015 (Quality Management System); ISO 14001:2015 (Environmental Management System) and BS OHSAS 18001:2007 (Occupational health & Safety); and • compliance with Security and Emergency Measures Direction 1998. Self-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 company's non-audit fee policy.

Governance continued

Audit Committee report (continued)

SIGNIFICANT ISSUES CONSIDERED BY THE AUDIT COMMITTEE IN RELATION TO THE 2019/20 FINANCIAL STATEMENTS

The Committee considered the appropriateness of the company's accounting policies and requirements to adopt new financial reporting standards applicable in the 2019/20 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 49 to 53**.

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 concluded that the approach and conclusions reached were appropriate.
Policy for the loss allowance of trade receivables	The Committee reviewed the policy for providing for the impairment of trade receivables 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.
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 would 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.

We challenged management on the following areas described below:

Area of challenge	Outcome of this challenge
Arrangements for ensuring compliance	Third party review and new compliance register
Business continuity planning	Updated business continuity planning
Consequences of potential credit rating downgrades	Additional credit rating obtained from Fitch
Reliability and consistency of published data	New data management arrangements put in place

We observed that PwC challenged management on the following areas described below:

Area of challenge	Outcome of this challenge
• Accuracy of the measured income accrual • Adequacy of the loss allowance • Assessment of cost capitalisation • Assessment of pension assumptions • Impact of COVID-19 • Going concern basis	No issues noted during the interim or year end audit. See the audit opinion on **page 136** onwards for more details.

We requested that PwC looked at the following specific areas described below:

Area and reason for our request	Work undertaken by PwC and outcome of this work
Cost capitalisation	PwC reviewed the processes around cost capitalisation, including capitalising staff time and corporate overheads. No issues were found during the audit. See the audit opinion on **page 136** onwards for more details.

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.

Governance continued

Audit Committee report (continued)

EXTERNAL AUDIT (CONTINUED)

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 was recognised as having expertise in this area;
- provided agreed upon procedures in relation to the accuracy of the company's proposed water charges for 2020/21;
- provided risk assurance work in respect of the company's PR19 submissions;
- 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; and
- was engaged to provide assurance services with respect to financial information included within a debt prospectus.

Auditor objectivity and independence were safeguarded in these instances through the work being performed on a review and recommend basis with final decisions being taken by management, and through ensuring advice was only provided by partners and staff who were not involved in the statutory audit of the financial statements where the information was 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;
- feedback from the management and finance teams;
- 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 2021.

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.

INTERNAL AUDIT

The Head of Audit, Risk and Compliance has direct access to the company Chair and the Audit Committee Chair.

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
Chair of the Audit Committee
24 June 2020

Governance continued

Remuneration report

SUSAN HOOPER

Remuneration Committee members at 31 March 2020

- Susan Hooper
- Tony Cocker
- Trevor Didcock
- Mark Horsley
- Jaroslava Korpanec
- Angela Roshier

We believe that the remuneration policy has worked well to support the company's strategy in AMP6. The changes made to the policy for AMP7 will allow the company to focus on delivering against the tough challenges embodied in our settlement. 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 2020/21 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.

A revised structure for the LTIP for 2019/20 and AMP7 was in place for the year with the objective of better incentivising the delivery of long term sustainable performance for customers and communities, employees and shareholders and to help to ensure executive retention.

The company will be reviewing executive pension contributions in 2020/21 with the view to align them with those of the workforce to ensure compliance with the Code by 31 March 2021.

I am pleased to present the report on directors' remuneration, which sets out the remuneration paid to the directors of the company for the year ended 31 March 2020, and changes to the remuneration policy, as presented in last year's report, for 2019/20.

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. The achievement of performance against these targets provided the basis for determining the value of annual bonus awards. We continued to link the remuneration of executive directors to the standards of performance experienced by customers by aligning the leakage target for 2019/20 to the commitment for AMP6 in our Business Plan and setting ambitious water quality and SIM score targets. The Remuneration Committee exercised discretion in determining the level of bonus awarded in relation to personal performance. Given the tough challenges the company faces in AMP7, the executive directors and other senior managers committed to not taking the 2019/20 AMP7 readiness bonus reported in the 2018/19 remuneration report. **See page 116** for more details.

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.

The purpose of the LTIP is 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 was undertaken by Deloitte LLP, unconnected to the company, in 2017/18 to provide advice on the design and implementation of the 2019/20 and AMP7 LTIP proposals for our executive directors and other senior managers. See **page 116** for details of the LTIP.

See **page 204** for a signed statement from the Board confirming the transparency of our disclosures.

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 but are reported under to ensure transparency. 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.

At our 2019 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. At the same time, the remuneration implementation report, which is subject to an annual advisory vote, was also approved.

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 that 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 the 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 INED.

Membership of the Committee during the year is shown in the table below:

Director	Independence
Susan Hooper (Chair)	Independent
Chris Bolt (until 3 September 2019)	Independent
Tony Cocker	Independent
Trevor Didcock (appointed 1 July 2019)	Independent
Mark Horsley (appointed 19 December 2019)	Independent
Jaroslava Korpanec	Shareholder appointed
Angela Roshier	Shareholder appointed

Pauline Walsh, CEO, Stuart Ledger, CFO and the Human Resources Director attended the meetings when requested by the Committee. Tim Monod was the secretary to the Committee until his resignation on 6 November 2019, with Sunita Kaushal appointed secretary on 1 April 2020. Colin Caldwell was interim secretary to the Committee for the period 7 November 2019 to 31 March 2020. 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.

Governance continued

Remuneration report (continued)

REMUNERATION POLICY REPORT (CONTINUED)

Remuneration policy for non-executive directors

Tony Cocker was appointed as Chair 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 chairperson roles was undertaken by Deloitte LLP, unconnected to the company, in the prior year.

The other non-executive directors in office at 31 March 2020 fell into two groups.

Group A	Group B
Patrick O'D Bourke	Jaroslava Korpanec
Trevor Didcock	Tony Roper
Susan Hooper	Angela Roshier
Mark Horsley	
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 prior 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 2019/20 remained unchanged from that reported in the 2018/19 remuneration policy report and will apply during 2020/21, unless the Committee agrees changes during the year.

The directors in Group B are appointed by our shareholders. They do not receive any fees or other form of remuneration from the company in respect of their services. At each AGM all directors 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.

Other payments may be made in relation to relocation expenses and other incidental expenses as appropriate.

Shareholder views on executive directors' remuneration for 2019/20 were considered through the presence of two directors appointed by our shareholders on the Committee.

As with other Committee members, shareholder directors must have regard to the views of other stakeholders, the risk appetite of the company and alignment to the company's long strategic term goals when fulfilling their duties.

The Committee did not consult with employees when drawing up the directors' remuneration policy but considered the average base salary of employees, which is subject to inflationary increases, in setting base salaries for the executive directors. The Committee reviewed the Workforce Pay Policy to ensure it was being sensitive to pay and employment conditions elsewhere in the company when setting directors' remuneration. This ensured that pay for both directors and employees is at the median of the market it operates in and that pay reflects the competence and experience of the individual at the time of appointment. The Committee reviewed the relevant sections of the Workforce Pay Policy relating to salary at appointment, annual pay reviews, company bonuses and variable pay when drawing up the directors' remuneration policy.

The company has put in place mechanisms to engage with employees on the 2020/21 directors' remuneration policy by communicating details of the policy to all employees in this Annual Report and in AMP7 will be obtaining feedback from employees at each Culture Forum.

The Committee 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 prior year. The base salary and other taxable benefits of the remuneration package for executive directors remained unchanged during 2019/20.

An exercise will take place in 2020/21 to review pension arrangements of the executives with the objective of aligning all contributions to the general employee population by the end of the financial year period. This is to ensure compliance with the Code from this date.

In the prior year, as reported in the 2018/19 remuneration report, the Committee reviewed and approved a revised structure for the LTIP for 2018/19 and 2019/20 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 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.

No further changes in relation to the LTIP have been introduced for 2019/20 or AMP7 versus those approved and reported in the prior year remuneration report.

The targets for each metric were reviewed and approved by the Remuneration Committee in 2019/20 following acceptance of the AMP7 Final Determination.

The Committee reviewed and approved the following changes to the annual bonus scheme for 2019/20:

- simplification of the metrics included in the operational, customer and community performance targets, with the metrics leakage, water quality and SIM score being the focus, and water availability, unplanned interruptions to supply and PCC being removed; and
- No award to be made where a performance commitment is not met and a penalty is incurred by the company.

No further changes have been introduced for the AMP7 annual bonus scheme versus those approved and reported in the 2018/19 remuneration report.

Governance continued

Remuneration report (continued)

REMUNERATION POLICY REPORT (CONTINUED)

Remuneration policy for executive directors (continued)

No changes have been made to the remuneration policy for executive directors since the publication of the annual report and financial statements for the year ended 31 March 2019; however the targets and their weighting for the AMP7 annual bonus plan and LTIP for executive directors and senior management have been finalised by reference to the company's final determination for AMP7. The details are presented in the following table, which sets out all elements of executive director remuneration.

Given the tough challenges the company faces in AMP7, the executive directors and other senior managers committed to not taking the 2019/20 AMP7 readiness bonus reported in the 2018/19 remuneration report. This commitment was made in the context of our shareholders' commitment to re-invest all planned returns from the company's appointed business for the benefit of its customers for the time being and the need to work in partnership with the company's trade unions to transform the business so that the company can deliver for the company's customers and other stakeholders in AMP7. Executive directors have also not received a salary increase for the year 2020/21.

Purpose and link to strategy	Policy and approach	Maximum potential value (as % of base pay)	Performance metrics	Changes for 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. There is a payout scale with 37.5% of the award paid out for the achievement of threshold performance, 100% of the award paid out for the achievement of target performance and 150% of the award paid out for outperformance. 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 based on the performance of the company over the three years. For 2019/20, 50% of the scheme pay-out is based on a financial target, cash available for distribution[1], and 50% is based on strategic outcomes, including service and performance commitments, specifically 20% on shadow RCV[2], 15% on the achievement of long term plan outcomes and ODIs[3], 7.5% on our ongoing customer service position and 7.5% on employee engagement survey score.	Changes for AMP7, as reported in our 2018/19 remuneration report, are detailed below: 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 (6.25%) and D-MeX (6.25%) position, water quality (6.25%), helping vulnerable customers (6.25%), leakage (6.25%), consumption (6.25%), mains bursts (6.25%) and environmental innovation (6.25%); and 10% based on employee commitments , including culture surveys (5%) and safety (5%). No award will be made for a metric if performance is below target/plan.

[1] The aggregate of operating profit and proceeds from any asset disposals received less any expenses, capital expenditure, taxes or other costs paid; less any interest, fees or other costs paid in respect of financial debt, any repayments, prepayments or accretion of financial debt or any termination costs or upfront fees payable in relation to any derivative contracts.
[2] As reported in table 4C of our regulatory Annual Performance Report
[3] As reported in table 3A of our regulatory Annual Performance Report

Purpose and link to strategy	Policy and approach	Maximum potential value (as percentage of base pay)	Performance metrics	Changes for 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 have been made to the policy for 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 have been made to the policy for 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. Where discretion is applied to executives relating to the performance of measures, the same level of discretion must be applied to all employees and managers.	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, specifically 8% for leakage, 8% for water quality and 9% for SIM performance). 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.	As reported in our 2018/19 remuneration report, in AMP7 there will be a rebalance of the bonus with 40% relating to financial performance, which is based on net cash outflow before taxation and financing, and 40% performance on customer service and stakeholder commitments including C-Mex (5.7%), leakage (5.7%), consumption (5.7%), water quality (5.7%), water pressure (5.7%), interruptions to supply (5.7%) and safety (5.7%). The personal element of the bonus, which will be based on performance in relation to personal objectives and company values, 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. Reduction in the discretion of the Committee to award any bonus outside performance delivery targets.

Governance continued

Remuneration report (continued)

REMUNERATION POLICY REPORT (CONTINUED)

Remuneration policy for executive directors (continued)

Purpose and link to strategy	Policy and approach	Maximum potential value (as percentage of base pay)	Performance metrics	Changes for 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 plan. 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%.	20% of executive salary.	N/A	An exercise will take place in 2020/21 to review the pension arrangements of the executives with the objective to align all contributions to the general employee population by the end of the financial year period. This is to ensure compliance with the Code from this date.
Compensation for the forfeit of variable remuneration from previous employer				
To provide compensation for 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. cashor shares), time horizons, attributed expected value and performance conditions.	N/A	N/A	No changes have been made to the policy for AMP7 up to the date of approval of this annual report and financial statements.

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 Pauline Walsh	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 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.

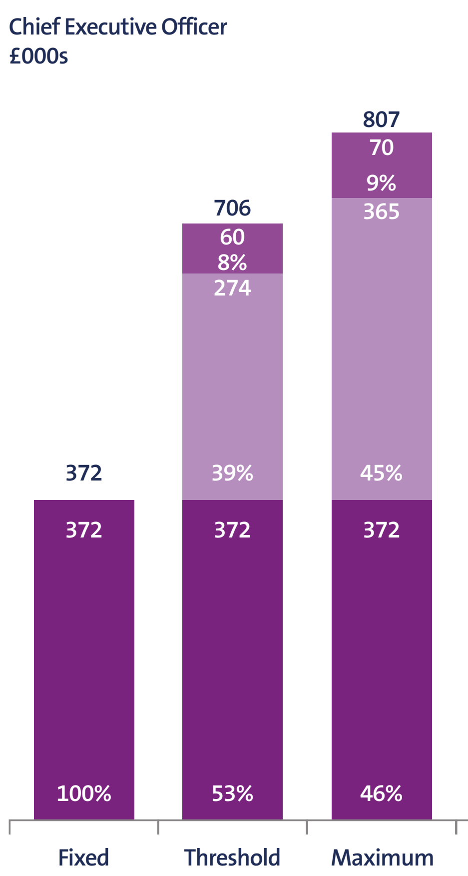
Governance continued

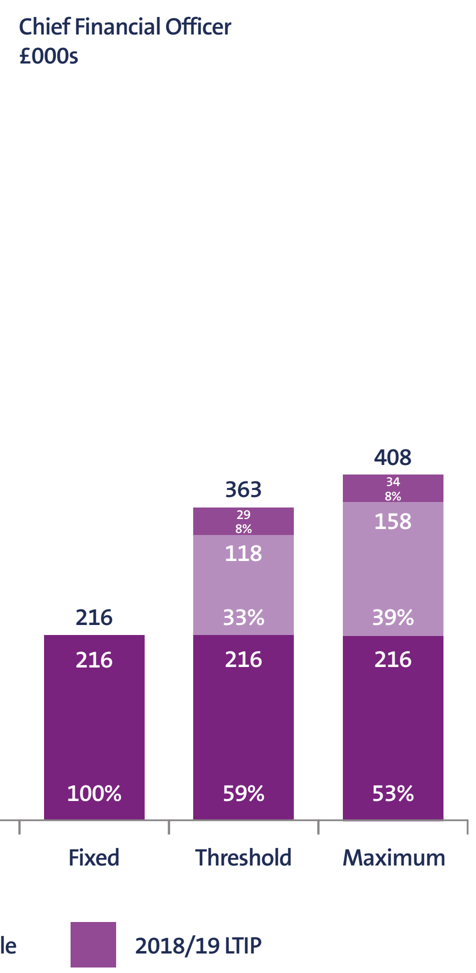
Remuneration report (continued)

REMUNERATION POLICY REPORT (CONTINUED)

Payouts under different scenarios

The following charts show the potential remuneration in respect of 2020/21 under the proposed arrangements for the CEO and CFO 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 an executive director would receive if the threshold level of performance relating to the company bonus was achieved: annual variable pay out at 75% of maximum (assuming the financial, operational, customer and community, safety and health, and personal targets are met), in addition to awards from the 2018/19 LTIP that vests in 2020/21, one third of the total of which becomes payable.
Maximum	Based on what an executive director would receive if the threshold level of performance relating to the company bonus was achieved: annual variable pay out at 100% of maximum (assuming the financial, operational, customer and community, safety and health, and personal targets are met), in addition to awards from the 2018/19 LTIP that vests in 2020/21, one third of the total of which becomes payable.

Management

We operate a discretionary performance bonus scheme for other senior managers (the Executive Management Team) and other 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 for up to 40% of their salary. This is payable after the end of the financial year. Bonus awards are dependent on the success of the company. For the Executive Management Team 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 other 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%. This will ensure our focus on customer service and stakeholder commitments is heightened, whilst ensuring we continue to work to meet our financial and personal targets.

The scheme is designed to provide a direct link between senior management and company performance and both bonus award and payment remain discretionary. As noted previously, given the tough challenges the company faces in AMP7, the executive directors and other senior managers committed to not taking the 2019/20 AMP7 readiness bonus reported in the 2018/19 remuneration report.

Company culture

The Remuneration Committee reviewed the workforce and executive pay policies in line with company culture by ensuring culture is included in executive LTIP schemes and forms part of the target measures in AMP7. This sets a target over the three years to change the culture of the company so it is a more 'create and constructive' style of culture, whilst achieving long term shareholder value.

For employees, over the five year period to 2019/20, the company has increased the maximum potential annual bonus by approximately 50% to help drive the company towards a performance based culture. To drive this further in 2020/21, the Personal Best (performance review framework), an assessment that considers individuals' performance against their own set objectives, will be calibrated and new performance ratings will be introduced.

The framework assesses employee performance as a combination of both what is achieved and how it is delivered. The combination of these elements and inclusion of the way in which work is delivered enables the consideration of behavioural aspects to drive positive behaviours through the organisation which underpin ongoing cultural change. Once this process is fully embedded and working effectively, the company will look to introducing an element of personal performance in the company wide annual bonus scheme.

Governance continued

Remuneration report (continued)

REMUNERATION IMPLEMENTATION REPORT

Company-wide bonus scheme

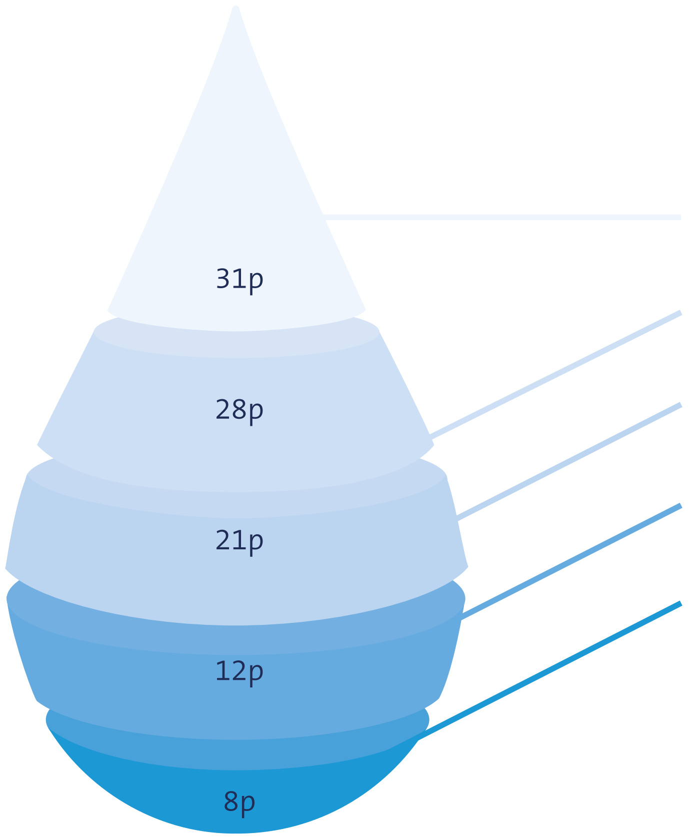
The Committee reviews and approves a discretionary company-wide performance bonus scheme for all employees, who are not otherwise entitled to the discretionary senior manager or selected manager performance bonus scheme. The discretionary company-wide bonus scheme comprises operational and customer performance 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

The amount spent on our people decreased in 2019/20 due to the restructuring of our business in order to be able to deliver the significant efficiencies planned for AMP7, which led to a lower headcount. The reduced headcount has been partially offset by inflationary salary increases. An initiative to decrease the number of consultants being used by the business has continued into the current year, resulting in a cost saving. Additionally, there was a one-off defined benefit pension plan cost in the prior year as a result of the court ruling in October 2018 to remove historical gender inequalities in relation to GMP.

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



Our suppliers for operating services: 31p (2019: 27p)
Operational cost of suppliers' services

Our assets: 28p (2019: 29p)
Investment in our assets

Our people: 21p (2019: 23p)
Wages, salaries and pensions

Our bondholders: 12p (2019: 12p)
Interest paid on debt financing

Local and central government: 8p (2019: 9p)
Corporation tax, business rates, abstraction charges, employer's national insurance, Climate Change Levy and streetworks permits.

[1] Figures are based on our regulatory financial statements for the year ended 31 March 2020 and have been rounded.

Directors' remuneration 2019/20 (audited)

The following table shows directors' remuneration in respect of 2019/20.

	Base salary/fees £000		Taxable benefits[1] £000		Annual bonus £000		LTIP £000		Pension related benefits[2] £000		Other[3] £000		Total £000	
	19/20	18/19	19/20	18/19	19/20	18/19	19/20	18/19	19/20	18/19	19/20	18/19	19/20	18/19
Non-executive														
Current														
Patrick O'D Bourke	**49**	48	**-**	-	**-**	-	**-**	-	**-**	-	**-**	-	**49**	48
Trevor Didcock	**49**	43	**-**	-	**-**	-	**-**	-	**-**	-	**-**	-	**49**	43
Susan Hooper	**49**	48	**-**	-	**-**	-	**-**	-	**-**	-	**-**	-	**49**	48
Mark Horsley	**13**	-	**-**	-	**-**	-	**-**	-	**-**	-	**-**	-	**13**	-
Chris Newsome	**49**	8	**-**	-	**-**	-	**-**	-	**-**	-	**-**	-	**49**	8
Former														
Simon Cocks	**-**	15	**-**	-	**-**	-	**-**	-	**-**	-	**-**	-	**-**	15
Chris Bolt	**19**	45	**-**	-	**-**	-	**-**	-	**-**	-	**-**	-	**19**	45
Company Chair														
Current														
Tony Cocker	**195**	195	**-**	-	**-**	-	**-**	-	**-**	-	**-**	-	**195**	195
Executive														
Current														
Stuart Ledger	**209**	203	**6**	6	**140**	48	**-**	-	**32**	41	**-**	-	**387**	298
Pauline Walsh	**361**	326	**16**	10	**331**	108	**-**	-	**72**	53	**95**	169	**876**	666
Former														
Simon Cocks	**-**	50	**-**	2	**-**	-	**-**	-	**-**	11	**-**	**132**	**-**	195
	993	981	**22**	18	**471**	156	**-**	-	**104**	105	**95**	301	**1,686**	1,561

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 InfraRed Capital Partners Limited on behalf of HICL Infrastructure plc did not receive any emoluments from the company.

[1] Taxable benefits comprise company car allowance, living accommodation benefit, relocation costs and healthcare insurance.
[2] Pension related benefits for Stuart Ledger and Pauline Walsh comprised £32,000 and £72,000 respectively of contributions paid to money purchase schemes (2018/19: £41,000 and £53,000); there were no amounts outstanding at year end. Pension related benefits for former executive director Simon Cocks included an allowance of £11,000 in the prior year in lieu of being a member of the company's retirement benefit schemes.
[3] Other remuneration in 2019/20 and 2018/19 for Pauline Walsh related 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 related 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.

Governance continued

Remuneration report (continued)

REMUNERATION IMPLEMENTATION REPORT (CONTINUED)

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 2019/20 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 22)	2019/20 target	2019/20 actual	Weighting for 2019/20 (as a % of base salary)		2019/20 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	£43.3m	£45.0m	50.00%	37.50%	50.00%	37.50%
Operational measures	Leakage: volume of water lost through leaks on the network (Ml/d)	Customer outcome	162.2 or less	162.1	7.69%	5.77%	7.69%	5.77%
	Water quality: number of water quality compliance failures	Customer outcome	44 or less	50	7.69%	5.77%	0.00%	0.00%
Customer and community measures	SIM[2] : score	Customer outcome	82.3	82.4	9.62%	7.21%	9.62%	7.21%
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	0.20	5.00%	3.75%	5.00%	3.75%
Personal performance[3]					20.00%	15.00%	18.40%	12.75%
Total % of base salary					**100.00%**	**75.00%**	**90.71%**	**66.98%**
Base salary							**£365,000**	**£210,000**
Bonus paid							**£331,000**	**£140,000**

The remuneration policy operated as intended during the year. Executive director bonuses are only being paid where operational targets were met and base salaries were set at a level that attracted and retained key employees, reflecting their experience and position in the company. Executive directors and other senior managers committed to not taking the AMP7 readiness bonus previously reported – see **page 116** for more details. The Remuneration Committee believes this was appropriate.

[1] This "non-GAAP" measure is the total of the following line items per the statement of cash flows (refer to **page 148**): cash generated from operations; purchases of property, plant and equipment; proceeds on disposal of property, plant and equipment; purchase of intangible assets; and principal elements of lease payments. The bonus measure excludes the impact of one-off corporate legal consultancy fees and payments bought forward into 2019/20 from 2020/21 and is before statutory adjustments.

[2] SIM was previously the industry's measure of customer experience. One element was quantitative (the volume of unwanted contact and complaints we receive) and the other was qualitative (the quality of the experience derived from an independent quarterly survey). SIM was not formally measured by Ofwat in 2019/20 and has been replaced by a C-Mex score. The internal proxy SIM score above has been calculated using the C-Mex score adjusted for our performance on customer complaints and contacts. This internal proxy SIM score is different to that published in table 3D of our Annual Performance Report as table 3D has been calculated using Ofwat's revised methodology to include customer complaints via social media.

[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.

Percentage change in remuneration of CEO

In 2019/20, a one-year pay deal covering the period 1 April 2019 to 31 March 2020 was negotiated with trade unions resulting in the following:

- 2.7% increase to the basic pay of all employees; and
- 2.7% increase in allowances that are taxable and pensionable, primarily flex and standby allowances.

The maximum potential annual bonus available to employees remained unchanged from 2018/19, although the maximum potential has increased by 48% over AMP6.

The salary increase of the CEO compared to other company employees was 4.3%. As the CEO's annual bonus is dependent on base salary, the maximum potential annual bonus also increased by 4.3%. There was no movement in taxable or pension related benefits for the CEO in the year.

The pay rise was set following a review by the Committee of 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 prior year, and a re-evaluation of the job role. The policy for executive directors in relation to base salary is to target around market median, dependent on experience in the role.

Executive directors have committed to not receiving an increase in their salary for the year 2020/21. All other employees will receive a 2% pay increase to their basic pay and allowances that are taxable and pensionable in 2020/21.

Pay ratios table

The ratio of the CEO's single figure remuneration is compared to the 25th percentile, median and 75th percentile total employee remuneration in the table below.

Year	Methodology used	25th percentile pay ratio	Median pay ratio	75th percentile pay ratio
2019/20	Option B	32.7:1	21.0:1	18.3:1

The ratios above are calculated using the 5 April 2019 gender pay gap data as permitted under Option B. Option B was used as the gender pay gap reporting date falls within the 2019/20 financial year and is a good representation of the data for the year. As we have a significant employee base, due to the size and complexity of the data it was felt to be overly complicated to prepare single figure calculations for each individual.

We have used the 5 April 2019 gender pay gap data to identify three employees at median, 25th and 75th percentiles. The Committee has considered the methodology and is confident the employees identified are reasonable representatives of the employee population as the structure of their remuneration arrangements is in line with that of the majority of the employee population.

Payroll data has then been used to calculate total 2019/20 remuneration for the employees identified, which includes wages and salary, taxable benefits, their accrued 2019/20 annual bonus and pension benefits, but excludes overtime payments to ensure consistency amongst the employees. This has been compared to the CEO's single figure of remuneration reported in the 2019/20 remuneration report, including the non-recurring discretionary payment made in connection with commencement of qualifying services during 2019/20 shown in the other column in the single figure remuneration.

Governance continued

Remuneration report (continued)

REMUNERATION IMPLEMENTATION REPORT (CONTINUED)

Pay ratios table (continued)

	Salary component of total pay and benefits	Total pay and benefits
25th percentile pay ratio	£24,269	£26,796
Median pay ratio	£38,034	£41,814
75th percentile pay ratio	£41,424	£47,896

We have published our gender pay gap report for April 2019 on our website: **affinitywater.co.uk/responsibility**, which showed a 16% reduction in our mean gender pay gap from 22.5% in April 2018 to 19.0%.

The Remuneration Committee has considered the executive remuneration in light of the CEO and gender pay gap ratios and considers that the current and forward looking policies are appropriate and that ratio is representative of the pay and progression policies for employees. The company looks to offer a total reward package which is equitable and fair for all employees, regardless of gender, and that attracts and retains talent for both executives and all employees.

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 24 June 2020 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 2020.

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 2020. Details of the ownership of the company and the group structure are set out on **pages 99 to 100** of the governance section and note 27 of the financial statements. The address of the principal place of business is Tamblin Way, Hatfield, Hertfordshire, AL10 9EZ.

The strategic report on **pages 14 to 63** 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 2020. Details of the risks and principal uncertainties facing the company are set out on **pages 39 to 48**.

DIRECTORS

The directors of the company, together with their periods of office and their biographical details, are shown on **pages 70 to 75**.

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 14**.

RESULTS AND FINANCIAL PERFORMANCE

Loss for the year was £21.7m (2019: profit of £10.6m).

The statement of financial position detailed on **page 146** shows total equity amounting to £187.0m (2019: £208.6m).

Further analysis of our financial performance can be found in the Chief Financial Officer's review on **page 17** of the strategic report.

INFORMATION REQUIRED UNDER THE LISTING RULES

During the year no interest was capitalised by the company (2019: £nil).

For disclosures in relation to relevant requirements of the Listing Rules, refer to the remuneration report on **pages 112 to 126**.

DIVIDENDS

No dividends were paid during the year ended 31 March 2020.

This compares to dividends of £6.6m declared and paid in the year ended 31 March 2019. All the dividends declared and paid in the year ended 31 March 2019 related to the company's non-appointed business.

No final dividend is proposed (2019: £nil).

Governance continued

Directors' report (continued)

ENERGY AND CARBON REPORTING

Scope 1

The annual quantity of emissions in tonnes of CO2 equivalent resulting from activities for which the company is responsible (scope 1) is 8,811 tCO2e, shown in the table on the next page. Sources of fuel emissions from burning of fossil fuels is the use of Natural Gas used for the heating and cooling of our buildings, and Gas Oil and other fuels used primarily by generators at our water treatment works. Fugitive emissions includes ozone used in the disinfection process and waste sludge recycled to land or landfill and refrigerant gases. Fleet fuel emissions result from the combustion of purchased fuel for fleet liveried vehicles.

Scope 2

The annual quantity of emissions in tonnes of CO2 equivalent resulting from activities for which the company is responsible (scope 2) is 58,350 tCO2e, shown in the table on the next page. Purchased electricity is total grid electricity which we primarily use for the pumping and treatment of water and a small amount for office use.

Total energy consumption

Our total energy consumption including electricity, natural gas, gas oil, self-generated and fleet vehicles was 236,683,065 kWh.

Methodology used

For Scope 1, Scope 2 and selected Scope 3 GHG emissions, we follow the most common approach to calculate GHG emissions from emission sources, which is to take activity data (e.g. units of electricity consumed, or distance travelled) and covert the activity data into tCO2e.
We have reported the common intensity metric for the Water Industry which is Carbon tCO2e per Ml, which is our tCO2e divided by water into supply (Ml).

Energy efficient actions

The company has implemented a number of energy efficient actions over the past two years, detailed below:

- a Carbon Reduction Strategy Working Group was created to help deliver strategy development and drive change within the company. The Water UK Public Interest Commitment - Zero Carbon by 2030, our working group will help to inform next steps;
- there are various initiatives and interventions aimed at energy saving implemented in the last two years, including optimisation, energy monitoring, and maintenance regime of our assets;
- we reviewed how our UV plants operate and adapted our maintenance plans to improve performance and reliability of our assets. Following maintenance interventions, huge improvements have been noticed in the amount of drawn current, improving efficiency and plant reliability;
- we completed pump and ozone diffuser refurbishment also to improve performance and reliability, thereby reducing the power consumption of the ozone generators;
- thermodynamic pump efficiency monitoring has been installed on high and low lift pumps at one of our sites. This collects data and gives continuous updates to recommended running configurations. In our Wey region raw water and high lift pump duties are being selected based on the pump efficiency report recommendations; and
- Rapid Gravity Filters and Granular Activated Carbon backwashing is being optimised at a number of sites to maximise throughput and increase efficiency.

A number of behavioural change programmes have also been undertaken:

- Production Engineers, Business Leads and Area Managers have completed IEMA Environmental Sustainability Skills for the Workforce;
- a company eLearning module on "Reduce Carbon, Reduce Costs" was introduced and completed by Production and Supply as part of the Competent Operator Scheme; and
- schemes to encourage teams to turn off lights have been introduced.

We have worked to improve our data insights to better inform on initiatives by:

- monitoring pump efficiency and we have installed new pumps at some of our sources to improve site efficiency;
- completing Energy Savings Opportunity Scheme ('ESOS') audits and reporting in December 2019 for the reporting year 2018/19; our Estates and Facilities Department are actively reviewing the recommendations; and
- we have sent Triad communications and produced awareness posters for display across our offices and sites.

The company supplies water to 3,780,000 consumers in our supply area (2019: 3,610,000).

GREENHOUSE GAS ('GHG') EMISSIONS STATEMENT [1]

GHG emission source	2019/20		2018/19	
	Gross[2] (tCO_2e)	Intensity ($kgCO_2e/Ml$)	Gross (tCO_2e)	Intensity ($kgCO_2e/Ml$)
Scope 1	**8,811**	**26.1**	10,173	29.3
Fuel combustion	**1,679**	**5.0**	1,533	4.4
Process and fugitive emissions	**5,198**	**15.4**	4,335	12.5
Vehicle fleet	**1,934**	**5.7**	4,305	12.4
Scope 2	**58,350**	**172.7**	63,886	184.1
Purchased electricity	**58,350**	**172.7**	63,886	184.1
Statutory total (scope 1 & 2)[3]	**67,161**	**198.8**	74,059	213.4
Scope 3	**5,018**	**14.9**	5,625	16.2
Business travel in other vehicles	**33**	**0.1**	25	0.1
Outsourced IT activities	**31**	**0.1**	154	0.4
Electricity- transmission and distribution	**4,954**	**14.7**	5,446	15.7
Total gross emissions	**72,179**	**213.6**	79,684	229.6

[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 ('tCO2e').
[3] Statutory carbon reporting disclosures required by the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013.

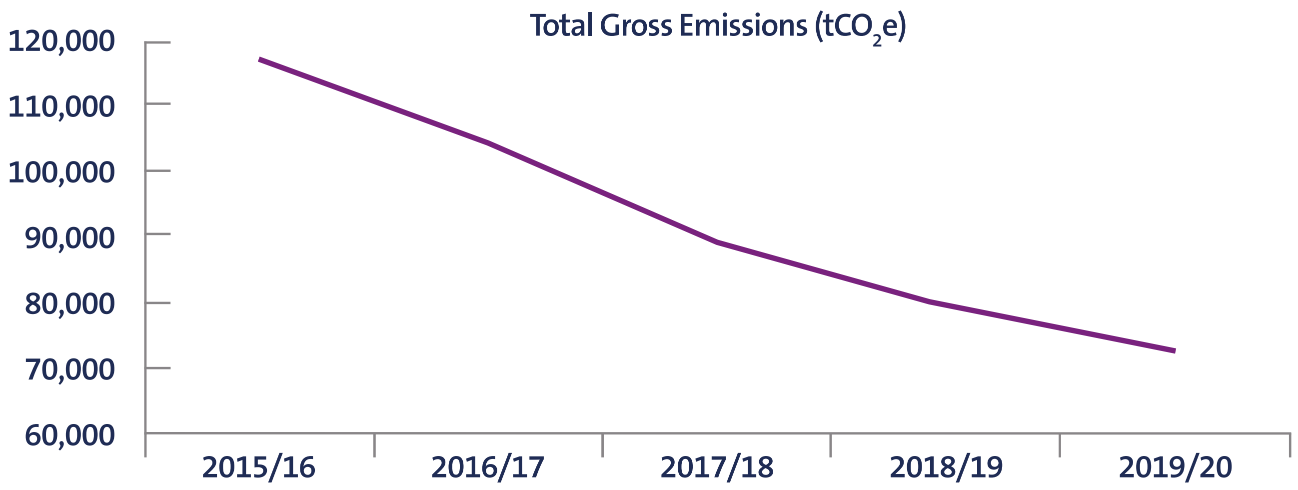
Governance continued

Directors' report (continued)

GREENHOUSE GAS ('GHG') EMISSIONS STATEMENT (CONTINUED)

Our total gross GHG emissions have reduced by 9.42% this year. Similarly to businesses across the UK, the DEFRA emissions factor associated with our purchased electricity (accounting for 87% of our statutory total) has been decreasing rapidly with an increasing amount of renewable energy entering the mix of energy in the National Grid. This more than offset the impact of higher electricity usage during the year (2019/20: 228,284,840 kWh; 2018/19: 226,190,332 kWh), which increased in line with higher demand during the hot, dry summer weather period and water levels lowering in our underground aquifers.

We have achieved a 6.95% decrease in intensity metric to 213.6 kgCO2e/Ml. This was due to a combination of changes in the DEFRA emissions factor and our own more efficient use of energy in the year, as we continue 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.



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, Sensor for Water Interest Group, the Water Regulations Advisory Scheme 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 source of supply.

POLITICAL CONTRIBUTIONS

No political contributions were made during the year (2019: £nil), in accordance with the company's policy of not making political contributions.

FINANCIAL INSTRUMENTS DISCLOSURES

Details are included within risk number 13 on **page 48** of the strategic report and in note A4 of the financial statements.

EMPLOYEE MATTERS

We maintain a network of trained mental health first aiders within the business and continue to publicise our Employee Assistance Programme.

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.

ENGAGEMENT WITH EMPLOYEES

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.

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.

See **page 54** for details in our section 172 statement on how directors have engaged with employees.

ENGAGEMENT WITH OTHER STAKEHOLDERS

See **page 54** for details in our section 172 statement on how directors have engaged with suppliers, customers and other stakeholders.

Governance continued

Directors' report (continued)

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 20**.

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 68 to 98** 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

Affinity for Business (Retail) Limited, one of the company's fellow group undertakings, was sold to Castle Water Limited on 1 April 2020. The entity changed its name on 3 April 2020 to Castle Water (Southern) Limited.

Following on from the £25.0m CPI linked inflation swap entered into in March 2020, the company has entered into further CPI linked inflation swaps, bringing the total nominal value up to £250.0m.

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 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 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 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.

Directors' confirmations
The directors consider that the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's position and performance, business model and strategy.

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
- they have taken all the steps that they ought to have taken as a director in order to make themselves aware of any relevant audit information and to establish that the company's 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

Stuart Ledger
Chief Financial Officer
24 June 2020

Registered Office:
Affinity Water Limited
Tamblin Way
Hatfield
Hertfordshire
AL10 9EZ

Statutory Financial Statements

for the year ended 31 March 2020

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Affinity Water Limited

(Registered Number 02546950)

A water treatment works in the Alkham Valley: providing sustainable water for this generation and the next

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 2020 and of its loss 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 2020; the income statement, the 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, which include a description of the significant accounting policies.

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

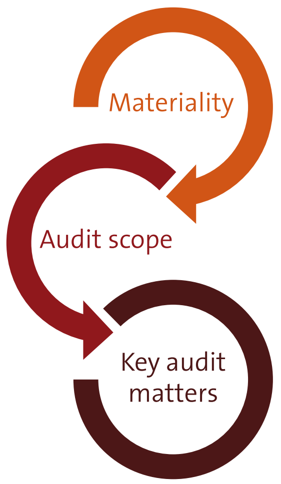
We remained independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which include the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

Our audit approach

Context

The terms of the company's licence 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 Authority (FCA).

Overview



- Overall materiality: £4.1 million (2019: £4.3 million), based on 3.5% (2019: 3.5%) 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 expected credit loss on receivables
- Assessment of cost capitalisation
- Assessment of pension assumptions applied in the valuation of plan liabilities
- Assessment of impact of COVID-19

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 the measured income accrual Refer to **page 105** (Audit Committee Report), **page 149** (accounting policies) and **page 166** (note 13). The directors have recorded a measured income accrual of £39.1 million (2019: £32.4 million) relating to revenue from the provision of water services to customers on water meters that had not been billed at the year-end date. Revenue recognition in respect of the measured income accrual is judgemental, and 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 associated revenue could be misstated.	The measured income accrual is a manual calculation underpinned by data from the HiAffinity billing system. We tested the mechanics of the spreadsheet used to calculate the measured income accrual without exception. We also understood and ensured the methodology had been consistently applied compared to previous periods. With regard to the integrity of the data within HiAffinity, we tested the design and operating effectiveness of key controls within the revenue and receivable cycle, including the reconciliation of reports produced from the HiAffinity billing system and the revenue journals posted to the Oracle general ledger, and the quarterly review of tariff changes made in the HiAffinity billing system with no exceptions noted. To validate the accuracy of the data in the HiAffinity billing system we agreed a sample of meter readings to the system and then traced the consumption from HiAffinity to the bills raised by Affinity Water (which we obtained directly from customers) with no exceptions noted. We also investigated significant variances in the measured revenue compared to prior year and corroborated these movements to supporting information including property statistic reports detailing additional households in the company's geographical catchment area and the movement of customers from unmeasured to measured tariffs. We tested a sample of household customer amounts accrued for as at 31 March 2020 to subsequent billing post year end and noted immaterial differences. We extrapolated the results of this testing across the remaining accrual and noted no material difference. We also evaluated the historical accuracy of the estimation process by reviewing bills raised in the current year for all amounts accrued at the prior year. The bills raised post year end confirmed the material accuracy of the prior year accrual.

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
Accuracy of the measured income accrual (continued)	We considered management's approach not to record an adjustment to reflect increased consumption over the lockdown period for household customers; based on the sensitivity analysis performed on the potential impact of the lockdown period we have concluded this approach is materially reasonable. We also obtained evidence of the subsequent payment of the major wholesale customer of the company and consider the accrued income for the non-household customers to be materially accurate. Overall, we consider the income accrual as at 31 March 2020 to be materially accurate.
Adequacy of the expected credit loss on receivables Refer to **page 105** (Audit Committee Report), **page 149** (accounting policies) and **page 166** (note 13) and **pages 186 to 194** (note A4). The provision for expected credit loss is calculated by applying a percentage based on actual collection history to individual aged debt categories and management also consider any significant economic changes that may impact future credit losses. In order to account for the increased risk of credit loss as a result of the COVID-19 pandemic, management made use of a third-party tool, Acorn consumer classification, to segment their existing customers based on postcode into demographic segments. These demographic segments were then grouped into three risk buckets, low, medium and high, and allocated a percentage reflecting management's estimate of the likelihood of potential default. The weighted average across the three buckets was then applied to the previously unprovided debt book to calculate the COVID-19 overlay. Some customers have difficulty paying 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 which is increased in the current economic environment. The provision for expected credit loss is an estimate which needs to take account 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 materially understated.	We reviewed the methodology for calculating the provision for expected credit loss. The current year calculation has been produced by applying a methodology consistent with prior periods to calculate the "regular provision" and then applying an additional adjustment to reflect the additional risks arising from the impact on the economic environment arising from COVID-19. We have understood and tested the mechanics of the spreadsheet used to calculate the regular provision by type of customer, the measurement basis (measured vs unmeasured) and the methodology applied to calculate provision rates and noted that they are consistent with the prior year. To ensure the appropriate classification of customers into sub-categories to apply the historical expected credit loss methodology, we selected a sample of debts and ensured they have been allocated the appropriate provision rate based on ageing, customer type and measurement basis. No exceptions were noted during this testing. In addition, we compared the actual 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 2020 to ensure the accuracy of management's estimates. We have not noted significant levels of bad debt which were not previously provided for. For the additional bad debt charge in relation to COVID-19, we assessed management's use of the Acorn customer classification system and reviewed the demographic groupings assigned to the household customers together with the risk grouping performed by management. The Acorn customer classification system is a tool provided by a reputable third party, underpins the UK House Price Index and we consider it to be a reasonable basis for management's assessment. We applied sensitivity analysis on the allocation of demographic segments into the risk buckets, moving each segment into a higher risk bucket, which did not result in a material difference to the COVID-19 overlay. We also applied sensitivity analysis on the percentages allocated to each risk bucket which did not result in a material difference. Overall, we consider the level of provisioning as at 31 March 2020 to be materially accurate.

Key audit matter	How our audit addressed the key audit matter
Assessment of cost capitalisation Refer to **page 105** (Audit Committee Report), **page 149** (accounting policies) and **page 163** (note 7). 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 £131.2m there is a risk that incorrect classification could give rise to material misstatement.	We reviewed the process for allocating costs to capital projects and are satisfied that this allocation was made on an appropriate basis and is in line with the company's capitalisation policy. We selected a sample of items capitalised in the year and ensured these were consistent with the company's accounting policy and were appropriately capitalised in line with IAS 16. We examined the process of capitalising staff time through the inspection of time sheet data and tested a sample of staff costs capitalised. We did not note any exceptions from our testing and conclude that the time capitalised relates to spend on valid capital projects. We challenged the assumptions and judgements made in allocating overheads to capital projects, through understanding the nature of activities performed. There continue to be a number of projects capitalised as construction in progress and therefore not yet depreciated. At 31 March 2020, assets with a total cost of £129.7m (2019: £131.0m) have been included as assets under construction. We reviewed a sample of these projects in progress to confirm they are still active, contain no separately identifiable assets that are in use, and agree no depreciation is required as the project is not yet live. Management continues to perform a quarterly control of reviewing ongoing projects to determine if it is appropriate for the project to remain as construction is in progress. Overall, we consider the capitalisation of costs as at 31 March 2020 to be materially accurate.
Assessment of pension assumptions applied in the valuation of the pension scheme Refer to **page 105** (Audit Committee Report), **page 149** (accounting policies), **page 165** (note 11) and **pages 195 to 198** (note A5). The company has a defined benefit pension plan and has recognised a net retirement benefit surplus of £104.6m (2019: £101.2m). The plan liabilities as at 31 March 2020 amounted to £396.6m (2019: £417.5m). 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 used our own actuarial experts to evaluate the assumptions made in relation to the valuation of the scheme assets and liabilities. We benchmarked the various assumptions used (e.g. discount and inflation rate) and compared them to our internally developed benchmarks; assessed the salary increase assumption against the company's historical trends and expected future outlook; considered the consistency and appropriateness of methodology and assumptions applied compared to the prior year end and the most recent actuarial valuation. We tested the accuracy of the retirement benefit obligation disclosures. We confirmed that the company's actuarial experts are qualified, appropriately affiliated to third party industry bodies, and are independent of the company. Overall, we consider that the plan liabilities as at 31 March 2020 are materially accurate.

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
Assessment of impact of COVID-19 Refer to **page 105** (Audit Committee Report), **page 49** (viability statement) and **page 149** (accounting policies). The COVID-19 pandemic commenced before the financial year end, impacting the financial results of the company for the year and is expected to continue to impact the company for the remainder of the next financial year, albeit the severity of the impact is expected to reduce over time. In order to conclude that it is appropriate for the financial statements to be drawn up on a going concern basis and on the viability of the company, management have performed a detailed bottom-up analysis of the impact of COVID-19 including its impact on revenue, operating costs including expected credit losses referred to earlier, cash flows and covenants including possible mitigating action that management might take. In doing so, management have made estimates and judgments that are critical to the assessment of the company's liquidity and consideration of future covenant compliance. The results of the severe but plausible downside modelling on liquidity and covenants have led the directors to conclude there is no material uncertainty regarding the company's ability to operate as a going concern. Disclosure of the risk to the company of COVID-19 and management's conclusions on going concern and viability have been included within the relevant sections of the Annual Report.	We assessed both the base case going concern model prepared by management which includes the anticipated impact of COVID-19, and the downside scenarios which have been used to sensitise the base case model. In relation to the base case model, we have agreed the key inputs back to board approved budgets. In addition, we have considered the historical accuracy of the budgeting process to assess the reliability of the data. Specifically, in relation to the COVID-19 overlay, and the severe but plausible downside modelling conducted by management, we have obtained management's revised forecasts and assessed the underlying assumptions. This included consideration of the adequacy of expected credit losses as detailed in the related key audit matter above, and an understanding of the mitigating actions identified by management. We have challenged these assumptions based on our understanding of the business and our knowledge of the industry. In conjunction with the above we have reviewed management's analysis of both liquidity and covenant compliance to satisfy ourselves that no covenant breaches are anticipated over the period of assessment in either the base case or the severe but plausible downside scenarios. In relation to covenant compliance we have assessed the stress testing performed on management's adjusted baseline model and considered to what extent sufficient headroom exists to absorb any further downside risk after considering the impact of mitigating actions. On the basis of the analysis performed we are satisfied that management's going concern assessment provides an appropriate basis for management's conclusion that there is no material uncertainty regarding the company's ability to operate as a going concern and that appropriate disclosures are contained within the Annual Report.

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	£4.1 million (2019: £4.3 million).
How we determined it	3.5% 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 measure for our audit.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £0.2 million (2019: £0.2 million) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Going concern

In accordance with ISAs (UK) we report as follows:

Reporting obligation	How our audit addressed the key audit matter
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.

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 and Directors' Report, 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).

Statutory Financial Statements continued

Independent auditors' report to the member of Affinity Water Limited (continued)

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 2020 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 96** 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 49 to 53** 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 96**, 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 105** 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 **page 132**, 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.

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 member 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
Watford

24 June 2020

Statutory Financial Statements

Statutory Financial Statements continued

Income statement for the year ended 31 March 2020
(Registered Number 02546950)

	Note	2020 £000	2019 £000
Revenue	1	**307,240**	311,569
Cost of sales		**(227,820)**	(216,643)
Gross profit		**79,420**	94,926
Administrative expenses		**(42,839)**	(48,117)
Impairment losses on financial and contract assets	2.1	**(9,470)**	(6,128)
Other income	2.2	**18,449**	17,896
Operating profit	2	**45,560**	58,577
Profit on disposal of subsidiary	3	**-**	25
Finance income	5	**8,391**	6,590
Finance costs	5	**(52,044)**	(49,131)
Fair value loss on financial instrument	5	**(1,816)**	(2,389)
Net finance costs		**(45,469)**	(44,930)
Profit before tax		**91**	13,672
Tax expense	6	**(21,773)**	(3,103)
(Loss)/profit for the year		**(21,682)**	10,569

All results of the company in the current period and prior period are from continuing operations.

The notes on **pages 148 to 200** are an integral part of these financial statements.

Statement of comprehensive income for the year ended 31 March 2020
(Registered Number 02546950)

	Note	2020 £000	2019 £000
(Loss)/profit for the year		**(21,682)**	10,569
Other comprehensive income/(loss) for the year which will not be reclassified to profit or loss:			
Re-measurements of post-employment benefit assets	11	**38**	(8,747)
Deferred tax (charge)/credit on items that will not be reclassified	6	**(7)**	1,487
Other comprehensive income/(loss) for the year, net of tax		**31**	(7,260)
Total comprehensive (loss)/income for the year		**(21,651)**	3,309

The notes on **pages 148 to 200** are an integral part of these financial statements.

Statutory Financial Statements continued

Statement of financial position as at 31 March 2020
(Registered Number 02546950)

	Note	2020 £000	2019 restated[1] £000
Assets			
Non-current assets			
Property, plant and equipment	7	**1,479,039**	1,419,556
Right-of-use assets	8	**12,436**	-
Intangible assets	9	**45,768**	47,903
Investments	10	**100**	100
Retirement benefit surplus	11	**104,619**	101,194
Other receivables	13	**2,300**	2,215
		1,644,262	1,570,968
Current assets			
Inventories	12	**3,017**	2,716
Other investments	10	**25,202**	15,049
Trade and other receivables	13	**82,099**	74,763
Cash and cash equivalents	14	**85,587**	96,482
		195,905	189,010
Total assets		**1,840,167**	1,759,978
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		**128,918**	150,569
Total equity		**186,974**	208,625
Liabilities			
Non-current liabilities			
Trade and other payables	16	**132,694**	115,759
Borrowings	17	**1,090,641**	1,081,253
Lease liabilities	18	**9,068**	-
Derivative financial instrument	19	**9,149**	3,997
Deferred tax liabilities	20	**198,644**	178,961
Provisions for other liabilities and charges	21	**5,507**	4,907
		1,445,703	1,384,877
Current liabilities			
Trade and other payables	16	**199,330**	160,109
Lease liabilities	18	**3,491**	-
Current tax liabilities		**4,062**	4,205
Provisions for other liabilities and charges	21	**607**	2,162
		207,490	166,476
Total liabilities		**1,653,193**	1,551,353
Total equity and liabilities		**1,840,167**	1,759,978

The notes on **pages 149 to 200** are an integral part of these financial statements. The statutory financial statements on **pages 144 to 200** were approved by the Board of Directors and were signed and authorised for issue on 24 June 2020 on its behalf by:

Pauline Walsh Chief Executive Officer **Stuart Ledger** Chief Financial Officer

[1] Prior year figures have been restated by £15.049m, moving this amount from cash and cash equivalents to other investments.

Statement of changes in equity for the year ended 31 March 2020
(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 2018		26,506	1,400	30,150	153,860	211,916
Profit for the year		-	-	-	10,569	10,569
Other comprehensive income		-	-	-	(7,260)	(7,260)
Total comprehensive income		-	-	-	3,309	3,309
Dividends	22	-	-	-	(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
Balance as at 1 April 2019		**26,506**	**1,400**	**30,150**	**150,569**	**208,625**
Loss for the year		-	-	-	**(21,682)**	**(21,682)**
Other comprehensive income		-	-	-	**31**	**31**
Total comprehensive income		-	-	-	**(21,651)**	**(21,651)**
Dividends	**22**	-	-	-	-	-
Total transactions with owners recognised directly in equity		-	-	-	-	-
Balance as at 31 March 2020		**26,506**	**1,400**	**30,150**	**128,918**	**186,974**

The notes on **pages 149 to 200** are an integral part of these financial statements.

Statutory Financial Statements

Statutory Financial Statements continued

Statement of cash flows for the year ended 31 March 2020
(Registered Number 02546950)

	Note	2020 £000	2019 restated[1] £000
Cash flows from operating activities			
Cash generated from operations	23.1	**110,116**	117,680
Interest paid		**(35,336)**	(39,757)
Tax paid		**(2,175)**	-
Group relief paid		**(63)**	-
Net cash generated from operating activities excluding capital contributions		**72,542**	77,923
Capital contributions		**57,690**	30,746
Net cash generated from operating activities		**130,232**	108,669
Cash flows from investing activities			
Investment in subsidiary		**-**	(50)
Investment in short-term deposits		**(10,153)**	(15,049)
Disposal of subsidiary		**-**	35
Purchases of property, plant and equipment		**(122,386)**	(101,007)
Proceeds from sale of property, plant and equipment		**1,630**	1,058
Purchases of intangible assets		**(7,469)**	(6,222)
Interest received		**962**	806
Net cash used in investing activities		**(137,416)**	(120,429)
Cash flows from financing activities			
Principal elements of lease payments	18	**(3,711)**	-
Equity dividends	22	**-**	(6,600)
Net cash used in financing activities		**(3,711)**	(6,600)
Net decrease in cash and cash equivalents		**(10,895)**	(18,360)
Cash and cash equivalents at beginning of year		**96,482**	114,842
Cash and cash equivalents at end of year	14	**85,587**	96,482

The notes on **pages 149 to 200** are an integral part of these financial statements.

[1] Prior year figures have been restated by £15.049m, moving this amount from cash and cash equivalents to other investments, and include a £30.746m reclassification of capital contributions from investing activities to operating activities.

Accounting policies

BASIS OF PREPARATION

These financial statements have been prepared under the historical cost convention modified by revaluation of financial assets and financial liabilities held at fair value through profit and loss 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 49 to 53**, 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

The following new standard became applicable for the current reporting period:

- IFRS 16: 'Leases' ('IFRS 16')

The impact of the adoption of this standard and the new accounting policies are disclosed below.

The standard 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' ('IAS 17'), and related interpretations. The standard is effective for reporting periods beginning 1 January 2019.

The company has adopted IFRS 16 from 1 April 2019, but has not restated comparatives for the prior reporting period, as permitted under the specific transitional provisions in the standard. Reclassifications and adjustments arising from the new leasing rules are therefore recognised in the opening balance sheet on 1 April 2019.

On adoption of IFRS 16, the company has recognised lease liabilities in relation to leases which had previously been classified as operating leases under the principles of IAS 17. These liabilities have been measured at the present value of the remaining lease payments, discounted using the incremental borrowing rate for each type of asset as at 1 April 2019, as the company could not identify the implicit rate for existing leases, equal to the right-of-use asset recognised. The weighted average lessee's incremental borrowing rate applied to the lease liabilities on 1 April 2019 was 2.37%. The company had no leases previously classified as finance leases.

Statutory Financial Statements continued

Accounting policies (continued)

ADOPTION OF NEW AND REVISED STANDARDS (CONTINUED)

	£000
Operating lease commitments disclosed as at 31 March 2019	**15,785**
Discounted using the lessee's incremental borrowing rate	**14,687**
(Less): short-term leases recognised on a straight-line basis as expense	**(178)**
(Less): low-value leases recognised on a straight-line basis as expense	**(15)**
Lease liability recognised as at 1 April 2019	**14,494**
Of which:	
Current lease liabilities	**3,327**
Non-current lease liabilities	**11,167**
	14,494

The change in accounting policy affected the following items in the balance sheet at 1 April 2019:

- Right-of-use assets – increase by £14,494,000; and
- Lease liabilities – increase by £14,494,000.

There was no net impact on retained earnings at 1 April 2019.

In applying IFRS 16 for the first time, the company has used the following practical expedients permitted by the standard:

- the use of a single discount rate for a portfolio of leases with reasonably similar characteristics;
- the accounting for operating leases, with a remaining lease term of less than 12 months as at 1 April 2019, as short-term leases;
- the exclusion of initial direct costs for the measurement of right-of-use assets at the date of initial application; and
- the use of hindsight in determining the lease term where the contract contains options to extend or terminate the lease.

The company has also elected not to reassess whether a contract is or contains a lease at the date of initial application. Instead, for contracts entered into before the transition date, the company relied on its assessment made applying IAS 17 and IFRIC 4 'Determining whether an arrangement contains a lease'.

The company leases its head office building, IT server space and vehicles.

The company enters into agreements with employees to use vehicles that it leases from a third party as a company car. These agreements are considered by the company to be part of the overall compensation package of an employee and, as such, the company has applied IAS 19 'Employee benefits' in accounting for these arrangements rather than considering the arrangements as subleases of vehicles to employees under IFRS 16.

Rental contracts for IT server space and vehicles are typically for fixed periods of two to five years. The company has an option to extend its leases; however no contracts are reasonably certain to be extended after their lease term has expired. The lease contract of the head office building has a remaining period of 6.5 years. Lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions. The company's lease agreements do not impose any covenants, but leased assets cannot be used as security for borrowing purposes.

Until 31 March 2019, all the company's leases of property, plant and equipment were classified as operating leases. Payments made under operating leases were charged to profit or loss on a straight-line basis over the period of the lease.

From 1 April 2019, leases are recognised as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use by the company. Each lease payment is allocated between the principal and finance cost. The finance cost is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The right-of-use asset is depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis.

The company's ongoing accounting policy is for assets and liabilities arising from a lease to be initially measured on a present value basis. Lease liabilities include the net present value of one or more of the following lease payments:

- fixed payments (including in-substance fixed payments), less any lease incentives receivable; and
- payments of penalties for terminating the lease, if the lease term reflects the lessee exercising that option.

Lease payments may be discounted using the lessee's incremental borrowing rate if the interest rate implicit in the lease cannot be determined. The incremental borrowing rate is the rate that the lessee would have to pay to borrow the funds necessary to obtain an asset of similar value in a similar economic environment with similar terms and conditions. The company uses an independent third-party to determine the incremental borrowing rate.

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

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

Payments associated with short-term leases and leases of low-value assets are recognised on a straight-line basis as an expense in profit or loss. Short-term leases are leases with a lease term of 12 months or less. Low-value assets comprise small items of office equipment and IT equipment.

NEW STANDARDS, AMENDMENTS AND INTERPRETATIONS NOT YET ADOPTED

There are no new standards and interpretations, which are not yet effective and have not been early adopted by the company, that will have a material effect on future years.

Statutory Financial Statements continued

Accounting policies (continued)

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

The preparation of financial statements in conformity with FRS 101 requires the use of certain critical accounting estimates.

Estimates 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.

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. Revenue for the year ended 31 March 2019 included a measured income accrual of £32,618,000. The value of billing recognised in the year ended 31 March 2020 for consumption in the prior year was £33,230,000. This resulted in an increase of £592,000 in the current year's revenue due to the under-estimation of the prior year's revenue. This represented 0.2% of 2019/20 revenue and is within acceptable tolerance for accounting estimates.

Loss allowance of trade receivables and contract assets

The company makes an estimate of the recoverable value of trade receivables and contract assets and records a loss allowance 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 and resultantly has accounted for an additional bad debt charge given the national health pandemic. This was calculated by applying an additional loss allowance provision to each segment of our customer base, based on the likely impact to that segment of the pandemic. The actual level of receivables collected may differ from the estimated levels of recovery, which could impact operating results positively or negatively.

A 2% increase in the loss allowance for trade receivables and contract assets would result in an additional bad debt charge of £691,000 and a corresponding reduction in net assets. A 2% decrease in the loss allowance for trade receivables and contract assets would result in a reduction in the bad debt charge of £691,000 and corresponding increase in net assets.

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 7 for the carrying amount of property, plant and equipment and note A3 for the useful economic lives for each class of assets.

Based on the current useful lives, the carrying amount of property, plant and equipment is £1,479,039,000 at 31 March 2020. If the useful lives of the assets were 10% shorter, the carrying amount would instead be £1,087,417,000 and if they were 10% longer, the carrying amount would be £1,631,125,000 at 31 March 2020.

Based on the current useful lives, the carrying amount of intangible assets, excluding goodwill, is £30,807,000 at 31 March 2020. If the useful lives of the assets were 10% shorter, the carrying amount would instead be £26,625,000 and if they were 10% longer, the carrying amount would be £34,990,000 at 31 March 2020.

The above estimates have been calculated using the average useful life for each class of asset and assumes that the assets in each category are midway through their useful life.

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'. A sensitivity analysis has been performed based on changing different assumptions – see note A5 for the impact of changes in assumptions used.

CRITICAL ACCOUNTING JUDGEMENTS IN APPLYING THE ENTITY'S ACCOUNTING POLICIES

The preparation of financial statements 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 are disclosed below.

Revenue recognition

IFRS 15 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.

Refer to note 1 for the amount of revenue recognised in the income statement.

Statutory Financial Statements continued

Accounting policies (continued)

CRITICAL ACCOUNTING JUDGEMENTS IN APPLYING THE ENTITY'S ACCOUNTING POLICIES (CONTINUED)

Grants and contributions

Grants and contributions (consisting of contributions for diversions and requisitioned mains/extensions, and infrastructure charges) are received in respect of property, plant and equipment. Judgement is required in identifying what the performance obligation is for each type of contribution, which in turn impacts on how the revenue is recognised.

Contributions received in respect of diversions, requisitioned mains/extensions and infrastructure charges are recognised over a period of time. Contributions received in respect of connections charges are recognised immediately in the income statement. Refer to note A3 for more further detail on our accounting policies in relation to these.

Refer to note 1 for the amount of revenue recognised in the income statement.

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 7 for the carrying amount of property, plant and equipment.

PRIOR YEAR RESTATEMENTS AS A RESULT OF ERROR AND CHANGE IN PRESENTATION

During the year, it was assessed that term deposits with maturity of greater than three months and that were irredeemable prior to maturity should be disclosed as short-term deposits within other investments, having previously been disclosed as cash and cash equivalents in error. Prior year figures have been restated by £15,049,000, moving this amount from cash and cash equivalents to other investments in the statement of financial position. Both are treated as current assets.

Capital contributions received have been presented as operating cash flows in 2019/20 as these credits are released to operating costs over the useful economic life of the non-current asset to which they relate. These were presented as investment cash flows in prior periods. Comparatives have been restated increasing operating cash inflows by £30,746,000 and increasing investing cash outflows by the same amount.

Finally, in note 14, a change in presentation has resulted in £10,076,000 being shown as cash at bank and in hand in this note, having previously been shown as term deposits. Both are shown as cash and cash equivalents in the statement of financial position, with no change to the statement of financial position as a result of this change in presentation.

Notes to the financial statements

1. REVENUE

1.1 Disaggregation of revenue from contracts with customers

	2020 £000	2019 £000
Timing of revenue recognition – at a point in time		
Unmeasured supplies	**106,577**	116,829
Measured supplies	**137,426**	128,249
Non-household wholesale revenue	**50,015**	54,582
Connection charges	**10,076**	9,317
Chargeable services	**45**	84
	304,139	309,061
Timing of revenue recognition – over time		
Requisitioned mains/extensions	**576**	569
Diversions	**1,375**	827
Infrastructure charges	**992**	956
Other	**158**	156
	3,101	2,508
	307,240	311,569

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 2020 £000	31 March 2019 £000	1 April 2018 £000
Net trade receivables	**26,868**	28,010	27,206
Contract assets			
Unbilled accrual for metered customers – household customers	**36,013**	32,392	28,722
Unbilled accrual for metered customers – non-household customers	**3,137**	-	-
Amounts owed by group undertakings relating to contract assets	**-**	-	-
Contract liabilities			
Payments received in advance – water supplies	**39,191**	36,147	32,750
Deferred income – water supplies	**72**	3,122	4,426
Deferred income – other	**1,605**	2,049	2,125
Deferred grants and contributions	**134,933**	117,894	100,515
Payments received in advance – grants and contributions	**77,577**	35,685	22,655

'Payments received in advance – grants and contributions' in the table above relate to contributions received from developers where the asset is still work in progress and not yet being depreciated. Once the asset is complete, the contribution is moved from 'payments received in advance – grants and contributions' to 'deferred grants and contributions' and amortised, to ensure the accounting treatment is consistent.

Significant changes in contract assets and liabilities

Up to 31 March 2020, the company had been reimbursed £79,123,000 (2019: £30,494,000) 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, £13,408,000 (2019: £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. At 31 March 2020, £55,205,000 (2019: £19,984,000) 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 monthly in advance for wholesale charges determined by billing/volume reports created by the market operator. The company recognises deferred income in relation to these accounts and presents 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 these payments as being received in advance and discloses them 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:

	2020 £000	2019 £000
Revenue recognised that was included in the contract liability balance at the beginning of the year		
Payments received in advance – water supplies	**36,147**	32,750
Deferred income – water supplies	**3,280**	5,059
Deferred income – other	**1,208**	2,209
Deferred grants and contributions	**3,101**	2,508
Payments received in advance – grants and contributions	**9,027**	7,669
Revenue recognised from performance obligations satisfied in previous years		
Unbilled accrual for metered customers – household customers	**592**	339

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 2020, £134,933,000 (2019: £117,894,000) 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:

	2020 £000	2019 £000
Staff costs (note 4.1)	64,476	67,027
Profit on disposal of property, plant and equipment	(1,630)	(1,058)
Loss on disposal of infrastructure assets	1,262	1,714
Loss on disposal of intangible assets	12	-
Purchase of bulk water and water supplied under statutory entitlement	7,960	6,911
Water abstraction charges	3,791	4,122
Business rates	15,382	15,922
Chargeable services direct expenditure	444	372
Depreciation of infrastructure assets (note 7)	11,751	12,275
Depreciation of other property, plant and equipment (note 7)	51,640	45,956
Depreciation of right-of-use assets (Note 9)	3,859	-
Amortisation of intangible assets (note 8)	9,190	9,651
Impairment of trade receivables and contract assets (note 13)	9,470	6,128
Research and development	114	192
Operating lease rentals – land and buildings	-	1,547
Operating lease rentals – other	-	2,659
Short-term lease rentals	10	-
Low-value lease rentals	44	-
Auditors' remuneration (note 2.3)	555	805
Cost of inventories used	1,106	351

Statutory Financial Statements continued

Notes to the financial statements (continued)

2. OPERATING PROFIT (CONTINUED)

2.2 Other income

	2020 £000	2019 £000
Timing of revenue recognition – at a point in time		
Commission and rentals	**18,449**	17,896

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 25).

2.3 Auditors' remuneration

During the year the company obtained the following services from its auditor and its associates:

	2020 £000	2019 £000
Fees payable to the company's auditor and its associates for the audit of the financial statements	**180**	142
Fees payable to the company's auditor and its associates for other services:		
Audit of the company's associates	**113**	104
Audit-related assurance services		
– regulatory reporting	**59**	55
– Thames Water and Anglian Water annual returns	**9**	9
– audit related assurance service - other	**36**	34
Other assurance services including services related to bond issue	**38**	6
Other non-audit services	**120**	455
Total auditors' remuneration	**555**	805

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. £25,000 profit on disposal was recognised in the prior year.

4. EMPLOYEES

4.1 Employee benefit expense (including executive directors)

	2020 £000	2019 £000
Wages and salaries	**60,390**	62,546
Social security costs	**6,007**	6,124
Defined benefit pension costs (note 11)	**4,008**	5,783
Defined contribution pension costs (note A5)	**3,281**	3,170
Other pension administration costs	**1,319**	1,285
Staff costs	**75,005**	78,908
Staff costs capitalised	**(10,529)**	(11,881)
Staff costs recognised in the income statement	**64,476**	67,027

4.2 Average number of people employed

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

By activity	2020 Number	2019 Number
Operations	**776**	830
Customer service	**266**	272
Administration	**254**	262
	1,296	1,364

4.3 Directors' remuneration

Directors' emoluments were as follows:

	2020 £000	2019 £000
Aggregate emoluments	**1,686**	1,561

Aggregate amounts receivable under long-term incentive schemes were £nil (2019: £nil), 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 Allianz Capital Partners on behalf of the Allianz group, DIF and InfraRed Capital Partners Limited on behalf of HICL Infrastructure plc did not receive any emoluments from the company, or any company within the Affinity Water group.

Highest paid director

The highest paid director's emoluments were as follows:

	2020 £000	2019 £000
Aggregate emoluments	**876**	666

Amounts receivable by the highest paid director under long-term incentive schemes were £nil (2019: £nil), not included within aggregate emoluments above.

The company made £72,000 of contributions to a pension plan in respect of the highest paid director's qualifying services during the year (2019: £53,000). 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 112 to 126**.

Statutory Financial Statements continued

Notes to the financial statements (continued)

5. FINANCE INCOME AND COSTS

	2020 £000	2019 £000
Finance income		
Bank interest income	**954**	806
Net interest receivable on RPI linked inflation swap	**4,950**	2,955
Net income from post-employment benefits	**2,487**	2,829
	8,391	6,590
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	**(37,458)**	(37,293)
Accretion payable in respect of interest on loans from subsidiary undertakings	**(10,202)**	(9,483)
Accretion payable on financial instrument	**(3,357)**	(1,679)
Interest payable on lease liabilities	**(383)**	-
Other	**(484)**	(516)
	(52,044)	(49,131)
Fair value loss on financial instrument	**(1,816)**	(2,389)
Net finance costs	**(45,469)**	(44,930)

6. TAX EXPENSE

6.1 Tax expense included in the income statement

	2020 £000	2019 £000
Current tax:		
– UK corporation tax on profits for the year	**3,553**	4,338
– Adjustment in respect of prior years	**(1,457)**	(417)
Total current tax	**2,096**	3,921
Deferred tax		
– Origination and reversal of temporary differences	**(2,452)**	(952)
– Impact of change in tax rate	**20,910**	-
– Adjustment in respect of prior years	**1,219**	134
Total deferred tax	**19,677**	(818)
Tax expense	**21,773**	3,103

Tax expense assessed for the period is higher (2019: higher) than the standard rate of corporation tax in the UK for the year ended 31 March 2020 of 19% (2019: 19%). The differences are explained below:

	2020 £000	2019 £000
Profit before tax	**91**	13,672
Tax calculated at the standard rate of tax in the UK of 19% (2019: 19%)	**17**	2,598
Tax effects of:		
– Adjustments in respect of prior years	**(238)**	(283)
– Expenses not deductible for tax purposes	**1,084**	(2,082)
– Impact of change in tax rate on deferred tax	**20,910**	-
Tax expense	**21,773**	3,103

6.2 Tax expense/(credit) included in the statement of comprehensive income

	2020 £000	2019 £000
Deferred tax:		
- Origination and reversal of temporary differences on retirement benefit surplus	**7**	(1,487)

6.3 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.

In the Spring Budget 2020, the Government announced that from 1 April 2020 the Corporation Tax rate would remain at 19% (rather than reducing to 17%, as previously enacted). This new law was substantively enacted on 17 March 2020.

Statutory Financial Statements continued

Notes to the financial statements (continued)

6. TAX EXPENSE (CONTINUED)

6.4 Reconciliation of current and deferred tax charge

	2020 £000	2020 %	2019 £000	2019 %
Profit before tax	**91**	**-**	13,672	-
Tax on profit on ordinary activities at standard UK tax rate of 19% (2019: 19%)	**17**	**19.00%**	2,598	19.00%
Tax effect of:				
Depreciation in excess of capital allowances	**4,022**	**4,419.20%**	2,327	17.00%
– Pension movements	**(644)**	**(707.40%)**	(833)	(6.10%)
– Increase in provisions	**103**	**113.60%**	56	0.40%
– Expenses not deductible for tax purposes	**55**	**60.40%**	190	1.40%
Adjustment to tax charge in respect of prior years	**(1,457)**	**(1,600.00%)**	(417)	(3.10%)
Reported current tax charge and effective rate	**2,096**	**2,304.80%**	3,921	28.60%
Depreciation in excess of capital allowances	**(2,937)**	**(3,227.30%)**	(1,647)	(12.00%)
Increase in provisions	**(92)**	**(101.10%)**	(50)	(0.40%)
Pension movements	**576**	**632.90%**	745	5.50%
Impact of change in tax rate on deferred tax	**20,910**	**22,978.00%**	-	-
Adjustments to tax charge in respect of prior years	**1,219**	**1,341.10%**	134	1.00%
Reported deferred tax charge and effective rate	**19,677**	**21,623.60%**	(818)	(5.90%)
Total tax charge and effective rate	**21,773**	**23,928.80%**	3,103	22.70%

Impact of change in tax rate

In the 2020 Spring Budget the Government announced that the Corporation Tax rate would remain at 19% from 1 April 2020, rather than reducing to 17% as had been previously announced. The deferred tax liability at 31 March 2020 has been recalculated at 19%, resulting in an additional deferred tax charge of £20,910,000.

All other significant adjustments to taxable profits for the year ended 31 March 2020 are temporary differences. These will reverse in future years, so a higher tax charge in 2019/20 will result in a lower tax charge in a later year and vice versa. The impact on the tax charge in future years is reflected in the deferred tax account.

Depreciation in excess of capital allowances

The tax relief on our infrastructure assets is different from the depreciation of these assets in the accounts (although over the total life of the assets the two amounts will be equal). In 2019/20 the amount written off for tax purposes was lower than the depreciation in the accounts, resulting in a higher tax charge for the year.

Pension movements

Tax relief is given for the amount actually paid into the company's pension plan in the year, not the amount charged in the accounts. In 2019/20 the amount paid into the pension plan was higher than the amount charged in the accounts, resulting in a lower tax charge for the year.

Increase in provisions

Some provisions charged in the accounts are not deductible until the amounts provided are actually paid. This has the effect of increasing taxable profit, and results in a higher tax charge for the year.

Expenses not deductible for tax purposes

These will not reverse in future years, therefore the increase in the tax charge is permanent. Permanent disallowable expenses include fines, business entertaining and certain legal fees.

Adjustment to tax charge in respect of prior years

The tax provision in the accounts is a best estimate at the time. The estimate is corrected when the tax returns are finalised and submitted to HMRC 12 months after the year end. The correction made to the tax return for the year ended 31 March 2019 resulted in a lower tax charge, mainly as a result of claiming capital allowances.

7. 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 2019	297,851	809,553	22,793	797,210	66,992	122,967	**2,117,366**
Additions	-	-	-	-	-	124,136	**124,136**
Transfers	7,391	54,635	-	47,769	17,540	(127,335)	**-**
Disposals	-	(1,345)	(14)	-	(1,483)	-	**(2,842)**
At 31 March 2020	305,242	862,843	22,779	844,979	83,049	119,768	**2,238,660**
Accumulated depreciation							
At 1 April 2019	(92,197)	(54,477)	(1,675)	(520,640)	(28,821)	-	**(697,810)**
Charge for the year	(4,592)	(11,427)	(324)	(41,344)	(5,704)	-	**(63,391)**
Disposals	-	96	1	-	1,483	-	**1,580**
At 31 March 2020	(96,789)	(65,808)	(1,998)	(561,984)	(33,042)	-	**(759,621)**
Net book amount							
At 1 April 2019	205,654	755,076	21,118	276,570	38,171	122,967	**1,419,556**
Movement in year	2,799	41,959	(337)	6,425	11,836	(3,199)	**59,483**
At 31 March 2020	208,453	797,035	20,781	282,995	50,007	119,768	**1,479,039**

All land and buildings are held as freehold.

8. RIGHT-OF-USE ASSETS

	Buildings £000	Vehicles £000	Other £000	Total £000
Cost				
At 1 April 2019	9,079	5,013	402	**14,494**
Additions	-	1,822	-	**1,822**
Disposals	-	(46)	-	**(46)**
At 31 March 2020	9,079	6,789	402	**16,270**
Accumulated depreciation				
At 1 April 2019	-	-	-	**-**
Charge for the year	(1,397)	(2,232)	(230)	**(3,859)**
Disposals	-	25	-	**25**
At 31 March 2019	(1,397)	(2,207)	(230)	**(3,834)**
Net book amount				
At 1 April 2019	9,079	5,013	402	**14,494**
Movement in year	(1,397)	(431)	(230)	**(2,058)**
At 31 March 2020	7,682	4,582	172	**12,436**

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 2019	14,961	72,492	**87,453**
Additions	-	7,067	**7,067**
Disposals	-	(2,754)	**(2,754)**
At 31 March 2020	14,961	76,805	**91,766**
Accumulated amortisation			
At 1 April 2019	-	(39,550)	**(39,550)**
Charge for the year	-	(9,190)	**(9,190)**
Disposals	-	2,742	**2,742**
At 31 March 2020	-	(45,998)	**(45,998)**
Net book amount			
At 1 April 2019	14,961	32,942	**47,903**
Movement in year	-	(2,135)	**(2,135)**
At 31 March 2020	14,961	30,807	**45,768**

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 2020. 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 £9,895,000 of capitalised intangible assets under construction, which is not amortised. £5,156,000 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 2020 (2019: £nil).

10. INVESTMENTS

	2020 £000	2019 restated £000
Non-current assets Investments in subsidiaries (refer to note A6)	**100**	100
Current assets Short-term deposits	**25,202**	15,049

The directors confirm 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:

	2020 £000	2019 £000
Total current service cost of the Affinity Water Pension Plan	**(3,952)**	(4,132)
Contributions from participating employer	**92**	97
Past service cost	**(148)**	(1,748)
Pension expense charged to operating profit	**(4,008)**	(5,783)
Net pension interest income credited to finance income (note 5)	**2,487**	2,829
Net pension expense charged before taxation	**(1,521)**	(2,954)

The opening and closing retirement benefit surpluses included in the statement of financial position are summarised as follows:

	2020 £000	2019 £000
At 1 April	**101,194**	105,558
Principal employer contributions	**4,908**	7,337
Net current service cost (per above)	**(3,860)**	(4,035)
Past service cost	**(148)**	(1,748)
Net interest income	**2,487**	2,829
Net re-measurement gain/(loss)	**38**	(8,747)
At 31 March	**104,619**	101,194

Re-measurement gains and losses are recognised directly in the statement of comprehensive income and are summarised as follows:

	2020 £000	2019 £000
Re-measurement (losses)/gains on plan assets	**(18,556)**	2,485
Re-measurement gains/(losses) on plan liabilities	**18,594**	(11,232)
	38	(8,747)

The past service cost in the prior year fully relates to the impact of the court ruling in October 2018 to remove historical gender inequalities in relation to Guaranteed Minimum Pensions.

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

	2020 £000	2019 £000
Raw materials and consumables	**3,017**	2,716

Inventories are stated after provisions for impairment of £538,000 (2019: £538,000).

13. TRADE AND OTHER RECEIVABLES

	2020 £000	2019 £000
Non-current:		
Other receivables	**2,300**	2,215
Current:		
Trade receivables	**61,453**	55,806
Less: loss allowance for trade receivables	**(34,585)**	(27,796)
	26,868	28,010
Amounts owed by group undertakings	**-**	207
Interest receivable from external parties	**5,051**	4,044
Other receivables	**5,411**	4,563
Unbilled accrual for metered customers	**39,150**	32,392
Prepayments and accrued income	**5,619**	5,547
	82,099	74,763

The carrying amounts of trade and other receivables approximate to their fair value.

13.1 Loss allowance for trade receivables and contract assets

Trade receivables and contract assets do not carry interest and are stated net of a loss allowance, as follows:

	Trade receivables		Unbilled accrual for metered customers		Total	
	2020 £000	2019 £000	2020 £000	2019 £000	2020 £000	2019 £000
At 1 April	**27,796**	27,764	**307**	306	**28,103**	28,070
Provision for receivables impairment charged to income statement	**9,508**	6,127	**(38)**	1	**9,470**	6,128
Receivables written off during the year as uncollectable	**(2,719)**	(6,095)	**-**	-	**(2,719)**	(6,095)
At 31 March	**34,585**	27,796	**269**	307	**34,854**	28,103

See note A4 for details of the nature and the calculation of the loss allowance.

£1,680,000 of the £9,470,000 total provision for receivables impairment charged to the income statement in the year is an additional charge arising as a result of COVID-19.

13.2 Ageing analysis of trade receivables

The aged analysis of receivables at the reporting date is as follows:

	2020 £000	2019 £000
Aged less than one year	**14,891**	15,396
Aged between one year and two years	**9,369**	11,191
Aged greater than two years	**2,608**	1,423
	26,868	28,010

14. CASH AND CASH EQUIVALENTS

	2020 £000	2019 restated £000
Cash at bank and in hand	**28,368**	31,263
Term deposits	**57,219**	65,219
	85,587	96,482

The carrying amounts of cash and cash equivalents approximate to their fair value.

15. SHARE CAPITAL, SHARE PREMIUM AND CAPITAL CONTRIBUTION RESERVE

Allotted 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 2020 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 continued

Notes to the financial statements (continued)

16. TRADE AND OTHER PAYABLES

	2020 £000	2019 £000
Non-current		
Amounts falling due after more than one year:		
Deferred grants and contributions	**10,187**	10,458
Amounts falling due after more than five years:		
Deferred grants and contributions	**122,507**	105,301
	132,694	115,759
Current		
Amounts falling due within one year:		
Trade payables	**9,544**	13,506
Amounts due to group undertakings	**389**	250
Interest payable to subsidiary companies	**13,850**	13,761
Commitment fees	**65**	63
Social security and other taxes	**1,559**	1,618
Other payables	**5,221**	8,448
Capital accruals	**14,498**	13,149
Deferred grants and contributions	**2,239**	2,135
Payments received in advance	**116,768**	71,832
Deferred income	**1,677**	5,171
Other accruals	**33,520**	30,176
	199,330	160,109
	332,024	275,868

The carrying amounts of trade and other payables approximate to their fair value.

17. BORROWINGS

	2020 £000	2019 £000
Borrowings measured at amortised cost:		
Loan from Affinity Water Finance (2004) PLC financed by bond issue	**253,462**	253,922
Loan from Affinity Water Finance PLC financed by bond issue	**833,595**	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
	1,090,641	1,081,253

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%.

The net proceeds of the bond issues and the tap issue were lent to the company on the same terms.

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.

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 2020 is £1,348,245,000 (2019 restated: £1,378,075,000). 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 has 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.

Statutory Financial Statements continued

Notes to the financial statements (continued)

18. LEASE LIABILITIES

	31 March 2020 £000	1 April 2019 £000
Non-current		
Lease liabilities	**9,068**	11,167
Current		
Lease liabilities	**3,491**	3,327

Depreciation charge of right-of-use assets recognised in the income statement for the year ended 31 March 2020 is £3,859,000 (refer to note 8).

The interest expense on lease liabilities recognised in the income statement for the year ended 31 March 2020 is £383,000 (refer to note 5).

Expense relating to short-term leases recognised in the income statement for the year ended 31 March 2020 is £10,000 (refer to note 2.1).

Expense relating to leases of low-value assets that are not shown above as short-term leases recognised in the income statement for the year ended 31 March 2020 is £44,000 (refer to note 2.1).

Total cash outflow for leases for the year ended 31 March 2020 was £4,094,000, of which £3,711,000 was principal elements of lease payments and £383,000 was interest payments.

Additions to right-of-use assets in the year ended 31 March 2020 was £1,822,000 (refer to note 8). The carrying amount of right-of-use assets at 31 March 2020 is £12,436,000 (refer to note 8).

19. DERIVATIVE FINANCIAL INSTRUMENT

	2020 £000	2019 £000
Non-current		
Fair value of RPI linked inflation swap	**2,430**	2,389
Accretion on RPI linked inflation swap	**4,975**	1,608
Fair value of CPI linked inflation swap	**1,775**	-
Accretion on CPI linked inflation swap	**(31)**	-
	9,149	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 (maturity July 2026), was entered into in August 2018.

A CPI linked inflation swap with a nominal value of £25.0m, which is linked to the maturity of the Class A fixed rate £250.0m bond (maturity March 2036), was entered into in March 2020.

20. DEFERRED TAX LIABILITIES

20.1 Analysis of deferred tax assets and deferred tax liabilities

	2020 £000	2019 £000
Deferred tax assets:		
– Deferred tax asset to be recovered after more than 12 months	**(629)**	(500)
	(629)	(500)
Deferred tax liabilities:		
– Deferred tax liability to be settled after more than 12 months	**199,273**	179,461
	199,273	179,461
Deferred tax liabilities - net	**198,644**	178,961

The gross movement on the deferred tax account is as follows:

	£000
At 1 April 2018	181,266
(Credited) to the income statement	(818)
(Credited) to other comprehensive income	(1,487)
At 31 March 2019	**178,961**
Prior year adjustment	**1,219**
Charged to the income statement	**18,456**
Charged to other comprehensive income	**7**
At 31 March 2020	**198,644**

Statutory Financial Statements continued

Notes to the financial statements (continued)

20. DEFERRED TAX LIABILITIES (CONTINUED)

The movement in deferred tax assets and liabilities during the year is as follows:

20.2 Deferred tax liabilities

	Accelerated capital allowances £000	Retirement benefit obligations £000	Total £000
At 1 April 2018	163,910	17,944	181,854
(Credited)/charged to the income statement	(1,651)	745	(906)
Credited to other comprehensive income	-	(1,487)	(1,487)
At 31 March 2019	**162,259**	**17,202**	**179,461**
Prior year adjustment	**1,190**	**-**	**1,190**
Charged to the income statement	**15,946**	**2,668**	**18,614**
Charged to other comprehensive income	**-**	**7**	**7**
At 31 March 2020	**179,395**	**19,877**	**199,273**

20.3 Deferred tax assets

	Provisions £000
At 1 April 2018	(588)
Charged to the income statement	88
At 31 March 2019	(500)
Prior year adjustment	**29**
Credited to the income statement	**(158)**
At 31 March 2020	**(629)**

21. PROVISIONS FOR OTHER LIABILITIES AND CHARGES

	Insurance £000	Other £000	Total £000
At 1 April 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
Charged to the income statement	808	-	808
Utilised in the year	(208)	(1,555)	(1,763)
At 31 March 2020	4,837	1,277	**6,114**

Insurance

Provisions for insurance represent 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 these provisions is an amount of £2,300,000 (2019: £2,215,000), which is expected to be recoverable from the company's insurer. The provision above is shown gross, with the corresponding receivable disclosed as a non-current other receivable on the company's statement of financial position.

Other provisions

Other provisions include £607,000 (2019: £2,162,000) in relation to a corporate reorganisation, which is expected will be utilised by 31 March 2021 and therefore presented as a current liability in the statement of financial position, and £670,000 (2019: £670,000) in relation to unfunded pension liabilities for a former non-executive director, which it is expected will be utilised by January 2051.

22. DIVIDENDS

	2020 £000	2019 £000
No first interim dividend paid (2019: 1.89p per share)	-	5,000
No second interim dividend paid (2019: 0.60p per share)	-	1,600
	-	6,600

Statutory Financial Statements continued

Notes to the financial statements (continued)

23. NOTES TO THE STATEMENT OF CASH FLOWS

23.1 Cash generated from operations

		2020 £000	2019 £000
Profit before tax		**91**	13,672
Adjustments for:			
Depreciation of property, plant and equipment (note 7)		**63,391**	58,231
Depreciation of right-of-use assets (note 8)		**3,859**	-
Amortisation of grants and contributions		**(3,101)**	(2,508)
Amortisation of intangible fixed assets (note 9)		**9,190**	9,651
Profit on disposal of subsidiary		**-**	(25)
Profit on disposal of property, plant and equipment		**(1,630)**	(1,058)
Loss on disposal of infrastructure assets		**1,262**	1,714
Loss on disposal of intangible assets		**12**	-
Post-employment benefits		**(900)**	(1,554)
Net finance costs (note 5)		**45,469**	44,930
Changes in working capital			
– Inventories		**(301)**	(1,085)
– Trade and other receivables		**(7,421)**	(7,868)
– Trade and other payables:	- provision element	**(955)**	3,837
	- other	**1,150**	(257)
Cash generated from operations		**110,116**	117,680

23.2 Reconciliation of liabilities arising from financing activities

	At 1 April 2019 £000	Cash flow £000	Non-cash flows £000	At 31 March 2020 £000
Loan from Affinity Water Finance (2004) PLC financed by bond issue	**253,922**	**-**	**(461)**	**253,461**
Loan from Affinity Water Finance PLC financed by bond issue	**823,747**	**-**	**9,849**	**833,596**
Loan from intermediate parent company	**3,550**	**-**	**-**	**3,550**
Lease liabilities	**14,494**	**(4,094)**	**2,159**	**12,559**
Debenture stock	**34**	**-**	**-**	**34**
Total liabilities arising from financing activities	**1,095,747**	**(4,094)**	**11,547**	**1,103,200**

	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 and net additions of leases.

Statutory Financial Statements continued

Notes to the financial statements (continued)

24. COMMITMENTS

24.1 Capital commitments

Capital expenditure contracted for at the end of the reporting period but not yet incurred is as follows:

	2020 £000	2019 £000
Property, plant and equipment	**15,442**	18,616
Intangible assets	**1,137**	1,041
	16,579	19,657

24.2 Commitments under operating leases

The company leases its head office building, IT server space and vehicles under non-cancellable operating leases expiring within a maximum of six years. The leases have varying terms, clauses and renewal rights. With the exception of the head office building, the company does not expect to extend any leases after their lease term has expired. The company will assess closer to the expiry of the lease of the head office building whether another formal agreement will be entered in to.

From 1 April 2019, the company has recognised right-of-use assets for these leases, except short-term and low-value leases, see note 18 for further information.

The future aggregate minimum lease payments under non-cancellable operating leases are as follows:

	2020		2019	
	Land and buildings £000	Other £000	Land and buildings £000	Other £000
No later than one year	-	**72**	1,547	2,302
Later than one year and no later than five years	-	**212**	6,187	3,558
Later than five years	-	-	2,191	-
	-	**284**	9,925	5,860

25. 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 2020 (2019: £nil) and the company incurs no bad debt risk in relation to this service.

26. EVENTS AFTER THE REPORTING PERIOD

Affinity for Business (Retail) Limited, one of the company's fellow group undertakings, was sold to Castle Water Limited on 1 April 2020. The entity changed its name on 3 April 2020 to Castle Water (Southern) Limited.

Following on from the £25,000,000 CPI linked inflation swap entered into in March 2020, the company has entered into further CPI linked inflation swaps, bringing the total nominal value up to £250,000,000.

27. 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 2020 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 Holding I Pte. Limited (during the period and up to 20 November 2019 Allianz Infrastructure Luxembourg I Sarl)
- DIF Management Holding BV
- DIF Management UK Limited
- HICL Infrastructure plc
- InfraRed Capital Partners (Management) LLP[1]

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 Manager to HICL is InfraRed Capital Partners Limited, a leading international investment manager focused on infrastructure and real estate.

[1] Sun Life Financial Inc has exchanged contracts to acquire an 80% interest in the InfraRed business from InfraRed Capital Partners (Management) LLP. Following completion, which is subject to regulatory consents and other customary closing conditions and which is expected to occur in Summer 2020, Sun Life Financial Inc will become an ultimate controller.

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 4,500km² 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 limited by shares 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 27 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 quarterly 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 wholly 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 of property, plant and equipment 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.

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.

Computer software development costs 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.

Investments

Investment in subsidiaries
Investments in subsidiaries are held at cost less accumulated impairment losses.

Other investments
Other investments include short-term deposits that cannot be withdrawn prior to maturity and are held at cost.

Trade and other receivables

Trade and other receivables are recognised initially at transaction price. The company holds the trade receivables with the objective of collecting the contractual cash flows, and therefore the trade and other receivables are 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. The historical recoverability of trade receivables is deemed a good estimate of future 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. To estimate the impairment to our trade receivables from COVID-19, we have assessed our debtors based on postcode driven customer demographics. We have assessed what we believe to be the sensitivity of each demographic to the current and emerging effects of the pandemic on household finances and ability to maintain payments.

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. Deposits that cannot be withdrawn prior to maturity are classed as investments.

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.

Statutory Financial Statements continued

Notes to the financial statements – appendices (continued)

A3. ACCOUNTING POLICIES (CONTINUED)

Current and deferred tax (continued)

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.

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 are written off to the income statement in full.

Derivatives

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 the 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. Certain performance commitments contain an ODI, which can carry a financial reward or penalty, or both, that for the first four years of AMP6 was to be realised as part of the AMP7 price review process in the form of revenue or RCV adjustments (end-of-period ODIs), and for the final year of AMP6 will be recognised as a revenue adjustment in AMP7. In AMP7, the ODIs will be in-period and recognised as a revenue adjustment in the next charging period. For both in-period and end-of-period ODIs, the company adjusts future tariffs to reflect such amounts and therefore the benefit or cost is linked to the provision of future services as well as future performance. Resultantly the company does not recognise a provision for penalties or rewards in the financial year in which they are incurred or achieved as these amounts are not an asset or liability at the balance sheet date.

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.

Where non-household retailers are billed in advance monthly for wholesale charges, as 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

The company leases its head office building, IT server space and vehicles.

Rental contracts for IT server space and vehicles are typically for fixed periods of two to five years. The company has an option to extend its leases; however no contracts are reasonably certain to be extended after their lease term has expired. The lease contract of the head office building is for a significantly longer period. Lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions. The company's lease agreements do not impose any covenants, but leased assets cannot be used as security for borrowing purposes.

Leases are recognised as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use by the company. Each lease payment is allocated between the liability and finance cost. The finance cost is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The right-of-use asset is depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis.

The company's ongoing accounting policy is for assets and liabilities arising from a lease to be initially measured on a present value basis. Lease liabilities include the net present value of one or more of the following lease payments:

- fixed payments (including in-substance fixed payments), less any lease incentives receivable; and
- payments of penalties for terminating the lease, if the lease term reflects the lessee exercising that option.

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

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

Lease payments are discounted using the interest rate implicit in the lease. If that rate cannot be determined, the lessee's incremental borrowing rate is used, being the rate that the lessee would have to pay to borrow the funds necessary to obtain an asset of similar value in a similar economic environment with similar terms and conditions. The company uses an independent third-party to determine the incremental borrowing rate.

Payments associated with short-term leases and leases of low-value assets are recognised on a straight-line basis as an expense in profit or loss. Short-term leases are leases with a lease term of 12 months or less. Low-value assets comprise small items of office equipment and IT equipment.

The company enters into agreements with employees to use vehicles that it leases from a third party as a company vehicle. These agreements are considered by the company to be part of the overall compensation package of an employee and, as such, the company has applied IAS 19 'Employee benefits' in accounting for these arrangements rather than considering the arrangements as subleases of vehicles to employees under IFRS 16.

The company does not use sale and leaseback transactions.

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.

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.

Statutory Financial Statements continued

Notes to the financial statements – appendices (continued)

A3. ACCOUNTING POLICIES (CONTINUED)

Retirement benefits (continued)

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

A4. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Risk management

The company's financial instruments comprise borrowings, derivatives, debentures, cash and liquid resources, lease liabilities, 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 39** 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.

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 2020, the company had £271,789,000 (2019: £272,531,000) of available liquidity, which comprised £110,789,000 (2019: £111,531,000) of cash and term deposits and £161,000,000 (2019: £161,000,000) of undrawn committed borrowing facilities.

In August 2018, the company entered into an RPI linked inflation swap, and in March 2020, the company entered into a CPI linked inflation swap, as detailed in the interest rate and inflation risk section of note A4.

These transactions lead to a net interest receivable cashflow over the life of the swap, offset by an accretion payment on maturity (2026 for the RPI swap and 2036 for the CPI swap). There is no liquidity risk prior to these dates 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 total forecast cash payment of £40,544,000, included in this 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	2020 £000	2019 £000
Floating rate:		
– Expiring within one year	**61,000**	61,000
– Expiring in more than one year	**100,000**	100,000
	161,000	161,000

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 (2019: £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 (2019: £23,000,000), 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 (2019: £60,000,000) provided by Barclays Bank PLC and £40,000,000 (2019: £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 July 2024 and July 2023 respectively. These facilities were renewed on 24 June 2020 and use SONIA as the reference rate and have sustainability performance measures included.

Statutory Financial Statements continued

Notes to the financial statements – appendices (continued)

A4. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

Liquidity risk (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 (borrowings and lease liabilities) with agreed repayment periods on an undiscounted basis.

At 31 March 2020 Non-derivatives	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	Total £000
Loans from subsidiaries	**38,403**	**38,628**	**52,807**	**38,585**	**38,830**	**1,432,315**	**1,639,568**
Loan from intermediate parent	**160**	**160**	**160**	**160**	**160**	**5,466**	**6,266**
Lease liabilities	**3,798**	**3,045**	**2,506**	**1,845**	**1,547**	**645**	**13,386**
Total non-derivatives	**42,361**	**41,833**	**55,473**	**40,590**	**40,537**	**1,438,426**	**1,659,220**

At 31 March 2019 Non-derivatives	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	Total £000
Loans from subsidiaries	38,231	38,421	38,577	52,684	38,389	1,442,910	1,649,212
Loan from intermediate parent	160	160	160	160	160	5,466	6,266
Total non-derivatives	38,391	38,581	38,737	52,844	38,549	1,448,376	1,655,478

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 for the CPI linked swap, as it was entered into during the year.

At 31 March 2020 Derivatives	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	Total £000
RPI linked inflation swap net payment/ (receivable)	**(4,876)**	**(4,784)**	**(4,690)**	**(4,592)**	**(4,492)**	**20,580**	**(2,854)**
CPI linked inflation swap net payment/ (receivable)	**(715)**	**(706)**	**(698)**	**(689)**	**(681)**	**2,664**	**(825)**
Total derivatives	**(5,591)**	**(5,490)**	**(5,388)**	**(5,281)**	**(5,173)**	**23,244**	**(3,679)**

At 31 March 2019 Derivatives	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	Total £000
RPI linked inflation swap net payment/ (receivable)	(3,930)	(4,856)	(4,758)	(4,656)	(4,551)	23,166	415
Total derivatives	(3,930)	(4,856)	(4,758)	(4,656)	(4,551)	23,166	415

Statutory Financial Statements

Statutory Financial Statements continued

Notes to the financial statements – appendices (continued)

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. The historical recoverability of trade receivables is deemed a good estimate of future 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.

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.

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 subsequent 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 2020 and 31 March 2019 was determined as follows for both trade receivables and contract assets (unbilled accrual for metered customers):

At 31 March 2020	Current £000	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	0.74%	0.00%	8%	26%	47%	66%	100%	
Gross carrying amount – metered household receivables	-	-	15,805	4,855	2,850	2,147	2,862	28,519
Gross carrying amount – unbilled accrual for metered customers (household)	36,282	-	-	-	-	-	-	36,282
Gross carrying amount – unbilled accrual for metered customers (non-household)	-	3,137	-	-	-	-	-	3,137
Provision at expected loss rate	269	-	1,203	1,273	1,349	1,416	2,862	8,372
Additional provision for COVID-19	-	-	840	-	-	-	-	840
Amounts provided at 100%	-	-	2,689	3,287	1,830	1,097	820	9,723
Loss allowance	269	-	4,732	4,560	3,179	2,513	3,682	18,935

	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	0.00%	9%	19%	35%	54%	100%	
Gross carrying amount – unmetered household receivables	-	7,000	3,897	2,492	1,853	3,228	18,470
Provision at expected loss rate	-	633	743	863	1,005	3,228	6,472
Additional provision for COVID-19	-	840	-	-	-	-	840
Amounts provided at 100%	-	2,169	2,295	1,656	1,035	75	7,230
Loss allowance	-	3,642	3,038	2,519	2,040	3,303	14,542

	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%	49%	50%	74%	98%	
Gross carrying amount – developer services	2,064	593	155	87	959	3,858
Loss allowance	0	290	78	64	945	1,377
Total loss allowance						**34,854**

Statutory Financial Statements continued

Notes to the financial statements – appendices (continued)

A4. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

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**

A reconciliation between the opening and closing loss allowances for trade receivables and contract assets for the year ended 31 March 2020 is shown in note 13.

At 31 March 2020 and 31 March 2019, the maximum exposure to credit risk was represented by the carrying amount of each financial asset in the statement of financial position:

	2020 £000	2019 £000
Cash and term deposits (note 14)	**85,587**	96,482
Short-term deposits (note 10)	**25,202**	15,049
Trade and other receivables (excluding prepayments and amounts recoverable from the company's insurer)	**77,897**	70,735
	188,686	182,266

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 and short-term deposits treated as investments exposed to credit risk at each of the external credit ratings at 31 March 2020 is:

	2020 £000	2019 £000
AAA*	**42,106**	30,060
A-1+*	**10,105**	5,017
A-1*	**57,959**	61,762
P-1**	**-**	10,005
	110,170	106,844

* 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.

A CPI linked inflation swap with a nominal value of £25.0m, which is linked to the maturity of the Class A fixed rate £250.0m bond (March 2036), was entered into in March 2020.

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.

Statutory Financial Statements continued

Notes to the financial statements – appendices (continued)

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 2020	**673,030**	**355,610**	**62,001**	**1,090,641**
31 March 2019	673,647	346,719	60,887	1,081,253

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 2020. The following table details the sensitivity of profit before taxation to changes in RPI and CPI on the company's index-linked borrowings, RPI linked inflation swap and CPI 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 CPI linked inflation swap as this was entered into during the year to 31 March 2020.

Impact on profit before taxation	2020 £000	2019 £000
1% increase in RPI	**(3,542)**	(3,450)
1% decrease in RPI	**3,542**	3,450
1% increase in CPI	**(625)**	(614)
1% decrease in CPI	**625**	614

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 78.9% at 31 March 2020 (78.3% at 31 March 2019).

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, BBB+ with Standard & Poor's and BBB+ with Fitch 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.

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).

Investment strategy
Following a Trustee investment strategy review in the prior year, and the focus towards a 'cashflow driven investment' strategy, the Trustee implemented the following changes to the plan's portfolio during the year:

- increased the level of interest rate and inflation hedging provided by the plan's assets from 90% to 92.5%; and
- introduced a new segregated actively managed investment 'liability driven investment/cashflow driven investment' portfolio managed by Insight Investment Management Limited, which is expected to provide stable returns and regular income to meet the plan's outgoings.

Statutory Financial Statements continued

Notes to the financial statements – appendices (continued)

A5. RETIREMENT BENEFITS (CONTINUED)

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.

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 2021 are £4,954,000 by the company (£4,908,000 in the year ended 31 March 2020) and £5,000,000 taking into account both participating employers (£5,000,000 in the year ended 31 March 2020).

The weighted average duration of the defined benefit obligation is 16.3 years (2019: 17.1 years).

Defined benefit section - financial and demographic assumptions

Adjustments to actuarial valuations have been made based on the following assumptions:

	2020	2019
Discount rate	**2.30% pa**	2.40% pa
Salary growth	**2.70% pa**	3.15% pa
RPI	**2.50% pa**	3.15% pa
CPI	**1.70% pa**	2.15% 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)	**24**	23
Life expectancy from age 65 (years) for a female participant currently aged 45 (years)	**26**	25

Deferred pensions are revalued to retirement age in line with the CPI assumption of 1.70% per annum (2019: 2.15% per annum) unless otherwise prescribed by statutory requirements or the plan rules.

Defined benefit section - sensitivity analysis

	Change in assumption	Impact on defined benefit obligation	Change in assumption	Impact on defined benefit obligation
2020				
Discount rate	**0.5% decrease**	**8.5% increase**	**0.5% increase**	**8.5% decrease**
Salary growth	**0.5% increase**	**0.9% increase**	**0.5% decrease**	**0.9% decrease**
Pension growth rate	**0.5% increase**	**6.9% increase**	**0.5% decrease**	**6.9% decrease**
Life expectancy	**1 year increase**	**4.0% increase**	**1 year decrease**	**4.0% decrease**
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

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 %	2020 £000	Plan assets %	2019 £000
Equity securities	**4%**	**21,840**	5%	27,129
Debt securities	**71%**	**358,693**	25%	127,658
Diversified growth funds	**0%**	**-**	10%	51,770
Property	**0%**	**288**	0%	654
Infrastructure	**2%**	**9,066**	2%	11,726
Liability driven investments	**18%**	**88,507**	57%	296,412
Cash and cash equivalents	**5%**	**22,857**	1%	3,337
Total fair value of the plan's assets	**100%**	**501,251**	100%	518,686
Present value of defined benefit obligations		**(396,632)**		(417,492)
Net retirement benefit surplus		**104,619**		101,194

Statutory Financial Statements continued

Notes to the financial statements – appendices (continued)

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 2019 / 1 April 2018	**518,686**	511,943
Benefits paid	**(16,670)**	(16,899)
Principal employer contributions	**4,908**	7,337
Contributions by plan participants	**557**	615
Interest income	**12,326**	13,205
Re-measurement (losses) / gains	**(18,556)**	2,485
At 31 March 2020 / 31 March 2019	**501,251**	518,686

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 2019 / 1 April 2018	**(417,492)**	(406,385)
Benefits paid	**16,670**	16,899
Contributions by plan participants	**(557)**	(615)
Net current service cost	**(3,860)**	(4,035)
Past service cost	**(148)**	(1,748)
Interest expense	**(9,839)**	(10,376)
Re-measurement gains / (losses)	**18,594**	(11,232)
At 31 March 2020 / 31 March 2019	**(396,632)**	(417,492)

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 2020 was £3,281,000 (2019: £3,170,000). There are no amounts prepaid or outstanding in respect of the defined contribution section at 31 March 2020 (2019: £nil).

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 2020 (2019: £1,000), relating to bond management fees charged to Affinity Water Limited.

The company also has an investment of £50,000 in 100% of the £1 ordinary shares of another subsidiary company, Affinity Water Finance PLC. 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 £6,000 for the year ended 31 March 2020 (13 November 2018 to 31 March 2019: £2,000[1]), relating to bond management fees charged to Affinity Water Limited.

The four dormant subsidiaries listed above file accounts at Companies House.

[1] In January 2019, the company transferred its investment of £10,000 in 100% of £1 ordinary shares of Affinity Water Programme Finance Limited to Affinity Water Capital Funds Limited for £35,000. Affinity Water Programme Finance Limited made a profit of £4,000 for the year ended 31 March 2019.

Statutory Financial Statements continued

Notes to the financial statements – appendices (continued)

A7. RELATED PARTY TRANSACTIONS

Purchases of goods and services

			2020		2019	
Related party	Nature of relationship	In respect of	Value £000	Balance £000	Value £000	Balance £000
Allianz Global Corporate & Speciality	Common ownership	Insurance	**1,852**	**(1,009)**	1,569	(930)
Allianz Engineering	Common ownership	Insurance	**2**	**(1)**	2	(1)
SSE plc	Shared director	Electricity	**26,068**	**5,991**	21,879	1,857

See note 4.3 for disclosure of the directors' remuneration.

Statutory Financial Statements

Regulatory Annual Performance Report

for the year ended 31 March 2020

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)

Restoration work on the River Gade: looking after beautiful landscapes everyone can enjoy

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 2020. 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 we head into AMP7.

As a Board, we spend a significant amount of time aligning our company plans to the interests of customers, employees and wider stakeholders. Ofwat published its Final Determination for AMP7 in December 2019, which gives us clarity on what we need to deliver up to 2025 for all those we serve. We welcome Ofwat's support of our investment to protect the environment, improve service and boost resilience. We know that it will be challenging but we are determined to deliver our Plan, both to improve the services we provide to our customers and to improve our environment. We have re-invigorated the business considerably in the last two years, with improved operational performance at the end of AMP6, a new executive team, strengthened Board, committed long-term investors, an excellent team of colleagues, and a clear purpose to help us move forwards.

How the company has set its aspirations and performed for all those it serves

During 2019/20, we defined our purpose, values and culture, ensuring we would be ready for AMP7. We conducted internal and external research, gathering insight from stakeholder interviews, focus groups and opinion polling. Our research showed that customers, employees and stakeholders have a strong appetite for us to place the environment, and, in particular the local environment, at the heart of our business. Details of the Board's involvement in defining our purpose and ensuring the business is ready to perform for all those we serve is on **page 76** of our Governance report. Our purpose is to provide high quality drinking water and to take care of our environment for our communities now and in the future. It 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.

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 have committed to delivering 28 performance commitments, detailed on **page 33**. 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. See details of our finances on **page 34**, including details on our investment plans and funding of these programmes.

Our Board approved revised dividend and executive remuneration policies during the year, available on the governance pages of our website: **affinitywater.co.uk/governance-assurance** 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 key change for dividends paid by the appointed business relates to the inclusion of consideration of performance delivery against the Final Determination for AMP7. The performance of the company comprises our financial performance as well as an assessment of performance in the following areas: operational performance, customer and community performance, and safety and health performance.

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, detailed in our Remuneration Report on **pages 112 to 126**. 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
Company Chair

Certificates of compliance

To: Water Services Regulation Authority, Centre City Tower, 7 Hill Street, Birmingham B5 4UA

CERTIFICATE OF ADEQUACY

This is to certify that on 24 June 2020 the Board of Affinity Water Limited ('the Appointee') resolved that in its opinion, in accordance with the company's licence requirements:

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 systems of planning and internal control; and

   (b) rights and resources other than financial resources

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:

Financial resources and facilities:

- the net worth of the company as shown in the financial statements and the budget for the forthcoming year supported by long-term plans and performance against the Final Determination set at the most recent price review, 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 39** for further details), including details of the company's credit rating; and
- the results of the stress-testing performed in relation to the company's viability statement for the year ended 31 March 2020 (refer to **pages 49 to 53**), which is subject to external assurance (refer to our Data Assurance Report, which is published on our website: **affinitywater.co.uk** for further details).

Management resources:

- the adequacy of the executive and senior management team, including their management skills, experience, relevant qualifications and their ability to focus their teams on delivering on a number of complex and high-profile projects during 2019/20 without detriment to the other services provided to its customers;
- the Board and its Committees have the resources available to them and the fact that they have sufficient independent membership to ensure they can make high quality decisions that address diverse customer and stakeholder needs; and
- the review of succession planning being performed by the Nomination Committee along with the company's Human Resources Team, as well as the recruitment process, staff engagement and diversity, the quality of training and development programmes and the company's purpose and principles.

Regulatory Annual Performance Report continued

Certificates of compliance (continued)

CERTIFICATE OF ADEQUACY (CONTINUED)

Systems of planning and internal control:

- the comprehensive suite of internal control procedures across both operational and financial matters to ensure maintenance of supply, supported by governance procedures, risk management frameworks, segregation of duties matrices and detailed delegated levels of authority, as well as policies to prevent fraud and other unethical behaviour (including but not limited to the company's whistleblowing policy);
- 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; and
- the fact that the company's output is subject to considerable external assurance, both fiscal and operational (refer to our Data Assurance Report, which is published on our website: **affinitywater.co.uk** for further details).

Rights and resources other than financial resources:

- the company principles, which are the values of the company that underpin how it delivers its underlying purpose and encourages an integrated approach to working; and
- the assets available to the company, including ensuring that it has effective operational systems, and resourcing plans and schedules in the operational business, that enable a continued supply of water, the maintenance and insurance of these systems, and sufficient physical resources through our abstraction licences and water levels.

Contracting:

- the work of the Contracts Committee, attended by the CFO, which operates to review and award significant contracts with suppliers; and
- no guarantees or cross-default obligations given without Ofwat's written consent.

Material issues or circumstances:

- no material issues or other circumstances outside those listed that directors took into account when assessing the sufficiency of financial resources.

In giving this certificate the main factors which the directors have taken into account in relation to contracts entered into with any Associated Company are:

- an examination of the contracts with Associated Companies;
- considerations made by the company's Market Oversight Committee; and
- leaving aside the company's contract to supply wholesale water to and the service agreement with Affinity for Business (Retail) Limited, the limited contractual arrangements with associated companies.

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 2020 (refer to **page 261**), which is subject to external assurance under Regulatory Accounting Guideline 5.07; Guideline for transfer pricing in the water and sewerage sectors (refer to our Data Assurance Report, which is published on our website: **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.

The Board obtained third-party assurance from the company's external Auditor in relation to the sufficiency of financial resources. A full report of the external Auditor's work on the ring-fencing certificate has been provided to Ofwat with no issues noted.

On behalf of the Board:

Tony Cocker
Company Chair
24 June 2020

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 2020 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 arm's 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 we have a full understanding of, and are meeting, our 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 2019/20, as presented in section 3 of this regulatory Annual Performance Report on **pages 240 to 247**.

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 2020, which include a summary of the company's operational performance for 2019/20 on **pages 36 to 38** and set out how the company manages risk and uncertainty from **page 39**.

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 and Strategy is responsible for monitoring regulatory compliance and is supported in discharging this responsibility by employees in the Regulation, Assurance, 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. The Reporter has highlighted that the company has full understanding of and has sufficient processes and internal systems of controls to meet its reporting obligations. The Reporter also highlighted that the vast majority of reporting processes continue to demonstrate either consistent good practice or improvements from previous years, and where areas of inadequacy in reporting procedures were noted in previous years, these have now been addressed, and clear written procedures are in place for all the AMP6 Performance Commitments.

The Reporter's report is available on the company's website: **affinitywater.co.uk/reports-publications**.

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 relevant statutory, licence 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, mitigate and review our risks.

On behalf of the Board:

Pauline Walsh
CEO

Patrick O'D Bourke
Independent non-executive director

Independent Auditors' report to the Water Services Regulation Authority (the WSRA) and the Directors of Affinity Water Limited

Report on the Regulatory Accounting Statements contained within the Regulatory Annual Performance Report

Opinion on Regulatory Annual Performance Report

In our opinion, Affinity Water Limited's Regulatory Accounting Statements within the Regulatory Annual Performance Report have been prepared, in all material respects, in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA (RAG1.08, RAG2.07, RAG3.11, RAG4.08 and RAG5.07) and the accounting policies (including the company's published accounting methodology statement, as defined in RAG 3.11, appendix 2) set out on **pages 223 to 226**.

The tables within Affinity Water Limited's Regulatory 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 non-household wastewater revenues by customer type (table 2H), the revenue analysis and wholesale control reconciliation (table 2I), the infrastructure network reinforcement costs (table 2J), the infrastructure charges 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 Regulatory 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 Regulatory Annual Performance Report section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

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

Regulatory Annual Performance Report continued

Independent Auditors' report to the Water Services Regulation Authority (the WSRA) and the Directors of Affinity Water Limited (continued)

Emphasis of matter – special purpose basis of preparation

In forming our opinion on the Regulatory Accounting Statements, which is not modified, we draw attention to the fact that the Regulatory Accounting Statements have been prepared in accordance with a special purpose framework, Condition F, the Regulatory Accounting Guidelines, the accounting policies (including the company's published accounting methodology statement(s), 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. In addition, we are not required to assess whether the methods of cost allocation set out in the accounting methodology statement are appropriate to the circumstances of the company or whether they meet the requirements of the WSRA.

The Regulatory Accounting Statements are separate from the statutory financial statements of the company and have 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 213 to 260** 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 Regulatory Annual Performance Report and the audit and use of this report sections below. As a result, the Regulatory Accounting Statements may not be suitable for another purpose.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which 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.

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.

Reporting on other information

The other information comprises all of the information in the Regulatory Annual Performance Report other than the Regulatory Accounting Statements 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, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon. In connection with our audit of the Regulatory Accounting Statements, 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 or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

Report on the Regulatory Accounting Statements contained within the Regulatory Annual Performance Report (continued)

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 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.

Responsibilities of the Directors for the Regulatory Annual Performance Report

As explained more fully in the Statement of Directors' Responsibilities set out on **page 207**, the directors are responsible for the preparation of the Regulatory 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 Regulatory Annual Performance Report that is free from material misstatement, whether due to fraud or error.

In preparing the Regulatory 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 Regulatory Accounting Statements within the Regulatory Annual Performance Report

Our objectives are to obtain reasonable assurance about whether the Regulatory Accounting Statements 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 Regulatory Accounting Statements.

A further description of our responsibilities for the audit of the Regulatory Accounting Statements within the Regulatory Annual Performance Report is located on the FRC's website at: **frc.org.uk/auditorsresponsibilities**. This description forms part of our auditors' report.

Use of this report

This report, including the opinions, 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. In giving these opinions, 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.

Regulatory Annual Performance Report continued

Independent Auditors' report to the Water Services Regulation Authority (the WSRA) and the Directors of Affinity Water Limited (continued)

Use of this report (continued)

Our opinion on the Regulatory Accounting Statements is separate from our opinion on the statutory financial statements of the company for the year ended 31 March 2020 on which we reported on 24 June 2020, 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 it 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 Regulatory Annual Performance Report.

PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Watford

24 June 2020

Section 1 – Regulatory financial reporting

1A - INCOME STATEMENT FOR THE 12 MONTHS ENDED 31 MARCH 2020

		Adjustments			
	Statutory £000	Differences between statutory and RAG definitions £000	Less: non-appointed £000	Total adjustments £000	Total appointed activities £000
Revenue	**307,240**	**(9,289)**	**-**	**(9,289)**	**297,951**
Operating costs	(280,129)	(3,737)	(4,216)	479	(279,650)
Other operating income	18,449	(1,875)	13,128	(15,003)	3,446
Operating profit	**45,560**	**(14,901)**	**8,912**	**(23,813)**	**21,747**
Other income	-	14,901	-	14,901	14,901
Interest income	5,904	-	-	-	5,904
Interest expense	(52,044)	-	-	-	(52,044)
Other interest expense	2,487	-	-	-	2,487
Profit before tax and fair value movements	**1,907**	**-**	**8,912**	**(8,912)**	**(7,005)**
Fair value gains/(losses) on financial instruments	(1,816)	-	-	-	(1,816)
Profit before tax	**91**	**-**	**8,912**	**(8,912)**	**(8,821)**
UK Corporation tax	(2,096)	-	(1,693)	1,693	403
Deferred tax	(19,677)	-	-	-	(19,677)
Profit for the year	**(21,682)**	**-**	**7,219**	**(7,219)**	**(28,901)**
Dividends	**-**	**-**	**-**	**-**	**-**
Tax analysis					
Current year	3,553	-	1,693	(1,693)	1,860
Adjustments in respect of prior years	(1,457)	-	-	-	(1,457)
UK Corporation tax	**2,096**	**-**	**1,693**	**(1,693)**	**403**

Regulatory Annual Performance Report continued

Section 1 – Regulatory financial reporting (continued)

1A - INCOME STATEMENT FOR THE 12 MONTHS ENDED 31 MARCH 2020 (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	Gain on disposal of fixed assets £000	Meter reading commission £000	Rental and sundry income £000	Total £000
Revenue	3,773	115	(949)	(9,127)	(3,101)	-	-	-	(9,289)
Operating costs	(3,773)	-	-	-	-	(187)	223	-	(3,737)
Other operating income	-	(115)	-	-	-	187	-	(1,947)	(1,875)
Other income	-	-	949	9,127	3,101	-	(223)	1,947	14,901
Total	-	-	-	-	-	-	-	-	-

£3,773,000 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 223**). A further £115,000 relates to the reclassification of third party non-price control revenue, which is presented within other operating income in the Statutory Accounts. These differences are offset by the reclassification of £9,127,000 of connection charges income, £949,000 of income from the administration of new connections including reviewing applications and providing quotations, and £3,101,000 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 £3,773,000 and the reclassification of a £187,000 net gain on disposal of fixed assets, which is presented within other operating income in the Regulatory Accounts. In addition, £223,000 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 gain on disposal of fixed assets from operating costs described in the previous paragraph of £187,000 and the reclassification of £1,947,000 of rental and sundry income, which is presented within other income in the Regulatory Accounts and by £115,000 of third party non-price control revenue described in previous paragraphs. £223,000 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 £9,127,000 of connection charges income, £949,000 of income from the administration of new connections including reviewing applications and providing quotations, £3,101,000 of amortisation associated with deferred grants and contributions and £1,947,000 of rental and sundry income.

The non-appointed business activities include services performed on behalf of the sewerage companies in our supply area, including meter reading, billing, cash collection and infrastructure commission. We also have support services and receive unregulated income for value added services.

Impact of IFRS 16

IFRS 16 became applicable for the current reporting period and the statutory numbers in the table above have been reported under the new standard. The impact of the new standard is shown below:

£'000	Total appointed activities under IFRS 16	Adjust for impact of adopting IFRS 16	Comparison under previous accounting treatment
Operating costs	279,650	261	279,911
Interest expense	52,030	(384)	51,646
Loss before tax	8,821	(123)	8,698

Operating lease costs have been replaced by additional depreciation and interest charges under IFRS 16. Operating lease costs and depreciation costs were previously included in operating costs in the APR. The impact of the change in accounting standard is therefore a reclassification of the new interest charge arising from operating costs to interest expense and timing differences on the depreciation of right-of-use assets.

1B - STATEMENT OF COMPREHENSIVE INCOME FOR THE 12 MONTHS ENDED 31 MARCH 2020

		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	**(21,682)**	-	**7,219**	**(7,219)**	**(28,901)**
Actuarial gains/(losses) on post employment plans	38	-	-	-	38
Other comprehensive income	(7)	-	-	-	(7)
Total comprehensive income for the year	**(21,651)**	-	**7,219**	**(7,219)**	**(28,870)**

Regulatory Annual Performance Report continued

Section 1 – Regulatory financial reporting (continued)

1C - STATEMENT OF FINANCIAL POSITION AS AT 31 MARCH 2020

		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	1,491,475	-	-	-	1,491,475
Intangible assets	45,768	-	-	-	45,768
Investments – loans to group companies	-	-	-	-	-
Investments – other	25,302	(25,202)	-	(25,202)	100
Financial instruments	-	-	-	-	-
Retirement benefit assets	104,619	-	-	-	104,619
Total	**1,667,164**	**(25,202)**	**-**	**(25,202)**	**1,641,962**
Current assets					
Inventories	3,017	-	-	-	3,017
Trade and other receivables	84,399	-	320	(320)	84,079
Financial instruments	-	-	-	-	-
Cash and cash equivalents	85,587	25,202	8,565	16,637	102,224
Total	**173,003**	**25,202**	**8,885**	**16,317**	**189,320**
Current liabilities					
Trade and other payables	(182,594)	55,205	613	54,592	(128,002)
Capex creditor	(14,498)	-	-	-	(14,498)
Borrowings	(3,491)	-	-	-	(3,491)
Financial instruments	-	-	-	-	-
Current tax liabilities	(4,062)	-	(2,279)	2,279	(1,783)
Provisions	(2,845)	2,238	-	2,238	(607)
Total	**(207,490)**	**57,443**	**(1,666)**	**59,109**	**(148,381)**
Net current assets/(liabilities)	**(34,487)**	**82,645**	**7,219**	**75,426**	**40,939**
Non-current liabilities					
Trade and other payables	-	-	-	-	-
Borrowings	(1,099,709)	(4,944)	-	(4,944)	(1,104,653)
Financial instruments	(9,149)	4,944	-	4,944	(4,205)
Retirement benefit obligations	-	-	-	-	-
Provisions	(5,507)	-	-	-	(5,507)
Deferred income – grants and contributions ('G&C's')	(132,694)	(57,443)	-	(57,443)	(190,137)
Deferred income – adopted assets	-	-	-	-	-
Preference share capital	-	-	-	-	-
Deferred tax	(198,644)	-	-	-	(198,644)
Total	**1,445,703**	**(57,443)**	**-**	**(57,443)**	**(1,503,146)**
Net assets	**186,974**	**-**	**7,219**	**(7,219)**	**179,755**
Equity					
Called up share capital	26,506	-	-	-	26,506
Retained earnings and other reserves	160,468	-	7,219	(7,219)	153,249
Total equity	**186,974**	**-**	**7,219**	**(7,219)**	**179,755**

The £25,202,000 difference between statutory and RAG defined investments – other and cash and cash equivalents consists of a reclassification of short-term deposits, treated as investments in the statutory accounts and cash and cash equivalents under RAG terminology.

The £55,205,000 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 2020, £23,149,000 had been commissioned and £23,149,000 of associated payments received have been recognised in deferred income with the remaining £55,205,000 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 would lead to a mismatch of costs incurred and payments received in relation to these costs in the totex tables in sections 2 and 4 of these Regulatory Accounts (tables 2B, 4B, 4D and 4J). 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 £48,629,000 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 £2,238,000 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 £4,944,000 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 £57,443,000 difference between statutory and RAG defined deferred income – G&C's relates to the reclassifications detailed in the previous paragraphs.

Impact of IFRS 16

IFRS 16 became applicable for the current reporting period and the statutory numbers in the table above are reported under the new standard. The impact of the new standard is shown below:

£'000	Total appointed activities under IFRS 16	Adjust for impact of adopting IFRS 16	Comparison under previous accounting treatment
Non current assets – Fixed assets	1,491,475	(12,436)	1,479,039
Current liabilities – Borrowings	(3,491)	3,491	-
Non-current liabilities – Borrowings	(1,104,653)	9,068	(1,095,585)
Equity – Retained earnings and other reserves	153,249	(123)	153,372

Operating leases previously recognised as operating costs are now recognised on balance sheet as right-of-use assets (included in fixed assets in the table above) and a corresponding lease liability (included in borrowings above).

These assets are then depreciated, as detailed under table 1A, and interest is incurred on the liability.

Regulatory Annual Performance Report continued

Section 1 – Regulatory financial reporting (continued)

1D - STATEMENT OF CASH FLOWS FOR THE 12 MONTHS ENDED 31 MARCH 2020

		Adjustments			
	Statutory £000	Differences between statutory and RAG definitions £000	Less: non–appointed £000	Total adjustments £000	Total appointed activities £000
Operating profit	**45,560**	**(14,901)**	**8,912**	**(23,813)**	**21,747**
Other income	-	14,901	-	14,901	14,901
Depreciation	76,440	-	-	-	76,440
Amortisation – G&C's	(3,101)	-	-	-	(3,101)
Changes in working capital	(6,572)	-	(3,286)	3,286	(3,286)
Pension contributions	(5,808)	-	-	-	(5,808)
Movement in provisions	3,953	-	-	-	3,953
Profit on sale of fixed assets	(356)	-	-	-	(356)
Cash generated from operations	**110,116**	**-**	**5,626**	**(5,626)**	**104,490**
Net interest paid	(35,336)	-	-	-	(35,336)
Tax paid	(2,238)	-	(1,706)	1,706	(533)
Net cash generated from operating activities	**72,542**	**-**	**3,921**	**(3,921)**	**68,622**
Investing activities					
Capital expenditure	(129,855)	-	-	-	(129,855)
Grants and contributions	57,690	-	-	-	57,690
Disposal of fixed assets	1,630	-	-	-	1,630
Other	(9,191)	10,153	-	10,153	962
Net cash used in investing activities	**(79,726)**	10,153	-	10,153	**(69,573)**
Net cash generated before financing activities	**(7,184)**	10,153	**3,921**	**6,233**	**(952)**
Cashflows from financing activities					
Equity dividends paid	-	-	-	-	-
Net loans received	(3,711)	-	-	-	(3,711)
Cash inflow from equity financing	-	-	-	-	-
Net cash generated from financing activities	**(3,711)**	-	-	-	**(3,711)**
Increase/(decrease) in net cash	**(10,895)**	10,153	**3,921**	**6,233**	**(4,663)**

The cash flow has been prepared in accordance with the RAG templates and resultantly net cash generated from operating activities in the table above does not align to the statutory cash flow. £57,690,000 of capital contributions are treated as operating cash flows in the statutory cash flow and are shown within investing activities in table 1D.

The difference between statutory and RAG defined operating profit consists of the reclassification of £9,127,000 of connection charges income, £949,000 of income from the administration of new connections including reviewing applications and providing quotations, £3,101,000 of amortisation associated with deferred grants and contributions and £1,947,000 of rental and sundry income all of which are shown in other income, offset by the reclassification of £115,000 of third party non-price control revenue, which is presented within other income in the Statutory Accounts. The £10,153,000 difference between statutory and RAG defined other investing activities is the movement in short-term deposits treated as investments in the statutory accounts and cash and cash equivalents under RAG terminology.

Total cash outflow for leases for the year ended 31 March 2020 was £4,094,000, of which £3,711,000 was principal elements of lease payments and £383,000 was interest payments. Under previous accounting standards, the total £4,094,000 would have been included in cash generated from operations. Under IFRS 16, £3,711,000 is shown as cashflows from financing activities - net loans received and £383,000 is included in net interest paid.

1E - NET DEBT ANALYSIS AT 31 MARCH 2020

	Fixed rate £000	Floating rate £000	Index linked £000	Total £000
Borrowings (excluding preference shares)	502,788	-	575,659	**1,078,447**
Preference share capital	-	-	-	-
Total borrowings				**1,078,447**
Cash	-	-	-	**(77,022)**
Short term deposits	-	-	-	**(25,202)**
Net debt				**976,223**
Gearing				79.20%
Adjusted gearing				78.93%
Full year equivalent nominal interest cost	21,962	-	25,204	**47,166**
Full year equivalent cash interest payment	21,962	-	10,775	**32,736**
Indicative interest rates:				
Indicative weighted average nominal interest rate (%)	4.37	-	4.38	**4.37**
Indicative weighted average cash interest rate (%)	4.37	-	1.87	**3.04**
Weighted average years to maturity	14.21	-	17.36	**15.89**

In previous regulatory APRs no differences have been reported between total borrowings presented in the above table and total borrowings presented in table 1C. To align with the methodology used to calculate gearing as part of the PR19 process, capitalised debt issue costs and bond premiums/discounts, and amortisation thereon have been excluded from total borrowings presented in the above table. Lease liabilities included in borrowings in table 1C on adoption of IFRS 16 have also been excluded from the table above to ensure consistency with prior periods. A reconciliation is provided below:

	Total £000
Total borrowings (excluding preference shares) presented in table 1C	**1,108,144**
Less: capitalised bond issue costs	**5,350**
Less: capitalised bond net premium	**(22,488)**
Less: Lease liabilities on adoption of IFRS 16	**(12,559)**
Net debt presented above	**1,078,447**

Regulatory Annual Performance Report continued

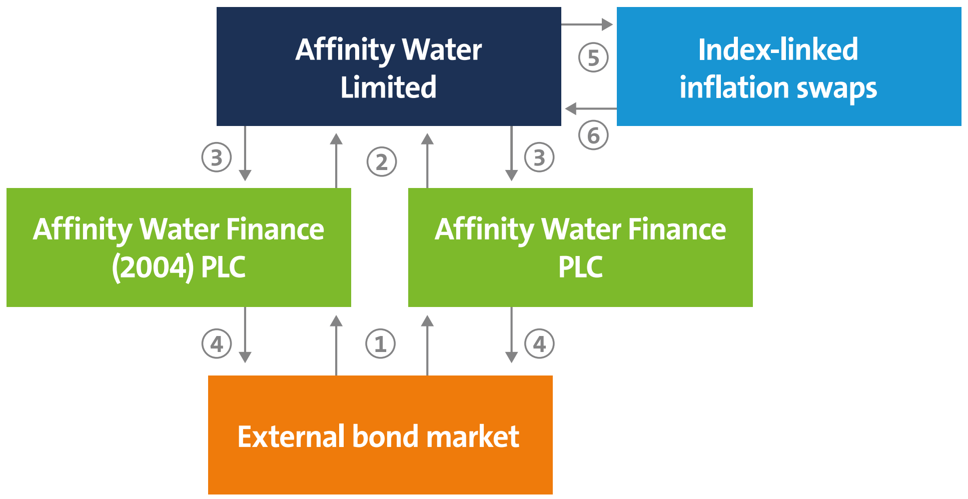
Section 1 – Regulatory financial reporting (continued)

1E - NET DEBT ANALYSIS AT 31 MARCH 2020 (CONTINUED)

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)	502,788	-	575,659	**1,078,447**
Preference share capital	-	-	-	-
Less: loan from intermediate parent company	-	-	-	**(3,550)**
				1,047,897
Add: accrued interest on borrowings	-	-	-	**8,799**
Total borrowings				**1,083,696**
Cash	-	-	-	**(110,789)**
Short term deposits (including non-appointed cash)	-	-	-	-
Net debt	-	-	-	**972,907**

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 103 and 104** 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 two 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 index-linked inflation swap.
6. Affinity Water Limited pays index linked interest payments annually for the index-linked inflation swap and will make a final accretion payment based on the mark to market valuation at maturity.

1F – FINANCIAL FLOWS FOR THE 12 MONTHS ENDED 31 MARCH 2020 (2012-13 FINANCIAL YEAR AVERAGE RPI)

	%			£		
12 months ended 31 March 2020	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	5.95	3.42	5.95	23,227	13,368	13,368
Actual performance adjustment 2010-2015	(0.35)	(0.20)	(0.35)	(1,352)	(778)	(778)
Adjusted return on regulatory equity	5.60	3.22	5.60	21,874	12,590	12,590
Regulatory equity	390,588	390,588	224,801	-	-	-
Financing						
Gearing	-	2.17	2.17	-	4,872	4,872
Variance in corporation tax	-	0.39	0.68	-	1,535	1,535
Group relief	-	-	-	-	-	-
Cost of debt	-	(0.32)	(0.56)	-	(1,254)	(1,254)
Hedging instruments	-	1.03	1.78	-	4,009	4,009
Financing total	**5.60**	**6.49**	**9.68**	**21,874**	**21,752**	**21,752**
Operational Performance						
Totex out / (under) performance	-	(2.31)	(4.02)	-	(9,036)	(9,036)
ODI out / (under) performance	-	(0.44)	(0.77)	-	(1,737)	(1,737)
Retail out / (under) performance	-	(1.19)	(2.07)	-	(4,644)	(4,644)
Other exceptional items	-	-	-	-	-	-
Operational performance total	**-**	**(3.95)**	**(6.86)**	**-**	**(15,418)**	**(15,418)**
Total earnings	5.60	2.54	2.82	21,874	6,334	6,334
RCV growth from RPI	2.59	2.59	2.59	10,111	10,111	5,819
Total shareholder return	8.19	5.13	5.41	31,986	16,445	12,154
Net dividend	4.00	-	-	15,624	-	-
Retained value	4.19	5.13	5.41	16,362	16,445	12,154
Dividends reconciliation						
Gross dividend	4.00	-	-	15,624	-	-
Interest received on intercompany loans	-	-	-	-	-	-
Net dividend	4.00	-	-	15,624	-	-

The regulatory return on equity of 5.95% as determined in PR14 decreases to 5.60% after adjusting for AMP5 performance adjustments. It increases to 7.77% after adjusting for the company's actual capital structure (2.17%, 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 79.20% creates an adjustment of +2.17%. This is offset by an adverse adjustment before hedging instruments of -0.56% 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 average RPI during the year (2.59%). Our hedging instruments have increased the favourable adjustment by +1.78%. 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 264**) increases the favourable adjustment by +0.68%.

The 9.68% regulatory return on equity adjusted for financing is reduced to 2.82% when considering the impact of operational performance. Totex underperformance in the year results in a -4.02% reduction (refer to table 4B), ODI underperformance in the year (refer to table 3A) results in a -0.77% reduction and the performance of the retail business unit (refer to table 2C) creates a -2.07% adverse adjustment. After factoring in RCV growth due to indexation, the total shareholder return for the year is 5.41%.

No dividend was paid out by the regulated business, which equates to a 0.00% return on equity which compares to the 5.41% covered above.

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)

	%			£		
Average 2015-2020	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	6.06	3.48	6.06	23,531	13,539	13,539
Actual performance adjustment 2010-2015	(0.24)	(0.14)	(0.24)	(915)	(527)	(527)
Adjusted return on regulatory equity	5.82	3.35	5.82	22,615	13,013	13,013
Regulatory equity	388,569	388,569	223,580	-	-	-
Financing						
Gearing	-	2.11	2.11	-	4,711	4,711
Variance in corporation tax	-	(0.38)	(0.66)	-	(1,484)	(1,484)
Group relief	-	-	-	-	-	-
Cost of debt	-	(0.44)	(0.77)	-	(1,722)	(1,722)
Hedging instruments	-	0.33	0.57	-	1,281	1,281
Financing total	**5.82**	**4.96**	**7.07**	**22,615**	**15,798**	**15,798**
Operational Performance						
Totex out / (under) performance	-	(0.98)	(1.71)	-	(3,821)	(3,821)
ODI out / (under) performance	-	(1.20)	(2.09)	-	(4,669)	(4,669)
Retail out / (under) performance	-	(1.09)	(1.89)	-	(4,232)	(4,232)
Other exceptional items	-	1.24	2.15	-	4,806	4,806
Operational performance total	**-**	**(2.04)**	**(3.54)**	**-**	**(7,916)**	**(7,916)**
Total earnings	5.82	2.92	3.53	22,615	7,883	7,883
RCV growth from RPI	2.52	2.52	2.52	9,787	9,787	5,631
Total shareholder return	8.34	5.44	6.04	32,402	17,670	13,514
Net dividend	4.00	6.04	10.50	15,543	23,485	23,485
Retained value	4.34	(0.60)	(4.46)	16,860	(5,816)	(9,971)
Dividends reconciliation						
Gross dividend	4.00	6.04	10.50	15,543	23,485	23,485
Interest receivable on intercompany loans	-	-	-	-	-	-
Net dividend	4.00	6.04	10.50	15,543	23,485	23,485

Figures for prior years of AMP6 used in the calculation of the above table have been restated from those used in the calculation of the republished 2018/19 table 1F included in the company's Regulatory Annual Performance Adjustments publication, which can be found on the company's website: **affinitywater.co.uk/reports-publications**, to reflect the ODI penalty of £9.961m (in 2012/13 prices) incurred for SIM performance over the first four years of the AMP (refer to table 3A). Prior year figures have also been updated for the methodology change to our gearing calculation described in the narrative under table 1E. These restatements have reduced retained values for prior years of the AMP.

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 AMP is -3.81%.

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

There are no new standards and interpretations, which are not yet effective and have not been early adopted by the company, that will have a material effect on future years.

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 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.

Where non-household retailers are billed in advance monthly for wholesale charges, as 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)

Revenue recognition (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 2019 included a measured income accrual of £32,618,000. The value of billing recognised in the year ended 31 March 2020 for consumption in the prior year was £33,230,000. This resulted in an increase of £592,000 in the current year's revenue due to the under-estimation of the prior year's revenue. This represented 0.2% of 2019/20 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.

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 relating to the purchase of property, plant and equipment, right-of-use assets or intangible assets 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 loss allowance based on experience. The loss allowance is charged to operating costs to reflect the company's assessment of the risk of non-recovery of trade receivables.

The loss allowance 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 loss allowance 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.

A large proportion of household write-offs have been delayed in 2019/20 pending potential sale of receivables in 2020/21. Our loss allowance has increased to reflect this and our charge for the year remains unaffected by this delay. An additional provision was included in the year as a result of the current COVID-19 pandemic. There has been a resultant increase in the provision from £28,103,000 at 31 March 2019 to £34,854,000 at 31 March 2020 as a result of the above reasons.

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. A large proportion of household write-offs has been delayed in 2019/20 pending the potential sale of receivables in 2020/21.

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.

Regulatory Annual Performance Report continued

Section 1 – Regulatory financial reporting (continued)

STATEMENT OF ACCOUNTING POLICIES (CONTINUED)

Bad debt (continued)

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 decreased from £6,095,000 in 2018/19 to £2,719,000 in 2019/20 primarily due to a large proportion of household write-offs being delayed in 2019/20 pending potential sale of receivables in 2020/21.

There has not been a significant decrease in trade receivables during the year (£26,906,000 at 31 March 2020; £28,010,000 at 31 March 2019).

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 2019/20 remuneration arrangements for executive directors were established by the company's Remuneration Committee in 2019/20.

No changes have been made to the remuneration policy for executive directors since the publication of the annual report and financial statements for the year ended 31 March 2019; however targets and their weighting for the AMP7 annual bonus plan and LTIP for executive directors and senior management have been finalised by reference to the company's final determination for AMP7. The details are presented in the following table, which sets out all elements of executive director remuneration.

Given the tough challenges the company faces in AMP7, the executive directors and other senior managers committed to not taking the 2019/20 AMP7 readiness bonus reported in the 2018/19 remuneration report. This commitment was made in the context of our shareholders' commitment to re-invest all planned returns from the company's appointed business for the benefit of customers for the time being and the need to work in partnership with the company's trade unions to transform the business so that the company can deliver for the company's customers and other stakeholders in AMP7. Executive directors have also not received a salary increase for the year 2020/21.

Purpose and link to strategy	Policy and approach	Maximum potential value (as percentage of base pay)	Performance metrics	Changes for 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 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 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 AMP7 up to the date of approval of this annual report and financial statements.

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 AMP7
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. Where discretion is applied to executives relating to the performance of measures, the same level of discretion must be applied to all employees and managers.	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, specifically 8% for leakage, 8% for water quality and 9% for SIM performance. 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.	As reported in our 2018/19 remuneration report, in AMP7 there will be a rebalance of the bonus with 40% relating to financial performance, which is based on net cash outflow before taxation and financing, and 40% performance on customer service and stakeholder commitments including C-Mex (5.7%), leakage (5.7%), consumption (5.7%), water quality (5.7%), water pressure (5.7%), interruptions to supply (5.7%) and safety (5.7%). The personal element of the bonus, which will be based on performance in relation to personal objectives and company values, 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. Reduction in the discretion of the Committee to award any bonus outside performance delivery targets.
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 plan. 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%.	20% of executive salary	N/A	An exercise will take place in 2020/21 to review pension arrangements of the executives with the objective to align all contributions to the general employee population by the end of the financial year. This is to ensure compliance with the Code from this date.

Purpose and link to strategy	Policy and approach	Maximum potential value (as percentage of base pay)	Performance metrics	Changes for 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. There is a payout scale with 37.5% of the award paid out for the achievement of threshold performance, 100% of the award paid out for the achievement of target performance and 150% of the award paid out for outperformance. 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. For 2019/20 performance, 50% of the scheme pay-out is based on the financial target, cash available for distribution[1], and 50% is based on strategic outcomes, including service and performance commitments, specifically 20% on shadow RCV[2], 15% on the achievement of AMP6 performance commitments and ODIs[3], 7.5% on SIM performance and 7.5% on employee engagement survey score.	Changes for AMP7, as reported in our 2018/19 remuneration report, are detailed below: 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 (6.25%) and D-MeX (6.25%) position, water quality (6.25%), helping vulnerable customers (6.25%), leakage (6.25%), consumption (6.25%), mains bursts (6.25%) and environmental innovation (6.25%); and 10% based on employee commitments , including culture surveys (5%) and safety (5%). No award will be made for a metric if performance is below target/plan.

[1] The aggregate of operating profit and proceeds from any asset disposals received less any expenses, capital expenditure, taxes or other costs paid; less any interest, fees or other costs paid in respect of financial debt, any repayments, prepayments or accretion of financial debt or any termination costs or upfront fees payable in relation to any derivative contracts.
[2] As reported in table 4C of our regulatory Annual Performance Report
[3] As reported in table 3A of our regulatory Annual Performance Report

Regulatory Annual Performance Report continued

Section 1 – Regulatory financial reporting (continued)

STATEMENT OF DIRECTORS' REMUNERATION AND STANDARDS OF PERFORMANCE (CONTINUED)

Tony Cocker was appointed as Chair 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 £000		Taxable benefits[1] £000		Annual Bonus £000		LTIP £000		Pension related benefits[2] £000		Other[3] £000		Total £000	
	19/20	18/19	19/20	18/19	19/20	18/19	19/20	18/19	19/20	18/19	19/20	18/19	19/20	18/19
Non-executive														
Current														
Patrick O'D Bourke	49	48	-	-	-	-	-	-	-	-	-	-	49	48
Trevor Didcock	49	43	-	-	-	-	-	-	-	-	-	-	49	43
Susan Hooper	49	48	-	-	-	-	-	-	-	-	-	-	49	48
Mark Horsley	13	-	-	-	-	-	-	-	-	-	-	-	13	-
Chris Newsome	49	8	-	-	-	-	-	-	-	-	-	-	49	8
Former														
Simon Cocks	-	15	-	-	-	-	-	-	-	-	-	-	-	15
Chris Bolt	19	45	-	-	-	-	-	-	-	-	-	-	19	45
Company Chair														
Current														
Tony Cocker	195	195	-	-	-	-	-	-	-	-	-	-	195	195
Executive														
Current														
Stuart Ledger	209	203	6	6	140	48	-	-	32	41	-	-	387	298
Pauline Walsh	361	326	16	10	331	108	-	-	72	53	95	169	876	666
Former														
Simon Cocks	-	50	-	2	-	-	-	-	-	11	-	132	-	195
	993	981	22	18	471	156	-	-	104	105	95	301	1,686	1,561

[1] Taxable benefits comprise company car allowance, living accommodation benefit, relocation costs and healthcare insurance.
[2] Pension related benefits for Stuart Ledger and Pauline Walsh comprise £32,000 and £72,000 respectively of contributions paid to money purchase schemes (2018/19: £41,000 and £53,000); there were no amounts outstanding at year end. Pension related benefits for former executive Simon Cocks in include an allowance of £11,000 in the prior year in lieu of being a member of the company's retirement benefit schemes.
[3] Other remuneration in 2019/20 and 2018/19 for Pauline Walsh related 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 related 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.

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 2019/20 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 22)	2019/20 target	2019/20 actual	Weighting for 2019/20 (as a % of base salary) Pauline Walsh	Weighting for 2019/20 (as a % of base salary) Stuart Ledger	2019/20 achievement (as a % of base salary) Pauline Walsh	2019/20 achievement (as a % of base salary) Stuart Ledger
Financial measure	Cash generated by operations: net cash outflow before taxation and financing[1]	Value creation imperative	£43.3m	£45.0m	50.00%	37.50%	50.00%	37.50%
Operational measures	Leakage: volume of water lost through leaks on the network (Ml/d)	Customer outcome	162.2 or less	162.1	7.69%	5.77%	7.69%	5.77%
	Water quality: number of water quality compliance failures	Customer outcome	44 or less	50	7.69%	5.77%	0.00%	0.00%
Customer and community measures	SIM[2] : score	Customer outcome	82.3	82.4	9.62%	7.21%	9.62%	7.21%
Safety and health measure	Accident frequency rate (annual target): number of lost time injuries per 100,000 hours worked	Responsibility and accountability imperative	0.24	0.20	5.00%	3.75%	5.00%	3.75%
Personal performance[3]					20.00%	15.00%	18.40%	12.75%
Total % of base salary					**100.00%**	**75.00%**	**90.71%**	**66.98%**
Base salary							**£365,000**	**£210,000**
Bonus paid							**£331,000**	**£140,000**

The remuneration policy operated as intended during the year. Executive director bonuses are only being paid where operational targets were met and base salaries were set at a level that attracted and retained key employees, reflecting their experience and position in the company. Executive directors and other senior managers committed to not taking the AMP7 readiness bonus previously reported – see **page 116** for more details. The Remuneration Committee believes this was appropriate.

[1] This "non-GAAP" measure is calculated as the total of the following line items per the statement of cash flows (refer to **page 148**): cash generated from operations; purchases of property, plant and equipment; proceeds on disposal of property, plant and equipment; purchase of intangible assets; and principal elements of lease payments. The bonus measure excludes the impact of one-off corporate legal consultancy fees and payments bought forward into 2019/20 from 2020/21 and is before statutory adjustments
[2] SIM was previously the industry's measure of customer experience. One element was quantitative (the volume of unwanted contact and complaints we receive) and the other was qualitative (the quality of the experience derived from an independent quarterly survey). SIM was not formally measured by Ofwat in 2019/20 and has been replaced by a C-Mex score. The internal proxy SIM score above has been calculated using the C-Mex score adjusted for our performance on customer complaints and contacts. This internal proxy SIM score is different to that published in table 3D of our Annual Performance Report as table 3D has been calculated using Ofwat's revised methodology to include customer complaints via social media.
[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.

Regulatory Annual Performance Report continued

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 website:

affinitywater.co.uk/reports-publications

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. Changes to the methodology are also 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 2020

	Retail		Wholesale			
	Household £000	Non-household £000	Water resources £000	Water network+ £000	Water Total £000	Total £000
Revenue – price control	27,167	-	-	268,344	268,344	295,511
Revenue – non price control	-	-	-	2,440	2,440	2,440
Operating expenditure	(29,865)	-	(15,396)	(157,949)	(173,345)	(203,210)
Depreciation – tangible fixed assets	(12)	-	(319)	(66,919)	(67,238)	(67,250)
Amortisation – intangible fixed assets	(947)	-	-	(8,243)	(8,243)	(9,190)
Other operating income	1,835	-	62	1,549	1,611	3,446
Operating profit before recharges	**(1,822)**	**-**	**(15,653)**	**39,222**	**23,569**	**21,747**
Recharges in respect of 'principal use' assets						
Recharges from other segments	(899)	-	(202)	-	(202)	(1,101)
Recharges to other segments	-	-	-	1,101	1,101	1,101
Operating profit	**(2,721)**	**-**	**(15,855)**	**40,323**	**24,468**	**21,747**

2B - TOTEX ANALYSIS FOR THE 12 MONTHS ENDED 31 MARCH 2020 – WHOLESALE WATER

	Water resources £000	Water network+ £000	Total £000
Operating expenditure			
Power	3,036	19,356	22,392
Income treated as negative expenditure	-	-	-
Abstraction charges / discharge consents	3,632	-	3,632
Bulk supply / bulk discharge	840	7,108	7,948
Other operating expenditure			
Renewals expensed in the year (Infrastructure)	-	17,178	17,178
Renewals expensed in the year (Non-Infrastructure)	-	-	-
Other operating expenditure excluding renewals	6,020	98,810	104,830
Local authority and Cumulo rates	1,868	13,224	15,092
Total operating expenditure excluding third party services	**15,396**	**155,676**	**171,072**
Third party services	**-**	**2,273**	**2,273**
Total operating expenditure	**15,396**	**157,949**	**173,345**
Capital expenditure			
Maintaining the long-term capability of the assets - infra	-	9,622	9,622
Maintaining the long-term capability of the assets – non-infra	46,226	34,019	80,245
Other capital expenditure – infra	-	4,751	4,751
Other capital expenditure – non-infra	4,203	28,262	32,465
Infrastructure network reinforcement	-	4,991	4,991
Total gross capital expenditure (excluding third party)	**50,429**	**81,645**	**132,074**
Third party services	**-**	**331**	**331**
Total gross capital expenditure	**50,429**	**81,976**	**132,405**
Grants and contributions			
Less: Grants and contributions	39,522	24,964	64,486
Totex	**26,303**	**214,961**	**241,264**
Cash expenditure			
Pension deficit recovery payments	-	-	-
Other cash items	73	715	788
Totex including cash items	**26,376**	**215,676**	**242,052**

Regulatory Annual Performance Report continued

Section 2 – Price review and other segmental reporting (continued)

2C - OPERATING COST ANALYSIS FOR THE 12 MONTHS ENDED 31 MARCH 2020 – RETAIL

	Household £000	Non-household £000	Total £000
Operating expenditure			
Customer services	6,993	-	6,993
Debt management	2,109	-	2,109
Doubtful debts	9,450	-	9,450
Meter reading	1,416	-	1,416
Services to developers	-	-	-
Other operating expenditure	9,897	-	9,897
Total operating expenditure excluding third party services	**29,865**	**-**	**29,865**
Third party services operating expenditure	-	-	-
Total operating expenditure	**29,865**	**-**	**29,865**
Depreciation – tangible fixed assets	12	-	12
Amortisation – intangible fixed assets	947	-	947
Total operating costs	**30,824**	**-**	**30,824**
Debt written off	**2,719**	**-**	**2,719**

A large proportion of household write-offs has been delayed in 2019/20 pending the potential sale of receivables in 2020/21. Our loss allowance has increased as a result of this and our bad debt charge for the year remains unaffected by this delay.

Household operating costs and other operating income (£28,989,000; refer to table 2A) are £2,000 lower than revenue allowed in the PR14 determination (£28,991,000). As was the case in 2017-18 and 2018-19, we have incurred higher costs than allowed in our PR14 plan due to the assumption made in our plan that non-household costs would be on an allocation basis. When the non-household retail market opened in 2017 and the business units separated, actual costs relating to the non-household business were lower and higher costs remained in the household retail unit. As a result, only £2,000 profit was made on the retail unit in the year before depreciation and recharges.

Non-household operating costs and other operating income (refer to table 2A) are £3,415,000 less than revenue allowed in the PR14 determination. This is due to exiting the non-household retail market on 1 April 2017.

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 2019	40,901	2,086,312	4,647	-	2,131,860
Disposals	-	(2,888)	-	-	(2,888)
Additions	50,382	75,500	76	-	125,958
Adjustments	-	-	-	-	-
Assets adopted at nil cost	-	-	-	-	-
At 31 March 2020	**91,283**	**2,158,924**	**4,723**	**-**	**2,254,930**
Depreciation					
At 1 April 2019	(13,637)	(683,159)	(1,014)	-	(697,810)
Disposals	-	1,605	-	-	1,605
Adjustments	-	-	-	-	-
Charge for the year	(319)	(66,919)	(12)	-	(67,250)
At 31 March 2020	**(13,956)**	**(748,473)**	**(1,026)**	**-**	**(763,455)**
Net book amount at 31 March 2020	**77,327**	**1,410,451**	**3,697**	**-**	**1,491,475**
Net book amount at 1 April 2019	27,264	1,403,153	3,633	-	1,434,050
Depreciation charge for year					
Principal services	(319)	(65,775)	(12)	-	(66,106)
Third party services	-	(1,144)	-	-	(1,144)
Total	**(319)**	**(66,919)**	**(12)**	**-**	**(67,250)**

Net book amount includes £119,768,000 in respect of assets in the course of construction.

Capital expenditure in the year incurred was principally in our mains renewals, trunk main replacement, lead pipe replacement, water treatment (including pesticide treatment) and integrated water savings programmes.

Regulatory Annual Performance Report continued

Section 2 – Price review and other segmental reporting (continued)

2E - ANALYSIS OF CAPITAL CONTRIBUTIONS AND LAND SALES FOR THE 12 MONTHS ENDED 31 MARCH 2020 – 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	9,126	-	-	**9,126**
Infrastructure charge receipts	-	5,203	-	**5,203**
Requisitioned mains	-	545	-	**545**
Other contributions (price control)	-	-	-	-
Diversions	-	49,612	-	**49,612**
Other contributions (non-price control)	-	-	-	-
Total	9,126	55,360	-	**64,486**
Value of adopted assets	-	725	-	725

Movements in capitalised grants and contributions	
Brought forward	**137,878**
Capitalised in year	**55,360**
Amortisation (in income statement)	**(3,101)**
Carried forward	**190,137**

Land sales	
Proceeds from disposals of protected land	**1,458**

£48,629,000 of payments received in 2019/20 for costs incurred in relation to the HS2 rail programme are included in diversions in the above table.

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	97,902	10,424	108,326	562,959	18.52
Measured water only customer	120,426	16,743	137,169	824,726	20.30
Total	**218,328**	**27,167**	**245,495**	**1,387,685**	**19.58**

Total average household retail revenue per customer has remained consistent with the prior year. A number of customers have moved onto measured tariffs from unmeasured as part of our Water Savings Programme.

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	**29**	-	**29**	**3**	-
Default tariffs					
AFW Metered 0-5 Ml, including assessed customers and unmeasured RV customers	28,633	-	28,633	71,817	-
Water supplies 5 to 50 Ml	11,964	-	11,964	2,304	-
Water supplies 50 Ml and over	9,390	-	9,390	188	-
Total default tariffs	**49,987**	-	**49,987**	**74,309**	-
Total	**50,016**	**-**	**50,016**	**74,312**	**-**

	Number of customers	Average non–household retail revenue per customer £
Revenue per customer		
Total	**74,312**	**-**

Following the exit from the non-household market on 1 April 2017, the company no longer receives retail revenue from these customers.

Regulatory Annual Performance Report continued

Section 2 – Price review and other segmental reporting (continued)

2I - REVENUE ANALYSIS FOR THE 12 MONTHS ENDED 31 MARCH 2020

	Household £000	Non-household £000	Total £000
Wholesale charge – water			
Unmeasured	97,902	2,321	100,223
Measured	120,426	47,695	168,121
Third party revenue	-	-	-
Wholesale total	**218,328**	**50,016**	**268,344**
Retail revenue			
Unmeasured	10,424	-	10,424
Measured	16,743	-	16,743
Other third party revenue	-	-	-
Retail total	**27,167**	**-**	**27,167**
Third party revenue – non-price control			
Bulk supplies			2,280
Other third party revenue			160
Principal services – non-price control			
Other appointed revenue			-
Total appointed revenue			**297,951**

	Total £000
Wholesale revenue governed by price control	268,344
Grants & contributions[1]	14,874
Total revenue governed by wholesale price control	**283,218**
Amount assumed in wholesale determination	291,828
Adjustment for in-period ODI revenue	-
Adjustment for WRFIM[2]	(4,272)
Total assumed revenue	**287,556**
Difference	**4,338**

£2.2m of the variance between allowed and actual revenue under the wholesale price control relates to lower grants and contributions received than allowed in the determination. The remaining £2.1m variance primarily relates to lower non-household income following business closures in March and resultant reduced consumption due to the national health pandemic, and lower non-household revenue on the final settlement reports, offset by higher measured consumption from our household customers.

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 £4,272,000 WRFIM adjustment relating to prior years' accumulated revenue over recoveries.

2J – INFRASTRUCTURE NETWORK REINFORCEMENT COSTS FOR THE 12 MONTHS ENDED 31 MARCH 2020

Wholesale water network+ (treated water distribution)	Network reinforcement capex £000	On site/site specific capex (memo only) £000
Distribution and trunk mains	4,929	-
Pumping and storage facilities	62	-
Other	-	-
Total	**4,991**	**-**

2K – INFRASTRUCTURE CHARGES RECONCILIATION FOR THE 12 MONTHS ENDED 31 MARCH 2020

	Total £000
Impact of infrastructure charge discounts	
Infrastructure charges	5,203
Discounts applied to infrastructure charges	-
Gross infrastructure charges	**5,203**
Comparison of revenue and costs	
Variance brought forward	(76)
Revenue	5,203
Costs	(4,991)
Variance carried forward	**136**

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.

Regulatory Annual Performance Report continued

Section 3 – Performance summary

3A - OUTCOME PERFORMANCE TABLE

ID	Performance commitment	Unit (and decimal places)	2018-19 performance level - actual	2019-20 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 actual – total AMP6 out/ under-performance payment (indicator)	31 March 2020 actual – total AMP6 out/ under-performance payment (£m)
PR14AF WWSW _W-A1	Leakage	Ml/d (1)	196.1	162.1	Yes		0.0126	Under-performance payment	(7.9853)
PR14AF WWSW _W-A2	Average water use	l/person/d (1)	152.2	153.0	No		(1.7500)	Under-performance payment	(1.7500)
PR14AF WWSW _W-A3	Water available for use	Ml/d (1)	1,105.3	1,075.3	Yes				
PR14AF WWSW _W-A4	Sustainable abstraction reduction	Ml/d (1)	-42.1	-42.1	Yes			Out-performance payment	1.2648
PR14AF WWSW _W-A5	Abstraction incentive mechanism (AIM)	N/A (N/A)	-4.150	-7.510	-	N/A	N/A	N/A	N/A
PR14AF WWSW _W-B1	Compliance with water quality standards	% (2)	99.96	99.97	Yes				
PR14AF WWSW _W-B2	Customer contacts for discolouration	Number per 1,000 people (2)	0.23	0.25	Yes				
PR14AF WWSW _W-C1	Unplanned interruptions to supply over 12 hours	Number of properties (0)	309	499	No			Under-performance payment	(4.9128)
PR14AF WWSW _W-C2	Mains bursts	Number of bursts (0)	2,530	2,102	Yes				
PR14AF WWSW _W-C3	Customers not being notified of planned interruptions	Number of properties (0)	68	433	No				
PR14AF WWSW _W-C4	Planned works taking longer than notified	Number of events (0)	477	178	Yes				
PR14AF WHHR _R-A1	Service Incentive Mechanism (SIM)	Score out of 100 (2)	81.20	78.65	-			Under-performance payment	(9.9610)
PR14AF WHHR _R-A2	Value for money survey	Score out of 100 (1)	68.3	69.4	-				

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. Our CCG, which consists of individuals with experience of representing household customers and special interest groups, holds us to account as to how we are performing against our performance commitments.

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 our website: **affinitywater.co.uk/performance**.

Table 3A shows that we had 13 performance commitments for AMP6, of which ten had a defined performance commitment level to be met. In 2019/20 we met or exceeded seven out of our ten performance commitment levels, earning a reward of £12,600 through our ODI regime for our leakage performance. Unfortunately, we did not meet our performance commitment level for average water use and incurred a penalty of £1,750,000 through our ODI regime for average water use. We also missed our performance commitment level for unplanned interruptions to supply over 12 hours, but did not incur a penalty as we remained within the deadband. We also missed our target for affected customers not notified of planned interruptions, which was a reputational performance commitment only and does not carry a penalty.

Total net penalties of £1,737,400 incurred in 2019/20 will be considered as part of the PR19 Reconciliation framework, for which final rules are expected in the latter half of 2020.

Across the whole of AMP6 we incurred further penalties of £4,912,800 for failing to meet our performance commitment for unplanned interruptions to supply over 12 hours in 2015/16, 2016/17 and 2017/18; £7,997,880 for failing to meet our leakage target in 2017/18 and 2018/19; and £9,961,000 for SIM underperformance over the first four years of the AMP. We also earned a reward of £1,264,800 for outperformance in relation to our sustainable abstraction reduction, achieved in 2017/18.

The total net penalty for the first four years of AMP6, of £21,606,880 in 2012/13 prices, has been factored into the AMP7 price review process.

Leakage

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 failed to meet our leakage targets for 2017/18 and 2018/19, and incurred a total penalty of £7,997,880. Most of this leakage was from a long-running large pipeline burst, but there were other failings in the way we manage and control leakage. In 2019/20 we took action to ensure we met the industry's largest leakage percentage reduction target (14%) for AMP6 and are proud to have turned around our performance. The actions we took were:

- adopting a greater skills-based approach to leakage supported by improved analytics;
- introducing software that improves leakage monitoring and our response time;
- making contractor recruitment competence-based, less reliant on lower skilled workforces and integrated into our own teams;
- breaking down long-running high leakage areas into smaller zones through step testing in order to identity areas of water loss;
- utilising new technology to help our teams and complement our current large estate of permanent and mobile acoustic loggers; and
- putting in place a new policy for customer supply pipe leakage that increases provision of free repair if the leak size justifies this decision.

As we head into AMP7, we are committed to working hard to continue to meet our leakage target.

Regulatory Annual Performance Report continued

Section 3 – Performance summary (continued)

3A - OUTCOME PERFORMANCE TABLE (CONTINUED)

Average water use

During 2019/20 we recorded average water use of 153.0 l/p/d, so did not meet our PCC performance commitment level and incurred a penalty of £1,750,000 through our ODI regime.

During the year, a new team was created to focus efforts on reducing PCC, resulting in the development of a defined PCC strategy and programme. Data insight work was undertaken to understand the water savings from meter installations and our Home Water Efficiency Checks across different customer demographics, shaping the delivery plan for 2020/21 and beyond as we plan to install over 50,000 water meters per year for the next five years.

We improved communications with our customers through our My Account online portal, which now shows customers their personal water use in litres per day as well as average usage in their area in order to drive behavioural change. We also continue to collaborate with the wider industry through regional working groups, Water UK and UKWIR to improve our understanding of current and future household consumption, as we aim to reduce average PCC to 129.0 l/p/d in AMP7.

Water available for use

We met our performance level commitment for 2019/20, although our water available for use decreased from the prior year, primarily due to the dry weather conditions and working within our drought management plan, by rescheduling planned maintenance and responding to unplanned outage events quicker.

Sustainable abstraction reduction

We delivered a 42.1 Ml/d reduction in abstraction as at 31 March 2020, achieving our sustainability reductions in line with our AMP6 Business Plan. We achieved a £1,264,800 reward in 2017/18.

During AMP6, we 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 also completed projects on six chalk streams as part of our river restoration and habitat enhancement programme, using a collaborative approach to deliver this work under our Revitalising Chalk Rivers partnership with the EA.

Abstraction incentive mechanism ('AIM')

Please refer to table 3C for more detailed commentary on this performance.

Compliance with water quality standards

In the calendar year 2019 there were 50 exceedances of standards out of 190,000 compliance samples taken from our sites and consumer properties (2018: 64 exceedances out of 180,000 compliance samples). Of these, 18 exceedances (2018: 19 exceedances) contributed to the MZC calculation. Another measure of our performance is the number of serious and significant incidents. During 2019 one event notified to the DWI was classified as serious or significant (2018: seven events).

We continue to work to reduce the number of exceedances and events through making improvements to our asset resilience, completing planned programmes such as pesticide removal schemes at our water treatment works and replacing lead pipes. We are also coaching and developing our people whilst adhering to processes and procedures.

Customer contacts for discolouration

We met our performance commitment level in that we received only 0.25 customer contacts for discolouration per 1,000 customers. The number of customer contacts regarding discolouration decreased over AMP6 as a result of work we carried out on improvements to our procedures for returning mains pipes to service after repair or maintenance and effective delivery of our mains renewals projects. We have also proactively identified the worst performing areas with regards to discoloration and then targeted work to remove deposits from the pipes.

Unplanned interruptions to supply over 12 hours

We failed to meet our target this year, primarily due to a single burst incident in a difficult town-centre location which affected 312 properties. Although we did not incur an ODI penalty for 2019/20, this was still a disappointing result as we have worked hard over the past two years to focus our resources on a speedy remedy to such events and to learn from the reasons for delays in restoring customers' supplies where they have occurred.

We achieved this performance commitment in 2018/19, after having failed to meet the target in each of the first three years of AMP6, incurring total penalties of £4,912,800, which have been realised as part of the AMP7 price review process.

For the newly-started five-year AMP period our targets for supply interruptions will focus on reducing both the number and duration of all supply interruption events that last for three hours or longer. Throughout 2019/20 we have been working in preparation for this new measure, improving response times, local resources and alternative techniques for repairs and restoration of supplies. Improvements of this nature will continue along with root-cause analysis of events in order to meet a reducing target over the next five years.

Mains bursts

We achieved our target every year of AMP6, achieving our lowest number of bursts in 2019/20, benefitting from settled weather conditions, seeing neither prolonged periods of dry weather in the summer nor long freezing spells in winter, both of which are likely to increase the occurrence of mains bursts.

Moving into AMP7, our mains burst reporting target has changed to mains repairs per 1,000 km of mains, the target for which equates to a significant reduction over that for the period from 2015 to 2020. We anticipate this will require significant monitoring and work to continue to ensure we look for ways to reduce bursts and their effects on customers.

Work will continue to be focused on reducing night pressure, reducing the volatility of our network and providing analysis where and when bursts occur to inform our mains renewals programme, identifying areas in most need of investment.

Customers not being notified of planned interruptions

During 2019/20, 433 customers were not notified of planned interruptions, so our performance commitment was not met. This is a reputational performance commitment only, with no reward or penalty attached to it.

Planned works taking longer than notified

During 2019/20, 178 planned works took longer to complete than the advance notification, which is within our performance commitment level.

Regulatory Annual Performance Report continued

Section 3 – Performance summary (continued)

3A - OUTCOME PERFORMANCE TABLE (CONTINUED)

Service Incentive Mechanism ('SIM')

SIM was not measured in 2019/20, having been replaced with the 'shadow reporting year' C-Mex[1] metric. Ofwat tracked a 'proxy' SIM score for 2019/20 but this was based on C-Mex and is not consistent with the SIM score in prior years.

While we saw year on year improvements in the first four years of AMP6, and significant improvements within the quantitative SIM measure, by reducing unwanted contacts and complaints, our performance remained below the industry average, incurring penalties of £9,961,000 which have been factored into the AMP7 price review process.

Value for money survey

Our value for money survey returned a score of 69.4 out of 100 which is an improvement on the prior year, although a drop was seen in the last quarter of 2019/20 which coincided with the start of the COVID-19 pandemic causing general uncertainty and greater worry about financial issues.

3B - SUB-MEASURE PERFORMANCE TABLE

This table has not been presented, as the company does not have any sub-measures to report.

3C - ABSTRACTION INCENTIVE MECHANISM ('AIM')

Abstraction site	Decimal places	2019-20 AIM performance (Ml)	2019-20 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	2	N/A	N/A	321.63	0.26	AIM calculated for BRIC and NETH combined. AIM not triggered in 2019/20.
NETH	2	-	-	-	-	
WELL	2	55.68	0.35	103.17	1.21	
OUGH	2	(840.96)	(0.87)	(1,359.95)	(2.59)	AIM calculated for OUGH and OFFS combined
OFFS	2	-	-	-	-	
DIGS	2	(8.80)	(0.03)	14.30	0.02	
FULL	2	N/A	N/A	N/A	N/A	Source switched off permanently due to sustainability reductions as of 1 April 2017
BOWB	2	N/A	N/A	N/A	N/A	Source switched off permanently due to sustainability reductions as of 1 April 2016
HOLY	2	(0.64)	0.00	12.49	0.01	AIM calculated for HOLY and MUDD combined
MUDL	2	-	-	-	-	
MARL	2	(53.94)	(0.06)	(156.71)	(0.13)	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	2	-	-	-	-	
AMER	2	4.20	0.04	(168.70)	(0.15)	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	2	-	-	-	-	
WHIT	2	(0.30)	(0.03)	(15.18)	(0.42)	AIM baseline varied as of 1 April 2018 to be the post sustainability reduction annual average licence of the source
CHES	2	(30.38)	(0.15)	(185.24)	(0.58)	
HUGH	2	N/A	N/A	(181.28)	(0.60)	Source switched off permanently due to sustainability reductions as of 1 April 2017
PERI	2	(870.75)	(0.41)	(6,222.30)	(2.33)	AIM calculated for PERI and RUNL combined
RUNL	2	-	-	-	-	
SLIP	2	(108.77)	(1.77)	(212.33)	(0.21)	AIM baseline varied as of 1 April 2018 in accordance with rolling trigger based on licence condition – see AIM 2018/19 annual report
SPRI	2	(203.04)	(0.43)	(947.69)	(1.57)	AIM calculated for SPRI and SBUC combined
SBUC	2	-	-	-	-	
SDNG	2	N/A	N/A	(112.91)	(0.44)	AIM not triggered in 2019/20
Total	**2**	**(2,057.70)**	**(3.37)**	**(9,110.70)**	**(7.51)**	

[1] C-Mex is a measure of customer service levels to be used by Ofwat in AMP7.

Regulatory Annual Performance Report continued

Section 3 – Performance summary (continued)

3C - ABSTRACTION INCENTIVE MECHANISM ('AIM') (CONTINUED)

The AIM has the objective of encouraging water companies to reduce the environmental impact of abstracting water at environmentally sensitive sites when water is scarce. All three of our supply regions have been designated as areas of 'serious water stress' by the Secretary of State. We proposed 23 sites for the AIM in AMP6, the highest number of any water company in the UK.

Since 2017, 19 sites have been included in AIM as the deployable output was reduced to zero Ml/d at three sites subject to sustainability reductions, so these were omitted from the AIM assessment. This is in addition to the CHAL source, which was deemed to be 'not environmentally sensitive', following discussion with the EA.

In 2019/20, we reduced abstraction by 2,057.7Ml compared to the AIM baseline, primarily at our OUGH, PERI and RUNL sites. The AMP6 cumulative reduction is 9,110.7Ml.

To allow for the comparison of performance between abstraction sites, the AIM score is normalised by the baseline average daily abstraction and the length of time for which flows were at or below the trigger threshold. This is because a performance of -1Ml is better if the AIM baseline is smaller or if the period for which flows are at or below the trigger threshold is smaller. Our normalised AIM performance in 2019/20 was -3.37, with the score primarily contributed to from our OUGH and SLIP sites. The AMP6 cumulative normalised performance is -7.51.

WELL & OUGH & OFFS

For the 192 days that the AIM trigger was in effect, the AIM performance at WELL was +55.68 Ml and the normalised AIM performance was +0.35. This signifies that after subtracting the volume of water used for augmentation, we abstracted 0.29 Ml/d more than we have done during previous droughts. The AIM performance at our OUGH and OFFS sources was -840.96 Ml and the normalised AIM performance was -0.87. This is mainly attributed to the long-running outage at OUGH due to high nitrate concentrations.

MARL & PICC

The flow was below the AIM trigger for 62 days during 2019/20. The AIM performance score was -53.94 Ml and the normalised AIM score was -0.06. This equates to an outperformance of 0.87 Ml/d.

PERI & RUNL

The AIM performance and the normalised AIM performance score for PERI and RUNL for 2019/20 were -0.41 and -870.75 Ml respectively. The negative figure signifies an improved performance as average abstraction was lower than the baseline, over the 215 days that AIM was in effect, equating to an outperformance of 4.05 Ml/d. This is the highest outperformance figure of all of the AIM sources. The under-abstraction compared to the AIM baseline is mainly attributed to the outage at RUNL up to May 2019 due to water quality issues. Abstraction recommenced in May 2019 but at a lower rate to the historic abstraction, due to blending restrictions at CHAU, for water quality compliance.

SLIP

Flow here was below the trigger for 42 days during 2019/20. During this time, our AIM score was 108.77 Ml and our normalised AIM score was -1.77, suggesting that we abstracted on average 2.59 Ml/d less than the rolling AIM baseline each day the trigger was in effect. The negative figure signifies an improved performance as average abstraction was lower than the baseline. The 2018/19 figures were high in comparison at +21.36 Ml and a normalised AIM score of +2.68. The large normalised AIM score was generated in 2018/19 because we abstracted significantly over the AIM trigger for a short period of time without having been asked by the EA to cut back abstraction as per the licence condition. There is also a two-day grace period on the SLIP licence in which to implement a reduction. This suggests that the source has been managed more effectively in 2019/20, as a good normalised AIM score was generated.

SPRI & SBUC

The AIM trigger was active for 72 days during 2019/20. The AIM performance during this period was -203.04 Ml and our normalised AIM performance was -0.43. This equates to a daily outperformance of 2.82 Ml/d compared to historic drought periods.

3D - SIM SCORE TABLE

Row	Line description	Units	Decimal places	Score
1	1st survey score	Nr	2	4.10
2	2nd survey score	Nr	2	3.96
3	3rd survey score	Nr	2	4.27
4	4th survey score	Nr	2	4.37
5	Qualitative SIM score (out of 75)	Nr	2	59.53
6	Total contact score	Nr	2	17.64
7	Quantitative SIM score (out of 25)	Nr	2	19.12
8	Total annual SIM score (out of 100)	Nr	2	78.65

Please refer to the table 3A commentary on **page 240** onwards for SIM performance.

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.

Our performance in the 'shadow year' of reporting is shown in the table below:

Line description	Units	Decimal places	Score
Customer measure of experience (C-MeX)	Score	2	72.70
Developer measure of experience (D-MeX)	Score	2	74.38

Regulatory Annual Performance Report continued

Section 4 – Non-audited additional regulatory information

ACCOUNTING SEPARATION POLICY

Tables 4B, 4C, 4D, 4F, 4G, 4H, 4J, 4L and 4V within this section have been prepared in accordance with the company's Accounting Separation Methodology Statement, which can be found on the company's website:

affinitywater.co.uk/reports-publications

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. Changes to the methodology are also 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 2020

	Unmeasured	Measured
Retail - household		
Number of void households (000s)	20.456	14.750
Per capita consumption (excluding supply pipe leakage) l/h/d	177.36	136.12
		Water
Wholesale		
Volume (Ml/d)		
Bulk supply export		25.976
Bulk supply import		57.736
Distribution input		925.634

4B - WHOLESALE TOTEX ANALYSIS

	2020 £000	Cumulative £000
Actual totex	**242,052**	**1,240,362**
Less: Items excluded from the menu		
Third party costs	**2,604**	14,585
Pension deficit recovery payments	**-**	10,497
Other 'Rule book' adjustments	**884**	(137)
Total costs excluded from the menu	**3,488**	24,945
Add: Transition expenditure		
Transition expenditure	**-**	2,263
Adjusted actual totex	**238,564**	1,217,679
Adjusted actual totex – base year prices	**200,833**	1,086,565
Allowed totex based on final menu choice – base year prices	**175,035**	1,063,059

Actual cumulative totex reported in the above table results in an overall overspend over AMP6 of 2.59%, (£1,217.7m compared to £1,187.1m in outturn prices). Although there is a £30.6m overspend on totex in outturn prices compared to the company's allowance, the amount customers would be expected to fund through the sharing mechanism is only £4.0m (in 19/20 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 £1,217.7m (£1,086.6m in 12/13 prices) compared to allowed totex in outturn prices of £1,187.1m (£1,063.1m in 12/13 prices) for the five year period to 31 March 2020 (an overspend in outturn prices of £30.6m and £23.5m in base year prices) are discussed in detail.

Pension cost

The company's PR14 Final Determination allowed £3.4m in outturn prices of pension deficit cost cumulative to 31 March 2020. Actual total AMP6 pension cost cumulative to 31 March 2020 was £9.6m, which resulted in an overspend cumulative to 31 March 2020 of £6.2m. The internal plan over AMP6 was for the company to pay more into its pension plan than the allowance. This was 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 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 NHH retail market has been higher than planned across the industry. Over the five years to 31 March 2020, £17.4m more was spent than was 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)

4B - WHOLESALE TOTEX ANALYSIS (CONTINUED)

Leakage expenditure

One of the company's significant challenges in AMP6 has been reducing leakage. This was particularly the case in the final two years of AMP6. Investment was made in new technology to improve leakage detection and additional dedicated resources were 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 £21.7m incurred cumulative to 31 March 2020 however we have significantly improved our leakage volumes as a result.

Supply chain management

Additional costs of £11.0m cumulative to 31 March 2020 were incurred in the company's supply chain for operational activities. During 2017/18 the company's main supplier agreed to end its contract with the company. To maintain continuity of service and cause the least disruption to customers, temporary contracts were put in place with several suppliers to deliver the services. Management services that were provided by the company's main supplier were insourced. This led to an increase in costs. In parallel the supply chain strategy for AMP7 and beyond was developed and completed during the last year of AMP6.

Business rates

There was a saving in business rates of £5.0m cumulative for the five year period to 31 March 2020 mainly driven by the 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 were realised on our energy costs. An energy optimisation programme was run over AMP6 to reduce energy usage across production sites. An activity based costing model was developed to provide more detail on the costs of production and in particular energy costs. In total, savings of £8.0m cumulative for the five year period to 31 March 2020 have been achieved on energy.

Import (bulk supply)

The company relies on imports from Anglian Water, Grafham reservoir and Thames Water, 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 is limited. This imported water is at a much higher marginal cost than the water produced from the company's own sites. Imports increased especially during the summer of 2018/19 to meet higher peak demands and during drought conditions experienced in 2019/20. This increased costs by £3.0m more than the amount allowed.

Capex efficiencies

£11.6m of savings were delivered in our lead programme through unit rate and a targeted approach to mains and trunk mains replacement, which maintained bursts rates below the reference level. Savings in our central services were realised and there was a delay in our metering programme.

Atypical expenditure

We incurred £1.4m of wholesale atypical expenditure in relation to a one-off board review in 2019/20 disclosed in table 4J. In 2018/19, we also incurred £1.8m of atypical expenditure in relation to one-off reorganisation costs 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.

4C - IMPACT OF AMP PERFORMANCE TO DATE ON RCV

	2020 £000
Cumulative totex over/underspend so far in the price control period	**27,922**
Customer share of cumulative totex over/underspend	**12,269**
RCV element of cumulative totex over/underspend	**6,081**
Adjustment for ODI outperformance payment or underperformance payment	**(27,465)**
RCV determined at FD at 31 March	**1,232,561**
Projected 'shadow' RCV	**1,211,177**

Refer to the narrative under table 4B for details of the cumulative totex underspend to 31 March 2020.

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 (£5,780,000 in 2019/20 prices), the company's 2017/18 and 2018/19 leakage performance (£9,395,000 in 2019/20 prices), and the company's 2019/20 average water use performance (£2,059,000 in 2019/20 prices) which more than offset an outperformance payment in relation to the company's sustainable abstraction reductions performance in 2017/18 (£1,488,000 in 2019/20 prices).

The adjustment for ODI underperformance also includes a SIM penalty relating to our performance over the first four years of AMP6 (£11,719,000 in 2019/20 prices) which was confirmed during the year to 31 March 2020.

Regulatory Annual Performance Report continued

Section 4 – Non-audited additional regulatory information (continued)

4D - TOTEX ANALYSIS FOR THE 12 MONTHS ENDED 31 MARCH 2020 – 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	-	3,036	3,101	-	2,535	13,720	22,392
Income treated as negative expenditure	-	-	-	-	-	-	-
Abstraction charges / discharge consents	3,632	-	-	-	-	-	3,632
Bulk supply	615	225	-	-	7,108	-	7,948
Other operating expenditure							
Renewals expensed in the year (Infrastructure)	-	-	-	-	-	17,178	17,178
Renewals expensed in the year (Non-Infrastructure)	-	-	-	-	-	-	-
Other operating expenditure excluding renewals	445	5,575	1,002	1,009	14,579	82,220	104,830
Local authority and Cumulo rates	-	1,868	317	1	2,791	10,115	15,092
Total operating expenditure excluding third party services	**4,692**	**10,704**	**4,420**	**1,010**	**27,013**	**123,233**	**171,072**
Third party services	-	-	-	-	-	2,273	2,273
Total operating expenditure	**4,692**	**10,704**	**4,420**	**1,010**	**27,013**	**125,506**	**173,345**
Capital expenditure							
Maintaining the long-term capability of the assets – infra	-	-	-	-	105	9,517	9,622
Maintaining the long-term capability of the assets – non-infra	-	46,226	3	-	13,359	20,657	80,245
Other capital expenditure – infra	-	-	-	-	-	4,751	4,751
Other capital expenditure – non-infra	-	4,203	7	-	9,654	18,601	32,465
Infrastructure network reinforcement	-	-	-	-	-	4,991	4,991
Total gross capital expenditure (excluding third party)	**-**	**50,429**	**10**	**-**	**23,118**	**58,517**	**132,074**
Third party services	-	-	-	-	331	-	331
Total gross capital expenditure	**-**	**50,429**	**10**	**-**	**23,449**	**58,517**	**132,405**
Less: Grants and contributions	-	39,522	-	-	-	24,964	64,486
Totex	**4,692**	**21,611**	**4,430**	**1,010**	**50,462**	**159,059**	**241,264**
Cash expenditure							
Pension deficit recovery payments	-	-	-	-	-	-	-
Other cash items	1	72	6	2	145	562	788
Totex including cash items	**4,693**	**21,683**	**4,436**	**1,012**	**50,607**	**159,621**	**242,052**

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)	459,350	336,587	101,429	98	337,857	337,857
Unit cost (£/Ml)	10.21	31.80	43.58	10,306.12	79.95	371.48
Population	3,777,997	3,777,997	3,777,997	3,777,997	3,777,997	3,777,997
Unit cost (£/pop)	1.242	2.833	1.170	0.267	7.150	33.220

Impact of IFRS 16

IFRS 16 became applicable for 2019/20 and the statutory numbers in the table above have been reported under the new standard. The impact of the new standard is shown below:

	£000
Totex including cash items per table 4D above under IFRS 16	**242,052**
Less: Right-of-use asset additions included in capital expenditure	**(1,822)**
Add: Operating costs under previous accounting standard	**4,119**
Totex including cash items under previously accounting standard	**244,349**

Totex including cash items would have been £2,297,000 higher under the previous accounting standard. This is because the lease costs were previously included in other operating expenditure in the table above, whereas under IFRS 16, these are now shown as right-of-use additions, included in capital expenditure in the table above, with higher depreciation and interest costs, which are not included in totex in this table.

Regulatory Annual Performance Report continued

Section 4 – Non-audited additional regulatory information (continued)

4F - OPERATING COST ANALYSIS FOR THE 12 MONTHS ENDED 31 MARCH 2020 – HOUSEHOLD RETAIL

	Unmeasured £000	Measured £000	Total £000
Operating expenditure			
Customer services	2,742	4,251	6,993
Debt management	950	1,159	2,109
Doubtful debts	3,003	6,447	9,450
Meter reading	-	1,416	1,416
Other operating expenditure	4,024	5,873	9,897
Total operating expenditure excluding third party services	**10,719**	**19,146**	**29,865**
Third party services operating expenditure	-	-	-
Total operating expenditure	**10,719**	**19,146**	**29,865**
Depreciation – tangible fixed assets			
– on assets existing at 31 March 2015	5	7	12
– on assets acquired since 1 April 2015	-	-	-
Amortisation – intangible fixed assets			
– on assets existing at 31 March 2015	35	56	91
– on assets acquired since 1 April 2015	333	523	856
Total operating costs	**11,092**	**19,732**	**30,824**
Capital expenditure	**240**	**380**	**620**

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	1,758
Demand-side water efficiency – expenditure funded by wholesale	(1,298)
Demand-side water efficiency – net retail expenditure	**460**
Customer-side leak repairs – gross expenditure	1,307
Customer-side leak repairs – expenditure funded by wholesale	-
Customer-side leak repairs – net retail expenditure	**1,307**

4G - WHOLESALE CURRENT COST FINANCIAL PERFORMANCE FOR THE 12 MONTHS ENDED 31 MARCH 2020

Income Statement	Total £000
Revenue	**270,784**
Operating expenditure	(173,345)
Capital maintenance charges	(101,843)
Other operating income	1,611
Current cost operating profit	**(2,793)**
Other income	13,951
Interest income	5,904
Interest expense	(52,044)
Other interest expense	2,487
Current cost profit before tax and fair value movements	**(32,493)**
Fair value gains/(losses) on financial instruments	(1,816)
Current cost profit before tax	**(34,309)**

Regulatory Annual Performance Report continued

Section 4 – Non-audited additional regulatory information (continued)

4H - FINANCIAL METRICS FOR THE 12 MONTHS ENDED 31 MARCH 2020

	Current year	AMP6 to date
Financial indicators		
Net debt	£976.223m	
Regulated equity	£256.338m	
Regulated gearing	79.20%	
Post tax return on regulated equity	(2.93)%	
RORE (return on regulated equity)	3.80%	4.48%
Dividend yield	-	
Retail profit margin – Household	(1.49)%	
Retail profit margin – Non household	-	
Credit rating	Baa1 (negative outlook)	
Return on RCV	2.93%	
Dividend cover	-	
Funds from operations (FFO)	£71.908m	
Interest cover (cash)	3.03	
Adjusted interest cover (cash)	1.57	
FFO/Debt	0.07	
Effective tax rate	(26.54)%	
Free cash flow (RCF)	£71.908m	
RCF/capex	0.55	
Revenue and earnings		
Revenue (actual)	£295.511m	
EBITDA (actual)	£92.301m	
Movement in RORE		
Base return	6.06%	6.13%
Totex out/(under) performance	(2.28)%	(0.95)%
Retail cost out/(under) performance	(0.98)%	(0.69)%
ODI out/(under) performance	(0.37)%	(1.01)%
Financing out/(under) performance	1.49%	1.08%
Other factors[1]	(0.12)%	(0.07)%
Regulatory return for the year	3.80%	4.48%
Borrowings		
Proportion of borrowings which are fixed rate	46.62%	
Proportion of borrowings which are floating rate	-	
Proportion of borrowings which are index linked	53.38%	
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	2.10%	
Proportion of borrowings due in more than 5 years but no more than 20 years	62.53%	
Proportion of borrowings due in more than 20 years	35.37%	

AMP6 average RORE has been restated to reflect the ODI penalty incurred for SIM performance in the first four years of the AMP, refer to narrative under table 1F for further details.

[1] 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.

4I - FINANCIAL DERIVATIVES FOR THE 12 MONTHS ENDED 31 MARCH 2020

	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 2020)	
	1 to 2 years £000	2 to 5 years £000	Over 5 years £000	Nominal value (net) £000	Mark to market £000	£000	Payable %	Receivable %
Interest rate swap (sterling)								
Fixed to index-linked	-	-	160,000	160,000	(4,205)	5,036	2.05	5.66
Total financial derivatives	-	-	160,000	160,000	(4,205)	5,036	2.05	5.66

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 interest cover 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.

A CPI linked inflation swap with a nominal value of £25.0m, which is linked to the maturity of the Class A fixed rate £250.0m bond (March 2036), was entered into in March 2020.

Regulatory Annual Performance Report continued

Section 4 – Non-audited additional regulatory information (continued)

4J - ATYPICAL AND NON-ATYPICAL EXPENDITURE BY BUSINESS UNIT FOR THE 12 MONTHS ENDED 31 MARCH 2020 - 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	-	3,036	3,101	-	2,535	13,720	22,392
Income treated as negative expenditure	-	-	-	-	-	-	-
Abstraction charges	3,632	-	-	-	-	-	3,632
Bulk supply	615	225	-	-	7,108	-	7,948
Other operating expenditure							
Renewals expensed in the year (Infrastructure)	-	-	-	-	-	17,178	17,178
Renewals expensed in the year (Non-Infrastructure)	-	-	-	-	-	-	-
Other operating expenditure excluding renewals	445	5,423	996	1,002	14,352	81,205	103,423
Local authority and Cumulo rates	-	1,868	317	1	2,791	10,115	15,092
Total operating expenditure excluding third party services	**4,692**	**10,552**	**4,414**	**1,003**	**26,786**	**122,218**	**169,665**
Third party services	-	-	-	-	-	2,273	2,273
Total operating expenditure	**4,692**	**10,552**	**4,414**	**1,003**	**26,786**	**124,491**	**171,938**
Capital expenditure (excl. atypicals)							
Maintaining the long-term capability of the assets – infra	-	-	-	-	105	9,517	9,622
Maintaining the long-term capability of the assets – non-infra	-	46,226	3	-	13,359	20,657	80,245
Other capital expenditure – infra	-	-	-	-	-	4,751	4,751
Other capital expenditure – non-infra	-	4,203	7	-	9,654	18,601	32,465
Infrastructure network reinforcement	-	-	-	-	-	4,991	4,991
Total gross capital expenditure (excluding third party)	**-**	**50,429**	**10**	**-**	**23,118**	**58,517**	**132,074**
Third party services	-	-	-	-	331	-	331
Total gross capital expenditure	**-**	**50,429**	**10**	**-**	**23,449**	**58,517**	**132,405**
Less: Grants and contributions	-	39,522	-	-	-	24,964	64,486
Totex	**4,692**	**21,459**	**4,424**	**1,003**	**50,235**	**158,044**	**239,857**
Cash expenditure (excl. atypicals)							
Pension deficit recovery payments	-	-	-	-	-	-	-
Other cash items	1	72	6	2	145	562	788
Totex including cash items	**4,693**	**21,531**	**4,430**	**1,005**	**50,380**	**158,606**	**240,645**
Atypical expenditure							
One-off board review costs	-	152	6	7	227	1,015	1,407
Total atypical expenditure	**-**	**152**	**6**	**7**	**227**	**1,015**	**1,407**
Total expenditure	**4,693**	**21,683**	**4,436**	**1,012**	**50,607**	**159,621**	**242,052**

4L - ENHANCEMENT CAPITAL EXPENDITURE BY PURPOSE FOR THE 12 MONTHS ENDED 31 MARCH 2020 - 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)	-	3,002	-	-	-	-	3,002	-	325	-	-	-	-	325
NEP - Eels Regulations (measures at intakes)	-	122	-	-	-	-	122	-	-	-	-	-	-	-
NEP – Invasive Non Native Species	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Addressing low pressure	-	-	-	-	-	375	375	-	-	-	-	-	-	-
Improving taste / odour / colour	-	12	-	-	1,084	(17)	1,079	-	-	-	-	615	-	615
Meeting lead standards	-	-	-	-	-	5,766	5,766	-	-	-	-	-	2,052	2,052
Supply side enhancements to the supply/demand balance (dry year critical / peak conditions)	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Supply side enhancements to the supply/demand balance (dry year annual average conditions)	-	636	-	-	(2)	208	842	-	685	-	-	-	1,806	2,491
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	-	(6)	-	-	(15)	9,883	9,862	-	-	-	-	-	2,775	2,775
New connections element of new development (CPs, meters)	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Investment to address raw water deterioration (THM, nitrates, Crypto, pesticides, others)	-	-	-	-	4,974	-	4,974	-	-	-	-	-	-	-
Resilience	-	53	7	-	1,113	888	2,061	-	-	-	-	-	-	-
SEMD	-	-	-	-	2,500	-	2,500	-	-	-	-	105	-	105
NEP – Drinking Water Protected Areas (schemes)	-	-	-	-	-	-	-	-	-	-	-	-	-	-
NEP – Water Framework Directive measure	-	-	-	-	-	-	-	-	-	-	-	-	-	-
NEP - Investigations	-	384	-	-	-	-	384	-	-	-	-	-	-	-
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	-	-	-	-	-	11,240	11,240	-	-	-	-	-	-	-
Metering (excluding cost of providing metering to new service connections) – other	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total enhancement capital expenditure	**-**	**4,203**	**7**	**-**	**9,654**	**28,343**	**42,207**	**-**	**1,010**	**-**	**-**	**720**	**6,633**	**8,363**

Regulatory Annual Performance Report continued

Section 4 – Non-audited additional regulatory information (continued)

4V - OPERATING COST ANALYSIS FOR THE 12 MONTHS ENDED 31 MARCH 2020 - 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	15	231	953	1,837	-	-	-	3,036
Income treated as negative expenditure	-	-	-	-	-	-	-	-
Abstraction charges / discharge consents	18	276	1,140	2,198	-	-	-	3,632
Bulk supply	4	64	264	508	-	-	-	840
Other operating expenditure								
Renewals expensed in year (Infrastructure)	-	-	-	-	-	-	-	-
Renewals expensed in year (Non-infrastructure)	-	-	-	-	-	-	-	-
Other operating expenditure excluding renewals - direct	16	226	934	1,800	-	-	-	2,976
Other operating expenditure excluding renewals - indirect	15	231	956	1,842	-	-	-	3,044
Total functional expenditure	**68**	**1,028**	**4,247**	**8,185**	**-**	**-**	**-**	**13,528**
Local authority and Cumulo rates	9	142	587	1,130	-	-	-	1,868
Total operating costs (excluding 3rd party)	**77**	**1,170**	**4,834**	**9,315**	**-**	**-**	**-**	**15,396**
Depreciation	2	24	100	193	-	-	-	319
Total operating costs (excluding 3rd party)	**79**	**1,194**	**4,934**	**9,508**	**-**	**-**	**-**	**15,715**

4V - OTHER EXPENDITURE FOR THE 12 MONTHS ENDED 31 MARCH 2020 - WHOLESALE WATER

	Water resources	Raw water distribution	Water treatment	Treated water distribution	Total
Item					
Employment costs - directly attributable (£000)	2,250	291	4,791	23,999	31,331
Employment costs - indirectly attributed (£000)	1,880	743	3,045	10,754	16,422
Number FTEs – directly allocated	84	7	125	561	777
Number FTEs – indirectly allocated	21	2	31	138	192
Costs associated with Traffic Management Act (£000)	-	-	-	1,808	1,808
Service charges					
Canal & River Trust service charges and discharge consents (£000)	-	-	-	-	-
Environment Agency service charges/ discharge consents (£000)	3,632	-	-	-	3,632
Other service charges / permits (£000)	-	-	-	-	-
Statutory water softening (£000)	-	-	-	-	-

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
Interest paid on loan	Affinity Water Finance (2004) PLC*	-	At market rate, on-lent by associate on the same terms	14,239
Interest paid on loan	Affinity Water Finance PLC*	-	At market rate, on-lent by associate on the same terms	33,407
Service provided				
Wholesale water charges	Castle Water (Southern) Limited (formerly Affinity for Business (Retail) Limited	60,071	At market rate from MOSL reports	41,342
Wholesale water deposit		60,071	At market rate	4,906
Recharges for support services – finance		60,071	No market – services charged at a fixed annual fee based on actual cost or recharged by time allocation	158
Recharges for support services – Information Technology		60,071	No market – services charged at a fixed annual fee based on actual cost or recharged by time allocation	502
Recharges for support services – HR, legal, and other support recharges		60,071	No market – services charged at a fixed annual fee based on actual cost or recharged by time allocation	81
Recharges for meter read costs		60,071	Actual costs to the company recharged	380

* 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.

Regulatory Annual Performance Report continued

Section 4 – Non-audited additional regulatory information (continued)

TRANSACTIONS WITH ASSOCIATED COMPANIES (CONTINUED)

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 £253,461,000 (2019: £253,922,000).

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 £833,595,000 (2019: £823,747,000).

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%.

In February 2020, Castle Water Southern Limited (formerly Affinity for Business (Retail) Limited), one of the company's fellow group undertakings until its sale to Castle Water Limited on 1 April 2020, moved from a pre-pay to post-pay mechanism for its wholesale water charges. As a result, Castle Water Southern Limited (formerly Affinity for Business (Retail) Limited) paid a deposit to Affinity Water Limited of £4,906,000.

There are no loans to group companies.

DIVIDEND POLICY

The dividend policy of Affinity Water Limited is to pay a dividend commensurate with the long-term returns and performance of the business and allowing shareholders to earn an appropriate return from an investment in the company, whilst not impairing the company's longer term financeability and taking into account commitments to its stakeholders and customers. In determining the level of dividend, the financial performance of the appointed and non-appointed businesses are considered separately.
Our dividend policy was changed during the year to ensure that any group debt above Affinity Water Limited can be serviced from the non-appointed business before a distribution to shareholders is considered.

The base dividend for the appointed business will be set in reference to the company's internal Business Plan and will not exceed a nominal 5% yield on equity as an annual average over the AMP, based on the company's actual financial structure. Dividends can be increased or lowered from the base depending on the actual performance of the company. An assessment will be 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, such assessment includes the following areas: customer service; operational commitments; community commitment; and employees and the health of the pension plans. This assessment will also demonstrate that the dividend policy for AMP7 will take account of obligations and commitments to customers and other stakeholders, including performance of delivery against the final determination for AMP7. This will include in particular assessment of performance commitments with associated ODIs as set in the final determination and any ODI penalties or rewards earned. It will also require an assessment of the long-term financial resilience of the company in relation to liquidity, distributable profits of the company, cash facilities available and financial ratios.

Finally, 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.

No dividends were declared or paid during the year ended 31 March 2020. This reflects the shareholders' commitment to re-invest all planned returns from the company's appointed business for the benefit of its customers for the time being and the need to work in partnership with the company's trade unions to transform the business so that the company can deliver for the company's customers and other stakeholders in AMP7. This compares to £6,600,000 declared and paid in the year ended 31 March 2019.
No final dividend is proposed (2019: £nil).

VIABILITY STATEMENT

The Board's consideration of the company's longer-term viability and prospects is an extension of our business planning process. This includes financial budgeting and forecasting, and a robust risk management process.
Our strategy aims to enhance our long-term prospects by making sure that our operations and finances are sustainable. The directors have assessed the company's long-term prospects in the context of our WRMP, which sets out our plan to secure the long-term provision of resilient and sustainable water supplies for customers from 2020 to 2080. The results of financial modelling presented to the Board over this period to enable the assessment of the company's long-term prospects reflect the expected level of investment implied by this plan and recovery of this investment from customers.

The directors have assessed the company's financial viability over a shorter ten-year period to 31 March 2030 (the 'lookout period'). 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 61 to 64**. 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 base case has also taken into consideration the impact of COVID-19 in the first year of AMP7, using the assumption that the pandemic has a one-off impact impacting revenue and bad debt projections and has reprofiled capital expenditure, however has not been considered to have a material impact on our operating costs. Any longer term financial implications of COVID-19 are then considered to be covered as part of our stress test scenarios.

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 Ofwat's feedback relating to our 2018/19 viability statement, cross references have been added to the 2019/20 viability statement linking key risks to further details provided in our strategic report on operational activities. The viability statement also includes mitigating actions the company might put in place for the scenarios in the stress testing.

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 website: **affinitywater.co.uk**. PwC did not include any matters in its independent auditors' report on **pages 142 to 148** in relation to the viability statement.

Regulatory Annual Performance Report continued

Section 4 – Non-audited additional regulatory information (continued)

CURRENT TAX RECONCILIATIONS

The appointed current tax charge assessed for the period is higher than the standard rate of corporation tax in the UK of 19% for the year ended 31 March 2020. The differences are explained below:

	£000
Loss on appointed activities before tax and fair value movements	**(7,005)**
Tax calculated at the standard rate of tax in the UK of 19%	(1,331)
Tax effects of:	
– Adjustments in respect of prior years	(1,456)
– Expenses not deductible for tax purposes	266
– Accelerated capital allowances	4,180
– Other timing differences - pension	(644)
– Other timing differences - provisions	(267)
– Fair value movements	(345)
Appointed current tax charge	**403**

Significant variations between the appointed current tax charge and the total current tax charge for the year ended 31 March 2020 allowed in the company's price limits are explained below:

	£000
Appointed current tax charge	**403**
Variance in profit before tax excluding fair value movements	5,921
Variance in fair value movements	345
Adjustments in respect of prior years	1,456
Variance in assumptions - capital allowances	(6,198)
Other timing differences – pensions	157
Other	423
Total current tax charge allowed in price limits	**2,507**

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.

In the Spring Budget 2020, the Government announced that from 1 April 2020 the Corporation Tax rate would remain at 19% (rather than reducing to 17%, as previously enacted). This new law was substantively enacted on 17 March 2020.

Tax strategy related to the appointed business

Our approach to tax is based on the values incorporated in the "Behave ethically" section of Affinity Water's Code of Conduct:

We always act honestly, openly and responsibly, so that we are trusted. We uphold our Standards of Conduct 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.

Regulatory Annual Performance Report continued

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 96.

For further information on our assurance procedures and results, please refer to our Data Assurance Report, which is published on our website: **affinitywater.co.uk**.

Areas of supply

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