

SOUTH WEST WATER LIMITED  
ANNUAL REPORT AND  
FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 MARCH 2022

[southwestwater.co.uk](http://southwestwater.co.uk) [bournemouthwater.co.uk](http://bournemouthwater.co.uk)

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## OUR BUSINESS AND BRANDS



- Water services
- Wastewater services
- **c.1.8 million** population served plus c.10 million visitors during the year



- Water services
- **c.0.5 million** population served

# OUR PURPOSE AND VALUES

## HOW OUR PURPOSE DRIVES EVERYTHING WE DO

As a purpose-led business, committed to the effective stewardship of the environment, we are:

*SHAPED BY OUR VALUES AND CULTURE:*



### TRUSTED

We do the right thing for our customers and stakeholders



### RESPONSIBLE

We keep our promises to our customers, communities and each other



### COLLABORATIVE

We forge strong relationships, working together to make a positive impact



### PROGRESSIVE

We are always looking for new ways to improve and make life better.

*INFORMED BY OUR ENGAGEMENT WITH STAKEHOLDERS*



Environment



Customers



People



Communities



Suppliers



Regulators



Policy Makers

## OUR PURPOSE AND STRATEGY BROUGHT TO LIFE...

Our purpose isn't just what we believe in, it's what we do every day. Continuing to ensure we are doing the right thing for our customers and stakeholders, delivering fresh clean drinking water, protecting the environment and continuing to innovate will help us look after the Great South West now and into the future.

### *DELIVERING CLEAN, SAFE AND RELIABLE DRINKING WATER*

We are committed to ensuring the continuous supply of clean, safe and reliable drinking water to our customers, whilst protecting the natural resources within the South West. Read more on page 37.

### *ENHANCING THE ENVIRONMENT, GOING FURTHER FASTER*

We have been listening to our stakeholders - customers, colleagues and communities and it is clear they want us to go further and faster in protecting and enhancing our rivers and seas. We have recently launched WaterFit - our commitment to our stakeholders and the environment, which sets out how we will play our part. Read more on page 43.

## *OPERATING WITH A RESPONSIBLE AND SUSTAINABLE APPROACH TO BUSINESS*

With robust risk management and strong governance, we ensure our operations and the long-term decisions we make are for the benefit of all. Read more on page 58.

## *DELIVERING FOR COLLEAGUES, CUSTOMERS AND COMMUNITITES*

Our people are our greatest asset and we couldn't do what we do without them. Through community programmes, graduate schemes and environmental efforts, we strive to deliver for the region. Read more on page 34.

## *INNOVATING TO DELIVER FOR OUR STAKEHOLDERS NOW AND IN THE FUTURE*

We continue to look at new ways of working, using technology and nature-based solutions to make progress in protecting the environment and delivering for our stakeholders. Read more on page 13.

## **SUPPORTING THE LIVES OF PEOPLE AND PLACES THEY LOVE**

We're proud to be based in the South West, serving customers and communities across our operating area.

## **OUR KEY STRENGTHS AND RESOURCES**

### *OUR CUSTOMERS RELY ON US*

We provide safe, clean drinking water, to an estimated population of c.2.3 million people every day. And when they've finished with it, over 19,000km of sewers take used water and surface water run-off to one of our 653 wastewater treatment works where it is treated, tested and safely returned to the environment.

We have expanded our support to vulnerable customers in these difficult times with over 70,000 customers benefitting from one or more of our affordability initiatives.

### *OUR TEAM*

We are a dedicated team of over 1,700 people, working 24 hours a day, 365 days a year to deliver essential services for our customers.

### *LIVING OUR VALUES*

We know it's not only what we do, but how we do it that matters to our customers and communities and to ourselves. That's why we live our values across the Company, every day.

### *INVESTING IN OUR FUTURE*

We're proud to be investing in future talent through graduate and apprenticeship schemes across the Group. These schemes will give over 600 talented people the opportunity to join us by 2025.

We were also one of the first companies to sign up to the Government's Kickstart programme, offering young people the chance to gain training, support and valuable work experience. Over half of our Kickstarters have now joined our team.

And we are going further, faster with our environmental investment to achieve significant improvements in performance that benefit every one of us.

Read more on our environment and social plans and performance on pages 23 to 36 and 45 to 62.

## **OUTLOOK**

As we look towards our next price review, which we will submit in October 2023, the Board is already focused on ensuring we can continue to develop and deliver innovative and sustainable solutions for the things that matter most, doing what's right for customers and communities, and in delivering even greater environmental and social value across the South West.

# CHAIR'S LETTER

## Doing what's right

I will look back on 2021 as a year South West Water focused on doing what's right. Externally, this has been a difficult year dominated by rising inflation and energy prices, the Russian invasion of Ukraine and the legacy of the pandemic creating uncertain for many.

In February 2022, we announced that average bills for customers would reduce. Supporting the Board's commitment to eliminate water poverty, South West Water has increased the number of customers on our social tariffs with over £18 million of affordability support in K7 to date.

We've also achieved 100% coastal bathing water quality for the first time, we acknowledge there's more to do to protect our environment, and our rivers and coastal waters. The Board has focused significant attention on this, working with our regulators, communities and customers to drive a step change in performance. What we do matters and we are privileged to be in a position to respond.

This was also the year in which global action on climate change was rightly demanded. Good progress was made at COP26 in Glasgow, although the UK remains on an uncertain path towards a net zero society. The water sector is leading the way, with ambitious timelines to achieve Net Zero by 2030, ahead of the rest of the UK. South West Water's own promise to the planet is progressing, and an important step has been in engaging our key suppliers to support and align in the effort.

The South West is particularly vulnerable to climate change given its long coastline and adjacency to the western approaches of the Atlantic Ocean. Assessing the impacts and mitigations on our operations, networks and assets is an ongoing and iterative process. This year, our parent company, Pennon Group plc, was required to report on Task-force for Climate-Related Disclosures (TCFD), having disclosed voluntarily last year, and receiving positive feedback. Pennon Group plc want to build on that feedback by giving shareholders the opportunity to vote on our disclosure, and South West Water have also included dedicated climate change related sections in our Annual Report.

This is the second year in my role as Chair, and I am grateful to work alongside our diverse and talented Board. Everyone who works for South West Water deserves credit for the achievements in the year. We now employ over 1,700 people and 321 through our wholly owned subsidiary South West Water Customer Services, and it's their dedication and care for each other and to our customers, as well as their passion for the places they live and work in, that has enabled us to deliver another year of robust results. On behalf of the Board, thank you.

# SOUTH WEST WATER'S BUSINESS MODEL

## CREATING LONG-TERM SUSTAINABLE OUTCOMES AND VALUE

Our purpose, with sustainability at its heart, guides the decisions we make in delivering our strategy. We believe this clear focus drives the best sustainable outcomes for all our stakeholders.

We take our responsibilities to ensure the environmental, social and economic wellbeing of the South West region with the utmost importance, which is why everything we do is underpinned by our Environmental, Social and Governance (ESG) approach. We take pride in measuring ourselves against national and international benchmarks of responsible business practice, and ensure we stay in touch with issues on both a local and global scale.

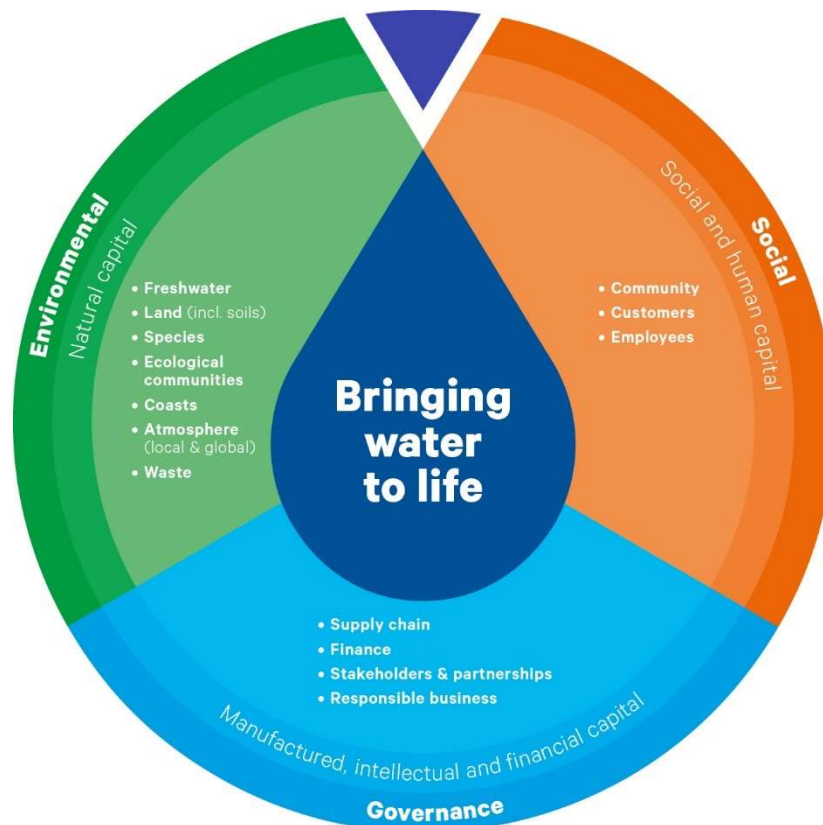
## WHAT WE DO

We provide water and wastewater services to our communities in the most efficient and sustainable way possible.

## OUR BUSINESS MODEL

The Company provides strong pillars of strategic direction, financial management, risk management and governance.

Our business model is shaped by our purpose, Bringing water to life – supporting the lives of people and the places they love for generations to come which means we are not only seeking to create value for our stakeholders today but to reinvest in our business in a carefully planned and sustainable way for the future.



Our Natural Capital	Our Social & Human Capital	Our Manufactured, Intellectual & Financial Capital
<b>Environment</b>	<b>Social</b>	<b>Governance</b>
<ul style="list-style-type: none"> <li>• Environment</li> <li>• Freshwater</li> <li>• Land (including soils)</li> <li>• Species</li> <li>• Ecological communities</li> <li>• Coasts</li> <li>• Atmosphere</li> <li>• Waste</li> </ul>	<ul style="list-style-type: none"> <li>• Colleagues</li> <li>• Customers</li> <li>• Communities</li> </ul>	<ul style="list-style-type: none"> <li>• Supply chain</li> <li>• Responsible business</li> <li>• Stakeholders and partnerships</li> <li>• Finance</li> </ul>

## FOR THE BENEFIT OF OUR STAKEHOLDERS

**Customers** – Our high quality services support households and businesses in the regions we serve

**Shareholders and investors** – Our strong business model ensures shareholders and investors get a fair return

**Regulators and stakeholders** – Our engagement with regulators and key stakeholders ensures transparency of our business approach

**Employees** – Our employees are highly valued and are integral to our success. Their health & safety is paramount

**Suppliers and contractors** – The relationships we have with our suppliers and contractors are fair and deliver many regional economic benefits.

## OUR STRENGTHS

### High-quality assets

We invest in world-class facilities and plants, using innovation and technology to help safeguard our natural resources.

### Environmental stewardship

We constantly seek more sustainable ways of working to protect, enhance and reduce our impact on the natural environment.

### Strong reputation and customer services record

Our parent company, Pennon, was voted Britain's Most Admired Company (Utilities) and market leading customer service.

### The best people

Outstanding talent, providing training and development, with their health, safety and wellbeing our absolute priority.

### Effective governance

A strong governance framework supporting robust decision-making and performance management.

### Efficient financing

We are well-funded with efficient long-term financing.



### Well-managed risk

Comprehensive and fully embedded risk management processes to help deliver the Company's strategy and objectives.

### Strong relationships with our suppliers

We always ensure their performance meets our expectations and uphold our standards, align with our policies, protect human rights and promote good working conditions.

### SERVICES AND CORE ACTIVITIES

1. **Upstream catchment** – managing water in the landscape alongside landowners and partner agencies.
2. **Raw water reservoirs/water resources** - Ensuring an available and sufficient supply of raw water collected from rivers, reservoirs and a small number of boreholes.
3. **Water treatment works** - treating water to high standards to ensure it is clean, safe and reliable.
4. **Drinking water mains network to homes and businesses** – managing an extensive network to deliver an uninterrupted supply of drinking water to households and businesses.
5. **Wastewater mains network and Surface water catchment** – a resilient and reliable network of sewers to take wastewater from properties to our treatment works
6. **Wastewater treatment works (including businesses)** – ensuring treated wastewater is returned to the environment safely
7. **Recycling waste into bio-resources** – supporting local communities and businesses
8. **Domestic customer services** - billing and help provided from our call centres

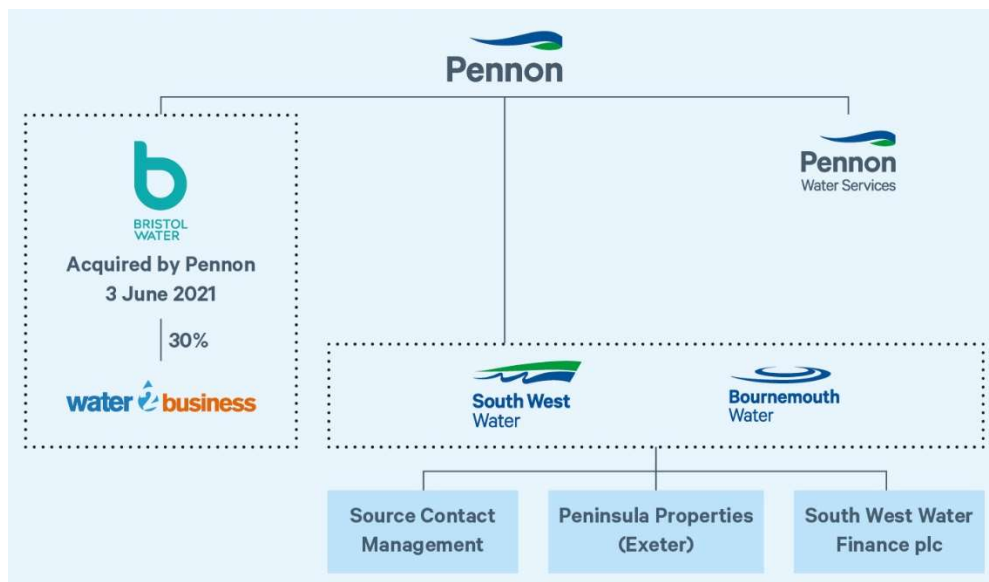
### OUR OUTCOMES AND OTHER PERFORMANCE

In line with our vision of 'Bringing Water to Life' we focus on three strategic focus areas:

ENVIRONMENTAL – Natural capital		SOCIAL – social and human capital				GOVERNANCE – manufactured, intellectual and financial capital	
PROTECTING PLACES		SUPPORTING PEOPLE				CREATING VALUE	
Environmentally sustainable actions and initiatives	Reliable wastewater services	Clean, safe and reliable supplies	Available and sufficient resources	Responsive to our customers' needs and priorities	Supporting our people and local communities	Providing reliable services even in extreme conditions	Fair charging and affordability for all

## SOUTH WEST WATER'S GROUP CONTEXT

South West Water Limited is a subsidiary of Pennon Group plc (which is South West Water's immediate and ultimate parent company), a FTSE 250 company, whose principal significant trading subsidiaries are shown below:



Note: South West Water's subsidiaries are described in note 16 (page 199).

### *SOUTH WEST WATER*

South West Water provides regulated water and wastewater services across Cornwall, Devon, Isles of Scilly and parts of Dorset and Somerset, water only services in areas of Dorset, Hampshire and Wiltshire (the Bournemouth Water area) and a small amount of non-appointed services. It is responsible for delivering the 2020-25 business plan, in both the original South West Water area of operation and the Bournemouth Water area of operation. South West Water provides retail services to residential (household) customers. On 1 April 2020, South West Water's licence was extended to provide water and waste water services to the Isles of Scilly.

### *BRISTOL WATER*

On 2 June 2021, Pennon approved the acquisition of Bristol Water Holdings UK Limited, including its subsidiary Bristol Water UK plc, which provides water only services to c.12 million customers in the Bristol region. The acquisition completed on 3 June 2021 and the Competition and Markets Authority published their clearance for a merger between South West Water and Bristol on 7 March 2022.

### *PENNON WATER SERVICES*

Pennon Water Services provides retail services to non-household customers. Whilst part of the wider Pennon Group, South West Water has in place robust policies and practices to ensure full competition compliance with the market codes for the non-household retail market.

### *SOUTH WEST WATER'S SUBSIDIARIES*

**South West Water Customer Services** manages South West Water's billing, collections and customer contact activities.

**Peninsula Properties (Exeter)** advises South West Water on property development opportunities.

**South West Water Finance** acts as a financing company, raising borrowings for South West Water.

# MARKET AND REGULATORY OVERVIEW

## THE UK WATER SECTOR

Customers in England and Wales receive their services from 11 regionally appointed water and wastewater companies, alongside six water-only companies. Historically the sector was comprised of only of these incumbent companies but today they operate alongside new appointees which are licensed to serve specific geographic areas, predominantly new developments. Together, they provide services to over 50 million household and non-household customers.

## REGULATORY FRAMEWORK

Water companies operate in the public interest, with a vital role in providing customers with safe, clean and reliable drinking water, with the added importance this has on health and hygiene. They also have a unique role to play societally, and environmentally. To balance these sometimes conflicting demands the sector operates within a highly regulated framework with Defra providing strategic direction to the economic regulator, Ofwat and environmental regulator the Environment Agency, as well as to other policy makers. Inevitably tensions between the requirements of our various regulators arise, and maintaining good relationships enables us to engage positively with all stakeholders and contribute to direction of travel and future policy.

While the sector in which we operate is established, numerous and significant challenges are requiring us to react and evolve more rapidly than has previously been the case. Macro environment issues such as climate change, population growth and evolving consumer needs and expectations are driving regulators and companies to think and operate in new ways to ensure that we deliver environmental and customer value.

## WELL POSITIONED FOR THE MARKET CHANGE

In the medium-term, we expect the sector to undergo a step-change in how it delivers services to customers. This will create challenges but also opportunities, and we welcome the development of market mechanisms within the sector to drive innovation and value for customers, the environment and stakeholders.

Our expertise and financial stability make us well positioned to leverage these opportunities and to be at the forefront of shaping the future water sector.

Within the regulated framework we will actively seek opportunities and continue to work with partners to unlock the potential for water trading. However, there is more to do to unlock the potential for the trading of bioresources, to remove barriers and create value for money while delivering essential environmental protection.

Our ambition is to lead the sector on innovation. In partnership with the University of Exeter, South West Water has established a pioneering new collaborative research centre, designed to address some of the most pressing environmental challenges facing the water sector. The Centre for Resilience in Environment, Water and Waste (CREWW) will accommodate state-of-the-art, specialist laboratory facilities to help academics and our own experts conduct world-leading research that will help us deliver environmental improvements whilst safeguarding water supply, improving wastewater management and service to customers.

## PREPARING FOR THE NEXT REGULATORY PERIOD

Our PR24 strategic business plan for 2025-30, will be submitted to Ofwat in October 2023. Ofwat's key themes for PR24 will be increasing focus on the long term; delivering greater environmental and social value; reflecting a clearer understanding of customers and communities; and driving improvements through efficiency and innovation. Regulators and stakeholders will expect to see a step change in our plans with respect to long term

outcomes. We will engage with customers and stakeholders to balance all needs and the pace of investment for optimal outcomes, whilst maintaining focus on affordable bills at a time of rising costs of living.

We are well positioned to meet this challenge:

- Long-term planning processes are underway, with the water resource and drainage management planning processes considering long term investment needs for our region
- We understand our climate change investment needs and how they shape our resilience plans and operations
- We understand market and commercial opportunities, which are also good for the sector and the environment.

Ofwat's Asset Management Maturity Assessment (AMMA), and ISO 55001 accreditation, confirmed South West Water's capability in the sector. AMMA has confirmed that we have the right building blocks to assess future asset and environmental risks, and the impact of uncertainties on our assets and communities.

The PR24 strategic business plan will bring together a number of plans alongside other aspects of performance. It will demonstrate that the entire plan is deliverable and financeable, and in line with long term outcomes.

Every five years, companies develop a Water Resources Management Plan (WRMP) setting out how they will meet the demands for water now and for the next 25 years. The water sector is facing uncertainty and change, stemming from climate change, population growth, and greater environmental protections. To respond to these challenges, water companies are also working in regional groups to co-ordinate approaches to water resource planning. These Regional Plans set out how the supply of water should be managed in the region, recognising that it may be optimal to share resources across company boundaries.

On the wastewater side of the business, Drainage and Wastewater Management Plans (DWMP) are a new feature of the price review. They are long-term plans, with a 25 year horizon, to improve drainage and wastewater planning by increasing transparency, robustness and clarity of investment decisions.

Development of DWMPs is led by water companies, bringing together organisations that have a role to play in ensuring drainage and wastewater systems are sustainable, robust and resilient to future pressures such as climate change and population growth.

# STAKEHOLDERS ENGAGEMENT

Engaging with our wide group of stakeholders is important to us. Regular engagement, feedback and input from our stakeholders supports the long-term success of the Company and helps us continue to deliver long-term sustainable value and benefits for all.

We listen, engage and reflect our stakeholders needs and priorities in our business plans and operations. Our engagement approach involves regular dialogue so that we can build open, meaningful relationships, based on trust and transparency. Understanding our stakeholders needs and priorities helps to shape our strategy and social purpose as well as shape our Board decisions. For more information on how stakeholder feedback shapes our Board decisions, read our Section 172(1) statement on page 20.

## Customers

### WHO THEY ARE

Our businesses supply water and wastewater services to around one million household customers in the South West.

### WHY WE ENGAGE

We engage regularly with our customers, about their day to day interactions with us and on future plans and strategy. Regular engagement provides feedback to our teams to help deliver the services our customers want.

We also engage with trade and customer bodies including Consumer Council for Water (CCW) - the voice of water consumers aiming to work together to the benefit of our customers and water consumers.

### HOW WE ENGAGE

- Regular customer satisfaction surveys Customer support centre
- Focus groups
- Co-creation workshops
- Forums
- Customer AGM (the first of which was held in November 2021)
- Quarterly public customer meetings
- WaterShare+ Advisory panel

Customer trust score:

**93%**

Reduction in complaints:

**c.60%**

### KEY CHALLENGES AND HOW WE ARE RESPONDING

Our customers continue to tell us that the provision of safe drinking water is always considered the most important. Our aim is to prevent any issues which cause customers to contact us about their water supply. This is the foundation of our customer service strategy. Where there is an issue, we resolve it as quickly as possible.

This year 95% of contacts were resolved first time – exceeding our annual target for the sixth year in a row.

As part of the nationwide effort for companies to play their part in the green economic recovery from COVID-19, and after consulting with our customers on the challenge faced, South West Water responded with a Green

recovery plan to increase environmental investment by c.£82 million with six projects focused on improving public health, protecting the environment and addressing climate change.

## People

### WHO THEY ARE

A total of c.1,700 people work across the company, in corporate and operational roles. It's our people that keep things moving 24/7 to deliver wastewater services and to ensure our customers receive clean and safe drinking water.

### WHY WE ENGAGE

Our employees are our greatest asset. We provide the opportunity for them to be engaged at multiple levels of the business and through a variety of two-way dialogue and feedback channels so we can listen to them and make improvements based on their feedback of what's important to them. We continually engage and communicate with our people on their health, safety and wellbeing, our organisational culture, promoting diversity and inclusion, training and development. We use our annual colleague Great Place To Work trust and engagement survey as a mechanism to measure progress and obtain feedback.

### HOW WE ENGAGE

- Annual colleague Great Place To Work trust and engagement survey and work with senior leaders to develop local action plans
- RISE employee engagement forums – Represent, Inspire, Share and Energise
- Trade Union partners (GMB and Unite)
- Two-way communication activities including - Bi-weekly Big Chats, 'Ask Susan' email, monthly senior leadership calls and focus groups
- Executive and Board site visits
- Employee training programmes
- Internal communication activities including - weekly internal newsletter, social channels e.g. Yammer and our Group-wide intranet
- Monthly 'Time to Talk' sessions, primarily focusing on wellbeing, featuring both internal and external speakers
- Regular 'This is Me' features including videos and podcasts
- Regular appraisals and 1:1's

Completion rate for  
our Great Place To  
Work survey:

**85%**

### KEY CHALLENGES AND HOW WE ARE RESPONDING

- Proactively recognising and addressing employees' mental health and wellbeing by delivering a broad and comprehensive programme of offerings for all employees' and their family members
- Maintaining focus on Health and Safety with continued investment through HomeSafe
- Supporting diversity and inclusion by launching our new employee networks
- Involving existing colleagues as we recruit and train the next generation of employees through our apprenticeship, kickstart and graduate programmes
- Addressing employee survey feedback by enhancing group communications and employee pay and bonuses.

## Communities

### WHO THEY ARE

Our businesses operate in the heart of local communities.

### WHY WE ENGAGE

We are integral to the communities across our region and we are committed to listening and engaging regularly to understand their needs, working together to ensure water for all and protecting our environment today and for future generations.

Our charitable donations and community funds support hundreds of amazing causes making a real difference to the lives of people and the places they love. Our education programme aims to inspire future champions across the region to learn about the value of water in fun and interactive ways. Our community outreach programme works directly in the communities we serve offering support to those who need a little extra help when it matters most and talking directly to customers about environmental challenges and how we can work together to secure the future we all want to see.

Over the past decade we have been working with local community partners to protect and restore our environment, including working with our local farming community to help create more sustainable farming practices and restoring the South West's precious peatlands. Our partnerships with charities also seek to provide health and recreational benefits to local communities through the use of our lakes and reservoirs – helping us support the health and wellbeing in our region.

### HOW WE ENGAGE

- Regular community outreach meetings across the region
- Print, digital and social media – e.g. engaging our communities in behavioural change campaigns including Love Your Loo, and Think Sink!
- Bi-annual Conservation and Recreation Forum
- Specific partner engagement to support access to our land and sites for recreation in the South West – e.g. South West Lakes Trust
- 'Value of Water' educational programme
- Community outreach programme working directly within the communities we serve – e.g. with local support groups

**59 million litres**  
of water estimated saved  
through our Water-Saving  
Community Fund

**£580,000**  
Contributed to our  
communities during  
2021/22

### KEY CHALLENGES AND HOW WE ARE RESPONDING

- Our region has over a third of all the UK's bathing waters and it is important that we protect these vital recreational areas – we already support charitable partnerships to provide access through the use of our lakes and reservoirs. We are seeking to go further by making bathing water accessible, within less than an hour drive for our communities and visitors supporting the health and wellbeing of the communities in our region.

## Environment

### WHO THEY ARE

Beaches, bathing waters, rivers, our natural environment set us apart as a region. We recognise that is what makes us unique. It also creates a similarly unique set of challenges and opportunities. We also recognise that to meet these properly, we need to collaborate and to build strong, value-filled partnerships with the wide range of environmental stakeholders in the region. These stakeholders include South West Lakes Trust, Westcountry Rivers Trust, The Wildlife Trusts, Natural England and various conservation, environmental and recreational interest groups and charities.

### WHY WE ENGAGE

- We seek to identify and build strategic relationships around shared ambitions and objectives. By working in collaboration with our partners we can amplify the impact of our work
- Our core activities are directly linked to the health and wellbeing of the people and environment of our unique region. We seek to carry out our business in a sustainable and responsible way and recognise that to do this collaboration and partnership working are key
- It is our role to listen and respond, innovate and help find solutions to the challenges we all face today and for generations to come. We see that we need to work collectively to do this. For example, through our CREWW partnership with the Exeter University
- We want to ensure we are delivering on our environmental commitments and support stakeholders in the work they do, in partnership with us
- We want to bring together partners to help manage, protect and enhance our catchment areas.

### HOW WE ENGAGE

- Regular meetings and liaison with partners such as the Wildlife and River Trusts in our operational areas in relation to specific strategic projects and objectives
- Regular attendance by operational colleagues at local, regional and national working groups, forums and partnership meetings to ensure business position and narrative are represented and that information gathered is fed back into the business
- Our senior leadership team, including CEO Susan Davy, meets routinely with CEOs and leaders of environmental organisations and charities
- Regular meetings with the Environment Agency as environmental regulator, both at strategic and catchment level.

**100%**  
Costal bathing water  
quality

### KEY CHALLENGES AND HOW WE ARE RESPONDING

- We keep stakeholders abreast of latest news and messaging from the business - through regular review and revision of our stakeholder communication and engagement strategy
- We ensure the business keeps abreast of stakeholder news and development – through regular review and revision of our engagement strategy.



## Suppliers

### WHO THEY ARE

As a large organisation we work with a large and diverse supply chain. Our supply chain partners play a vital role in supporting sustainable growth and cost base efficiency across the business.

### WHY WE ENGAGE

We are committed to ensuring our supply chain partners align with the same values, standards and behaviours we expect of ourselves. Through rationalising and segmenting our supply base to reflect either strategic, key, preferred or transactional relationships, we are developing an approach that maximises our engagement with each supply chain partner. As a signatory to the EU Skills Accord, we work collaboratively to support skills development and investment throughout the supply chain and as part of our ESG and Net Zero strategy we engage our supply chain so that we can better understand and manage our collective environmental impact through collaboration.

### HOW WE ENGAGE

- Regular meetings and communications
- Supplier reviews and audits
- Code of Conduct for Supply Chain Partners
- Sustainable Procurement Policy
- Formal contracts and framework agreements
- E-procurement and Risk Management platforms

**100%**  
of our supply chain engaged  
with our Code of Conduct for  
Supply Chain Partners

### KEY CHALLENGES AND HOW WE ARE RESPONDING

- We minimise risk of supplier failure and/or insolvency – although comprehensive due diligence checks and continually seek to strengthen resilience within our supply chain
- We mitigate current market and macro environmental impacts – through collaborative working with our suppliers to ensure early awareness and joint resolution to potential issues.

## Our regulators

### WHO THEY ARE

We have an open dialogue and meet regularly with our regulatory bodies: Ofwat, the Department for Environment, Food & Rural Affairs (Defra), the Environment Agency, Drinking Water Inspectorate and the Health and Safety Executive (HSE).

### WHY WE ENGAGE

We ensure that our business plans address our regulators' priorities and concerns, for our strategy, performance, risks and opportunities and delivery for customers.

We also engage with key trade and customer bodies, including CCW – the voice for water consumers. We have a well-established independent WaterShare customer panel which reviews and challenges our performance against our business plan commitments and, to support the development of our five-year business plan, we have established an independent WaterShare+ advisory panel.

## HOW WE ENGAGE

- Regular meetings
- Reports and reviews
- Consultations
- Workshops

**100%**  
regulators engaged each year

## KEY CHALLENGES AND HOW WE ARE RESPONDING

With technological advances and a heightened focus on the environment, our customers and stakeholders want us to go further to protect the environment by assessing and responding to water quality and water scarcity issues. This is against the backdrop of changing weather patterns, increased growth and urbanisation, and wider pressures on household incomes. We are collaborating with our regulators to ensure the regulatory framework can meet these challenges, and support the identification of the right business plans to meet current and future needs.

### Policy makers

#### WHO THEY ARE

Our stakeholder strategy includes building an open and transparent relationship with the widest range of policy makers, from local MPs, who seek to reflect the local priorities of their constituents, to UK government who ultimately set water priorities and policy, through bodies such as Defra, Natural England, and the EA.

In addition, we collaborate with third parties such as the CBI and Chambers of Commerce helping to ensure that the voice of business in the UK is heard.

#### WHY WE ENGAGE

Water is a precious national resource, requiring water companies and policy makers to work together to deliver the best possible outcomes for the environment, customers and communities.

As one of the largest employers and businesses in the South West, we have a responsibility to support the local economy and support growth in the region.

## HOW WE ENGAGE

- We are a member of Water UK, which works with government, regulators and stakeholders to develop policy on water and the sustainable delivery of water services in the UK.
- At a local level, we meet on a regular basis with MP's, hosting site visits and constituency-based meetings. We also contribute to round table debates as and when relevant to do so.
- We regularly respond to all consultations, and over the past 12 months, appeared before the Environmental Audit Select Committee into river water quality.
- We are one of the founding members of Back the South West campaign, and in July 2021, published our response to the G7 legacy, 'Levelling Up the Great South West'. This has helped focus our social mobility activity and recruitment opportunities across the region, offering varying roles and opportunities for the range of our communities, providing jobs across our operations and bringing in talent and diversity into the business.

**100%**  
of corporate  
partnerships  
aligned with the  
stewardship of  
responsible  
business,  
community and  
environment

## KEY CHALLENGES AND HOW WE ARE RESPONDING

Over the next 25 years and beyond, the water sector faces challenges from population growth, climate change, rising environmental standards with the Environment Act and evolving customer priorities.

These challenges will require further investment, and continuing evolution of the sector's regulatory framework, to be able to flex to meet changing priorities and meet the needs sustainably, whilst keeping customer bills low.

We continue to work collaboratively with policy makers, to ensure we can deliver these commitments, now and in the future, playing our societal role as well as investing for the future.

For example, our c.£82 million investment in Green Recovery for the region, our Net Zero plans to 2030, and most recently WaterFit, which sets out our plan to improve river and sea health, working in collaboration with others in the region.

# SECTION 172(1) STATEMENT

## OVERVIEW

All of our decisions are considered against the importance of acting in a sustainable, ethical and collaborative way, understanding the views of our different stakeholders and weighing their competing interests.

Our Board leads and sets the tone by carefully noting the priorities of our stakeholders during its discussions and when it takes decisions. We also know the importance of continually assessing the long-term impacts of our decisions. This helps us live our purpose and our values, as a responsible, trusted and sustainable business acting in a way which benefits all our stakeholders as much as possible. Properly understanding the impact of what we are doing has become part of how we operate.

## OUR s.172 APPROACH

Each Director has a duty to act in the way they consider, in good faith, would be most likely to promote the success of the Company for the benefit of members as a whole, and in doing so, must have regard to a range of broader issues. Therefore, when we make decisions, we always take full account of the following:

- the long-term consequences of our decisions
- ensuring we maintain our reputation for the highest standards of business conduct
- the interests of our employees
- the impact our operations have on our on our community and environment
- the importance of having excellent business relationships with suppliers, customers and anyone else who we impact

As part of every decision we make, we look at how we will impact our stakeholders. To enable us to understand the points of view of our stakeholders and where our decisions could affect them, we have a stakeholder engagement programme. We see stakeholder engagement both as fundamental to development and delivery of our purpose and strategy and as critical for our long-term sustainable success. Although there are often competing interests and priorities involved, being clear on what matters to our stakeholders, allows our Board to weigh-up all relevant factors.

## MATTERS CONSIDERED BY THE BOARD

Below are examples of decisions taken by the Board during the year and how Stakeholder views and inputs, as well as other s.172 considerations, were considered.

Matter	Section 172 Considerations	Our Engagement	The Board's Role
Net Zero strategy	We recognise our vital role in playing our part to reduce pollution, whilst also delivering against worldwide climate change priorities within our region and our stewardship of essential resources is critical in this, to ensure that we are supporting	In line with our strategy, a significant part of which is focused on our environmental and social impacts, we have developed initiatives following discussion with our regulators and government, presentations to customer focus groups including the WaterShare+ Advisory Panel and reviews with suppliers.	This resulted in Board approval of a Pollution Incident Reduction Plan and monitoring progress of the plan, regulatory and environmental compliance, Board approval of the strategic plan and roadmap agreed, with ongoing monitoring to ensure we meet ever more stringent

Matter	Section 172 Considerations	Our Engagement	The Board's Role
	<p>our communities and the places they love for generations to come.</p>	<p>We engaged with our employees via the Big Chat and the employee survey, which indicated strong support from employees for our approach.</p>	<p>regulatory and public scrutiny.</p> <p>The Board's decision-making process was based on its objective to ensure that the business is environmentally and socially sustainable in the long-term. The Board reviewed these initiatives throughout their development taking into account the engagement with all those whose interests would be affected by its plans, with ongoing Board monitoring of progress, to ensure tracking to the previously approved plans.</p> <p><b>Key stakeholders:</b></p> <ul style="list-style-type: none"> <li>• <b>Shareholder</b></li> <li>• <b>Policy Makers</b></li> <li>• <b>People</b></li> <li>• <b>Customers</b></li> <li>• <b>Environment</b></li> </ul>
<p>Pollution reduction</p>	<p>We have a vital role to play in pollution reduction within our region, which speaks to our determination to operate in an environmentally sustainable and responsible manner. We developed our Pollution Incident Reduction Plan following intensive review and engagement with stakeholders and alignment with our wider customer engagement processes.</p>	<p>In building our processes around pollution reduction, we deliberately focused on environmental and related societal impacts, based on key deliverables and metrics agreed with our regulators. We listened to customer focus groups, including the WaterShare+ Advisory Panel and other relevant stakeholders in assessing our environmental impacts and planning our response. This has allowed us to deliver a Pollution Incident Reduction Plan achieving:</p> <ul style="list-style-type: none"> <li>• significant reduction of the number and impact of pollution incidents on customers, communities and the environment</li> </ul>	<p>The Board's approval process around our plan and roadmap was based on its objective to ensure that the business is environmentally and socially sustainable in the long-term, with a real understanding of the points of view and interests of relevant stakeholders. During development and review of the Pollution Incident Reduction Plan, the Board specifically considered the outcome of engagement with all those whose interests would be affected. The ongoing Pollution Incident Reduction Plan includes mechanisms allowing monitoring of plan progress and regulatory /environmental compliance ensuring that we can meet and react appropriately to</p>

Matter	Section 172 Considerations	Our Engagement	The Board's Role
		<ul style="list-style-type: none"> <li>• reduction of the financial and regulatory impact of pollution incidents</li> <li>• through aligned initiatives, providing other positive impacts on the environment</li> <li>• improvement of environmental outcomes and better public perceptions.</li> </ul>	<p>ever more stringent scrutiny from our stakeholders, including regulators, Government and the public.</p> <p><b>Key stakeholders</b></p> <ul style="list-style-type: none"> <li>• <b>Shareholder</b></li> <li>• <b>Policy Makers</b></li> <li>• <b>Regulators</b></li> <li>• <b>People</b></li> <li>• <b>Customers</b></li> <li>• <b>Environment</b></li> </ul>
<p>COVID-19 response</p>	<p>The continuing safety of our employees, customers and other stakeholders, whilst maintaining operational effectiveness was paramount during the pandemic and we were quick to put in place appropriate measures to mitigate any adverse impacts.</p>	<p>We continued the measures implemented in 2020, which required working closely with our employees, regulators and customers, including many customers who were vulnerable. Our employee engagement included regular briefings and question and answer sessions both at a company and team level around measures to ensure their ongoing health, safety and wellbeing, whilst delivering our essential operations during sustained periods of lockdown and uncertainty for many. Our engagement with regulators included two-way reviews both of our business continuity plans and our specific and company-wide health, safety and wellbeing measures across our entire operation and all sites.</p>	<p>The Board receives ongoing updates via its H&amp;S reports, with particular focus on the following:</p> <ul style="list-style-type: none"> <li>• Health, safety and wellbeing of employees and customers</li> <li>• Continued delivery of essential services</li> <li>• Helping vulnerable customers</li> <li>• Financial security for employees</li> </ul> <p>This has resulted in maintaining a solid funding and liquidity position, with no requirement for government financial support and strong Board support for measures taken by the management team and maintained throughout the year.</p> <p><b>Key Stakeholders:</b></p> <ul style="list-style-type: none"> <li>• <b>Shareholder</b></li> <li>• <b>Policy Makers</b></li> <li>• <b>People</b></li> <li>• <b>Customers</b></li> </ul>

# COLLEAGUES, CUSTOMERS AND COMMUNITIES 2021/22

## PERFORMANCE

### **SUPPORTING THE LIVES OF PEOPLE**

Our purpose is to support our people and communities to increase our social value. Therefore as a business serving a population of c.2.3 million customers over 1,700 employees, we go to great lengths to protect one of our most precious resources.

#### *AREA OF HIGHEST IMPORTANCE FOR 2022/23*

We continue to provide excellent service to our customers through our talented employees, with most targets achieved across these areas. We remain on track with our plans targeting 9th position in the industry in 2025.

Our drinking water quality (CRI) performance was impacted by one-off events in 2021/22, however underlying performance remains strong, achieving above the industry average of 3.56. Our future plans include innovative research into advanced treatment technologies, including ceramic membranes and granular activated carbon, which is designed to ensure compliance measures improve in future years. Further resilience improvements being delivered across a number of our water treatment works will enable us to proactively intervene before failures occur.

In September 2021 South West Water successfully implemented the globally recognised B4SI framework to capture the qualitative outputs our community investments generate. In 2021/22 South West Water invested £580,000 in local businesses and charities across the South West, with this planned to increase by 30% by 2025.

# OUR PEOPLE STRATEGY

Our people strategy is all about, 'talented people doing great things for customers and each other'.

This means that we are focused on doing everything we can to recruit, train, develop and support all of our employees, whatever their background, experience or outlook, unlocking their potential now and for the longer term.

At South West Water, we believe our people are our most valuable asset. We are proud of the values we live by in all that we do.

We were delighted when our parent company was recognised as the winner in the longest-running annual survey of corporate reputation in the UK – Britain's Most Admired Companies awards (Utilities) for the second year in a row. This award demonstrates our commitment to engaging employees in our strategy and the important role they play in delivering it.

During the year, we have made a significant step-change improvements in the following people activities:

- Emerging talent programmes
- Leadership development
- People engagement
- Employee wellbeing.

## **SUPPORTING THE DEVELOPMENT OF OUR TALENTED PEOPLE**

### *TRAINING AND DEVELOPMENT*

We have a strong commitment to investing in the development of our employees and in building and recognising talent across the Group. Training and development is available for employees at all levels within the Company and is actively encouraged. Our aim is to increase productivity, job satisfaction and safety, and to equip the next generation of leaders and employees with appropriate knowledge, skills and the competencies they need to thrive.

To demonstrate our commitment to investing in the next generation further, we signed up to the 5% Club, committing to have at least 5% of our employees on structured apprenticeship or graduate programmes. We are delighted to report that we currently exceed this target with over 10% of Company employees on these programmes.

During the year, we delivered 12,981 training days for our c. 1,700 employees, ensuring that on average each employee received 56 hours of training.

### *LAUNCHING OUR NEW GRADUATE PROGRAMME*

In 2021, we successfully launched our brand-new Graduate Programme, committing to graduate recruitment for many years to come. We set a commitment to recruit 100 new graduates on a structured two-year programme of training, work experience and career development by 2025.

In year one, we set out to recruit 20 high calibre graduates largely undertaking placements rotating across Drinking Water, Wastewater, Engineering and Customer Services to ensure they develop a broad understanding



of these vital functions of the business and develop their operational and managerial knowledge. The quality and diversity of applicants was high so we extended the number of placements to 28. More business functions have been keen to join the programme which has supported the increase. 57% of the graduates are female and 54% are from ethnic minority backgrounds or from outside of the UK which is supporting our aim to make our workforce more diverse.

### *KICKSTART*

We continued to live our values and demonstrate we are a responsible employer during the year, doing what we can to support communities in the South West.

South West Water was one of the first water companies and the first in the South West to sign up to participate in the Government's new Kickstart scheme in 2021, offering 16-24 year olds, deemed at risk of long-term unemployment, six-month paid work placements. We committed to offering 50 placements and we are delighted to have exceeded this number, offering a total of 54. It is also very pleasing that over half of those completing their training and work placements have chosen to take up offers of employment with us.

### *APPRENTICESHIPS*

We continue to embrace apprenticeships. 92 new apprentices started with South West Water in the last year. This brings the total number of new apprentices we have supported since 2017 to 425 across the Company. We continue to have a strong focus on recruiting operational apprentices to ensure we have the future skills to deliver our essential services. To demonstrate our ongoing commitment to apprenticeships further, we set a target to offer 500 new apprenticeships over the next three years to the end of 2025. We are ahead of schedule with 209 currently in training.

### *LEADERSHIP DEVELOPMENT*

We have continued to invest in our senior leaders talent development programme to provide structured assessment and development workshop opportunities for our top 60 leaders. This programme was rolled out across the whole company during the year.

### *LISTENING AND ACTING ON EMPLOYEES' VIEWS*

Under the Financial Reporting Council's (FRC) code of standards, companies are required to explain how they are incorporating employee views in Board decisions. You can read more on how the Board are engaging and making decisions in our Section 172(1) statement on page 20.

Over the course of this year, we have continued to develop and evolve the opportunities for employees' views and input as well as enabling employee forums across the company to ensure employees are represented and have opportunities to understand and feed into discussions on matters that impact them and the work they do.

### *CREATING THE BEST PLACE TO WORK*

Responsible and trusted businesses today have a duty to make a positive societal contribution – whether that's through promoting social mobility, addressing racial and gender inequality, or in providing secure and meaningful employment where all employees are paid fairly for the work they do.

We know companies with high trust cultures enjoy better financial results, outperform the market by 2-3% a year over a 25-year period, have strong leadership, a talented workforce and are more collaborative and innovative.

We are officially a 'Great Place to Work' for a second year. We asked employees how it feels to work for South West Water using the Great Places to Work Best Workplace Survey™. We achieved our highest ever participation rate of 85% and again passed the threshold to become accredited as a Great Place to Work for the second year in a row.

The survey measures effectiveness in a range of categories including Innovation, Maximising Human Potential, Values, Leadership Effectiveness and Wellbeing. We were extremely pleased to see very high scores supporting our diversity, equity and inclusion priorities with employees believing people are treated fairly regardless of race (92%) or their sexual orientation (91%) and gender (89%). This is strong recognition of the Company's approach to diversity, equity and inclusion. Equally, our unwavering determination to further improve health and safety were supported in the employee responses to the questions, 'my manager takes health and safety seriously' (91%) and 'my safety related responsibilities have been explained' (89%). It was also pleasing to hear colleagues believe 'the organisation has supported me well during COVID-19' (85%).

These results show we have made good progress during the year in embedding the company's people strategy and ensuring our employees have felt supported.

#### *EMPLOYEE FORUMS*

The South West Water Employee Engagement Forum is a well-established forum which meets regularly to create two-way communications between senior managers of the Group and employees. During the year the forum has been relaunched and rebranded as RISE. It will be more inclusive, and employee led, with each area of the business establishing its own forum that feeds into the broader, group wide forum chaired by the Group Chief Executive Officer. We received 72 employee applications from colleagues to join RISE, pleasingly significantly higher than our initial target of 50. This forum helps to influence and support business changes and ensures that our employees are front and centre in all that we do, including being the employee voice in the evolving changes to working arrangements in response to COVID-19 during the year.

We also have trade union recognition agreements in place for our Craft and Industrial employees and continued to meet frequently across the year to discuss relevant topics including employee health, safety and wellbeing, pay awards, business planning, employee survey and engagement, IT system developments and innovation. During 2021/22, we refocused our employee forums to ensure they remain relevant to employees, focus on the key activities which impact employees and effectively engage with the wider workforce.

#### *SPEAK UP*

Our Speak Up whistleblowing policy continued to operate throughout 2021/22, providing another engagement channel. Speak Up helps to create an open, transparent and safe working environment, where workers feel able to speak up and are supported if they do so.

#### *ENHANCING OUR EMPLOYEE COMMUNICATIONS*

During the year, we developed a new employee communications and engagement programme reflecting improved and multiple approaches. Our Big Chat - our regular all employee virtual meeting via Microsoft Teams - where all employees have the opportunity to attend, enabled all employees access to the Executive. It created opportunities to ask questions and suggest topics that employees would like to hear more about. The new fortnightly frequency ensures regular and timely updates are provided to employees. We continued to receive positive feedback from employees who welcomed the opportunity to hear from the Executive team and ask them questions on key business matters.

Throughout the year and in line with Government guidelines, where possible, many of our office-based teams have been working from home, placing greater importance on supporting our employees with regular communications. Discussions have largely focused on health and safety, COVID-19 working arrangements, employee wellbeing, business plan delivery, investments in graduates, apprenticeships and Kickstarters and future workforce development.

For our remote teams, working tirelessly during the pandemic, we hosted regular virtual breakfast briefings with the Chief Executive Officer and other senior leaders. These have proved to be helpful in promoting more effective two-way communication. Additionally, all employees are invited to pose questions or comments to our Chief Executive Officer following the introduction of 'Ask Susan' and this has developed into a popular route for further engagement.

During the year, our employee communication enhancements have delivered:

- New Hub Intranet launch for all colleagues – making connecting with the latest updates, news and sharing files across teams easier
- Increased frequency of Big Chats, accessible for all colleagues. More varied topics and wider speaker programme including the Board and CEO, for the most important business updates
- Virtual colleague and leadership meetings to showcase the improvements in Microsoft Office 365 tools and the new digital spaces we have
- Weekly news roundup for all colleagues across multiple channels and developing how we tell the internal business story
- Yammer launch as a way for all colleagues to socially engage with each other in a more informal setting but with all the security, accessibility and ease of use that 365 offers
- Internal recruitment campaigns with spotlight vacancies and highlighted opportunities across apprenticeship, graduate and Kickstarter programmes
- Continuous colleague updates on COVID-19 and measures to ensure every colleague can carry out their role in a safe manner
- Ensured that our business vision and values were prominent in communications as we launched our 'Uniting colleagues against climate change' Yammer community and focused on the work that our Net Zero Pioneers are doing
- Celebrated our achievements through 2021 with a roundup of the good work we've done through the pandemic – showcased every colleagues hard work, dedication and drive to be able to bring water to life
- HomeSafe Heroes launch to celebrate the work of our colleagues across the business who make sure that everyone goes home safe every day.

## **PRIORITISING HEALTH AND WELLBEING**

### *OUR WELLBEING STRATEGY*

As a responsible employer, we have a vital role to play in ensuring colleagues' wellbeing and mental health is the best it can be. During the year, we made significant progress on our wellbeing strategy. Our activities are based on four wellbeing pillars: mental, community, financial and physical.

Our wellbeing strategy is about developing a culture where health, wellbeing and safety are as important as anything else we do and we want to make sure everyone goes home safe and well each day. Positive interventions around health and wellbeing have been proven to be an effective way of driving employee engagement and reducing absence levels and form the cornerstone of our approach.

Mental health remains an important issue in society and is one of our top five reasons for absence, requiring continued focus, engagement and prioritisation.

### *2021/22 ACHIEVEMENTS*

We have launched a number of initiatives this year to position us as a leader in health and wellbeing and create a culture where mental health is an everyday conversation. Our achievements include:

- signed up to the InsideOut Charter - a social enterprise providing a tangible way of demonstrating leadership and action to the mental health agenda by committing to a number of core, actionable principles
- trained 55 new Mental Health First Aiders (MHFAs) in the year. We now have the same ratio of MHFAs to employees as we do for physical first aid at around 1:40
- redelivered our e-learning module on mental health to all employees
- delivered 'Mental Wellbeing in the Workplace' training for managers to help them gain a broad understanding of stress, mental wellbeing and mental health conditions as well as tools and techniques to assist them in promoting positive mental wellbeing and discussing mental wellbeing with individuals and their teams
- took part in national wellbeing events with external speakers to support in educating our teams and provide tangible actions to improve wellbeing. These include: Mental Health Awareness Week and Movember. During Mental Health Awareness week all colleagues were sent a 'Bee Bomb' (handmade wildflower seed balls) to encourage them to support the 2021 theme of spending time in nature
- established our 'Time to Talk' and 'This is Me' sessions to encourage open conversations between colleagues and break down the stigma that surrounds mental ill health. The aim is to encourage open discussions and improve attitudes and behaviours towards people with mental ill health, dispelling myths and crucially, raise the importance of mental wellbeing. In the monthly Time To Talk sessions, internal or external speakers focus on topics that are of interest to employees including sessions on Mental Health and Wellbeing and WaterAid, our charitable partner. The This is Me initiative explores mental health challenges where internal and external speakers explain the challenges they have faced and how they have dealt with them
- launched an internal Wellbeing Champions network. The purpose of this group is to deliver campaigns, increasing awareness of all aspects of wellbeing; and
- launched the new Champion Health portal for all employees - a wellbeing platform that covers every area of health, complimenting existing wellbeing services and campaigns. It covers mental health, women's health, men's health, financial wellbeing, performance, activity, energy levels, parenting, nutrition, musculoskeletal health, leadership, cardiovascular health, cognitive functioning and much more. The data from the platform will be used to identify trends, gaps and opportunities and help focus our wellbeing activities in the right areas.

### *WHAT'S NEXT*

Whilst we have made excellent progress this year, we have further plans for the coming year with initiatives including the launch of our Wellbeing Awards, a focused Wellbeing Survey, the expansion of the Champion Health app, the development of our training and speaker programmes and the introduction to our first Mental Health focused annual reporting.

### *LAUNCHING OUR NEW EMPLOYEE NETWORKS*

We recognise and appreciate the importance of creating an environment in which all employees feel valued, included and empowered to do their best and share new ideas. Employee networks play a key role in encouraging and supporting employees in bringing the best version of themselves to work, contributing to an inclusive environment and building a sense of community.

Our employee networks providing:

- Peer to peer support, providing psychological safety to the group's members
- Awareness, sharing stories and learning opportunities with the wider business
- Accountability, providing support and contributing to the broader Diversity, Equity and Inclusion strategy, especially through lived experience

The nine employee network groups support:

- Race, Ethnicity and Cultural Heritage
- LGBTQ+
- Women
- Menopause
- Grief
- Financial Wellbeing
- New Parents
- Carers
- New Starters

#### *HOMESAFE - OUR FLAGSHIP HEALTH AND SAFETY PROGRAMME*

The Company's flagship health and safety programme, HomeSafe, continues to provide the framework for driving significant improvements in all health and safety activities. HomeSafe is built on the six strategic pillars; Managing Risk, Sharing & Learning, Working Together, Protecting Health, Enabling Leaders and Being Resilient.

We are developing a culture where every person takes ownership to ensure they and their colleagues go HomeSafe every day. In pursuit of this, Rich Rogers joined us in March 2022 as Director of Health and Safety, bringing 30 years of operational water sector experience and a track record for delivering best in class health and safety cultural change programmes translating to sector-leading performance. Within four months of Rich joining us, we had refreshed our HomeSafe strategy, targeting the key areas against each strategic pillar to improve risk management and reduce harm.

At Board level, we set out the ambition to have our best year ever on health and safety, measured by delivering our lowest ever injury numbers. We set out to achieve this through increasing Senior Manager engagement, improving incident investigations leading to better learning and sharing, improving collaboration through the new HomeSafe working group comprised of employee representatives at all levels to help shape, test and drive our strategy, increasing local ownership through hazard identification and our highest ever investment levels.

Reconnecting face to face with our employees has seen over 210 Senior Manager site visits across our region in the year providing leaders with the opportunity to see work as it is done and better support a healthier and safer working environment. 97% of visits have been described as useful or very useful by the hosts. We trebled

investment to improve the safety of our working environments and targeted specific improvement programmes as a direct result of comprehensive learning from incidents.

To showcase the great behaviours seen in many areas, we launched our HomeSafe Heroes scheme, where an employee can nominate a colleague for an award for any activity or intervention in support of our Homesafe principles and ambition. We have seen 48 nominations in the six months since launch and this is increasing as more people celebrate the great work their colleagues are doing, sharing great ideas and behaviours encouraging others to join the HomeSafe revolution.

Lost Time Injury Frequency Rate (LTIFR) LTIFR continues to be the company's primary measure of H&S performance. Against our ambition of our best year ever, (no more than 23 LTIs across the Company), we outturned at 22 Lost Time Injuries compared to 29 reported last year, delivering this ambition.

### *ENGAGEMENT PROGRAMME*

Building on the HomeSafe six strategic pillars, we launched an engagement programme bringing HomeSafe to life for everyone. This was built on a new multimedia platform, broken into eight bitesize modules, providing a full HomeSafe education programme. This was designed to set us up to deliver our best year ever again.

Our targets are ambitious, however ensuring everyone who works for us, with us or interacts with us goes HomeSafe everyday is paramount, and that requires us to have ambitious plans.

### *FUTURE PLANS*

HomeSafe is not a project to be completed. It is the way we work and deliver all our performance commitments. We recognise any injury is one too many, and have very ambitious HomeSafe 2025 plans to improve health and safety across the Company, requiring us to have our best year ever, year-on-year. We have set out our roadmap to 2025 to move us towards being leaders in health and safety in the water sector.

## **DIVERSITY, EQUITY AND INCLUSION**

### *CREATING A DIVERSE WORKFORCE*

Our parent company is one of a handful of top FTSE businesses to have both a female CEO and Chair. Ranking number 10 in the FTSE Women Leaders Review (previously Hampton Alexander) of the FTSE 250 for number of females on the Board, also exceeding the 40% target.

If there was ever a time for us to put gender and ethnic diversity at the top of our agenda, then that time is now. Building a sustainable, agile and diverse workforce is a key pillar of our People strategy. Once again, South West Water's parent company, Pennon, were listed in the 2022 Bloomberg Gender Equality Index, as one of 418 companies globally committed to disclosing their efforts to support gender equality through policy development, representation and transparency.

We have continued to make progress in this area through strong leadership and our gender diversity has improved for the third year running. With a workforce of over 1,700 employees, the gender split is 78% male and 22% female.

South West Water operate in the South West of England, an area which traditionally has some of the lowest proportions of ethnic diversity in the country. However, as a responsible business, we believe we have an

important role in ensuring we support mobility of all types. Over the last year, we have increased our proportion of ethnically diverse employees significantly, from less than 0.5% to 1.23%. This increase has come from our more targeted recruitment approaches clearly acknowledging we welcome applications from ethnically diverse applicants. Despite the good progress we have made during the last year, we recognise there is still much more to do if we are to achieve our ambition to have a much more diverse workforce.

#### *ACCESSIBILITY AUDIT*

In 2021/22, we carried out access audits across our Head Office in partnership with EMBED who will support us on our Diversity, Equity and Inclusion journey. Being part of an inclusion journey means feeling included and part of conversations to review existing services, policies and procedures, alongside knowledge and information sharing to create and build up inclusive workplaces and services. As part of that journey, we are looking at how accessible we are as an employer, particularly in the locations and facilities we make available for all our colleagues. Ensuring our sites are inclusive is important as they represent the collective services and practices which customers, colleagues and potential talent identify and engage with. The sites can indicate to customers and employees what the organisations commitment is to accessibility and inclusion throughout the physical building and how services are understood and initiated to be inclusive. We are now working with EMBED following the outcome of the audit to create an action plan to further improve our locations and facilities. We have recently installed a multi-faith prayer room in our Peninsula House office.

But it doesn't stop there. We recognise that our offices are not the sole representation of South West Water. Colleagues out in the field are a vital part of serving our customers and are critical to the conversation of understanding lived experience and in identifying what positive actions are required to improve accessibility and inclusion for all. Therefore, whilst we started with these two buildings, we will be auditing other locations throughout 2022.

#### *CBI CHANGE THE RACE RATIO INITIATIVE*

In 2020, Pennon pledged its support to the CBI Change the Race Ratio initiative (of which South West Water adopted), a campaign to increase racial and ethnic participation in the senior leadership of companies, as a route to encouraging more diversity at all levels and was the first water company to do so. During 2021/22, our pledge and ongoing commitment continues to help shape our business activities and decisions.

#### *10,000 BLACK INTERNS INITIATIVE*

As part of the Pennon Group structure, we are proud to be a supporter and sponsoring business of the 10,000 black interns initiative. We initially set out to offer six paid work experience internships. We were so impressed with the quality of applicants and the wider support from the business that we have offered 13 placements with the hope that many of these talented graduates will continue to work for us beyond their placements. This important scheme not only offers black students an opportunity to understand our business but also to improve the levels of ethnic diversity across our industry.

#### *RECRUITMENT*

Changing our approach to diversity and inclusion has also changed the way we monitor diversity in all company job applications. The Company uses a software gender decoder tool which allows us to check all of our job advertising for masculinity to reduce the potential risk of alienating female applicants. In addition, we have refreshed our equal opportunities forms to be included in all onboarding packs. The new version allows us to monitor, analyse and utilise diversity data to inform and shape our business activities to become a more diverse

workplace. We also refreshed our job adverts to ensure they clearly demonstrate that we are a diverse employer and welcome applications from all ethnicities. Our recent success is most notably seen in our 2022 Graduate Programme recruitment which received 1,064 applications with 56% of them coming from ethnically diverse applicants.

### *TRAINING*

We have continued our programme of Unconscious Bias training and have rolled this out to the majority of our senior leadership and hiring managers during the year.

We held Lived Experience group sessions to understand what it is like to work at South West Water for employees from minority groups. The outputs have been shared with our Diversity Committee to understand these perspectives and consider appropriate actions when issues are raised.

### *WOMEN IN WATER NETWORK*

South West Water is part of the Women in Water network, supported by Water UK, and aims to encourage women into the water industry, support their development into more senior roles and ensure that their industry voices are heard.

### *OUR GENDER PAY GAP*

The gender pay gap for the Company in 2021 stood at 6.7%.

During 2021, we recognised colleagues' loyalty and dedication to customers with an additional discretionary bonus. The full bonus was paid to all employees irrespective of whether they work full or part-time and this one-off payment has inflated the mean bonus pay gap artificially. This has contributed to a negative mean bonus pay gap of -28.4%. The median bonus gap which compares the male and female employee at the 50% percentile of each gender group was 0%.

The company continues to develop greater gender alignment in middle manager and senior positions and is seeing strong progress in this area. South West Water is an active supporter of the Women in Water initiative.

During the year, we were recognised for our progression in gender equality by external bodies. In early 2022, our parent company, Pennon, was recognised in the FTSE Women Leaders survey, previously the Hampton Alexander review). Pennon came first in the Utilities sector, ranking tenth overall in the FTSE 250 group compared with 23rd in 2021 and positioned 16th as a Best Workplace for women. Our performance in the Bloomberg Gender Equality Index also showed improvement. The index measures gender equality across five key areas.

### *SOCIAL MOBILITY PLEDGE*

We continue to be a signatory of the Social Mobility Pledge, the cross-party campaign to improve social mobility in the UK established by the Rt Hon Justine Greening MP. This pledge reflects our social commitments through our partnerships with local schools, our open-door approach to visitors and our provision of work experience opportunities. As part of our Social Mobility Pledge, we are undertaking a gap analysis to help us develop a detailed action plan to drive further improvements during this year. Our head office and customer call centre are based in Exeter, providing jobs and investment to the local community. In addition to directly employing c. 1,700 employees, South West Water employs up to a further 100 temporary employees and contractors.



### *SLAVE-FREE ALLIANCE MEMBERSHIP*

Also, as part of the Pennon Group, we have maintained its membership of the Slave-Free Alliance, which is part of Hope for Justice, the global anti-slavery charity. Our membership demonstrates our commitment to the highest employment standards for both our direct employees and those within our supply chain.

### *HUMAN RIGHTS*

We are fully supportive of the principles set out in the UN Declaration of Human Rights and the Group ethics policy outlines the high standards of employment practice with which all employees of South West Water are expected to comply with. The Company also supports the International Labour Organisation's core conventions for the protection and safety of employees wherever they may work throughout the Company. These standards are also embedded in our sustainable supply chain and documented in our procurement policy and Code of Conduct for supply chain partners.

# OUR CUSTOMERS AND COMMUNITIES

## *BUILDING A DEEPER RELATIONSHIP WITH CUSTOMERS THROUGH WATERSHARE+*

We believe there's no better way to respond to or capture public sentiment than building a deeper relationship with customers – really engaging with them and putting them at the heart of our decision-making.

That's why, as part of our New Deal Business Plan, we launched our innovative and pioneering WaterShare+ scheme, sharing £20 million of outperformance with customers, and giving them not only a say in what we do, but a stake in our parent company too.

Shaped by customers for customers, its origins were in the largest ever customer consultation we have undertaken. One in 16 households in our region are now shareholders in our parent company Pennon as well as customers, heralding a new era in customer ownership – a true partnership.

Sharing our success with customers is at the heart of WaterShare+ and put simply, if we deliver, customers also benefit.

Our independent WaterShare+ Advisory Panel, chaired by Lord Matthew Taylor, also provides a strong platform to empower customers, having held four quarterly public meetings this year in addition to the industry's first Customer Annual General Meeting in November 2021, enabling our customers to talk directly with the executive team about those matters most important to them. This is just the start of real and honest customer engagement, resulting in a richer and deeper relationship with customers.

Membership of the Panel is strengthened with expert advisors from the Consumer Council for Water, Environment Agency and Natural England. All provide specialist insight and challenge to the company on behalf of our customers.

## *HELPING WHEN IT MATTERS MOST*

South West Water's New Deal included a pledge to eliminate water poverty by 2025 by expanding the toolkit of affordability support to those who need it most.

We have continued to work hard to deliver quality services at an efficient cost, so that bills remain as low as possible - South West Water's bills are lower in real terms than they were 10 years ago thanks to our continued focus on driving efficiency through innovation. Announcing average bills would be lower in 2022/23 was particularly important for our customers meaning that whilst the majority of utility prices are increasing, our average bill will be reducing at this critical time. In 2021/22, we increased the number of customers benefiting from one or more of our affordability initiatives including social tariffs. These tariffs provide discounts to bills or a level of bill certainty to suit customers circumstances. We are targeting a further increase in 2022/23 as we work to address water poverty for all our customers by 2025, in line with South West Water's Board Pledge.

Alongside ensuring our bills remain as low as possible, South West Water's innovative WaterCare+ programme continues to offer support to customers through a number of initiatives including direct account reviews and benefit entitlement checks, in addition to working in partnership with organisations such as Social Housing providers and Carer organisations to ensure that our schemes are promoted and easy for our customers to access. Since the start of this regulatory period, we have unlocked almost £18 million of support for customers in the first two years, through a programme of physical and virtual home visits to help customers ensure they are

receiving all eligible benefits. As a result, they are financially better off – 93.3% of customers now find bills affordable, up from 89% last year.

### *STRIVING FOR SERVICE EXCELLENCE*

During the year, South West Water saw a c.60% reduction in written complaints, maintaining our position as an upper quartile company. The level of total complaints has fallen significantly, reflecting customer experience improvements implemented along with shortening resolution timescales.

At South West Water Customer satisfaction, as measured by Ofwat's Customer Measure of Experience (C-MeX), performance is not where we would like it to be (ranked 12<sup>th</sup>), and is an area where we're focusing our improvement efforts. Improved customer communications, using new channels convenient to our customers and a new education campaign form part of our plan to improve performance in this area.

### *OUR COMMUNITIES*

There are many amazing community projects which make a real difference to the lives of our region's people and the places they love. That is why we are tapping into the social consciousness of our customers in new ways through the industry's first Water Saving Community Fund, empowering customers to champion and drive initiatives to save water locally, as well as our Neighbourhood Fund which is supporting communities with much needed help.

Since launching our two funds in 2020, we've supported over 100 brilliant causes across the region. Our Neighbourhood Fund has supported vital local projects such as repairing buildings and providing sports equipment, to helping vulnerable people. Through our Water Saving Community Fund, we've inspired communities to get involved in saving water. This has already resulted in an estimated yearly saving of around c.59 million litres!

Playing our part in the community South West Water's revamped school's education programme is aimed at developing and delivering classroom material to local schools. This programme is focused on teaching school children the importance of water conservation and environmental protection, and illustrating the part they can play through being careful with what is discarded through the wastewater network. Following its relaunch in January 2022, we have directly taught 752 pupils about where our clean water comes from and how wastewater is treated.

In the coming year, we are extending our reach by working with our partners, including Devon Wildlife Trust and South West Lakes Trust.

Our ambition in this space is to engage with a further 500 pupils outside of the school term. We're also creating new partnerships to support our ambition to drive behavioural change across the region.

We not only service the South West community, we are also part of it. South West Water's Awesome Water programme has been launched this year and aims to connect directly with our local communities, creating new, fun, and interactive ways to promote and educate our communities about what we do, helping us support behavioural change initiatives, and helping us reach people beyond a traditional transactional relationship.

We are working to better understand the impact we have through our community programmes, through the adoption of the well-established Business for Social Impact (B4SI) framework. In addition to providing consistency in how we measure our community activity our aim is that through working with our community

partners in applying the framework we can better support projects and programmes that deliver the greatest impact aligned to our purpose. The full set of B4SI data can be found in the Pennon Group plc ESG data book, published alongside its annual report.

### *TAPPING INTO THE AMAZING WORLD OF WATER*

Having opened the doors to our educational visitor centre at Roadford Lake last year, this year South West Water launched a new educational programme to help us inspire future generations to be environmental champions right across the South West. Since the relaunch of our programme in primary schools in January 2022, 70% of children went away from these lessons saying they had learnt something new.

### *WATER SAVING COMMUNITY INITIATIVES*

Saving tap water makes sense. To help out communities get involved in saving water we've funded 22 projects - big and small - which have an estimated yearly saving of c.59 million litres!

- Water butts at a community allotment halved their water bill
- New taps installed at a school lowered the amount of water they used
- Toilet transformation on the Isles of Scilly saved up to a whopping 150,000 litres of water
- Heathfield Allotment Trust

### *HEATHFIELD ALLOTMENT TRUST*

In Autumn of 2020, Heathfield Allotment Trust carried out an investigation of their water usage across their site in Lymstone, Devon. Carrie, one of the trustees, was shocked to find how much was being wasted. People were leaving hoses on, not watering efficiently, and using the tap more than was necessary.

Convinced that something could change, Carrie began actively educating plot-holders about the importance of saving water. Policies were put in place to keep it at the forefront of their minds, and leaving the hosepipe on and using sprinklers was strictly banned.

But it still wasn't enough. That's where we stepped in. In 2021, the trust applied to our Water-Saving Community Fund for 25 water butts, we surprised them by sending 30.

The results speak for themselves.

### *PUTTING NATURE ON EVERYONE'S DOORSTEP*

From the very bottom of Cornwall all the way to Somerset, Bristol and Bournemouth, the South West is home to over 40 inland waters which play a critical role in keeping the regions water supplies plentiful. Our local lakes are natural marvels, not only for capturing and storing rainwater, they are also important for people and wildlife. Millions of people from across the UK visit our lakes every year, making them destinations in their own right and putting nature on the doorstep of our communities.

# OUR OPERATIONS

## OUR 2021/22 PERFORMANCE

Performance across the Company continues to be operationally resilient, delivering against our businesses' business plan commitments, and realising benefits for all stakeholders.

Performance as measured by our outcome delivery incentives was c.80% for South West Water, maintaining last years' strong performance.

Key areas of good performance include asset health measures, leakage and mains repairs with a relentless drive to maintain and invest our assets. Following the launch of our dedicated plan, South West Water saw a big improvement in the number of pollutions, reducing by a third year-on-year pollution incidents and significantly reducing the penalty incurred.

We have delivered cumulative WaterShare RORE outperformance with South West Water's cumulative RORE of 8.2% representing a more than doubling of base returns.

## REGULATED WATER

### *CLEAN, SAFE, RELIABLE DRINKING WATER*

Across the company, we are committed to ensuring the continuous supply of clean, safe and reliable drinking water, whilst preserving the natural resources within the South West. Our dedicated teams and ongoing investments ensure that we are able to respond to challenges, such as those posed by the COVID-19 pandemic and severe weather – such as Storm Eunice in February 2022.

## WATER QUALITY

### *CRI*

The Compliance Risk Index (CRI) score as reported by the Drinking Water Inspectorate measures water quality compliance. Performance was impacted by one-off events in 2021/22, however underlying performance remains strong.

South West Water CRI was 3.86. This is above the industry average of 3.56 and the target of 2 and this is a key focus for 2022/23 to improve this performance.

Continued investment in research and implementation of advanced treatment technologies, including ceramic membranes and granular activated carbon is designed to ensure compliance measures improve in future years.

Further enhanced maintenance and resilience improvements are being delivered across all our water treatment works as part of our innovative site MOT programme to again ensure we pro-actively intervene before failures occur.

### *TASTE, SMELL AND COLOUR CONTACTS*

We recognise that consumers expect their drinking water to look and taste great and that this is important in maintaining consumers' trust in the quality of our supplies and we continue to invest in all aspects of our operations from source to tap to maintain that trust.

South West Water contacts per 1,000 population decreased slightly to 1.55 from 1.65 achieving the performance commitment target of 1.59.

2021/22 was another challenging year with the ongoing change in water usage patterns associated with COVID-19 and an increase in third party damage to our mains. This national problem was exemplified by the accidental damage to both of our strategic water mains supplying Cornwall this year. Whilst supplies were restored quickly, consumers reported discolouration over the coming days and secondary bursts and disruption were seen for several weeks.

Our long-established operations and maintenance flushing programmes will be enhanced this year and we continue to progress well in delivering enhanced manganese removal schemes at Restormel and St. Cleer in Cornwall. To address taste and smell we are progressing further significant investments in advanced granular activated carbon treatment at Stithians in Cornwall and Littlehempston in South Devon.

### *BOURNEMOUTH WATER TREATMENT UPGRADES*

As part of our business plan we committed to building two new state of the art treatment works in the Bournemouth area. Good progress continues on both of these schemes at Alderney and Knapp Mill. As part of the additional expenditure allowed by Ofwat as part of Green Recovery, commencement of works at Knapp Mill has been accelerated to enable improved water quality and resilience in the Bournemouth area, which will improve both CRI and taste, smell and colour contacts into the future.

## **REDUCING LEAKAGE AND SUPPLY INTERRUPTIONS**

### *LEAKAGE*

We recognise that the prevention of water being lost in leakage from our pipes and assets is a key issue for all customers, and is something we work continuously to reduce.

At South West Water, the specific investments made since the start of the regulatory period, teamed with the launch of our targeted action plan are delivering results. Improved leakage performance for the year has resulted in us achieving our 3-year average target and represents a c.8% reduction on the prior year performance. Whilst we know there's still more to do to find, fix and prevent leaks on our network, we're encouraged by the progress we've made to date, and continue to focus on delivering further improvements to achieve a 15% reduction over the K7 period.

### *MINIMISING CUSTOMER SUPPLY INTERRUPTIONS*

As a Company, we understand the inconvenience that supply interruptions can cause.

At South West Water during 2021/22 performance was impacted by two large events, including one in Gunnislake, Cornwall and a significant third-party incident<sup>1</sup>, and reflects the way in which performance against this target can be impacted by a one-off issue as a result performance in 2021/22 of 6 minutes 47 seconds is higher than our target of 6 minutes 8 seconds. On an underlying basis South West Water's core performance continues to remain robust with our strategy of a dedicated, in-house supply continuity and alternative water

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<sup>1</sup> In late August 2021, a third-party utility company, performing work unconnected with South West Water, damaged mains supply pipes at Carland Cross in Cornwall, causing a localised loss of supply. Any impact from this event in terms of ODI mechanism remains under evaluation.

supply team making long term improvements to customers, reducing the number and duration of supply interruption events.

## **INVESTING TO SECURE RESILIENCE, NOW AND INTO THE FUTURE**

### *PER CAPITAL CONSUMPTION*

This is an important metric to help the industry be more resilient into the future and help incentivise companies to conserve the natural resources around us. Per capital consumption is measured in percentage terms from a baseline.

In the year South West Water reduced its measure by 142.1 l/day/person, beating the performance commitment for the year. While overall consumption increased, the population served in the South West also was at record levels – with high numbers of tourists into the region and utilisation of second homes also at very high levels by historic standards.

To help customers reduce their consumption we provide donations to charities supporting water conservation to help promote and educate customers. This is in addition to our schools outreach programme which aim to teach children about the importance of looking after our natural resources.

### *WATER AVAILABILITY*

In 2021, South West Water celebrated a silver jubilee - the 25th consecutive year without water restrictions. Bournemouth Water's track record of no water restrictions was also successfully maintained. Despite high demand over the year and hot weather over the summer, we successfully managed our water resources, taking advantage of the wetter periods over the winter. This strategy enabled us to replenish water storage and as we enter the summer period, our water resources are in a robust position with reservoir storage at c.93% at the end of March 2022.

### *SMARTER HEALTHIER HOMES*

Increased water usage and unexpected repair bills from leaking service pipes can result in acute financial pressures for individual customers and particularly for those who are financially vulnerable. As part of our Green Recovery plan, "Smarter, healthier homes" focuses on investments that directly benefits our customers and help improve supply resilience.

We plan to complete a large scale pilot programme across our North Devon supply area focused on installation of smart meters – enhancing customer engagement to help them manage their water use and bills more easily, carrying out a supply pipe 'adoption' trial – to relieve the worry of sudden unplanned financial demands arising from leaking and / or failed service pipes and embarking on a proactive lead pipe replacement programme.

These measures will directly help reduce consumption and help inform our wider plans into the future for all our operating areas.

## **MAINTAINING ASSET HEALTH**

### *MAINS REPAIRS*

Decreasing the number of mains failures is vital to ensuring we maintain a continuous supply of water to our customers.

The work to optimise the operation and control of our network by pressure management and other 'network calming' activities, along with targeted replacement of sections of water mains with higher failure rates has led to a significant lowering of overall numbers of mains failures across the year and across the Company.

We are pleased to have significantly reduced the number of reactive repairs compared to 2020/21 by c.30%. This year, we have substantially outperformed our target of 147 mains repairs per 1,000 km of mains with our year end position of 111.4 per 1,000 km of mains.

#### *UNPLANNED OUTAGES*

Water treatment unplanned outage is a new measure for the 2020-25 regulatory period and provides a means of assessing asset health (primarily for non-infrastructure - above ground assets), for water abstraction and water treatment activities. It tracks the temporary loss of production capacity across all water treatment works, resulting from unplanned breakdowns and asset failure.

Our performance in 2021/22 has remained strong and compares favourably with the rest of the industry. This is founded on effective investment and maintenance regimes, ensuring that unplanned failures are minimised. This in turn minimises the risk of any production outages resulting in service impacts for our customers. Our performance for 2021/22 was an unplanned outage figure of c.0.96%, achieving a better performance than our target of 2.34%.

#### *RISING TO THE CHALLENGE OF UNEXPECTED EVENTS*

Storm Eunice was only the second ever red weather warning issued by the Met Office for the South West, the first being the 'Beast from the East' in 2018. Across the Company, our colleagues worked tirelessly to ensure minimal operational impact occurred with the largest operational challenge being the effects of power outages.

We worked closely with the local power distribution supply to minimise outages and ensure continuity of supply for most customers during the storms.

#### *SHARING OUR SUCCESS – WATERSHARE+*

Through South West Water's New Deal business plan (2020-25), we committed to share our success with customers through our pioneering WaterShare+ scheme. Last year, we shared c.£20 million of outperformance from the previous regulatory period with South West Water and Bournemouth Water customers, through a choice of either a £20 reduction in their bill or through the ownership of shares in our parent company, Pennon Group plc. We were delighted that one in 16 households in the region opted to become shareholders, giving them a greater stake in the business and the opportunity to share in our success, as investors in the Pennon Group do.

We also committed to hold quarterly meetings in public, along with a dedicated customer AGM – the first of which we held just before Christmas, accessible to all customers and chaired by our independent WaterShare+ Chair, Lord Matthew Taylor.

Pennon has confirmed the intention to allow a second WaterShare+ issuance, further evolving South West Water's pioneering scheme.



## **REGULATED WASTEWATER**

### *PROTECTING THE ENVIRONMENT - ROBUST WASTEWATER DELIVERY*

At South West Water we continue to target and drive improvements in wastewater services through innovation by constantly seeking out new ideas, pioneering and piloting new technologies with a focus on nature-based solutions where possible and by enhancing governance and working in partnership with others.

### *REDUCING FLOODING INCIDENTS*

During 2021/22 the number of internal sewer flooding cases decreased year on year by c.40% in comparison to the prior year to 0.76 incidents per 10,000 sewer connections. This is a significant outperformance against target and places us as one of the best performers in the industry on this measure. External sewer flooding events also decreased, with a year on year reduction to 1,407 incidents – maintaining our strongest performance yet, supported by the use of artificial intelligence, such as Meniscus, enabling proactive interventions based on predictive analytics.

Our multi-faceted approach to improve our performance on sewer flooding with key activities including the installation of sewer-depth monitors at key points within the network to alert us to potential issues and enhanced data collection and analysis, and HYBACS technology to help peak network demand. This informs our forward plans for identifying repeat flooding risk areas and locations requiring further sewer cleansing and defect remediation.

## **IMPROVING ASSET HEALTH**

### *SEWER COLLAPSES*

Sewer collapses and blockages are a key cause of flooding, pollutions and service impacts to our customers as well as a lead indicator of assets health. We have seen a further c.30% reduction in collapses to 6.72 collapses per 1,000km of sewers and continue to see positive performance in our reducing our blockages through proactive management of our network including a relentless drive to investigate, clean, and repair sewers. We are using artificial intelligence to produce automated sewer condition surveys, and to detect and code faults accurately, resulting in faster proactive repairs at a lower cost.

### *SEWER BLOCKAGES*

The number of sewer blockages is already below that targeted in 2025 target with targeted education programmes influencing customer behaviours, reducing wet wipes, fat, oil and grease disposed of through the sewer network. South West Water also actively supports lobbying for retailers to stop selling wet wipes containing plastic to reduce the impact of micro-plastics entering the environment. The number of sewer blockages during the year was 6,458, substantially lower than our target of 7,280.

### *PIONEERING CATCHMENT MANAGEMENT FOR OVER 15 YEARS*

We maintain that our pioneering catchment management approach for over 15 years is fundamental to help unlock the environmental challenge we all face. Approximately 95,000 hectares have been improved to date and catchment management being undertaken across 80% of our region, working with over 1,700 farmers.

These activities lead to reduced ammonia and phosphate run-off thereby improving overall river quality. We're also well advanced with our plans to plant 250,000 trees by 2025 we achieved four years early. An additional c.50,000 trees were planted in 2021/22, bringing the total planted in K7 to 150,000 to date.

Thanks to the additional investment secured as part of the Green Recovery initiative we will expand our nature-based solutions through increased peatland restoration, reducing the risk of flooding and improving biodiversity, plant life and habitats with an additional c.300 hectares of peatland restored to date.

#### *TARGETING IMPROVEMENTS IN EPA*

A combination of a basket of measures, the EPA is the Environment Agency's assessment of environmental performance. With a planned strategy of achieving 4 star by 2024, there is much to focus on.

#### *POLLUTION INCIDENT REDUCTION PLAN DELIVERING RESULTS*

Our Wastewater Pollutions Incident Reduction Plan continues to deliver results after being launched in September 2020. This level of improvement has continued into 2021/22 reducing by a third from the previous year – 151 compared to 225 in the prior year.

Our steadfast focus remains in this area as we work to deliver a meaningful step change in performance. The year on year improvement was achieved through adopting best practice, focused on predictive modelling and using innovative techniques such as Meniscus AI solutions. These use asset data coupled with weather forecast models to predict potential pollution risks which are identified and fixed in advance of an issue occurring.

2021/22 saw the completion of the first phase of 210 'hotspot' investments (sites with multiple previous incidents) where issues identified were fixed during the year. A second phase has been identified for resolution in 2022 which in addition to other planned maintenance and enhancements to assets support our trajectory to improve our overall position and target continued reductions in pollutions incidents.

In addition we continue to collaborate with others in the industry to share best practice and operational insights, are enhancing the root cause analysis processes to deliver greater insight into developing risks and are helping customers to understand how their behaviour impacts on our assets and ultimately their local environment.

#### *NUMERIC COMPLIANCE*

Numeric permits place measurable conditions on the final effluent discharged to the environment and measures compliance with these conditions. South West Water's wastewater treatment compliance reduced slightly in the year to 97.5% from 99% last year as a result of the inclusion of Bournemouth Water treatment works (and the wastewater generated from these processes), following a change in reporting requirements, and third-party incidents.

Our ongoing MOT programme and planned improvements to our wastewater treatment sites will help us return to target in future years.

#### *RIVERS AND COASTAL WATER QUALITY*

Since our Final Determination, there has been a marked shift in the focus on the environment from customers, the media, government and other stakeholders. During 2021 we saw COP26 in Glasgow and the G7 meeting in Cornwall with climate change at the forefront of discussions.

Improving river and coastal water quality has taken centre stage, as water based recreation, such as wild-swimming and paddle boarding, have become more popular, and the pandemic has strengthened the bond our customers want to have with more open green and blue spaces, now and for generations to come.

A key concern and priority of our customers is protecting and enhancing the beautiful environment in the South West, and this has helped shape our brand new investment programme, WaterFit which is focused on protecting rivers and seas together. This programme brings together existing plans to deliver multiple benefits, as well as going further and faster with a new ambition, and piloting and proving the case for future investment, and in preparation for the next regulatory agreement, PR24.

WaterFit will see us nurturing healthy rivers and seas, reducing our impact on rivers by one-third by 2025, maintaining our excellent bathing water quality standards all year round and developing plans to target zero harm on river quality by 2030 with six pledges underpinned by specific targets. £45 million of additional investment for WaterFit will be funded through totex efficiencies delivered to date during the regulatory period, with the achievement of our existing environmental Outcome Delivery Incentives (ODIs) continuing to be a priority.

#### *RECORD QUALITY LEVELS RECORDED AT OUR BATHING WATERS*

We have over 860 miles of coastline to protect, representing over one-third of the UK's bathing waters. This is something we, and our customers, have always valued and prioritised, working tirelessly across the region to improve bathing water quality around our coastline, which now for the first time ever, has achieved 100% water quality, as measured by the Environment Agency.

We have advanced expenditure in this area and already delivered 8 bathing water scheme enhancements, six of these ahead of schedule, pioneering nature-based solutions, restoring, protecting and enhancing land to reduce pollution levels running off into our seas.

At Combe Martin, this amenity has regained designation, meeting quality standards following investment and collaboration with other agencies, landowners and customers in this area. This demonstrates our strategy to work with multiple stakeholder using a mixed investment approach, including use of nature based solutions, really delivers results.

#### *DRIVING RIVER WATER QUALITY IMPROVEMENTS*

As part of our Green Recovery investments, we are piloting schemes on the Rivers Dart and Tavy to understand the whole river health with the ambition of moving these rivers to bathing water status in the future and are engaging with stakeholders to inform our plans and priorities.

We have made an early start in going further and faster to improve river water quality by installing new monitors to measure quality and enable greater transparency with regulators and customers who wish to use the amenities in the South West.

Recognising that we there are many contributing factors to river water quality including farming and industry, we are taking the lead in supporting all those who might be a source of river water pollution. We are also on track to reduce the impact of our own assets and processes by one third by 2025.

We are also on track to reduce the impact of our own assets and processes, targeting a reduction of the impact by one third by 2025.

## **ISLES OF SCILLY**

### *RESILIENT WATER AND WASTEWATER SERVICES ON THE ISLES OF SCILLY*

South West Water was appointed and began operating the water and sewerage services on the Isles of Scilly in April 2020, at the very start of the COVID-19 pandemic. During 2021/22 investments have been delivered on the islands that include improved communication and control systems on key assets, and an enhanced water sampling programme which provides improved water quality data that will be used to design the new water treatment systems the islands require. We have also bolstered our teams, recruiting locally to strengthen the on island-based team that effectively manage these critical services.

All specified targets agreed with the DWI, and the Environment Agency have been achieved, in addition to extra commitments made to the DWI based on further water quality data that has been gathered since April 2020.

The programme now moves to the next stage of detailed design regarding replacement treatment processes that provide the resilience targeted on-island and deliver the environmental resilience through abstraction and discharge needed. We have been successful in agreeing an extension in timescales in the construction of the emergency storm tank on New Grimsby, Tresco so we can work closely with the Tresco Estate team and construct this when they are carrying out major refurbishment and changes to the main arrival quay on Tresco. This will help ensure the storm tank blends into its environment and delivered in the most efficient way.

# ENVIRONMENT - 2021/22 PERFORMANCE

## PROTECTING THE PLACES WE LOVE

Our purpose is to protect and enhance the environment for generations to come. As a business so closely associated with the environment, we are very aware of our environmental impact and obligations.

We recognise that the abstraction, treatment and delivery of clean, safe drinking water and the removal and safe disposal of wastewater all have implications for river and sea water quality, and we understand that the scale of our operations brings with it a scale of responsibility in how we manage our operational activities.

As a responsible business, we are taking seriously our responsibility to do better those things within our control and have robust plans in place to minimise impact during those times outside of our control - for example during extreme weather events. During 2021 we trialled the innovative use of smart water butts to reduce storm response and impacts of bad weather.

Our performance across several key areas remains robust most notably our freshwater stewardship performance and enhancing biodiversity by exceeding our target for habitat restoration. While we've made significant progress with our bathing water quality targets, we recognise we need to go further, which is reflected in both our pollutions performance and our EPA status. Our WaterFit plan targets c.£330 million investment to 2025 with delivery already in progress, driving performance improvement to further protect river and coastal water quality.

Our plans to deliver against climate related matters remains positive. Despite progress with our energy efficiency programme, higher water demand combined with less than expected energy generation resulted in South West Water being marginally behind target. New solar installations at 15 sites are already underway whilst we continue to seek opportunity to drive energy efficiency and demand reduction across our operations.

## TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES (TCFD)

We are driven by our strategic focus of leading in UK water infrastructure, delivering for the benefit of our customers, communities and the environment. Our commitment to meeting the challenges arising as a result of climate change forms part of our principal risks. Our parent company, Pennon Group plc, includes detailed TCFD disclosure on pages 106 to 122 of its Annual Report, this sets out some of the key climate-related risks and opportunities being addressed by South West Water and the Group as a whole. Pennon's regulated water businesses are the main focus of the TCFD disclosures with the majority of the Group's assets, revenues, and expenditures related to this area.

### *TCFD SUMMARY*

A summary of the Group's approach to TCFD disclosures is noted below:

**Governance:** The organisation's governance around climate related risks and opportunities

**Strategy:** The actual and potential impacts of climate related risks and opportunities on the organisation's business, strategy and financial planning

**Risk Management:** The processes used by the organisation to identify, assess, and manage climate-related risks and opportunities

**Metrics and Targets:** The metrics and targets used to assess and manage the relevant climate-related risks and opportunities

The Risks section reviews the physical risks associated with climate change as well as the transitional risks and opportunities arising. In alignment with the TCFD recommendations, we have assessed the risks and opportunities associated with climate change and the transition to a Net Zero climate resilient economy over short, medium and long term horizons using different scenarios.

# MITIGATING THE IMPACT OF CLIMATE CHANGE

Climate change is the single biggest risk facing the planet. According to the 2021 Intergovernmental Panel on Climate Change (IPCC), South West Water are already experiencing many climate change impacts, and these are expected to increase, anticipated to be at least 1.5°-2°C this century.

In November 2021, the world came together in the UK at COP26 to drive action to address climate change. The Glasgow Climate Pact seeks to increase the global pace of action across mitigation, adaptation, finance and collaboration, with the ultimate aim to ensure the goal of limiting temperature increases to 1.5°C remains in reach. But addressing climate change is not just a global issue, local impacts will be felt and local action needs to be taken. Our region is particularly vulnerable to climate change as we have 860 miles of coastline, and our proximity to the Atlantic Ocean means our area is exposed to impacts from rising sea levels and storm intensity.

Future trends for the South West show that by 2050 we could see a 3°C increase in average summer daily temperatures, with a 5°C increase by 2080, rainfall will become more variable with much drier summers and a fivefold increase in heavy rainfall events and by the end of the century sea levels are predicted to be 0.5-0.8m higher than they are today.

In December 2021, we published our climate change adaptation report. We have invested to ensure that we have the tools and data to understand the impact of climate change on our operations and services and have assessed over 60 climate related risks that could affect the services and the environment we rely on, each of which has been assessed using our Corporate Risk Framework. Assessing climate change risks, and the potential impacts, and possible mitigations on our various operations, assets and networks, is an ongoing and iterative process.

The key headline risks and themes, which reflect the most significant risks, and how we will address them are shown below.

1	Risks to the natural environment and biodiversity	<ul style="list-style-type: none"> <li>• Catchment management</li> <li>• Biodiversity enhancement and protection</li> </ul>
2	Risks to public water supply from drought and low river levels	<ul style="list-style-type: none"> <li>• 50% leakage reduction plans</li> <li>• Developing new water resources</li> <li>• Smart metering</li> <li>• Smarter operation</li> <li>• Helping customers to use less water</li> </ul>
3	Risks of poor water quality	<ul style="list-style-type: none"> <li>• Leading edge treatment technology</li> <li>• Catchment management</li> <li>• Cross-sector collaboration</li> </ul>

4	Risks of household water supply interruptions	<ul style="list-style-type: none"> <li>• 50% leakage reduction plan</li> <li>• Developing new water resources</li> <li>• Helping customers to use less water</li> </ul>
5	Risk of sewer flooding from heavy rainfall	<ul style="list-style-type: none"> <li>• Drainage management plans</li> <li>• Sustainable urban drainage</li> <li>• Customer engagement to prevent blockages</li> </ul>
6	Failures of other infrastructure networks	<ul style="list-style-type: none"> <li>• Renewable energy generation</li> <li>• Mains duplication</li> <li>• Flood protection</li> <li>• Leakage reduction</li> <li>• Central control room</li> </ul>
7	Risks from river or groundwater flooding	<ul style="list-style-type: none"> <li>• Asset protection</li> <li>• Catchment management</li> <li>• Drainage management plans</li> <li>• Partnership programmes</li> <li>• Failures of other infrastructure networks</li> </ul>
8	Risks of coastal flooding and erosion	<ul style="list-style-type: none"> <li>• Asset protection or relocation</li> <li>• Drainage management plans</li> <li>• Changes to treatment technology</li> <li>• Sustainable urban drainage</li> </ul>

All our assets will be affected in some way by climate change. Climate change will increase inundation at wastewater treatment works and pumping stations, sewers and water mains will be impacted by sea level rises and coastal erosion. Water resources will be impacted by increased demand and reduced availability caused by droughts and heatwaves.

Many parties have an important role to play, and we will continue to work with stakeholders and partners to deliver cross-sector solutions in areas such as flood prevention, coastal protection and improved water quality in the environment, to mitigate climate risks and keep costs affordable for our customers.

Our customer research shows that climate change and the environment are increasing in importance and customers tell us that these are significant issues that will require transformational changes, dealing with the highest priorities quickly and effectively with well-paced and prioritised investment.



Action we have taken and will take to mitigate, and adapt to, climate change will have broader environmental benefits for our region and the communities we serve. Our holistic approach to planning means that many of our existing activities will have a direct benefit on adapting to and mitigating the effects of climate change. For example, our ongoing commitment to catchment management and peatland restoration through our Upstream Thinking programme not only addresses raw water quality, but also provides environmental benefits and mitigates the impacts of climate change. Peat bogs are 'carbon sinks' that draw in carbon dioxide from the air. Damaged and drained peatlands lose their ability to hold greenhouse gases. Our peatland restoration projects allow those peat bogs to gain the water they need to recover and once again become carbon sinks. Additionally restored bogs release one-third less water during storms helping to prevent flooding.

This holistic, multi-benefit approach, is also evident in our Green Recovery plans where tackling climate change and protecting the environment are key outcomes from our investments, which include:

- bringing forward our upgrade of Knapp Mill water treatment works
- increasing water supply resilience by supporting water transfers
- trialling ways to help customers save water, protect customers from the costs of supply pipe failures, and reducing health risks from lead pipes
- using nature-based solutions to reduce flood risk and enhance natural habitats
- reducing harm from storm overflows and improve river quality.

We have already made great progress in mitigating the impacts of climate change, but the risks from climate change are growing over time so we need more action in the future and our plans will reflect this. Our Net Zero and WaterFit plans demonstrate our commitment to deliver real change and benefits to protect and enhance our region. These are driven through:

- Resource plans for the next 25 years
- Drainage plans for the next 25 years
- Five-year business plan covering the period 2025-2030.

# NET ZERO: OUR PROMISE TO THE PLANET

In 2021, we set our ambitious plans to reduce our operational carbon emissions and hit our Net Zero target by 2030. Since then we have gone further, adding a Race to Zero commitment to reduce greenhouse gas emissions (GHG) reduction across our entire value chain by 2045.

We have also committed to setting both near and long-term Science Based Targets (SBT) in accordance with the Science Based Targets Initiative (SBTi) criteria and Corporate Net Zero Standard.

South West Water Race to Zero (2045)			
South West Water Net Zero (2030)			
Scope 1	Scope 2	Scope 3	
Water and wastewater treatment process and fugitive emissions  Own and leased vehicle emissions  On site fossil fuel combustion  Refrigerant gases (F-gases)	Electricity	Outsourced activities  Power transmission & distribution  Business travel  Grey-fleet (private vehicles used on company business)	Waste  Employee commuting  Well-to-tank emissions  Embedded carbon: <ul style="list-style-type: none"> <li>• Purchased goods &amp; services</li> <li>• Capital goods</li> </ul>

## OUR NET ZERO STRATEGY

Our Net Zero strategy is driven by three pillars:

- **Sustainable living** – reducing emissions through operational practices, including our on-site water usage, increasing energy efficiency and using lower carbon fuel sources
- **Championing renewables** – investment is underway to support the achievement of 50% renewable energy generation at our sites by 2030
- **Reversing carbon emissions** – working in partnership to deliver natural carbon sequestration through peatland restoration and tree planting. We restored around 500 hectares of peatland in K7, and we are now targeting planting 250,000 trees by 2025 after having achieved our initial five-year plan of 100,000 trees in 2021.

Our strategy also depends on communication and engagement with all our stakeholders. We've made great progress in our first year which will continue but we cannot get there alone.

Our strategy is about doing the right thing for the environment and the planet. We also recognise that as a regulated business managing the region's water resources, we have to balance our Net Zero ambitions with other important priorities for our customers and the environment. Net Zero objectives may sometimes be challenged by the need to deliver environmental improvements. For example, achieving higher environmental standards may

demand increased energy intensity, and new capital investments may increase carbon impacts. Our capital carbon programme will ensure we seek the lowest impact carbon solutions where possible.

We are already seeing the impact of climate change on our operations as well as associated energy use and GHG emissions. Our strategic planning frameworks seek to actively manage these risks now and in the future. Read more on our approach to climate change on pages 47 to 49 and our Task Force on Climate-related Financial Disclosures (TCFD) on page 46.

#### *LEADING THE WAY WITH OUR NET ZERO PIONEERS*

The way to Net Zero will be led by our brilliant people. In November 2021, many responded to our invitation to become Net Zero Pioneers. Our pioneers will be crucial in shaping and delivering our plan and helping to galvanise the business to deliver the change necessary to reach Net Zero.

#### *SUSTAINABLE LIVING*

We use standalone power generators at our operational sites as back up so that we can provide an uninterrupted continual service in the event of a power cut. The majority of these generators run on diesel. As part of our Net Zero fuel switching strategy, we have undertaken a trial of the use of Hydrotreated Vegetable Oil (HVO) biofuel, as a diesel substitute. The trial demonstrated operation using HVO reduced GHG emissions as well as reducing air quality emissions (NOx, CO), when compared to diesel. Importantly the trial demonstrated no adverse impact to the generator's operation. As a result of the successful trial, we are exploring roll out of HVO to all our wastewater sites.

#### *CHAMPIONING RENEWABLES AND INNOVATION*

Achieving our Net Zero plan will require significant expansion of renewable energy across our sites. This will include both tried and tested technology which we already use, for example, Solar PV and Hydropower but will also require new and innovative solutions. Our first year of championing renewables has focused on both. We've approved investment in a large expansion of our solar schemes with an additional 4MW to be deployed during 2022. The projects are a mixture of rooftop and ground mount schemes across our sites including a 440kW array at Lords Meadow wastewater treatment works in Crediton. We are also investigating the potential role of hydrogen, geothermal energy and floating solar in our future energy mix. Where we cannot generate enough to meet all our needs ourselves, 100% of the electricity we purchase will be from renewable sources.

#### *PARK PIT - A NEW WOODLAND FOR BIODIVERSITY AND CARBON SEQUESTRATION BENEFIT*

In March 2022, a group of colleagues from across Estates, Commercial, Property, Drinking Water, Asset Management, Communications and Natural Resources teams went out to Park Lake on Bodmin Moor in Cornwall, on a mission to plant 335 trees.

Professional arboriculturist, Steve Evans from Tree Investment, gave a lesson on how to successfully plant the trees to encourage growth and diversity. The gorgeous location, a field very close to Colliford Lake, is now the home to Oaks, Hawthorns, Willows and Birch trees and is one of many tree planting initiatives we have planned.

#### *OUR PROGRESS*

It's been a progressive first year of Net Zero action. In addition to mobilising for the delivery of their Net Zero plans, we have also taken steps to better understand our impacts across the value chain, in particular through engagement with our key suppliers.

Our continued engagement with customers and communities on water efficiency will yield carbon savings towards our Net Zero goals, an issue we know from our recent materiality assessment is a priority for them. Read more on our Materiality Assessment on page 126.

The highlights and next steps of our Net Zero journey are set out below.

Pillar	Progress	Next steps
<p><b>1. Sustainable Living</b></p> <ul style="list-style-type: none"> <li>Reducing emissions through changes to operational practices, increasing energy efficiency, and switching to lower carbon fuel sources</li> <li>Meeting our commitments to reduce leaks and help customers to use less water - protecting the environment and saving carbon.</li> </ul>	<ul style="list-style-type: none"> <li>Extension of existing energy and water efficiency programmes</li> <li>Launched Net Zero pioneers programme</li> <li>First trial of 'HVO' bio-fuel for stand-by generation</li> <li>Established new governance to drive and manage our Net Zero delivery</li> <li>Delivered and embedded carbon and energy training across the business with energy management programme rolled out to 1,000 colleagues</li> <li>Engaged our top suppliers on our Net Zero plans and how they can support and align.</li> </ul>	<ul style="list-style-type: none"> <li>First 53 EV vans to be rolled out in 2022</li> <li>Deploy new 'capital carbon' tool to model life cycle carbon impact of different investment choices</li> <li>Expand Net Zero research opportunities with the University of Exeter through our CREWW partnership and further international research collaboration on fugitive emissions</li> <li>Working with key partners to support and align our shared journeys to Net Zero.</li> </ul>

Pillar	Progress	Next steps
<p><b>2. Championing Renewables</b></p> <ul style="list-style-type: none"> <li>Maximising self-generation from renewables at our sites across the South West - working with partnerships and utilising our expertise</li> <li>Where we cannot generate enough electricity to meet all our needs ourselves, 100% of what we purchase will be from renewable sources.</li> </ul>	<ul style="list-style-type: none"> <li>Agreed renewables delivery plan</li> <li>Approved first business case for new solar schemes</li> <li>Health check and optimisation of existing renewables assets</li> <li>Actively explored opportunities for further third-party renewables supply agreement</li> <li>Developed strategy for biomethane as part of developing enhanced bioresource strategy.</li> </ul>	<ul style="list-style-type: none"> <li>15 new solar schemes to be installed in 2022/23 doubling our solar installed capacity</li> <li>New renewable energy guarantees of origin (REGO) contract started in April 2022 guaranteeing 100% power purchased is green</li> <li>Progress exciting collaboration with Welsh Water and Thames Water on 'cold-digestion' through Ofwat's Innovation fund</li> <li>Investigations of biomethane applications within operational sites and transport.</li> </ul>
<p><b>3. Reversing Carbon Emissions</b></p> <ul style="list-style-type: none"> <li>Reversing carbon emissions from our core activities</li> <li>Working in partnership to ensure our core activities reverse carbon emissions through solutions such as peatland restoration</li> <li>Supporting the development of innovative solutions to develop low carbon footprint processes through research and development.</li> </ul>	<ul style="list-style-type: none"> <li>First tree planting schemes through Woodland Code verification</li> <li>Committed to additional 1,000 Ha of peatland restoration by 2025</li> <li>Research collaboration at Water UK and UKWIR including development of land-based carbon sequestration model.</li> </ul>	<ul style="list-style-type: none"> <li>Continue tree planting programme towards our ambitious 250,000 trees by 2025 target</li> <li>Modelling of wider environmental and societal benefits from nature-based activity.</li> </ul>

## **PROTECTING RIVERS AND SEAS THROUGH WATERFIT**

### *DELIVERING FOR THE ENVIRONMENT*

In the last few years, we have seen increased focus on the need to improve river and sea quality. The popularity of water-based activities, such as wild swimming and paddle boarding has increased, and through the pandemic we saw greater appreciation for our green and blue spaces. Alongside this, since we submitted our last business plan, there has been a broader policy shift with the Government's 25-year Environment Plan, COP26, the race to Net Zero, and the new Environment Act 2021.

We have always valued and prioritised our water environment, with our coastal bathing waters now achieving 100% quality.

We have always been committed to delivering for the environment and have already taken steps in the right direction. We were early pioneers of catchment management through our award-winning Upstream Thinking programme – working with local stakeholders to restore habitats, protect river water quality, reduce flooding and reverse climate change through managing agricultural land use practices and restoring peatlands across the catchments. Since 2015 over 95,000 hectares of land have been improved with schemes that have delivered low cost, low carbon ways of reducing harmful nutrient run-off (phosphates and ammonia) into rivers.

Our Green Recovery initiative outlined c.£82 million of investment, including pilots for storm overflows, improving river quality, smart metering, water resource development and peatland restoration.

We have set out our Net Zero ambitions, outlining our commitment to transform how we produce and use energy to become carbon neutral by 2030 through our three pillars – sustainable living, championing renewables and reversing carbon emissions. Initiatives, such as planting trees are an important part of this strategy and we plan to plant 250,000 trees by 2025, more than doubling our original target achieved four years early. To date in K7, we've planted c.150,000 trees.

We know that we need to and can go further, faster.

Over 10 million visitors come to the South West every year, in addition to the 2.3 million people that live in the region. We want the South West to be the destination for water quality.

We are reducing pollutions year on year, with 2021's performance the best ever and lowest for 10 years. However, it's clear there is a need to go further and faster now to reduce spills from our sewage system and reduce our impact on river water quality.

Launched in April 2022, WaterFit has been developed, to build on existing plans to ensure we can deliver this – ambition of going further and faster across a wider range of commitments. By front-loading and rebalancing c.£330 million of investment, we will focus on those projects that will deliver multiple benefits, focused on a catchment by catchment, community by community investment approach, ensuring all areas in our region are benefiting with no additional impact on bills.

Overall, WaterFit will enable to us to deliver a step change in both river and coastal water quality. It will enable us to expand our 100% excellent bathing water quality standards all year round, allowing everyone to enjoy our 860 miles of coastline. We'll also reduce our impact on river water quality by one third by 2025, reducing spills from storm overflows to an average of 20 per year per overflow, increasing capacity in our infrastructure to the

equivalent of 20 Olympic swimming pools. And we'll target delivering zero serious pollutions by 2025, with year on year reductions in all pollutions.

We have engaged with our customers, through focus groups, to explore reaction to our plans and commitments. All of those who took part expressed support for WaterFit, with support strongest for our commitments on coastal bathing waters and reducing storm overflow spills. The focus on rivers and lakes was welcome and customers recognise the wider benefits that the plan can deliver, for the economy, jobs, health and wellbeing.

We therefore know that our plans meet the wants of customers and communities and we will be seeking continued feedback and engagement with all of our stakeholders on our plans, about what we prioritise, and what we do first in each community, ensuring all areas in our region benefit.

Our plans involve total investment of c.£330 million over the next three years in our wastewater assets to deliver on our six WaterFit commitments.

Commitment	We will
1 Nurturing healthy rivers and seas	<p>Reduce our impact on rivers by 2025, by one third and put forward plans to target zero harm by 2030</p> <p>Reduce spills from storm overflows to an average of 20 per year by 2025</p> <p>Maintain our excellent bathing water quality standards, all year round, so that everyone can enjoy our 860 miles of coastline, whatever the time of year</p> <p>Deliver zero serious pollutions by 2025, and target a year on year reduction in all pollutions</p>
2 Putting nature on everyone's doorstep	<p>Make bathing water accessible, less than an hour's drive, for 100% of our residents and visitors</p> <p>Provide access to our 40 inland lakes and reservoirs, so that local communities can continue enjoying them for health and recreation</p> <p>Achieve the region's first bathing quality river, using learnings from our current pilots on the rivers Dart and Tavy</p> <p>Creating and restoring habitats</p>

Commitment	We will
3 Creating and restoring habitats	<p>Stop pollutants from 120,000 hectares of regional farmland getting into rivers and seas by 2025, by working with local partners</p> <p>Restore an additional 1,000 hectares of peatlands by 2025, to create new habitats, improve river quality and reduce flooding</p> <p>Plant a quarter of a million trees by 2025, to help combat climate change, support river health and create new wildlife habitats</p> <p>Inspiring our local champions</p>
4 Inspiring our local champions	<p>Donate 25% of our Community Fund to local groups that share our passion for river and sea health</p> <p>Launch our WaterFit Warriors programme, to inspire thousands of water quality champions in schools and communities across the region</p> <p>Share progress with our customers through our unique WaterShare+ scheme at quarterly public meetings and our annual Customer AGM</p>
5 Creating a sustainable future	<p>Work collaboratively on the building of new developments in our region, to help us manage our network</p> <p>Back the ban on non-flushable or plastic-containing wet wipes, to help prevent blockages</p> <p>Work with our 10 million visitors, and 2.3 million customers, so they understand the important role they play in protecting our region, through our Love Your Loo campaign</p>



	Commitment	We will
6	Putting people in control	<p>Work with partners to provide water quality information for residents and visitors, making it easily accessible on our website by the end of this year</p> <p>Help people understand river health, by sharing real-time river water quality information, just as we do for our bathing waters, by 2023</p> <p>Provide 100% monitor coverage at our treatment works and on our storm overflows, by 2023</p>

Our base plans for 2025 were already delivering much of WaterFit but going further and faster we are reinvesting efficiency achieved over the last two years to deliver this. By doing this customer bills will not be affected.

Read more on the WaterFit plan and wider environmental commitments on our website.

# RESPONSIBLE AND SUSTAINABLE BUSINESS

## RESPONSIBLE AND SUSTAINABLE BUSINESS - 2021/22 PERFORMANCE

As a responsible business, our activities are underpinned by strong governance frameworks that uphold our core values within the organisation and throughout our supply chain. We are committed to providing open, honest, and transparent reporting, and measure ourselves against both national and international benchmarks of responsible business practice.

Trust and transparency is one of our highest material issues, therefore we will continue regular dialogue with stakeholders, to build open and meaningful relationships. We have reinforced our supply chain resilience by further developing our ESG target for supplier engagement for 2025. This further strengthens our commitment to the importance we place on those we work with sharing our core ESG values.

As a Company, we have demonstrated our sustainability commitments with short and long-term pathways to emissions reduction, to drive innovation and support our long-term strategy. For more information on the development of our Science Based Targets (SBT) and Net Zero plans, go to page 50.

## SASB DISCLOSURE

For the first time, our parent company, Pennon Group plc, has aligned its non-financial disclosures to the Sustainability Accounting Standards Board (SASB) reporting framework. SASB provides a set of industry specific standards (Water Utility and Services industry), which each contain topics which are material to our investors. These topics contain a number of metrics that Pennon has disclosed against. The data and information supporting the metrics is primarily operations related and is contained within our annual performance report (APR) as indicated. Our latest APR was published in July 2021. Where relevant, the disclosure is included in the annual report of Pennon Group plc rather than the Company.

Metric	Code	Disclosure
<b>Energy Management</b>		
(1) Total energy consumed (2) percentage grid electricity (3) percentage renewable	IF-WU-130a.1	Pennon Annual Report, SECR, Energy Usage, page 91  The Company has taken advantage of the exemption offered under the Companies Act 2006 and has not reported details of Greenhouse gas emissions during the financial year. Details of South West Water's greenhouse gas emissions can be found in the APR.
<b>Drinking Water Quality</b>		
Number of: (1) acute health-based (2) nonacute health-based (3) non-health-based drinking water violations	IF-WU-250a.1	APR, Our Water, Taste Smell and Colour Contacts  APR, Our Wastewater, Odour Contacts from Wastewater treatment works  APR, Our Water, Water quality compliance
Discussion of strategies to manage drinking water contaminants of emerging concern	IF-WU-250a.2	For more information about our specific strategies such as the Upstream Thinking Project, please refer to: Upstream Thinking – available at <a href="https://www.southwestwater.co.uk/environment/working-in-the-environment/upstream-thinking/the-project/">https://www.southwestwater.co.uk/environment/working-in-the-environment/upstream-thinking/the-project/</a>
<b>Distribution Network Efficiency</b>		
Water main replacement rate	IF-WU-140a.1	APR, Our Water, Number of mains repairs
Volume of non-revenue real water losses	IF-WU-140a.2	APR, Our Water, Leakage
<b>Effluent Quality Management</b>		
Number of incidents of non-compliance associated with water effluent quality permits, standards, and regulations	IF-WU-140a.2	South West Water EPA Data Report, Section 4..Discharge Permit Compliance metric – produced by the EA, available from Gov.UK

Metric	Code	Disclosure
<b>Effluent Quality Management (continued)</b>		
Discussion of strategies to manage effluents of emerging concern	IF-WU-140a.2	To access data that South West Water contribute to the Chemical Investigation Programme (CIP), please refer to: CIP data portal – available at <a href="https://ukwir.org/sign-up-and-access-the-chemical-investigations-programme-data-access-portal">https://ukwir.org/sign-up-and-access-the-chemical-investigations-programme-data-access-portal</a>  To see the findings from the last CIP2 report, please refer to: CIP2 report – available at <a href="https://ukwir.org/the-chemicals-investigation-programme-phase-2,-2015-2020">https://ukwir.org/the-chemicals-investigation-programme-phase-2,-2015-2020</a>
<b>End-Use Efficiency</b>		
Percentage of water utility revenues from rate structures that are designed to promote conservation and revenue resilience	IF-WU-420a.1	Omitted based on lack of applicability – South West Water do not offer different rate structures
Customer water savings from efficiency measures	IF-WU-420.a	APR, Our Resilience, Litres of Water Saved Through Free Water Products
<b>Network Resiliency &amp; Impacts of Climate Change</b>		
Wastewater treatment capacity located in 100-year flood zones	IF-WU-450a.1	This year we are publishing our first Drainage and Wastewater Management Plans (DWMP), in accordance with new government regulations. Within this plan we have outlined which of our assets are within flood zones 3 (FZ3). This plan will be accessible from July 2022, via the South West Water webpage, hosted on the 'Window to the Environment' page.
1) Number and (2) volume of sanitary sewer overflows (SSO), (3) percentage of volume recovered	IF-WU-450a.2	Please refer to: EDM Return – accessible via <a href="https://www.southwestwater.co.uk/search/?category=0&amp;searchTerm=EDM">https://www.southwestwater.co.uk/search/?category=0&amp;searchTerm=EDM</a>
(1) Number of unplanned service disruptions, and (2) customers affected, each by duration category	IF-WU-450a.3	APR, Our water, interruptions to supply  APR, Our resilience, resilience in the round – water.
Description of efforts to identify and manage risks and opportunities related to the impact of climate change on distribution and wastewater infrastructure	IF-WU-450a.4	Water Resource Management Plan (WRMP), [sections] 2.3.5 Impacts of climate change on water supply, 3.4.5 The effect of climate change on household consumption, and 3.5.5 The effect of climate change on non-household demand – accessible via <a href="https://www.southwestwater.co.uk/siteassets/document-repository/environment/sww-bw-wrmp19---finalplan_aug2019.pdf">https://www.southwestwater.co.uk/siteassets/document-repository/environment/sww-bw-wrmp19---finalplan_aug2019.pdf</a>

Metric	Code	Disclosure
<b>Water Affordability &amp; Access</b>		
Average retail water rate for: (1) residential  (2) commercial  (3) industrial customers	IF-WU-240a.1	The average retail water rates for business customers is available at – <a href="https://www.source4b.co.uk/manage-your-account/publications-tariffs">https://www.source4b.co.uk/manage-your-account/publications-tariffs</a>  The average retail water rate for residential customers is available at – <a href="https://www.southwestwater.co.uk/bills/our-charges/">https://www.southwestwater.co.uk/bills/our-charges/</a>
Typical monthly water bill for residential customers for 10 Ccf of water delivered per month	IF-WU-240a.2	Our Charges document, available at – <a href="https://www.southwestwater.co.uk/bills/our-charges/">https://www.southwestwater.co.uk/bills/our-charges/</a>
Number of residential customer water disconnections for non-payment, percentage reconnected within 30 days	IF-WU-240a.3	Omitted based on lack of applicability – South West Water do not disconnect customers for non-payment
<b>Activity Metric</b>		
Discussion of impact of external factors on customer affordability of water, including the economic conditions of the service territory	IF-WU-240a.4	<a href="https://www.southwestwater.co.uk/siteassets/document-repository/business-plan-2020-2025/addressing-affordability-and-vulnerability.pdf">https://www.southwestwater.co.uk/siteassets/document-repository/business-plan-2020-2025/addressing-affordability-and-vulnerability.pdf</a>
<b>Water Supply Resilience</b>		
Total water sourced from regions with High or Extremely High Baseline Water Stress, percentage purchased from a third party	IF-WU-440a.1	WRMP, Summary of Final Water Resources Management Plan, Assurance  For further information of classifications, please refer to: EA Water Stressed Areas Report – Published by the EA, available at Gov.UK
Volume of recycled water delivered to customers	IF-WU-440a.2	Omitted based on lack of applicability – Pennon do not deliver recycled water to customers

Metric	Code	Disclosure
<b>Water Supply Resilience (continued)</b>		
Discussion of strategies to manage risks associated with the quality and availability of water resources	IF-WU-440a.3	WRMP, [Section] 2.5 Drinking Water Quality, and [section] 8.4 Ensure Availability of Existing Sourced and their Resilience to Future Droughts
Total water sourced, percentage by source type	IF-WU-000.B	APR, Additional regulatory information – water resources for total water sourced, Water resources asset and volumes data
Total water delivered to:  (1) residential  (2) commercial  (3) industrial  (4) all other customers	IF-WU-000.C	APR, Additional regulatory information – water network plus, Water network+ – Mains, communication pipes and other data
Average volume of wastewater treated per day, by:  (1) sanitary sewer  (2) stormwater  (3) combined sewer	IF-WU-000.D	APR, Additional regulatory information – wastewater network plus, Wastewater network+ – Sewer and volume data
Length of:  (1) water mains  (2) sewer pipe	IF-WU-000.E	APR Additional regulatory information – water network plus, Water network+ – Mains, communication pipes and other data  APR, Additional regulatory information – wastewater network plus, Wastewater network+ – Large sewage treatment works

# REPORT OF THE FINANCE DIRECTOR – FINANCIAL REVIEW

## OVERVIEW

South West Water's Performance continues to be operationally resilient, delivering against our business plan commitments, realising benefits for all stakeholders.

Our existing environmental plans to 2025 are already delivering significant benefits for the environment. We are well underway with the delivery of our c.£1.2 billion<sup>2</sup> capital programme in K7 across the Company – our largest environmental investment programme in 15 years. This includes our Green Recovery and Net Zero 2030 plans, delivering nature-based solutions and pilots to shape future investment plans, along with accelerating renewable energy generation to c.50% by 2030. Alongside this, WaterFit will see us reinvest c.£45 million totex efficiencies achieved to date in K7 to deliver a step change for river and coastal water quality.

South West Water's New Deal business plan 2020-25 was developed with customers, for customers. In helping to shape our business plan, customers told us they want a resilient and reliable service, and a fair and affordable bill. Through Covid-19, many of our customers saw significant additional pressures on their finances, and teamed with the current rising inflationary environment, our commitment to support customers has never been more important.

We have worked hard to deliver quality services at an efficient cost, so that bills remain as low as possible. During the year we announced that bills for 2022/23 would fall, meaning that whilst the majority of utility prices are increasing, our average bill will be reducing at this critical time. South West Water's bills are lower in real terms than they were 10 years ago thanks to our continued focus on driving efficiency through innovation.

In 2021/22, there was a c.4% increase in customers benefiting from one or more of South West Water's affordability initiatives, bringing the total to c.70,000. These initiatives include discounts to bills or a level of bill certainty to suit customers' circumstances. We are targeting a further increase in 2022/23 as we work to address water poverty for our customers by 2025, in line with South West Water's Board Pledge.

South West Water's strong operational and financial performance has contributed to a sector-leading RORE of 9.2%<sup>3</sup> with outperformance in all areas in 2021/22.

In 2021/22 South West Water achieved c.80%<sup>4</sup> of its ODIs across a broad range of challenging bespoke, common and comparative measures – in line with performance in 2020/21.

Ten ODIs continue to represent areas of excellence having achieved their 2025 target early, with a further 25 outperforming their 2021/22 target or on track.

We have delivered a significant step change in pollutions performance in line with our Pollutions Incident Reduction Plan, reducing wastewater pollution incidents by over a third, and whilst still an area of focus the financial penalty is substantially reduced from 2020/21.

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<sup>2</sup> In forecast nominal prices

<sup>3</sup> Based on Ofwat's K7 approach to RORE, including total tax impacts and using actual average inflation for totex and financing

<sup>4</sup> On track or within regulatory tolerances

Overall, financial ODI performance for South West Water for 2021/22 has improved significantly from the prior year, resulting in a net reward of c.£0.6 million (2020/21 net penalty of c.£10.4<sup>5</sup> million), reflecting an annual equivalent RORE<sup>^</sup> outperformance of 0.1%.

Our efficient financing strategy continues to drive outperformance with South West Water's effective interest rate<sup>^</sup> at 3.4% (2020/21 2.5%), lower than Ofwat's nominal cost of debt. While recent increases in inflation are driving an increase in finance costs of index-linked debt, we continue to outperform the cost of debt allowances through our flexible financing strategy and the company's diverse debt portfolio, with a relatively lower level of index-linked debt compared to the industry average.

South West Water's overall cumulative net efficiency savings in the regulatory period to date are c.£87 million<sup>6</sup>. Whilst the elevated inflationary environment is placing pressure on costs, we continue to focus on efficient totex delivery, supported by our pioneering approach to innovation across the Company.

## STATUTORY FINANCIAL PERFORMANCE

South West Water's statutory results show a small decline in profit before tax to £135.5 million (2020/21: £141.8 million). In 2021/22 a non-underlying charge of £2.0m has been recognised in relation to restructuring costs. In 2020/21 a non-underlying reduction in revenue of £20.5 million was recognised due to the Watershare+ rebate scheme and a curtailment charge of £3.5 million was recognised in respect of the defined benefit pension scheme being closed to future accrual from 30 June 2021 (see note 6).

### REVENUE

Underlying total revenue has increased by 3.6% to £584.6 million primarily reflecting the recovery in the non-household market from COVID-19 restrictions (up by c.18% compared to last year), household demand has fallen slightly in the year but has not decreased to pre-pandemic levels (down by 1.4% compared to last year).

84.2% of our household customers in the South West area are now benefitting from a metered supply, with 3,304 customers opting for a meter in 2021/22 (2020/21: 3,636). 74.2% of households in the Bournemouth Water region are metered with 586 switching in the year (2020/21: 524).

### EBITDA

Underlying earnings before interest, tax, depreciation and amortisation (EBITDA) were 2.7% lower than 2020/21 at £331.3 million (2020/21: £340.6 million). Underlying operating profit decreased by 3.6% to £214.3 million (2020/21: £222.3 million) and underlying profit before tax decreased by 17.1% to £137.5 million (2020/21: £165.8 million).

Operating costs have increased by £29.6 million (13.2%) compared to 2020/21 due to the following:

- Inflationary and other cost pressures on wholesale energy of c.£5.1 million, c.£2.0 million on wages, c.£0.8 million on chemicals (linked to energy markets), and £4.6 million on other cost lines including higher insurance costs
- Increased production volumes arising from the recovery of non-household demand driving increased power and chemical consumption of c.£4 million

<sup>5</sup> Reflects final outturn of prior year ODI performance, consistent with Ofwat reporting

<sup>6</sup> Based on Ofwat's approach to RORE using average actual inflation (2020/21 – 0.8%, 2021/22 – 3.7%)



- Additional operating costs of c.£5 million to enhance and accelerate our key areas of operational focus of pollutions and leakage and reflecting additional regulatory requirements such as 'farming rules for water'
- Higher developer activity such as government road schemes of c.£5 million associated with higher developer revenue
- Other operating costs of c.£5 million, partially offset by ongoing efficiency initiatives and property sales.

South West Water's bad debt performance remains strong with a charge of 0.5% of revenue (2020/21: 0.5%), reduced from 1.7% at March 2015. This continues to be driven by efficient collections as we work with our customers to manage their debt and strive to support those customers in vulnerable situations with affordability challenges.

We continue to look to efficiently manage and optimise value from our estates portfolio, recognising a profit on sale of assets in the year of £1.1 million (2020/21: £0.4 million).

#### *NET FINANCE COSTS*

Underlying net finance costs of £76.8 million were £20.3 million higher than last year (2020/21: £56.5 million). This primarily reflects higher RPI and CPI on index linked debt and leases.

We have secured funding at a cost that is efficient and effective. Index linked funding represents approximately 26% of borrowing; at 3.4% the Company interest rate on average net debt for 2021/22 remains amongst the lowest in the sector (2020/21: 2.5%).

#### *PROFIT BEFORE TAX*

South West Water's underlying profit before tax was £137.5 million, a decrease of 17.1% compared with the prior year (2020/21: £165.8 million). On a statutory basis, profit before tax was £135.5 million (2020/21: £141.8 million) as a result of a one-off charge of £2.0m made to the restructuring provision reflecting announced reorganisation across the Company.

#### *TAXATION*

The Company's mainstream UK corporation total current tax charge for the year (including prior year adjustments) was £9.2 million (2020/21: £24.3 million), reflective of an effective tax rate of 6.8% (2020/21: 17.1%). The lower effective rate of current tax reflects increased capital allowances on qualifying assets relative to depreciation. The Company had a current tax asset of £5.9 million at 31 March 2022, with current tax due being paid in four quarterly instalments during the year. The company paid tax of £11.2 million during the year in respect of periods 2016/17 to 2021/22, including £5.0 million paid to fellow group entities in respect of group relief.

Underlying deferred tax for the year (including prior year adjustments) was a charge of £3.1 million (2020/21: £3.5 million). This year there is a non-underlying deferred tax charge of £98.7 million (2020/21: £0.7 million credit). The non-underlying charge was primarily due to the restatement of the deferred tax liability for the change in rate of corporation tax, the prior year non-underlying credit reflects additional pension contributions arising on the closure of the pension fund to future accruals.

Overall the total tax charge for the year was £111.0 million (2020/21: £27.0 million). The increase being primarily due to the corporate tax rate change restating deferred tax liabilities in the current year and the additional capital allowances available in the year.

The next financial year will also benefit from the increased super-deduction rates of capital allowances, this will reduce the current tax charge.

#### *DIVIDENDS AND RETAINED EARNINGS*

The statutory net profit attributable to ordinary shareholders of £24.5 million has been transferred to reserves.

The Company has established a dividend policy which includes the following components:

- a sustainable level of base dividend growth, determined by a number of factors including the shareholder's investment and the cost of capital
- a further level of growth funded by efficiency outperformance
- comparison with the assumptions made by Ofwat in setting prices for the regulatory period.

Dividend payments are designed to ensure that key financial ratios are not prejudiced, whilst also taking into account balance sheet considerations.

Payments are designed to ensure that the ability of the Appointee to finance its Appointed Business is not impaired. Dividends of £45.0 million were paid to the parent undertaking (2020/21: £43.5 million). Payment of the outperformance dividend based on cumulative outperformance for 2020/21 of £43.0 million has been deferred to 2022/23 and recognised as a liability. The dividend was calculated with reference to the projections in the Ofwat 2019 Final Determination and the assumptions for 2021/22 included within the 2020-25 Business Plan.

#### *CAPITAL INVESTMENT*

South West Water's capital expenditure this financial year was £202.5 million (2020/21 £168.1 million), with the split between clean water investment and wastewater investment being largely balanced. This c.20% increase reflects the expected profile in the regulatory period with major capital schemes to replace the first of two water treatment works in the Bournemouth region progressing well, in addition to advanced expenditure on bathing water schemes and other environmental projects.

#### *CASH FLOW*

South West Water's operational cash inflows in 2021/22 at £233.6 million were £10.0 million lower than last year (2020/21: £243.6 million). These funds have been used to finance the Company's capital structure in an efficient way as well as investing in future growth through our substantial continuing capital investment programme.

Corporation tax payments were £11.2 million. Total tax payments reflecting all taxes borne by the Company in 2021/22 are described in more detail in the section on 'Tax Contribution (borne/collected)' on page 68.

#### *LIQUIDITY AND DEBT PROFILE*

South West Water has a strong liquidity and funding position with £193 million of cash and committed facilities at 31 March 2022. This consists of cash and deposits of £27.6 million (excluding £161.7 million of restricted funds representing deposits with lessors against lease obligations) and undrawn facilities of £165 million. At 31 March 2022 the Company's borrowings totalled £2,494.5 million. After the £189.3 million held in cash, this gives a net debt figure of £2,305.2 million, an increase of £31.6 million during the year (2021: £33.6 million decrease).

South West Water has a diversified funding mix of 59% fixed, 15% floating and 26% index-linked borrowings. The Company's debt has a maturity of up to 35 years with a weighted average maturity of 14.7 years matching the

asset base. Some of the Company's debt is floating rate, with derivatives being used to fix the rate on that debt. The Company has fixed, or put swaps in place to fix, the interest rate on a substantial portion of the existing debt, in line with the policy to have at least 60% of fixed funding.

£605.1 million of South West Water's debt is index-linked at an overall real rate of under 1.87%. As a result of the aforementioned initiatives, South West Water's cost of finance is among the lowest in the industry. Around half of the net debt is from finance leases, providing a long maturity profile to its debt. Interest payable on them benefits from the fixed credit margins, which were secured at the inception of each lease. A quarter of the net funding for South West Water is Retail Price Index (RPI) linked, a level below Ofwat's notional level of 33% leaving the water business at a comparative advantage through the regulatory transition from RPI to CPIH in light of current market conditions.

At 31 March 2022 the fair value of the Company's non-current borrowings (excluding leases) was £146.2 million more than its book value (2021: £159.9 million more than book value) as detailed in note 22 to the financial statements. This reflects the continued benefit of securing interest rates below the current market rate, offset by volatility in inflation markets.

#### *CAPITAL STRUCTURE – OVERALL POSITION*

The Company's net debt has increased by £31.6 million to £2,305.2 million. Cash inflow from operations was a strong £233.6 million. Cash outflows relating to the capital programme totalled £197.3 million (2020/21: £161.1 million), an increase from the prior year reflects the expected profile in the regulatory period with major capital schemes to replace the first of two water treatment works in the Bournemouth region progressing well, in addition to advanced expenditure on bathing water schemes and other environmental projects. The gearing ratio at 31 March 2022, being the ratio of net debt to (equity plus net debt) was 80.1% (31 March 2021: 81.2%).

The combined South West Water and Bournemouth Water debt to Regulated Capital Value (RCV) ratio is 63.6% (31 March 2021: 67.1%). Ofwat's notional gearing target for the K7 (2020-25) regulatory period is set at 60.0%.

	2017	2018	2019	2020	2021	2022
<b>Regulatory capital value as at 31 March (£m)</b>	3,291	3,431	3,505	3,573	3,388	3,623

The increase in RCV reflects the profile of expenditure in the business plan and higher March 2022 CPIH inflation.

South West Water utilises the role of the Pennon Group's treasury function to ensure it has the funding to meet foreseeable needs, to maintain reasonable headroom for future contingencies and to manage interest rate risk. It operates only within policies approved by the Board and undertakes no speculative trading activity.

The Board regularly monitors expected financing needs for at least the following 12 months. These are intended to be met for the coming year from existing cash balances, loan facilities and operating cash flows.

The Pennon Group has considerable financial resources. The Directors therefore believe that South West Water is well placed to manage its business risks in the context of the financial resources available to it.

#### *INTERNAL BORROWING*

South West Water's funding is treated for regulatory purposes as ring-fenced. This means that funds raised by, or for it, are not available as long-term funding for other areas of the Pennon Group.

## TAXATION STRATEGY

South Water has adopted the Pennon Group plc tax strategy. This means that we will:

- At all times consider the Company's corporate and social responsibilities in relation to its tax affairs
- Operate appropriate tax risk governance processes to ensure that the policies are applied
- Comply with our legal requirements; file all appropriate returns on time and make all tax payments by the due date
- Consider all taxes as part of ongoing business decisions
- Not enter into artificial tax arrangements or take an aggressive stance in the interpretation of tax legislation
- Not undertake transactions which are outside the Company's low risk appetite for tax or not in line with the our Code of Conduct
- Engage with HMRC in a proactive and transparent way and discuss our interpretation of tax laws in real-time, such interpretations following both the letter and spirit of the laws.
- Not have any connections with tax havens unless it is necessary for the purposes of trading within those jurisdictions.

The Company's approach to tax planning, risk management and governance is in line with the Finance Act 2016 requirements; the Company does not expect its tax strategy to change significantly year on year, however it is reviewed and updated annually. Further details are given in the Group's Tax Strategy document which is available on the Pennon Group website.

## TAXATION CONTRIBUTION (BORNE/COLLECTED)

The company's total tax contribution extends significantly beyond the UK corporation tax payments.

In addition to corporation tax the most significant taxes involved, together with their profit impact, were:

- Value Added Tax (VAT) of £70.4 million recovered (2020/21: £37.1 million) by South West Water from HMRC. VAT has no material impact upon the profit before tax
- Business rates of £29.4 million (2020/21: £29.5 million) paid to local authorities. This is a direct cost to the Company and reduces profit before tax
- Employment taxes of £19.4 million (2020/21: £17.8 million) including employees' Pay As You Earn (PAYE) and total National Insurance Contributions (NICs). This is a direct cost to the Company and reduces profit before tax
- Fuel Excise Duty of £0.9 million (2020/21: £0.9 million) related to transport costs. This reduces profit before tax
- Payments to the Environment Agency and other regulatory bodies total £12.5 million (2020/21: £11.8 million). This reduces profit before tax
- Climate Change Levy (CCL) payment for the Company of £2.5m (2020/21: £2.5m) This reduces profit before tax.

The corporation tax rate for 2021/22 used to calculate the current year's tax is 19%. During the Chancellor's Budget on 4<sup>th</sup> March 2021, it was announced that the UK main rate of corporation tax will increase to 25% from 1 April 2023. The change in tax rate was substantively enacted on 24 May 2021 and deferred tax assets and liabilities have been recalculated and recorded at the tax rate at which they are expected to crystallise. The change

in tax rate has meant a charge of £98.7 million has been recorded in the non-underlying result in the financial year.

To support the fact that we pay our 'fair' share, Pennon Group (including South West Water) again applied to the Fair Tax organisation to seek their independent award and were successful in obtaining certification. The Fair Tax Mark is the UK's accreditation scheme for businesses paying their fair share of corporation tax and reporting on their tax practices transparently.

## **PENSIONS**

The Company is a member of the Pennon Group's defined benefit pension schemes for certain employees of South West Water. The defined benefit schemes were closed to new entrants on or before 1 April 2008. The defined benefit scheme was closed to future accrual from 30 June 2021.

At 31 March 2022 the Company's share of the pension schemes showed an aggregate surplus (before deferred tax) of £47.1 million (2020/21: £14.3 million surplus). The increase in the surplus in 2021/22 primarily driven by remeasurements in financial assumptions during the year.

## **INSURANCE**

South West Water manages its property and third-party liability risks through insurance policies that mainly cover property, motor, business interruption, public liability and employers' liability.

The Company uses three tiers of insurance to cover operating risks:

- self-insurance – pay a moderate excess on most claims
- cover by the Pennon Group's subsidiary (Peninsula Insurance Limited) of the layer of risk between the self-insurance and the cover provided by external insurers
- cover provided by the external insurance market, arranged by our brokers with insurance companies that have good credit ratings.

## MANAGING OUR RISKS

The Board and the Executive are committed to the effective management of risks and opportunities to ensure the long-term success of the company.

South West Water operates mature and robust risk management and internal control frameworks which are aligned to the Company's strategic priorities and are embedded into our processes, culture and ways of working. These frameworks form a key part of our governance structure ensuring that there is robust review, challenge and assurance over the management of both our current and emerging risks and opportunities.

### OUR RISK MANAGEMENT FRAMEWORK



### GOVERNANCE OF THE RISK MANAGEMENT AND INTERNAL CONTROL FRAMEWORK

The Company's risk management framework encompasses both a 'top down' and 'bottom up' approach. This;

- allows risks and opportunities to be cascaded and escalated effectively
- enables a common understanding of the risks and opportunities and their potential impact on the achievement of the Company's strategic priorities
- provides a multi-layered approach to the review and challenge of risk.

A consistent methodology is applied in the identification and assessment of the Company's risks, which considers both the likelihood of the risk occurring over a long-term period and the potential impact across a range of categories including financial, safety, environmental and customer service, aligned with our strategic priorities. Principal and business-level risks are subject to regular review and challenge by the individual subsidiaries and functions, the Risk Committee, Executive and the Board.

The Company mitigates its risk exposure in line with the desired risk appetite and tolerance levels, through the operation of a robust internal control and assurance framework which is aligned to the 'three lines' model. The Executive and the Board obtain assurance over the effectiveness of the internal control environment through a variety of internal and external assurance providers, including an independent Internal Audit function.

The key responsibilities and activities which encompass the Company's risk management framework include:

		<b>Key risk management responsibilities</b>	<b>Key assurance activities</b>
<b>OVERSIGHT</b>	Board	<ul style="list-style-type: none"> <li>• Sets the Company's strategic objectives</li> <li>• Establishes the Company's risk appetite</li> <li>• Determines the Company's principal risks</li> <li>• Ensures an effective internal control framework</li> </ul>	<ul style="list-style-type: none"> <li>• Quarterly reviews of the Company's principal risks against the determined risk appetite</li> <li>• Quarterly reviews of the Company's emerging risk log</li> </ul>
	Audit Committee	<ul style="list-style-type: none"> <li>• Reviews the effectiveness of the risk management framework</li> <li>• Reviews the adequacy of the internal control framework</li> </ul>	<ul style="list-style-type: none"> <li>• Perform quarterly deep dive reviews on principal risks</li> <li>• Approves the Internal Audit Plan in respect of South West Water</li> <li>• Receive reports on the outcomes of key assurance activities</li> </ul>
<b>THIRD LINE OF DEFENCE</b>	Group Internal Audit	<ul style="list-style-type: none"> <li>• Provides independent, risk-based assurance on the effectiveness of the internal control framework</li> <li>• Coordination of independent assurance activities</li> </ul>	<ul style="list-style-type: none"> <li>• Regular reporting to Audit Committee and Executive on the effectiveness of internal controls and the outcomes of key assurance activities</li> </ul>
<b>SECOND LINE OF DEFENCE</b>	Executive	<ul style="list-style-type: none"> <li>• Day-to-day management of principal and operational risks</li> <li>• Establishes the relevant risk management processes and procedures</li> <li>• Maintains the internal controls framework</li> </ul>	<ul style="list-style-type: none"> <li>• Performs a thorough appraisal of principal and emerging risk profile quarterly</li> <li>• Monitor performance against ODIs, other KPIs and financial performance</li> <li>• Establish and review policies, procedures and delegated authorities</li> </ul>
	Risk Committee	<ul style="list-style-type: none"> <li>• Provides review and challenge over principal risks and mitigation strategies</li> <li>• Alignment of the 'top down' and 'bottom up' risk management process</li> <li>• Performs horizon scanning on emerging risks and opportunities</li> </ul>	<ul style="list-style-type: none"> <li>• Quarterly review of principal risks and key functional risks</li> <li>• Undertakes deep dive reviews of specific risks.</li> </ul>
<b>FIRST LINE OF DEFENCE</b>	South West Water directorate functions	<ul style="list-style-type: none"> <li>• The identification and assessment of risks</li> <li>• Implementation and execution of appropriate risk mitigation strategies, aligned with the agreed risk appetite</li> <li>• Monitor compliance with internal control framework</li> <li>• Review of principal risks on a quarterly basis by senior leadership teams</li> </ul>	<ul style="list-style-type: none"> <li>• Functions perform second line assurance across regulatory, legal, health &amp; safety</li> <li>• Self-certification of compliance with internal control framework</li> </ul>

In addition, the Company also received assurances from a variety of external assessments, including by our regulators, which compliments and further enhances the overall assurance framework.

### *ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) RISK MANAGEMENT*

The nature of the Company's operations means that environmental, social and governance (ESG) considerations are inherent in how the Company operates as a responsible business and are a key focus for the us.

The identification, assessment and management of ESG risks and opportunities, including the potential impact of climate change on our business, is integrated into the overall risk management framework and methodology, with the outcomes reflected within the assessment of relevant principal and business level risks. This includes the potential impact of physical and transitional climate change risks on our assets and operations. Further detail on specific physical and transitional climate change related risks, as well as examples of how these are being mitigated, are referenced further within our TCFD report on page 46. The delivery of the ESG actions and commitments is monitored through our ESG framework.

### *SOUTH WEST WATER TECHNICAL (NON- FINANCIAL) DATA*

In addition to the risk management framework detailed above, recognising the importance of the regulatory ODI framework, engage independent, third-party auditors to audit the accuracy of the technical (non-financial) data reported in the respective annual and annual performance reports, including its performance commitments and environmental data. Furthermore, DNV, have also performed additional assurance work over the Company's sustainability measures.

### *CONTINUOUS IMPROVEMENTS TO RISK MANAGEMENT AND INTERNAL CONTROL*

The Company is committed to continuously improving its ability to identify and respond to current and emerging risks. Examples of risk management improvements during the year include:

- A programme of legal compliance training was rolled out providing an update to all colleagues on key policies and procedures.
- The Company refreshed and relaunched its Information Security Awareness programme which is being delivered utilising a range of methods and tools.
- South West Water have been successfully accredited to the ISO 55001 Asset Management standard.
- The health and safety 'site pride' awards were launched recognising areas of the Pennon Group that deliver outstanding health, safety and wellbeing standards.
- A comprehensive Fraud Risk Assessment was completed with key outcomes reported to the Risk Committee.

### *OFWAT'S PRINCIPLES - BOARD LEADERSHIP, TRANSPARENCY AND GOVERNANCE*

Ofwat requires that holding companies manage their risks in such a way that the regulated company is protected from risk elsewhere in the Group. Pennon Group's principal risks and uncertainties include those Group-level risks which could materially impact on South West Water.

Pennon's risk management and internal control frameworks ensure that it does not take any action that would cause South West Water to breach its licence obligations. Further, the Group's governance and management structures mean that there is full understanding and consideration of South West Water's duties and obligations under its licence, as well as an appropriate level of information sharing and disclosure to give South West Water



assurance that it is not exposed as a result of activities elsewhere within the Group.

Further details of Group-wide principal risks and application of the Group's risk management framework across the Group are provided in the Pennon Group plc annual report (pages 96 to 105).

#### *HORIZON SCANNING*

Emerging risks and opportunities are considered to be factors and events which could have a future impact on the achievement of the Company's strategic priorities but lack the required clarity or certainty in order to adequately assess their impact. Horizon scanning of emerging risks and opportunities is embedded within the risk and opportunity review process performed by individual subsidiaries and functions. Emerging risks are also reviewed by the Risk Committee, Group Executive and Pennon Board as part of their regular assessment of the Group's risk profile. Once there is sufficient clarity and certainty over an emerging risk, it is assessed applying the Company's methodology and appropriate mitigating actions are established. Notable emerging risks and opportunities are detailed within the table below:

<b>Risk/opportunity</b>	<b>Comment</b>	<b>Risk category impact</b>	<b>Time horizon</b>
<b>COVID-19 long-term economic implications</b>	Continued uncertainty remains over the pace and scale of the long-term implications of COVID-19 on the global and UK economy, which could impact our business.	<ul style="list-style-type: none"> <li>• Legal, regulatory and finance</li> </ul>	Medium-term
<b>Micro-pollutants, plastics and micro-plastics</b>	The continued focus on the impact of micro-pollutants and micro-plastics could present both risks and opportunities arising from changes to treatment processes.	<ul style="list-style-type: none"> <li>• Operating performance</li> <li>• Business systems and capital investment</li> </ul>	Medium-term
<b>Biodiversity</b>	Threats to the region's biodiversity, as a result of climate change, may require changes to how we interact with species and habitats in the areas that we operate in.	<ul style="list-style-type: none"> <li>• Operating performance</li> </ul>	Long-term
<b>Changes to the demographics within the South West</b>	Increases in population migration to the South West due to the longer-term impact of COVID-19 and climate change could place further demand on our resources and assets.	<ul style="list-style-type: none"> <li>• Operating performance</li> </ul>	Long-term

#### *RISK APPETITE*

The UK Corporate Governance Code requires companies to determine the risk appetite considered appropriate in achieving the Company's strategic priorities. Striking an appropriate balance between risk and reward is key to the success of the Company's strategy.

The Board has established its risk appetite for each risk category and also for each principal risk. This allows the business to pursue value-enhancing opportunities, whilst maintaining an overall level of risk exposure that the Board considers to be appropriate. The Board's evaluation of the effectiveness of the comprehensiveness of the Company's internal controls in mitigating its principle risks to an acceptable level is considered with due consideration of the relevant risk appetite. The risk appetite for each risk category is detailed below:

Risk category	Risk appetite statement
Law, regulation and finance	<p>The Board is committed to fully complying with, and being seen to be complying with, all relevant laws, regulations and obligations and has no appetite for non-compliance in this area. This includes (but is not limited to) health &amp; safety, where the Board places the highest level of importance on the welfare of our employees, the public and those who work with, or on behalf of, South West Water. The Company also operates a prudent approach to our financing strategy to ensure our long-term financing commitments are met.</p> <p>The Board acknowledges, however, that South West Water operates in a complex environment influenced by Government policy and regulatory reform. Consequently, there is a greater acceptance of risk in these areas and the Company seeks to mitigate any potential downside and leverage opportunities that may arise from Government policy and regulatory change.</p>
Market and economic conditions	<p>The Board recognises that our activities are exposed to changes in macroeconomic and external market conditions. The Company seeks to take well-judged and informed decisions to mitigate these risks where possible, but accepts that a level of residual risk may remain beyond the Board's control.</p>
Operating performance	<p>The Board has a low appetite for significant operational failure of our assets and seeks to reduce both the likelihood and impact through long-term planning and careful management of our operational assets.</p> <p>There is greater appetite for well-informed risk taking to develop further markets, subject to this not detrimentally impacting on the level of service expected of our regulators, existing customer base and wider stakeholders.</p>
Business systems and capital investment	<p>The Board has a low risk appetite for risk associated with the delivery of capital investment within our regulated business plan. Broader investment decisions are taken on an informed basis with risks weighted against the expected level of return on a case-by-case basis.</p> <p>South West Water seeks to minimise technology and security risk to the lowest possible level without detrimentally impacting on the Company's operations.</p>

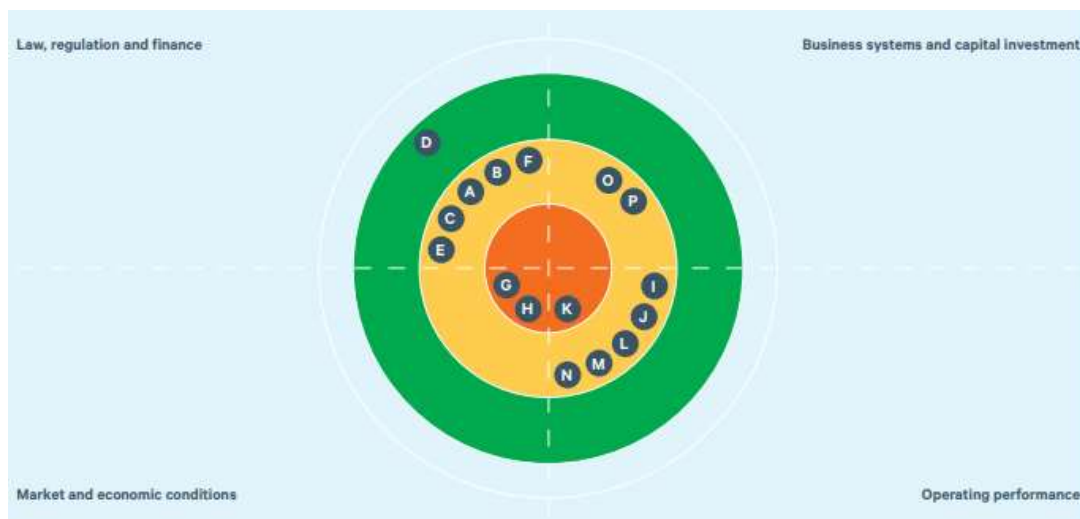
## PRINCIPAL RISKS AND UNCERTAINTIES

South West Water's business model exposes the business to a variety of external and internal risks which are influenced by the potential impact of macro political, economic and environmental factors. Specifically, the UK is currently experiencing a high inflationary environment as a result of a number of global factors.

While the ability of the company to influence these macro level risks is limited, they continue to be regularly monitored and the potential implications are considered as part of the ongoing risk assessment process. The company performs a range of scenario planning and analysis exercises to understand the risk exposure of one, or a number, of these events occurring.

The Directors confirm that during 2021/22, they have carried out a robust assessment of current and emerging risks facing the company. The assessment of the principal risks has considered the impact on its business model, future performance, solvency and liquidity. These principal risks have been considered in preparing the Viability Statement on page 86.

*AN OVERVIEW OF THE PRINCIPAL RISK PROFILE*



Principal risks	Ref	Strategic priorities - outcomes	Risk description	Net risk level	Trend
Law, regulation and finance	A	Creating value Protecting places	Changes in Government policy	AMBER	↑
	B	Creating value Protecting places	Regulatory reform	AMBER	↔
	C	Creating value Protecting places	Non-compliance with laws and regulations	AMBER	↑
	D	Creating value	Inability to secure sufficient finance and funding, within our debt covenants, to meet ongoing commitments	GREEN	↔
	E	Supporting people	Non-compliance or occurrence of avoidable health & safety incident	AMBER	↔
	F	Creating value	Failure to pay all pension obligations as they fall due and increased costs to the Company should the defined benefit pension scheme deficit increase	AMBER	↔
Market and economic conditions	G	Creating value	Non-recovery of customer debt	RED	↔

Principal risks	Ref	Strategic priorities - outcomes	Risk description	Net risk level	Trend
	H	Creating value	Macro-economic risks impacting inflation, interest rates and power prices	RED	↑
Operating performance	I	Protecting places Supporting people Creating value	The company's operations and assets are impacted as a result of climate change and extreme weather events	AMBER	↑
	J	Supporting people	Failure of operational water treatment assets and processes resulting in an inability to produce or supply clean drinking water	AMBER	↑
	K	Protecting places	Failure of operational wastewater treatment assets and processes resulting in an inability to remove and treat wastewater and potential environmental impacts. Including pollutions	RED	↑
	L	Protecting places Supporting people	Failure to maintain excellent service or effectively engage with our customers and wider stakeholders	AMBER	↑
	M	Supporting people	Insufficient skills and resources to meet the current and future business needs and deliver the Company's strategic priorities	AMBER	↔
	N	Protecting places Supporting people Creating value	Non-delivery of Regulatory Outcomes and performance commitments	AMBER	↔
Business systems and capital investments	O	Creating value	Inefficient or ineffective delivery of capital projects	AMBER	↑
	P	Supporting people Creating value	Inadequate technological security results in a breach of the Company's assets, systems and data	AMBER	↑

## LAW REGULATION AND FINANCE

Strategic impact	Mitigation and commentary	Risk appetite
<b>Principal Risk A: Changes in Government policy</b>		
<b>2022 Net risk and direction:</b>		<b>2021 Net risk and direction:</b>
<b>AMBER, INCREASING</b>		<b>AMBER, STABLE</b>
<p><b>Creating value</b></p> <p><b>Protecting places</b></p> <p>Changes in Government policy may fundamentally impact our ability to deliver the Company's strategic priorities.</p>	<p>The current UK Government remains supportive of the existing regulatory model. During the year the UK Government published its Strategic Policy Statement (SPS) which sets the strategic priorities for Ofwat and is consulting on their Storm Overflows Discharge Reduction Plan.</p> <p>South West Water has actively engaged and provided responses during the consultation process.</p> <p>The Company also regularly engages with a MPs and other political stakeholders, both directly and via Water UK, demonstrating the value from our operational performance and continued investment in our network infrastructure.</p> <p>Horizon scanning of emerging changes in Government policy, including policies designed to mitigate the impact of climate change, is regularly undertaken to monitor and assess the potential direct or indirect impact on the Company.</p>	<p>We recognise that Government Policy evolves. The Company seeks to minimise the potential risk and maximise opportunities through regular engagement and robust scenario planning.</p>
<b>Principal Risk B: Regulatory Reform</b>		
<b>2022 Net risk and direction:</b>		<b>2021 Net risk and direction:</b>
<b>AMBER, STABLE</b>		<b>AMBER, STABLE</b>
<p><b>Creating value</b></p> <p><b>Protecting places</b></p> <p>Reform of the regulatory framework may result in changes to our priorities and the service we provide to our customers. It may have a significant impact on our performance which can impact value.</p>	<p>Certainty over the 2020-25 regulatory framework has been provided through South West Water's Final Determination.</p> <p>The Company's Regulatory Affairs Steering Committee monitors changes in the regulatory environment.</p> <p>There remains the potential that regulatory mechanisms within the next Price Preview period do not provide sufficient funding to achieve the environmental ambitions set out by the Government within the Environment Bill.</p> <p>Internal PR24 planning has commenced and both South West Water have actively responded to positioning papers from Ofwat which will inform the PR24 price review methodology which will be published in July 2022.</p>	<p>We accept that regulatory reform occurs and seek to leverage opportunities where possible and minimise the potential risks by targeting changes which are NPV neutral over the longer term to protect customer affordability and shareholder value.</p>

**LAW REGULATION AND FINANCE (CONTINUED)**

Strategic impact	Mitigation and commentary	Risk appetite
<b>Principal Risk C: Non-compliance with laws and regulations</b>		
<b>2022 Net risk and direction:</b>		<b>2021 Net risk and direction:</b>
<b>AMBER, INCREASING</b>		<b>AMBER, INCREASING</b>
<p><b>Creating value</b></p> <p><b>Protecting places</b></p> <p>South West Water is required to comply with a range of regulated and non-regulated laws.</p> <p>Non-compliance with one, or a number of these may result in financial penalties negative impact on our ability to operate effectively and reputational damage.</p>	<p>The Company operates within robust and mature regulatory frameworks, ensuring compliance with the requirements of Ofwat, Environment Agency and other relevant regulators. These frameworks are subject to regular review and enhancement to ensure the Company remains compliant with the increasingly complex legal and regulatory landscape. There remains an increased appetite amongst regulators for pursuing enforcement action for perceived non-compliance with the Environment Agency and Ofwat both currently undertaking industry-wide investigations of wastewater treatment works permit compliance.</p> <p>The Company also maintains a comprehensive internal framework to ensure compliance with corporate laws and regulations. This is reinforced through key policies which are endorsed by the Board and refreshed legal compliance training has been provided to staff during the year.</p> <p>Confidential whistleblowing processes exist which allows concerns to be raised confidentially and appropriately investigated. Activity through the whistleblowing process is reported periodically to the Board.</p>	<p>South West Water has the highest standards of compliance and has no appetite for legal or regulatory breaches.</p>

Strategic impact	Mitigation and commentary	Risk appetite
<b>Principal Risk D: Inability to secure sufficient finance and funding, within our debt covenants, to meet ongoing commitments.</b>		
<b>2022 Net risk and direction:</b>		<b>2021 Net risk and direction:</b>
<b>GREEN, STABLE</b>		<b>GREEN, STABLE</b>
<p><b>Creating value</b></p> <p>Failure to maintain funding requirements could lead to additional financing costs and put our growth agenda at risk. Breach of covenants could result in the requirement to repay certain debt.</p>	<p>South West Water and the entire Pennon Group have well established treasury, funding and cash flow arrangements in place underpinned by a clear Treasury Management policy which has been endorsed by the Board.</p> <p>The impact of political, economic and regulatory risks on the Company's financing commitments and cash flow is regularly reviewed by the Executive and Board.</p> <p>South West Water retains £193 million of cash and committed facilities (excluding £161.7 million of restricted funds) as at 31 March 2022. South West Water are fully funded for the 2020-2025 regulatory period.</p> <p>During 2021/22 £50 million of new or renewed funding was entered into.</p>	<p>We operate a prudent approach to our financing strategy in order to ensure our funding requirements are fully met.</p>
<b>Principal Risk E: Non-compliance or occurrence of an avoidable health &amp; safety incident</b>		
<b>2022 Net risk and direction:</b>		<b>2021 Net risk and direction:</b>
<b>AMBER, STABLE</b>		<b>AMBER, STABLE</b>
<p><b>Supporting people</b></p> <p>A significant health &amp; safety event could result in financial penalties, significant legal costs and damage to the Company's reputation.</p>	<p>The effective management of health &amp; safety risks continues to be a priority for the Executive and Board. Our HomeSafe strategy has been refreshed during the year.</p> <p>Investment has also been accelerated for safety specific asset improvements, focused on operational sites and activities.</p> <p>The review of health and safety performance is monitored regularly through the dedicated Board and Executive Health and Safety Committees.</p> <p>To align ourselves with other Water Companies, we now report the rate per 100k hours as opposed to per 200k hours. South West Water's LTIFR has reduced during the year to 0.68 (FY2020/21; 0.80) and continues to target a LTIFR of 0.25 by 2025.</p>	<p>We have no appetite for health &amp; safety related incidents and we maintain the highest standards of compliance for our staff, contractors and other third parties.</p>
<b>Principal Risk F: Failure to pay all pension obligations as they fall due and increased costs to the Company should the deferred pension scheme deficit increase</b>		
<b>2022 Net risk and direction:</b>		<b>2021 Net risk and direction:</b>
<b>AMBER, STABLE</b>		<b>AMBER, STABLE</b>
<p><b>Creating value</b></p> <p>The Company could be called upon to increase funding to reduce the deficit, impacting our cost base.</p>	<p>The Company utilises an experienced in-house Pensions team who also engage with professional advisors to manage the pension scheme's investment strategy.</p> <p>Following consultation, the scheme was closed to future accrual for existing members from 30 June 2021.</p> <p>The Pennon Defined Benefit Pension schemes are fully funded, however these scheme are potentially impacted by volatility in the macro-economic environment.</p>	<p>The Company will ensure that all obligations are met in full but seeks to manage this without unnecessary increased costs to the Company.</p>

## MARKET AND ECONOMIC CONDITIONS

Strategic impact	Mitigation and commentary	Risk appetite
<b>Principal Risk G: Non-recovery of customer debt</b>		
<b>2022 Net risk and direction:</b>		<b>2021 Net risk and direction:</b>
<b>RED, STABLE</b>		<b>RED, STABLE</b>
<p><b>Creating value</b></p> <p>Reduced customer debt collection would adversely impact on the Company's revenue.</p>	<p>South West Water have robust collection strategies which have continued to adapt in response to the impact of COVID-19 and the increasing inflationary environment on customers during the year.</p> <p>The effectiveness of the measures taken have resulted in collection rates and debt levels at levels broadly comparable with prior year. Continued support has also been provided to South West Water customers most in need by proactively promoting affordability measures and tariffs.</p> <p>Despite the effectiveness of mitigations in place, further increases in inflation and the cost of living may result in future affordability challenges for our customers.</p>	<p>While seeking to minimise non-recoverable debt, we recognise customer affordability challenges and the inability to disconnect customers results in a residual risk of uncollectable debt remaining.</p>
<b>Principal Risk H: Macro-economic risks impacting on inflation, interest rates and power prices</b>		
<b>2022 Net risk and direction:</b>		<b>2021 Net risk and direction:</b>
<b>RED, INCREASING</b>		<b>AMBER, STABLE</b>
<p><b>Creating value</b></p> <p>Lower inflation or deflation could adversely impact on the Company's revenue and significant changes in interest rates and power prices could increase the Company's cost base.</p>	<p>The volatility currently being experienced in the global economy is impacting on the Company's near term cost base through increased operational costs, power prices and financing costs.</p> <p>Action is taken to mitigating these near term impacts through utilising the Company's in-house procurement function to drive value through competitive tendering, regularly review of the Company's debt portfolio and level of index linked debt, monitoring of forward power prices to manage the exposure to price volatility and increasing the level of renewable energy.</p> <p>Despite these mitigations there remains a degree of exposure beyond the Company's control.</p> <p>Long-term protection from the increasing inflationary environment is provided through inflation linked revenues and RCV growth, along with regulatory true-ups.</p>	<p>We seek to take well-judged and informed decisions whilst ensuring plans are in place to mitigate the potential impact of macro-economic risks.</p>



## OPERATING PERFORMANCE

Strategic impact	Mitigation and commentary	Risk appetite
<b>Principal Risk I: The Company's operations and assets are impacted as a result of climate change and extreme weather events</b>		
<b>2022 Net risk and direction:</b>		<b>2021 Net risk and direction:</b>
<b>AMBER, INCREASING</b>		<b>AMBER, INCREASING</b>
<p><b>Protecting places</b></p> <p><b>Supporting people</b></p> <p><b>Creating value</b></p> <p>Failure of our operations to cope with short term extreme weather or long term implications of climate change may result in an inability to meet customer needs, environmental impacts, increased costs and reputational damage.</p>	<p>A low appetite remains amongst regulators and stakeholders for reduced performance arising from extreme weather and climate change.</p> <p>The assessment of both transitional and physical climate change related risks on the Company's assets and operations has informed South West Water's Climate Change Adaptation Plan which was published in December 2021 and the Company's TCFD statement on page 46.</p> <p>Additionally, extensive water resource scenario planning has been undertaken as part of the development of South West Water's updated 25 year Water Management Plan, which will be published later in the year, and drought plans are subject to regular review.</p> <p>Proactive capital investment is undertaken on the Company's assets to ensure the continued resilience of both water and wastewater assets, particularly those located on or near flood plains or at risk of rising sea levels and costal erosion.</p> <p>Additionally the CREWW venture with the University of Exeter was launched during the year which will consider the impact of climate change in delivering resilient water supplies.</p> <p>The Company is also minimizing its environmental and climate change impact through the delivery of its 2030 Net Zero and WaterFit plans.</p>	<p>We seek to mitigate the impact of climate change and extreme weather events through long term planning, forecasting and investment.</p>
<b>Principal Risk J: Failure of operational water treatment assets and processes resulting in an inability to produce or supply clean drinking water</b>		
<b>2022 Net risk and direction:</b>		<b>2021 Net risk and direction:</b>
<b>AMBER, INCREASING</b>		<b>AMBER, INCREASING</b>
<p><b>Supporting people</b></p> <p>An inability to produce or supply clean drinking water could result in financial penalties, regulatory enforcement and damage to the Company's reputation.</p>	<p>Whilst the region continues to experience high levels of demand, water resources have remained resilient during the year and are in a robust position ahead of the summer period. The Company also seeks strategic value enhancing opportunities and has procured a site for the development of a new reservoir in the region.</p> <p>Asset health is managed through a well-established programme of planned and preventative maintenance works which has continued to assist in delivering further</p>	<p>We operate a low tolerance for significant operational failure of our water treatment assets and seek to mitigate these risks where possible.</p>

Strategic impact	Mitigation and commentary	Risk appetite
	<p>improvements within the our drinking water operations.</p> <p>In the event of a significant incident detailed contingency plans and incident management procedures are maintained which are regularly reviewed.</p>	
<b>Principal Risk K: Failure of operational wastewater assets and processes resulting in an inability to remove and treat wastewater and potential environmental impacts, including pollutions</b>		
<b>2022 Net risk and direction:</b>		<b>2021 Net risk and direction:</b>
<b>RED, INCREASING</b>		<b>RED, STABLE</b>
<p><b>Protecting places</b></p> <p>An inability to remove or treat wastewater could result in adverse environment impacts, financial penalties, regulatory enforcement and damage to the Company's reputation.</p>	<p>Wastewater assets are managed through an established programme of capital investment and planned and preventive maintenance.</p> <p>Minimising the impact of our activities on the environment is a strategic priority for the Executive.</p> <p>The continued delivery of South West Water's Pollution Incident Reduction Plan has resulted in one-third less pollutions compared with the previous year. This has been achieved through continued asset investment and maintenance, enhancing our systems and processes, collaborating with others in the industry to share best practice, helping customers to understand how their behaviour impacts on the local environment and a focus on culture, training, and standards with our workforce.</p> <p>It is recognised, however, that there is more to do to deliver the desired step change in this area.</p> <p>The Company's WaterFit investment programme will deliver £330 million of investment focused on protecting and improving the quality of the region's rivers and seas. Further detail is provided on page 54.</p> <p>In the event of a significant incident South West Water maintains detailed contingency plans and incident management procedures which are regularly reviewed.</p>	<p>We operate a low tolerance for significant operational failure of our wastewater processes and assets and maintains the highest level of environmental standards.</p>

Strategic impact	Mitigation and commentary	Risk appetite
<b>Principle Risk L: Failure to maintain excellent service or effectively engage with our customers and wider stakeholders.</b>		
<b>2022 Net risk and direction:</b>		<b>2021 Net risk and direction:</b>
<b>AMBER, INCREASING</b>		<b>AMBER, STABLE</b>
<p><b>Protecting places</b></p> <p><b>Supporting people</b></p> <p>Failure to maintain an adequate level of service and engagement could lead to financial penalties and reputational damage for South West Water.</p>	<p>South West Water continues to invest in its customer services teams and expand the channels by which it can interact with and support customers. Both South West Water hold the Institute of Customer Service's ServiceMark accreditation. Additionally, South West Water is BSI18477 accredited, a dedicated standard for identifying and responding to customer vulnerability.</p> <p>While written complaints have decreased by 60% in South West Water, C-Mex performance is not where we would like it to be and action is underway to address this.</p> <p>The independent WaterShare+ advisory panel acts as a key mechanism for engaging and demonstrating to customers how South West Water is delivering on its business plan and Board pledges. During the year the first WaterShare+ AGM was held.</p> <p>The Company regularly engages with a wide variety of internal and external stakeholders including our people, customers, regulators, environmental stakeholders and our supply chain. During the year an extensive stakeholder engagement process was undertaken and the outcomes have been aligned with the Group's ESG Capitals framework. Further detail is on page 13.</p>	<p>We continually seek to engage with and increase customer and wider stakeholder satisfaction levels.</p>
<b>Principal Risk M: Insufficient skills and resources to meet the current and future business needs and deliver the Companies strategic priorities</b>		
<b>2022 Net risk and direction:</b>		<b>2021 Net risk and direction:</b>
<b>AMBER, STABLE</b>		<b>AMBER, STABLE</b>
<p><b>Supporting people</b></p> <p>Failure to have a workforce of skilled and motivated individuals will detrimentally impact all of our strategic priorities. We need the right people in the right places to innovate, share best practice deliver synergies and move the Company forward.</p>	<p>There remains high demand nationally for skills and experiences utilised across the Company.</p> <p>During the year senior leaders from across the Company have participated in a talent development programme.</p> <p>Our HR strategy enables us to attract, retain and develop our employees and a number of reward and recognition initiatives have been launched during the year reflecting the significant contribution that our people make.</p> <p>During the year the Company has recruited a further 28 graduates, 92 apprentices and offered 54 placements through the Kickstart</p>	<p>While a certain level of employee turnover is desirable, we ensure the appropriate skills and experience is in place with succession plans providing adequate resilience.</p>

	<p>programme and 13 placements through the Black Intern initiative.</p> <p>The employee engagement forum has been refreshed during the year and a variety of opportunities for employees to engage and discuss their priorities and promote ideas to senior managers and the Executive.</p> <p>The continued impact of the Company's Employee Benefits and Reward Strategy, a focus on talent management and prioritisation of our diversity and inclusion agenda are reflected within the results of the most recent Great Place to Work Best Workplace survey and 65% of respondents believe South West Water is a great place to work.</p>	
<b>Principal Risk N: Non-delivery of regulatory outcomes and performance commitments</b>		
<b>2022 Net risk and direction:</b>		<b>2021 Net risk and direction:</b>
<b>AMBER, STABLE</b>		<b>RED, STABLE</b>
<p><b>Protecting places</b></p> <p><b>Supporting people</b></p> <p><b>Creating value</b></p> <p>South West Water's Regulatory Outcomes and performance commitments span all of our strategic focus areas.</p> <p>Non-delivery of these could result in financial penalties being applied as well as reputational damage.</p>	<p>The delivery of our regulatory outcomes and performance commitments is principally through our operational activities and initiatives.</p> <p>Performance against South West Water ODIs is subject to regular scrutiny and review by both the Executive and the Board. This is supplemented by a comprehensive programme of internal and external assurance over reported performance.</p> <p>Approximately 80% of South West Water's ODIs are on track or ahead of target.</p>	<p>We are committed to achieving all of our performance commitments over the length of each regulatory period.</p> <p>Where performance in an individual year falls below expectation action plans are implemented and targeted intervention to ensure performance returns to committed levels.</p>

## BUSINESS SYSTEMS AND CAPITAL INVESTMENT

<b>Strategic impact</b>	<b>Mitigation and commentary</b>	<b>Risk appetite</b>
<b>Principal Risk O: Inefficient or ineffective delivery of capital projects</b>		
<b>2022 Net risk and direction:</b>		<b>2021 Net risk and direction:</b>
<b>AMBER, INCREASING</b>		<b>GREEN, INCREASING</b>
<p><b>Creating value</b></p> <p>Inability to successfully deliver on our capital programme may result in increased costs and delays, detrimentally impacting our ability to provide top class customer service and achieve our growth agenda.</p>	<p>Capital projects are subject to an established and robust business case process, which includes challenge and risk modelling of key assumptions. Projects are delivered utilising skilled project management resource, complemented by Executive level oversight.</p> <p>The delivery of projects during the currently regulatory period, including as part of South West Water's Green Recovery Initiative, are progressing.</p> <p>The impact of both Covid-19 and the currently inflationary environment continues to place further strain on the financial health</p>	<p>The Board has a low risk appetite for risk associated with the delivery of capital investment within our regulated business plan.</p>

Strategic impact	Mitigation and commentary	Risk appetite
	<p>of key contractors and supply chain partners and remains a risk to the Company.</p> <p>Regular engagement is maintained with the Company's supply chain as well as regular monitoring of the financial health of key partners. Established plans and arrangements enable early intervention where necessary.</p>	
<b>Principal Risk P: Inadequate technological security results in a breach of the Company's assets, systems and data</b>		
<b>2022 Net risk and direction:</b>		<b>2021 Net risk and direction:</b>
<b>AMBER, INCREASING</b>		<b>AMBER, INCREASING</b>
<p><b>Supporting people</b></p> <p><b>Creating value</b></p> <p>Failure of our technology security, due to inadequate internal processes or external cyber threats, could result in the business being unable to operate effectively and the corruption or loss of data. This could have a detrimental impact on our customers and result in financial penalties and reputational damage to South West Water</p>	<p>External threats to the Company's assets and systems remain heightened, particularly due to the war in Ukraine. External threats, including additional risks resulting from the current conflict in Ukraine, are being regularly monitored by the our Information Security teams.</p> <p>The Company maintains a strong preventive and detective information security framework, aligned to guidance issued by the National Cyber Security Centre.</p> <p>A refreshed information security awareness programme has been launched during the year and South West Water continues to hold the ISO27001 accreditation.</p> <p>During the year both South West Water have continued to progress actions as part of the roadmap to meet the requirements of the Network and Information Systems Directive (NIS), with activities aligned to the priorities identified by the Drinking Water Inspectorate.</p> <p>Disaster recovery plans are in place for both corporate and operational technology and are regularly reviewed.</p>	<p>We seek to minimise technology and security risk to the lowest possible level without detrimentally impacting on the Company's operations.</p>

# VIABILITY STATEMENT

The Directors of South West Water are responsible for ensuring the long-term viability of the company. The Directors need to ensure the resilience of the Company by identifying, managing, avoiding or mitigating risks which may impact viability.

The Board's consideration of longer-term viability of the company is an extension of the strategic business planning which is managed through regular long-term modelling and monitoring of key measures including gearing, debt covenant headroom and level of liquidity. The resilience of the business and these key viability measures are appropriately assessed by a number of mechanisms including a robust risk management assessment, sensitivity analysis and stress tests of financial performance.

The viability assessment has been made with reference to the company's current position and prospects, including consideration of the ongoing impacts of the COVID-19 pandemic, climate change, the latest assessment of the impacts of the Ukraine crisis, its longer-term strategy, the Board's risk appetite and the company's principal risks and how these are managed, as detailed on pages 70 to 85 of the risk report.

## *PERIOD OF ASSESSMENT*

The Board regularly considers the appropriate period for the viability assessment to be performed in line with the UK Corporate Governance Code. The Board considers the appropriate period to assess the Company's viability remains unchanged until the end of 2030, which recognises the longer term visibility in the regulatory environment of the South West Water business.

## *RISKS*

The Board considers the preventative and risk management actions in place and the potential impact of the principal risks (as detailed on pages 74 to 85) against our ability to deliver the business plan. This assessment has considered the potential impact of these and other risks arising on the business model, future performance, solvency and liquidity over the period in question. The Company has a strong liquidity and funding position with £193 million of cash and committed facilities as at 31 March 2022 and net assets of £574.5 million. The Company has a mixture of fixed, floating and index linked debt financing with a weighted average maturity of 14.7 years. In making their assessment, the Directors reviewed the principal risks and considered which risks might threaten the Company's viability. Over the course of the year the Audit Committee has considered a deep-dive review of the following principal risks to enable a thorough assessment of the impact of these risks on ongoing viability:

- Health and safety
- Leakage
- Supply chain resilience
- Customer services performance
- Impact assessment of macroeconomic demand pressures
- Inefficient or ineffective delivery of capital projects

## *STRESS TESTING*

The Company's business plan has been stress-tested. Whilst the Company's risk management processes seek to mitigate the impact of principal risks as set out on pages 74 to 85, individual sensitivities (shown in the table below) have been identified. These sensitivities, which are ascribed a value with reference to risk weighting,

factoring in the likelihood of occurrence and financial impact, were applied to the baseline financial forecast which uses the Company's annual budget for FY2022/23 and longer-term strategic business plan through to March 2027.

The impact of climate risks have been assessed in detail in the Pennon Group plc Annual Report as referenced in the Task Force on climate-related Financial Disclosures (TCFD) section on page 46. The Company's strategic business plan includes the expected investment identified at this stage to meet climate changed adaptation. The stress testing scenarios applied during the viability assessment period do not include specific reference to climate change related risks alone as the sensitivities are not considered material during the period of assessment. Beyond the period of assessment additional impacts from climate change are considered in more detail within the TCFD section of the Pennon Group plc Annual Report as referenced on page 46, along with mitigating actions.

Principal risk	Viability sensitivities tested
A: Changes in government policy	Changes in Government policy affecting the water industry, such as additional environmental legislation may impact operational performance or investment requirements. The estimated average adverse impact on the Group's cash flows from a range of potential policy changes has been applied as a sensitivity.
B: Regulatory reform	Potential changes in PR24 price review may impact allowed regulatory returns in South West Water. The estimated average adverse impact on the Group's cash flows from a range of potential policy changes has been applied as a sensitivity.
C: Non-compliance with laws and regulations	The estimated impact of financial penalties and reputational damage from failure to comply with laws and regulations has been modelled as a sensitivity.
D: Inability to secure sufficient finance and funding to meet ongoing commitments	The impact of reduced availability of financing resulting in increased margins on new debt raised. A sensitivity of increased banking margins of 2% has been applied.
E: Non-compliance or occurrence of an avoidable health and safety event	The financial impact and cash outflows related to a major health and safety event has been applied as a sensitivity.
F: Failure to pay all pension obligations as they fall due and increased costs for the Group should the defined benefit pension scheme deficit increase	The financial impact on the Group's gearing from additional funding being required to support the Group's defined benefit pension schemes has been applied as an adverse scenario.
G: Non-recovery of customer debt	An application of reduced cash inflows from increased customer bad debt levels has been modelled. This includes an assessment of the residual impacts from COVID-19 and the affordability challenges arising from high inflation and rising power prices.
H: Macroeconomic risks impacting on inflation, interest rates and power prices	The adverse impact of higher operating and finance costs from increasing power prices and general inflation increases over and above increases assumed in base financial plans, including the impact on totex underperformance on regulatory returns and impact on debt financing costs.
J: Failure of operational water treatment assets and processes resulting in an inability to produce and supply clean drinking water	The adverse impact from non-delivery of regulatory performance targets which result in ODI penalties, other financial penalties and required additional investment reducing Group revenues and cash inflows have been applied as a sensitivity to the base plan.

Principal risk	Viability sensitivities tested
K: Failure of operational wastewater assets and processes resulting in an inability to remove and treat wastewater and potential adverse environmental impacts, including pollutions	
L: Failure to maintain excellent customer service or effectively engage with our customers and wider stakeholders	
M: Insufficient skills and resources to meet the current and future business needs and deliver the Group's strategic priorities	
N: Non-delivery of Regulatory Outcomes and performance commitments	
O: Inefficient or ineffective delivery of capital projects	
P: Inadequate technological security results in a breach of the Company's assets, systems and data	The adverse financial impacts of a cyber attack resulting in operational disruption, potential loss of data, potential detrimental impacts on customers with potential for financial penalties have been included in the sensitivity analysis.

#### STRESS TESTING EVALUATION AND MITIGATIONS

Through this testing, it has been determined that none of the individual principal risks would in isolation, or in aggregate, compromise the Company's viability over the period to 2030. The financial impacts of the risks were probability weighted to obtain a value that was used in the stress testing. While mitigations were not required in any of the above individual or combined scenarios to ensure that the company was viable, additional mitigations could be deployed to reduce gearing and increase covenant headroom, including reductions in operational and capital expenditure.

In addition, a reverse engineered scenario that could possibly compromise the Company's viability over the assessment period has been modelled. This scenario builds on the factors above and additionally assumes all the Company's principal risks each year with maximum effect and no probability weightings attached. The Board considered the likelihood of this scenario on the Company's viability over the period to 2030 and noted the potential mitigating actions which could include a reduction in capital and operational spend and dividends, concluding the Company could remain viable.

In making its assessment of the Company's viability, the Directors have taken account of the Company's robust capital solvency position, the Company's latest assessments of the consequential impacts of the COVID-19 pandemic as economic activity starts to return to pre-pandemic levels, the latest estimated impact of the Ukraine crisis on power and other commodity prices, latest inflation forecasts, its ability to raise new finance and a key potential mitigating action of restricting any non-contractual payments. In assessing the prospects of the Group, the Directors note that, as the Company operates in a regulated industry which potentially can be subject to non-market influences, such assessment is subject to uncertainty, the level of which depends on the proximity of the time horizon. Accordingly, the future outcomes cannot be guaranteed or predicted with certainty. As set out in the Audit Committee's report on pages 117 to 124, the Directors reviewed and discussed the process undertaken by management, and also reviewed the results of the stress testing performed.



#### *VIABILITY ASSESSMENT CONCLUSION*

The Board has assessed the Company's financial viability and confirms that it has a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due over the period to 2030 and the period considered to be appropriate by the Board in connection with the UK Corporate Governance Code.

# NON-FINANCIAL INFORMATION STATEMENT

The following table summarises the information required by section 414CB Companies Act 2006, and/or indicates where this information can be found within the annual report. Due diligence is carried out on all of our suppliers, and all are required to adhere to our Code of Conduct for supply chain partners. As such, equivalent standards are expected from our suppliers as we expect from our employees in respect of each of the areas set out below.

	<b>Description of policies</b>	<b>Policy outcomes</b>	<b>Principal risks and risk management</b>	<b>KPIs</b>
<b>Environmental matters</b>	Our social and environmental policy ensures that we pursue activities that conserve, protect, and enhance the natural environment. Environmental compliance is monitored as part of the regulatory framework within which the whole business operates.	The policy underpins the environmental improvement programmes set out on page 45	Environmental non-compliance may lead to non-delivery of regulatory outcomes and performance commitments – see page 81.	
<b>Employees</b>	Our range of employment policies that are designed to protect and support our workforce. The key features of these policies are disclosed on page 160 and as follows:  Health, safety and wellbeing (page 27)  Diversity, equity and inclusion (page 30)  Our Code of Conduct (page 114).	Under these policies, we seek to achieve the highest workplace standards and an engaged workforce, as reported on page 25.	Health and safety risks and their mitigations are set out on page 79.	

	<b>Description of policies</b>	<b>Policy outcomes</b>	<b>Principal risks and risk management</b>	<b>KPIs</b>
<b>Social matters</b>	<p>Our social and environmental policy requires us to undertake our activities in a way that minimises potential adverse effects on society and has a positive impact on the local economy.</p> <p>Our community relations and investment policy enables strong and clear governance, making positive community investments which create value, and benefits both the community and the business.</p>	<p>The policies support the social capital improvement programmes set out on page 24 to 33.</p>	<p>A number of our principal risks would impact our communities and customers if they occurred, for example: business interruption, poor operating performance and cyber risks. See pages 75 to 85 for further information.</p>	
<b>Respect for human rights</b>	<p>South West Water's Code of Conduct (described on page 114) sets out our respect for human rights throughout our operations and our anti-slavery and human trafficking policy requires the implementation and enforcement of systems and controls to ensure modern slavery is not taking place anywhere within our own business or in our supply chain.</p>	<p>We do not tolerate human rights abuses within the Company or modern slavery in any form and have developed processes and procedures to manage the risk of potential non-compliance (see page 160).</p>	<p>We explain the risks relating to non-compliance with laws and regulations and their mitigations on page 78.</p>	<p>We have a zero tolerance approach across the Company and within our supply chains.</p>
<b>Anti-corruption and anti-bribery</b>	<p>A description of our policy on anti-bribery and anti-corruption (including due diligence and enforcement procedures) is provided on page 115).</p>	<p>The policy's outcomes are explained on page 115.</p>	<p>We explain the risks relating to non-compliance with laws and regulations and their mitigations on page 78.</p>	<p>We have a zero-tolerance approach to bribery and corruption.</p>

## **FORWARD-LOOKING STATEMENTS**

The Strategic Report, consisting of pages 4 to 92, contains forward-looking statements regarding:

- the financial position
- results of operations
- cash flows
- dividends
- financing plans
- business strategies
- operating efficiencies
- capital and other expenditures
- competitive positions
- growth opportunities
- plans and objectives of management
- and other matters.

These forward-looking statements including, without limitation, those relating to the future business prospects, revenues, working capital, liquidity, capital needs, interest costs and income in relation to South West Water, wherever they occur in this strategic report, are necessarily based on assumptions reflecting the views of South West Water as appropriate.

They involve a number of risks and uncertainties that could cause actual results to differ materially from those suggested by the forward-looking statements. Such forward-looking statements should, therefore, be considered in the light of relevant factors, including those set out in this section on principal risks and uncertainties.

## **APPROVAL OF THE STRATEGIC REPORT**

Our Strategic Report consisting of pages 4 to 92 has been reviewed and approved by the Board.

Simon Pugsley  
Group General Counsel and Company Secretary  
5 July 2022

# GOVERNANCE AND REMUNERATION

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# GOVERNANCE AT A GLANCE

## BOARD MEETINGS AND ATTENDANCE

The Directors and their attendance at the six scheduled meetings of the Board during the financial year are shown below:

Position	Member	Appointment date	Attendance
Chair	Gill Rider	April 2016	6/6
Non-Executive Directors	Neil Cooper	April 2016	6/6
	Iain Evans	July 2020	6/6
	Claire Ighodaro	July 2020	6/6
	Jon Butterworth	September 2017	6/6
Executive Directors	Susan Davy	July 2020	6/6
	Louise Rowe	February 2015	6/6

## BOARD SKILLS MATRIX

Board members	Susan Davy	Louise Rowe	Gill Rider	Neil Cooper	Iain Evans	Claire Ighodaro	Jon Butterworth
Independence			X	X	X	X	X
<b>Skill areas</b>							
Water sector	X	X	X	X	X	X	X
Regulation	X	X	X	X	X	X	X
Finance and Accounting	X	X		X	X	X	
Strategy	X	X	X	X	X	X	X
Transformation	X	X	X	X	X	X	X
Health, safety and wellbeing	X				X		X
ESG including climate change	X	X			X		X
Data, technology and digital	X					X	X
Governance	X	X	X	X	X	X	X
Remuneration			X			X	
People	X	X	X			X	X

# CHAIR'S INTRODUCTION TO GOVERNANCE

## PROVIDING STRONG AND EFFECTIVE GOVERNANCE

I am pleased to introduce the corporate governance report for 2022, on behalf of the Board. This report provides detail around our governance practices and processes, our application of the principles of best practice corporate governance, our key focus areas and achievements for 2021/22 and how the Board continues to support the strategy and growth of the Company.

I'd firstly like to thank the Board and the c.1,700 colleagues that make up the Company, whose hard work and dedication allow us to continue to support our customers and communities, deliver on our strategy and continue to drive environmental change.

In a year where we were all still very much impacted by the COVID-19 pandemic, the Board has continued to convene and maintain a regular dialogue to discuss key areas of focus and maintain strong governance. Strong governance remains central to the successful management of the Company and provides the framework for effective delivery of our strategy, fulfilment of our purpose, the creation of value for all our stakeholders and the ongoing development of our sustainable business. We continue to operate to the highest standards of corporate governance, with our Board composition ahead of the diversity targets suggested by the Parker Review and the FTSE Women Leaders Review, whilst our ESG targets incorporate our commitment to Net Zero by 2030. Our refreshed H&S Committee and HomeSafe programme also sees us well placed to deliver on our ambitious targets in this area.

The table on pages 70 and 85 will help you to navigate our reporting and evaluate our performance against the Principles of the UK Corporate Governance Code 2018.

## ROLE OF THE BOARD AND ITS EFFECTIVENESS

It is my view that the Board continues to be highly effective with a good understanding of the Company's opportunities as well as the threats facing the business. This view is supported by the results of this year's Board and Committee performance evaluations, which are reported on pages 130 to 132. We keep under constant review the threats to the future success of the business. Other risks identified and reviewed are contained in our risk report on pages 70 to 85.

## BOARD INDEPENDENCE - SOUTH WEST WATER AND PENNON

In accordance with Ofwat's principles on board leadership, transparency and governance, the Company maintains separate and independent boards for South West Water and our parent Company, Pennon.

Our system of governance remains appropriate and effective, whilst continuing to support the delivery of our strategy.

Our Board and Committee framework also allows us to remain efficient in our decision-making process. The South West Water Board, who we share our Chair and the four Independent Non-Executive Directors with Pennon, convene on the same day as each Pennon Board meeting and consider all key issues separately. This arrangement allows full operational oversight and governance by the boards over water interests in the Company.

## **PROMOTING DIVERSITY**

I strongly believe that a diverse Board and a diverse workforce brings significant value to the growth and success of an organisation. As an organisation with a female Chair and CEO, we continue to ensure our Company is inclusive and diverse. I am pleased to see we continue to be ahead of the targets for women on Boards (now set out in the FTSE Women Leaders Review) and that we have met the target of at least one Director from a minority ethnic background (as set out in the Parker Review).

The Board supports the recent changes to the Listing Rules and the Disclosure Guidance and Transparency Rules in relation to Board and senior executive diversity, and will report under the new requirements in next year's Annual Report. Our commitment to diversity is also echoed across the business with a drive and commitment to recruit talent from all backgrounds and the support of a strong and diverse leadership team.

## **STAKEHOLDER ENGAGEMENT**

Engaging with all of our stakeholders has never been more vital, particularly with the national and global issues we are facing. As a sector, we face much scrutiny around our environmental impacts, and it is important that we listen to and respond to our stakeholders' views. We ensure that all decisions and the impact on our stakeholders are carefully considered. Our stakeholder engagement programme ensures that there continues to be an opportunity to provide feedback to the Board.

We continue to foster an open and transparent feedback culture within the business, with colleagues having the opportunity to share feedback in a number of ways with the Executive team and Board, including Big Chat, the Great Place to Work survey and our new Employee Forum RISE.

You can read more on how we are engaging with our stakeholders in our Section 172(1) statement on pages 20 to 22.

## **COMPLIANCE WITH THE UK CORPORATE GOVERNANCE CODE AND OTHER REQUIREMENTS**

South West Water aims to comply with the UK Corporate Governance Code (the 'UK Code') as fully as possible, within the context of being a subsidiary of a listed company, Pennon Group plc, which itself fully complies with the UK Code. The UK Code is published on the Financial Reporting Council (FRC) website, [www.frc.org.uk](http://www.frc.org.uk).

Given the Group structure, there are a limited number of areas in which South West Water does not comply with specific Code provisions. These areas are described on pages 106 to 108 alongside any additional mitigations deemed necessary.

In addition, South West Water has complied with Ofwat's revised 'Board leadership, transparency and governance' principles. Further details on our compliance with these principles will be provided in our Annual Performance Report and Regulatory Reporting.

## **LOOKING AHEAD**

As part of our focus for 2022/23, we will continue focus on delivering on our environmental commitments and ensuring we are well placed for PR24. There is much to do but I know we have the right people, expertise and governance framework in place to help us deliver on what will be another busy year.



## BOARD OF DIRECTORS

The South West Water Board of Directors at the end of the 2021/22 financial year comprises the Chair (a Non-Executive Director), a Senior Independent Director (Non-Executive), two Executive Directors and three further Independent Non-Executive Directors. In addition Paul Boote, Pennon Group Finance Director, attends the South West Water Board meetings. The Board considers the Non-Executive Directors to be independent in accordance with the UK Corporate Governance Code. The Board believes its Directors have an appropriate range of skills and experience in their respective disciplines and personality to bring independent and objective judgment to the Board's deliberations.

### **Gill Rider CB** Chair

**Appointment** Gill was appointed to the South West Water Board on 1 April 2016, having been appointed to the Pennon Group plc board on 1 September 2012.

She became Chair of South West Water on 31 July 2020 and is also Chair of Pennon Group plc.

She is also Chair of the Nomination Committee and a member of the Remuneration Committee, the Environmental, Social and Governance Committee and the Health and Safety Committee.

**Skills and experience** Gill has a wealth of experience in leadership, governance and remuneration across a broad range of sectors including professional services, education, not for profit and government.

Gill was the senior independent Director of Charles Taylor plc until its sale in January 2020.

Formerly, Gill was Head of the Civil Service Capability Group in the Cabinet Office, reporting to the Cabinet Secretary and prior to that held a number of senior positions with Accenture LLP culminating in the post of Chief Leadership Officer for the global firm. She was previously President of the Chartered Institute of Personnel and Development and Chair of the Council of the University of Southampton.

**External appointments** Gill is currently a Non-Executive Director of Intertek Group plc where she is also Chair of their Remuneration Committee. In addition to her Plc roles, Gill is the President of the Marine Biological Association.

### **Susan Davy** Pennon Group and South West Water Chief Executive Officer

**Appointment** Susan was appointed Chief Executive Officer on 31 July 2020. She was appointed to the Board in February 2015 as Chief Financial Officer, having joined the Group as Finance Director of South West Water in 2007.

She is a member of the Environmental, Social and Governance Committee, Health and Safety Committee, Pennon Executive and the Pennon Board.

**Skills and experience** Susan's knowledge of the industry, coupled with her financial and regulatory expertise, has underpinned the development of Pennon's strategy which has included the value creating acquisition of Bournemouth Water, Bristol Water and the Viridor disposal. In her 25+ years' experience in the utility sector, Susan has also held a number of other senior roles in the water sector, including at Yorkshire Water.

Under her guidance South West Water is the only water company to have achieved fast-track status for two consecutive business plans – the first in 2014, the second in 2019.

Susan is highly respected in the City and has been instrumental in building Pennon's reputation.

**External appointments** Susan is a non-executive director and Audit Chair of Restore Plc, a member of the CBI President's Committee, and deputy Chair of the CBI South West, having served as its Chair from 2018-2021. She holds a place on the board of Water UK, is a member of the Energy & Utilities Skills Partnership Council and was previously a member of the A4S (Accounting for Sustainability) CFO leadership network.

**Louise Rowe** Finance Director

**Appointment** Louise was appointed South West Water Finance Director on 1 February 2015. In October 2020 she was also appointed Pennon Sustainability Director.

**Skills and experience** Louise is a chartered accountant and has been with South West Water for over 12 years. She has held a range of managerial roles within Finance prior to her appointment as Finance Director.

Louise holds a number of directorships with South West Water Group companies and is a key member of several Executive subsidiary Committees including the ESG Committee.

Prior to joining South West Water, she qualified with KPMG, following completion of her physics degree at the University of Exeter.

**External appointments** None

**Neil Cooper** Senior Independent Director (Non-Executive Director)

**Appointment** Neil was appointed to the Board on 1 April 2016, having joined the Pennon Group plc Board on 1 September 2014. He is Chair of the Audit Committee and a member of the Remuneration, Nomination, Environmental, Social and Governance and Health and Safety Committees.

**Skills and experience** Neil brings to the Board extensive experience in a wide variety of corporate and financial matters.

Previously, he was group finance director of Barratt Developments plc and before that, group finance director of William Hill plc and Bovis Homes plc. Neil also held senior finance positions at Whitbread plc, worked for PricewaterhouseCoopers as a management consultant and held a number of roles with Reckitt & Colman plc.

As chair of the Audit Committee, Neil has been influential in directing South West Water's approach on a number of significant matters including internal control, governance and financial reporting.

**External appointments** He is currently the Chief Financial Officer of Currencies Direct, a foreign exchange broker and international payment provider.

**Jon Butterworth MBE** Independent Non-Executive Director

**Appointment** Jon was appointed to the Board on 28 September 2017.

Jon is also independent scrutineer of health & safety processes across South West Water to help ensure that these are robust and effective. He chairs the Health and Safety Committee.

He is a member of the Audit, Remuneration, Nomination and Environmental, Social and Governance Committees.

**Skills and experience** He is the Chief Executive Officer of UK Gas Transmission for National Grid plc and a member of the National Grid Group Executive Committee. Jon has a distinguished track record and an immense depth of experience within the utility industry, having begun his career over 44 years ago as an apprentice in British Gas.

He has been the Managing Director of Northwest Gas, Global Environment and Sustainability Manager of Transco, National Operations Director of National Grid, Group Safety, Resilience and Environmental Director of National Grid plc and formerly CEO of National Grid Ventures, building (£3bn) of growth in renewables across the USA and Europe.

Jon's utility background makes him keenly aware of the importance of maintaining a balance between profit and safety, and he constructively challenges the Board and management to constantly raise the bar in this area.

**External appointments** Jon is a Fellow of the Institute of Directors and is a Director of National Grid Gas, National Grid Metering Limited, E.Tapp & Co Limited, Shopfittings Manchester Limited and TMA Property Limited. He is also an Ex-Chair of the CORGI Board, an Ex-Ambassador of the HM Young Offenders Programme and a trustee of the National Gas Museum Trust.

**Iain Evans CBE** Independent Non-Executive Director

**Appointment** Iain was appointed to the Board on 31 July 2020, having served on the Pennon Board since 1 September 2018. He is Chair of the Environmental, Social and Governance Committee and a member of the Audit, Nomination, Remuneration and Health and Safety Committees.

**Skills and experience** Iain has 40 years of extensive global experience in advising companies and governments on issues of complex corporate strategy. In 1983, he co-founded L.E.K Consulting in London and built it into one of the World's largest and most respected corporate strategy consulting firms with a global footprint active in a wide range of industries. Iain was appointed a Non-Executive Director of Welsh Water plc in 1989 and served on the Board for nearly 10 years, including five as Chair.

As Chair of the ESG Committee for both Pennon Group and South West Water, Iain is leading the development of a sustainability programme that underpins the delivery of South West Water's strategy.

**External appointments** Iain is a Non-Executive Director of Bologna Topco Limited and HSM Advisory Limited and continues to act as an independent corporate strategy consultant.

**Claire Ighodaro CBE** Independent Non-Executive Director

**Appointment** Claire was appointed to the Board on 31 July 2020 having served on the Pennon Board since 1 September 2019. She is chair of the Remuneration Committee and is also a member of the Audit, Environmental, Social and Governance, Nomination and Health and Safety Committees.

**Skills and experience** Claire has held a number of senior roles and directorships with UK and international organisations and has extensive board experience, serving on audit, remuneration and governance committees.

She is a past president of the CIMA (Chartered Institute of Management Accountants) and was the first woman to lead this organisation.

Claire spent most of her executive career with BT plc. She has also held non-executive directorships across a diverse portfolio including Governance Committee Chair of Bank of America's Merrill Lynch International, Audit Committee Chair of Lloyd's of London, Flood Re, The Open University and various UK public bodies including UK Trade & Investment and the British Council.

As chair of the Remuneration Committee, Claire continues to guide the Company's approach to executive remuneration, ensuring that it is aligned with and supports the Company's strategy.

**External appointments** Claire is Non-Executive Chair for AXA XL UK entities and Non-executive Chair of the Audit Board of KPMG LLP.

#### IN ATTENDANCE AT THE BOARD

The following attend the Board alongside the Company's Directors:

**Paul Boote** Pennon Group Finance Director

**Skills and experience** Paul is a chartered accountant with over 20 years' experience, having also held senior finance roles at companies operating in the sport, construction and environmental infrastructure industries.

He has held a number of senior roles at Pennon, most recently as Pennon's Director of Treasury, Tax and Group Finance. During this time, he was responsible for the continuing development of Pennon's sector-leading sustainable debt portfolio, ensuring the Group maintains a responsible approach to tax, as well as leading on financial reporting matters.

Paul has been instrumental in the successful implementation of the Group's strategic review.

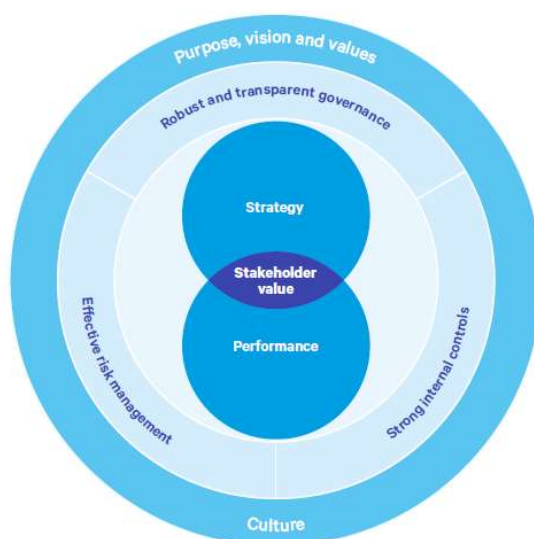
He holds a number of directorships with Group subsidiary companies and is a key member of the executive Finance Committee which he chairs.

Paul's knowledge of the Group and relationships with key external stakeholders, coupled with his corporate finance and financial reporting experience, provides continuity to the Board as the Group evolves through this strategic review period.

**External appointments** None

# OUR GOVERNANCE FRAMEWORK

The Board is responsible for the overall leadership and oversight of the Company. Our approach to governance is an integral part of our culture, guiding how we do business, make decisions, measure long term impacts and create value for our stakeholders. The Board's responsibilities include setting the Company's values, policies and standards, approving South West Water's strategy and objectives, and overseeing the Company's operations and performance. The Board makes decisions in relation to the Company's business in accordance with its schedule of matters reserved.



## Stakeholder value

We deliver long-term sustainable value for our stakeholders by providing high-quality environmental infrastructure and customer services.

## Strategy

Our strategy is to lead in the UK's water and wastewater sectors, invest for sustainable growth and drive value through efficiency.

## Performance

Our financial and operational performance is driven by our strategic sustainability objectives

## Robust and transparent governance

We are committed to operating to the highest standards of corporate governance.

## Effective risk management

We have a mature integrated risk management framework which is embedded into existing governance structures and ways of working.

## Strong internal controls

We keep the effectiveness of our internal control environment under regular review and seek continually to improve our approach.

## Purpose and values

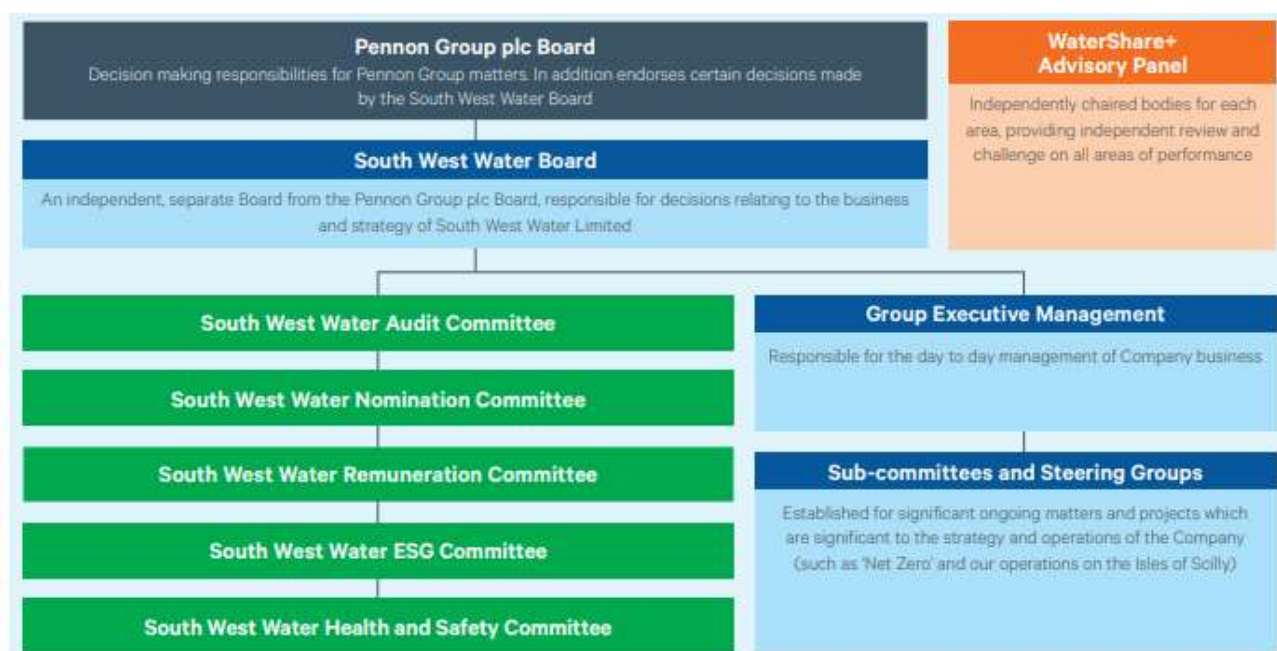
Our purpose – bringing water to life, supporting people and the places they love for generations to come – and upholding its supporting values by operating in a trusted, collaborative, responsible and progressive way will help drive our strategic priorities over the long term.

## Culture

We are developing a culture that can be lived throughout the Company with integrity and transparency, ensuring South West Water is trusted and valued by all its stakeholders.

## BOARD LEADERSHIP AND GOVERNANCE STRUCTURE

The following diagram summarises the context and structure which the South West Water Board operated aligned with the governance approach of Pennon Group plc:



## BOARD MEETINGS AND ATTENDANCE

The members of the Executive team, comprising executives of South West Water and Pennon, meets in advance of each Board meeting to ensure clear ownership and management of business operations prior to the formal Board and Committee meetings in March, May, September and November.

In addition to the six scheduled Board meetings, a strategy day is held each September, and extra ad hoc Board meetings are arranged as required.

## OPERATION OF THE BOARD

The Board operates by receiving written reports circulated in advance of the meetings by the Executive Directors and the Group General Counsel and Company Secretary on matters within their respective business areas. The Board also receives presentations on key areas of the business and undertakes site visits to meet employees and gain a better understanding of the operation of business initiatives. In the light of the continuing COVID-19 restrictions in place for much of the year, one physical full Board site visit took place. Further details of the Board site visit are provided on page 104.

Under the guidance of the Chair, all matters placed before the Board are discussed openly. Presentations and advice are received frequently from senior executives within the Company and from external advisers to facilitate the decision-making of the Board. In 2021/22, the Board has considered a wide range of matters in order to meet its obligations. More detail on the key activities of the Board can be found on page 105. Due to COVID-19 restrictions, Board and Committee meetings were held both physically and online, as required, throughout the year, allowing the Company's usual high standards of governance to be maintained.

## BOARD COMMITTEES' TERMS OF REFERENCE

In accordance with policies, a range of key matters are delegated to the Board's Committees as set out on pages 103 to 104 of this governance report.

The terms of reference of each of the Board's Committees are set out on the Company's website [www.southwestwater.co.uk](http://www.southwestwater.co.uk) and are also available from the Group Company Secretary upon request. The terms of reference, as well as the Board's schedule of matters reserved, were reviewed during the year to ensure that they remained appropriate and relevant.

## COMMITTEE ROLES

Committee	Roles
<b>Audit Committee</b>	<ul style="list-style-type: none"> <li>• Ensure the quality and integrity of the Company's financial reporting, which requires assessing the application of accounting policies given underlying standards, probing and testing accounting judgements made in preparing financial reporting and evaluating whether the presentation of the Company's activities is fair, balanced and understandable.</li> <li>• Review and challenge the ongoing effectiveness of the internal control environment.</li> <li>• Evaluate the scope and adequacy of risk management processes across the Company. This encompasses monitoring the Company's risk appetite as well as acting as a forum for carrying out more detailed reviews of higher risk areas of the operation.</li> <li>• These responsibilities are discharged throughout the year in accordance with a schedule of business reflecting the annual reporting cycle of the Company, which is designed to allow sufficient time for their consideration while also permitting time to be spent on related key accounting matters.</li> <li>• The scheduling of activities has also allowed for ad-hoc work on events as they have arisen. Monitoring and reviewing the effectiveness of the external auditor and the internal audit function is an equally important ongoing element of the Committee's assurance activities.</li> </ul>
<b>ESG Committee</b>	<ul style="list-style-type: none"> <li>• Ensure robust scrutiny of key aspects of environmental, social and governance (ESG) performance and to oversee South West Water's performance against its ESG strategy and strategic sustainability objectives.</li> <li>• Review and approve appropriate strategies, policies, management processes, initiatives, disclosures, targets and performance of the Company in the areas of environment and compliance, responsible and ethical business practice, supply chain, customer service and engagement, community benefit, and the role and value of the Company in society.</li> <li>• Ensure a transparent approach to conducting business in a responsible manner, within a business focused on delivering robust financial performance and sustainable value for shareholders and stakeholders.</li> </ul>

Committee	Roles
<b>Nomination Committee</b>	<ul style="list-style-type: none"> <li>• Regular review of the structure, size and composition (including the skills, knowledge, independence, diversity and experience) required of the Board, compared to its current position.</li> <li>• Make recommendations with regard to any changes, whilst also giving full consideration to succession planning for the Board and Senior Management.</li> <li>• Oversee the development of a diverse pipeline for succession, taking into account the challenges and opportunities facing the Company, as well as the skills and expertise needed in the future.</li> </ul>
<b>H&amp;S Committee</b>	<ul style="list-style-type: none"> <li>• Provide a 'review and challenge' function to support the Board and the Executive on all matters connected to health and safety including the deployment of the health and safety strategy, resilience and process safety.</li> <li>• Review the extent and effectiveness of the Company's reporting of health and safety performance, as well as comparisons to external benchmarks.</li> </ul>
<b>Remuneration Committee</b>	<ul style="list-style-type: none"> <li>• Ensure remuneration is aligned with the Group's strategy and reflects the values of the Company.</li> <li>• Set and, in every third year, review the remuneration policy to ensure it remains appropriate, considering shareholders' views and best practice.</li> <li>• Advise the Board on the framework of executive remuneration for the Company.</li> <li>• Setting the remuneration for the Chair, the Executive Directors and senior executives of the Company and reviewing the remuneration arrangements of the wider workforce.</li> <li>• Approve the design and determine targets for any performance-related pay schemes.</li> <li>• Determine the appropriate outturn of any incentive arrangements and apply discretion as required.</li> </ul>

## MONITORING THE GROUP'S PURPOSE AND CULTURE

The Board receives presentations from the Chief People Officer on key matters of importance, including the results of the annual Great Place to Work survey, with appropriate feedback from engagement with Unions, as well as site visits, along with the creation of appropriate focus groups. All of these mechanisms enable the Board to access and monitor the alignment of purpose and culture.

## BOARD SITE VISIT AND STRATEGY DAY

The Board visited Crantock and Newquay in Cornwall, as part of their strategy day in September 2021. The purpose was to see one of the areas where significant investment is planned to improve the existing sewage treatment capability in the area. Topics discussed at the strategy session included testing of the Company's strategic objectives, understanding and refining opportunities, key priorities and themes to take forward and our



relationship with key stakeholders. The Board hopes, following the relaxation of Covid-19 restrictions, to carry out more in-person visits in the 2022/23 financial year.

## ACTIVITY FOR THE YEAR

The key activities that were carried out by the Board during the year, together with an indication of the stakeholders affected and whose interests the Board considered in its discussions and decision-making are set out below.

Area	Activity	Outcome	Stakeholders affected
<b>Performance</b> ODI improvements	Meeting regulatory requirements, ongoing regulatory/ innovation initiatives, monitoring via H&S reports and adapting plans where needed	Successful regulatory outcomes, safe customer and employee experience, enhancing day to day operations	<b>Customers</b> <b>People</b> <b>Environment</b> <b>Regulators</b>
<b>Environmental</b> Net Zero Strategy Pollution Incident Reduction Plan Green Recovery investment programme	Implementation and monitoring of each of the plans and adapting each where needed Alignment of plans with our strategic priorities	Delivery to achieve ever more stringent targets as well as greater public/regulatory scrutiny	<b>Customers</b> <b>Communities</b> <b>Environment</b> <b>Regulators</b> <b>Policy Makers</b>
<b>Social</b> Supporting customers on low income	Monitoring of customer service levels and plans to deliver improved diversity mix and adapting where needed	Continued alignment of plans to achieve ever more stringent targets as well as greater public/regulatory scrutiny	<b>Customers</b> <b>People</b> <b>Regulators</b>
<b>Risk</b> Mitigation of key risks	Ongoing focus on key risks, with deep dives at Audit Committee meetings	Continued alignment of plans to ensure appropriate risk mitigation	<b>Customers</b> <b>People</b> <b>Suppliers</b>
<b>Governance, Legal and Regulatory</b> Compliance, governance and legal regulation	Regular updates on Corporate Governance and key legal developments during the year.	Continued alignment of plans to ensure appropriate compliance/best practice governance	<b>People</b> <b>Suppliers</b> <b>Regulators</b> <b>Policy Makers</b>

## PERFORMANCE AGAINST THE UK CODE

2018 UK Code principle	Section	Page	
<b>1. Board Leadership and Company Purpose</b>			
A	A successful company is led by an effective and entrepreneurial Board, whose role is to promote the long-term sustainable success of the company, generating value for shareholders and contributing to wider society.	Board of Directors	97
		Chair's introduction to governance	95
B	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.	Role of the Board	95
		Business model	7
C	The Board should ensure that the necessary resources are in place for the company to meet its objectives and measure performance against them. The Board should also establish a framework of prudent and effective controls, which enable risk to be assessed and managed.	Stakeholder overview	13
		Section 172(1) statement	20
D	In order for the company to meet its responsibilities to shareholders and stakeholders, the board should ensure effective engagement with, and encourage participation from, these parties.	Our material issues	126
		Our purpose and values	4
E	The Board should ensure that workforce policies and practices are consistent with the company's values and support its long-term sustainable success. The workforce should be able to raise any matters of concern.	Strategy overview	4
		Risk Management report	70
<b>2. Division of responsibilities</b>			
D	The Chair leads the board and is responsible for its overall effectiveness in directing the company. They should demonstrate objective judgement throughout their tenure and promote a culture of openness and debate. In addition, the chair facilitates constructive board relations and the effective contribution of all non-executive directors, and ensures that directors receive accurate, timely and clear information.	Board and Committee Structure	102
		Board independence	95
		Directors' roles and responsibilities	110
G	The Board should include an appropriate combination of executive and Non-Executive (and, in particular, Independent Non-Executive) Directors, such that no one individual or small group of individuals dominates the Board's decision-making. There should be a clear division of responsibilities between the	Committee reports	117

2018 UK Code principle	Section	Page
<p>leadership of the board and the executive leadership of the company's business.</p> <p>H Non-Executive Directors should have sufficient time to meet their board responsibilities. They should provide constructive challenge, strategic guidance, offer specialist advice and hold management to account.</p> <p>I The Board, supported by the Company Secretary, should ensure that it has the policies, processes, information, time and resources it needs in order to function effectively and efficiently.</p>	Code of conduct and policies	114
<b>3. Composition, Succession and Evaluation</b>		
<p>J Appointments to the Board should be subject to a formal, rigorous and transparent procedure, and an effective succession plan should be maintained for board and senior management. Both appointments and succession plans should be based on merit and objective criteria and, within this context, should promote diversity of gender, social and ethnic backgrounds, cognitive and personal strengths.</p> <p>K The Board and its committees should have a combination of skills, experience and knowledge. Consideration should be given to the length of service of the Board as a whole and membership regularly refreshed.</p> <p>L Annual evaluation of the Board should consider its composition, diversity and how effectively members work together to achieve objectives. Individual evaluation should demonstrate whether each director continues to contribute effectively.</p>	<p>Nomination Committee Report</p> <p>Board Effectiveness evaluation</p> <p>Board of Directors</p>	<p>128</p> <p>95</p> <p>97</p>
<b>4. Audit, Risk and Internal Controls</b>		
<p>M The Board should establish formal and transparent policies and procedures to ensure the independence and effectiveness of internal and external audit functions and satisfy itself on the integrity of financial and narrative statements.</p> <p>N The Board should present a fair, balanced and understandable assessment of the company's position and prospects.</p> <p>O The Board should establish procedures to manage risk, oversee the internal control framework, and determine the nature and extent of the principal risks the company is willing to take in order to achieve its long-term strategic objectives.</p>	<p>Audit Committee Report</p> <p>Risk report</p> <p>Director's report</p>	<p>117</p> <p>70</p> <p>159</p>
<b>5. Remuneration</b>		
<p>P Remuneration policies and practices should be designed to support strategy and promote long-term sustainable success. Executive remuneration should be aligned to Company purpose</p>	Directors' Remuneration Report	138

2018 UK Code principle	Section	Page
and values, and be clearly linked to the successful delivery of the company's long-term strategy.		
Q A formal and transparent procedure for developing policy on executive remuneration and determining Director and senior management remuneration should be established. No Director should be involved in deciding their own remuneration outcome.		
R Directors should exercise independent judgement and discretion when authorising remuneration outcomes, taking account of company and individual performance, and wider circumstances.		

### COMPLIANCE WITH THE UK CORPORATE GOVERNANCE CODE

Throughout the year, South West Water complied with its own Board leadership, transparency and governance Code. The South West Water Code states that the Company will comply with the current UK Corporate Governance Code (the UK Code) to the extent it can be applied to the Company in the context of the Pennon Group structure.

The Company complied fully with the provisions and spirit of the UK Code during the year, subject to the exceptions as described below. Most of the exceptions relate to the Group structure, where certain responsibilities rest with Pennon Group plc (South West Water's parent company) which is fully compliant with the UK Code.

Provision 25 of the UK Code state that the Audit Committee should make recommendations to the Board in relation to the appointment, re-appointment and removal of the external auditor and to approve the remuneration and terms of engagement of the external auditor. Provision 25 also states that the Audit Committee should develop and implement policy on the engagement of the external auditor to supply non-audit services. As the auditor is appointed on a Group basis, the appointment, re-appointment and removal of South West Water's external auditor is (and has been throughout the year) a matter for the Pennon Group Audit Committee, as is the auditor's remuneration, terms of engagement and non-audit services.

Provision 26 of the UK Code states that a separate section of the annual report should describe the work of the Committee in discharging its responsibilities, in particular an assessment of the effectiveness of the external audit process. Due to the Group structure, the overall assessment as to whether the external audit function is effective (and has been throughout the year) the responsibility of the Pennon Group Audit Committee, which carries out its assessment in conjunction with the South West Water Audit Committee.

Provision 33 of the UK Code states that the Remuneration Committee should have delegated responsibility for determining the policy for Executive Director remuneration and setting remuneration for the Chair, Executive Directors and senior management. However, the remuneration of the Chair, who is also the Chair of Pennon Group plc and the Pennon Group Chief Executive Officer, who is also a member of the Pennon Group plc Board is the responsibility of the Pennon Group Remuneration Committee.

During the year Pennon Group plc complied fully with the UK Code. Full reports of the Pennon Group plc Board's Committees are contained within the Pennon Group plc annual report and accounts.

## **STAKEHOLDER ENGAGEMENT**

The Board understands the part the Company can play in creating a more sustainable UK. We are committed to carrying out our business in a responsible way and remain focused on improving the provision of all our services for the benefit of all of our stakeholders.

Our Section 172(1) statement describes in more detail how the Board regards the interests of all our stakeholders when carrying out its duties. The statement, which can be found on page 20, should be read alongside the description on pages 20 to 22 to understand how stakeholder interests were taken into consideration by the Board in decision-making during the year.

We engage and consult with employees regularly through the employee engagement forum recently replaced with our new people panel, RISE, as well as the Big Chat, hosted by the Executive team. These forums provide employees with important up to date information about key events and give them an opportunity to hear from the Directors, provide feedback and ask questions. The Board believes South West Water's chosen approach is effective for communicating with and gathering feedback from employees from across the business so that the interests of employees can be considered by the Board in its discussions and decision-making. Further information on employee engagement can be found on pages 24 to 33.

We also actively engage with all our stakeholders, including our customers, our communities, our people, our suppliers and our investors. We are acutely aware that many of our stakeholders are struggling with the challenges posed by an uncertain future. We are committed to maintaining appropriate and regular dialogue to ensure that our strategy and our performance objectives reflect our stakeholders' expectations and needs. Our continuous engagement allows stakeholders to provide feedback on the matters they consider to be important and raise any issues which they would like to be addressed.

## **WATERSHARE+ QUARTERLY MEETINGS AND ANNUAL GENERAL MEETING (AGM)**

The WaterShare+ scheme was developed to build a closer relationship with South West Water's customers by offering them the opportunity to become shareholders in their water company, giving them both a voice and a financial stake in our business.

As part of our innovative and pioneering WaterShare+ scheme, and in an industry first, our first Customer AGM took place in November 2021. Attended by customers, our independent WaterShare+ Advisory Panel and our executive team, the meeting was well received and provided a strong platform for our customers to have direct, real and honest engagement.

The independent WaterShare+ Advisory Panel was able to discuss how they champion customer interests and needs by providing an independent view on the delivery of the company's business plan.

Our first Customer AGM was a real milestone in our determination to build a deeper relationship with our customers. Through our quarterly public meetings, held in addition to the Customer AGM, we will continue to focus on doing the right things, in the right way and giving our customers a stake and say in what we do, and how we do it.

## DIVISION OF RESPONSIBILITIES

There is a clear separation of responsibilities between the Chair and the Chief Executive Officer, divided between managing the Board and the business, while maintaining a close working relationship.

All the Directors are equally accountable for the proper stewardship of the Company's affairs and also have specific roles, which include those set out below:

Position	Director	Role
Chair	Gill Rider	<ul style="list-style-type: none"> <li>Leading the Board and setting its agenda</li> <li>Promoting the highest standards of integrity and probity and ensuring good and effective governance</li> <li>Managing Board composition, performance and succession planning</li> <li>Providing advice, support and guidance to the Executive Directors</li> <li>Representing the Company and being available to stakeholders</li> <li>Discussing separately with the Non-Executive Directors performance and strategic issues</li> </ul>
Chief Executive Officer	Susan Davy	<ul style="list-style-type: none"> <li>Managing South West Water and providing executive leadership</li> <li>Leading the operation of the Company in accordance with the decisions of the Board</li> <li>Co-ordinating with the Chair on important and strategic issues of the Company and providing input to the Board's agenda</li> <li>Contributing to succession planning and implementing the organisational structure</li> <li>Managing stakeholder relations</li> </ul>
Finance Director	Louise Rowe	<ul style="list-style-type: none"> <li>Supporting the Chief Executive Officer in providing executive leadership and developing strategy</li> <li>Reporting to the Board on performance and developments across the business</li> <li>Implementing decisions of the Board</li> <li>Managing specific business responsibilities</li> </ul>
Senior Independent Director	Neil Cooper	<ul style="list-style-type: none"> <li>Assisting the Chair with stakeholder communications and being available as an additional point of contact for stakeholders</li> <li>Acting as sounding board for the Chair</li> <li>Being available to other Non-Executive Directors if they have any concerns that are not satisfactorily resolved by the Chair</li> <li>Ensuring an annual performance evaluation of the Chair, with the support of the other Non-Executive Directors.</li> </ul>
Non-Executive Directors	Jon Butterworth Iain Evans Claire Ighodaro	<ul style="list-style-type: none"> <li>Critically reviewing the strategies proposed for the Company</li> <li>Critically examining the operational and financial performance of South West Water</li> <li>Evaluating proposals from management and constructively challenging management's recommendations</li> <li>Contributing to corporate accountability through being active members of the Committees of the Board</li> </ul>
Supported by the Group General Counsel and Company Secretary	Simon Pugsley	<ul style="list-style-type: none"> <li>As Group General Counsel, with remit covering compliance, statutory duties and governance, providing strategic legal and commercial advice to the Company and the Board in its deliberations.</li> </ul>

## **EXECUTIVE MANAGEMENT**

The role of the Executive is to define and drive the business priorities that will achieve delivery of the Company's strategy. It is responsible for ensuring, to the extent of the authority delegated by the Board, the proper and prudent management of Company resources to create and maximise value while protecting the interests of the wider stakeholder group. Chaired by the Chief Executive Officer, the Executive meets regularly to receive reports from the management committees and to review and refine recommendations to be presented to the Board. In addition to the Chief Executive Officer and Finance Director, the Executive also includes the Group General Counsel and Company Secretary and the Group Chief People Officer.

## **MANAGING SOUTH WEST WATER**

The South West Water Board continues to operate as a separate independent board - albeit with all but one of its Board members also serving on the Board of Pennon Group plc - in accordance with its schedule of matters reserved (see below) to ensure compliance with Ofwat's principles on Board leadership, transparency and governance.

The Pennon Group Board's responsibilities include overall leadership of the Group, setting the Group's values, policies and standards, approving Pennon's strategy and objectives and providing oversight of the Group's operations and its performance.

The Board delegates more detailed consideration of certain matters to the Board Committees and to the Executive Directors as appropriate, the matters reserved to the South West Water Board include:

- All acquisitions and disposals
- Major items of capital expenditure
- Authority levels for other expenditure
- Risk management process and monitoring of risks
- Approval of the strategic plan and annual operating budgets
- Company policies, procedures and delegations
- Appointments to the Board and its Committees
- Approval of the annual reports and financial statements and the Annual Performance Report and Regulatory Reporting.

Without reserving to itself the final decision-making power, the Pennon Group Board also endorses certain decisions taken by the South West Water Board, including major capital projects and investments, long-term objectives and commercial strategy, the five-year regulatory plan, annual budgets and certain decisions relating to financing. This approach remains compatible with Ofwat's 2019 Board leadership, transparency and governance principles. Approval of South West Water's dividend policy and the declaration of dividends to be paid by South West Water to Pennon remains reserved to the South West Water Board.

## **DEALING WITH DIRECTORS' CONFLICTS OF INTEREST**

In accordance with the Directors' interest provision of the Companies Act 2006 and the Company's Articles of Association, the Board has in place a procedure for the consideration and authorisation of Directors' conflicts or possible conflicts with the Company's interests. This Board consider that this has operated effectively during the year.

Each Director has a duty under the Companies Act 2006 to avoid a situation in which they have, or may have, a direct or indirect interest that conflicts or might conflict with the interests of the Company. This duty is in addition

to the existing duty owed to the Company to disclose to the Board any interest in a transaction or arrangement under consideration by the Company.

A register of Directors' conflicts is maintained and reviewed at each Board meeting. Other potential conflicts of interest that were examined during the year included:

- The appointment of Claire Ighodaro to her role at KPMG
- Neil Cooper's disclosure of his interest in a holiday home potentially impacted by a South West Water commercial agreement.

## **COMPOSITION, SUCCESSION AND EVALUATION**

### *BOARD SUPPORT AND TRAINING*

Directors have access to the advice and services of the Company Secretary, and the Board has an established procedure whereby Directors, may seek independent professional advice at the Company's expense in order to fulfil their duties. The Company Secretary is responsible for ensuring that the Board operates in accordance with the governance framework and that information flows effectively between the Directors, the Board and the Committees.

Newly appointed Directors receive a formal, tailored induction, which includes but is not limited to:

- An explanation of the Company structure, plus regulatory and legal issues
- The Company's governance framework and policies
- The Company's approach to risk management and its principal risks (financial and non-financial, including environmental, social and governance (ESG) risks)
- Duties and obligations (including protocols around conflicts of interest and dealing in shares)
- The current activities of the Board and its Committees
- Newly appointed Directors are also invited to visit different operating facilities across the Company and to meet with employees in order to better understand key processes and systems.

The training needs of Directors are reviewed as part of the Board's performance evaluation process each year. Training may include attendance at external courses organised by professional advisers and also internal presentations from senior management.

During the year, updates were provided to the Board and Committees via the Group General Counsel and Company Secretary and/or the Company's external advisors. These included updates on mandatory reporting and recent legal or governance changes.

## **BOARD COMPOSITION, INDEPENDENCE AND EXPERIENCE**

The Board comprises the Chair, four Non-Executive Directors and two Executive Directors. The Board continued to maintain its target of 33% female representation throughout the year. At year end it was 57.1%.

All of the Non-Executive Directors were considered by the Board to be independent throughout the year. None of the relationships or circumstances set out in Provision 10 of the UK Corporate Governance Code (the UK Code) applied to the Non-Executive Directors listed on page 94.



Notwithstanding their directorship of Pennon Group plc, Gill Rider, Neil Cooper, Jon Butterworth, Iain Evans and Claire Ighodaro are considered to be independent in character and judgement given that they were appointed to the South West Water Board in order to facilitate the Group's revised governance framework, rather than to represent the interests of the shareholder.

All Directors are subject to re-election each year. All the Non-Executive Directors are considered to have the appropriate skills, experience in their respective disciplines and personality to bring independent and objective judgement to the Board's deliberations. Their biographies on pages 97 to 100 demonstrate collectively a broad range of business, financial and other relevant experience.

Neil Cooper is Chair of the Audit Committee and in accordance with the UK Code and FCA Disclosure Guidance and Transparency Rule 7.1.1, has recent and relevant financial experience and competence in accounting and auditing (as set out in his biography on page 98). The Board is satisfied that the Audit Committee as a whole has competence relevant to the sector in which the Group operates.

## **BOARD EFFECTIVENESS REVIEW**

The 2021/22 Board and Committee evaluation was conducted internally, via an online questionnaire created by the Group General Counsel and Company Secretary in consultation with the Chair in February 2022. This year, more focus was placed on treating the evaluation as a strategic health check and forward-looking review, while also including questions that enabled the Board to reflect on its performance in accordance with the UK Code requirement. Therefore, of equal focus was the following:

- The processes required to enable the business to meet its new challenges
- How the Board can best respond to and lead the strategic direction of the Company
- The maturity of, and appropriate flex within, our current governance
- Board composition, numbers, and attributes required for new appointments
- The ways in which the Board can equip itself to respond to challenges and lead in the context of increased complexity, uncertainty, opportunity and risk in the UK Water business environment
- How we can better achieve and explain current and long-term corporate performance, and
- How can we operate more effectively and strategically.

The last external Board effectiveness evaluation took place in 2020 and was carried out by Duncan Reid. Plans will be put in place for an external effectiveness evaluation in 2023 in accordance with the UK Corporate Governance Code's recommendation to undertake an external evaluation at least every three years.

## **SUMMARY OF EVALUATION**

A summary of the Board and Committee evaluation results is included within the Nomination Committee report on pages 128 to 132.

## **SUCCESSION PLANNING**

Gill Rider, the Chair of the Company, is also the Chair of the parent company, Pennon Group plc. Gill was first appointed to Pennon's Board on 1 September 2012 and was appointed Chair in July 2020. In 2021, as her tenure as a Non-Executive Director of Pennon approached nine years, the Senior Independent Director led an independent review in relation to the extension of Gill's term as Chair. Following a thorough review and after consulting with shareholders, the Board was satisfied that an extension of no more than three years from July

2021 was appropriate, given the continuation of the strategic business review, the period of adjustment needed following the sale of Viridor and the re-positioning of the Group as a major operator in the UK water sector. The Board believes that continuity of leadership and strategic direction at this time continue to be especially important to the successful conclusion of these processes.

The Board is also keen to ensure that the work being undertaken to embed Group governance and control structures following the repositioning of the Group to focus on the UK water sector and the acquisition of Bristol Water continues to be carried out under Gill's stewardship, noting her close involvement in the strategic review process.

In addition, the Board considers that the extension of Gill's term as Chair both facilitates effective succession planning and the development and continuation of a diverse Board. For these reasons, and mindful of the recommendations of the UK Code, the Board believes it to be in the best interests of the Company and its shareholders, for Gill to remain as Chair, and recommends her re-election at the 2022 AGM.

Further information on succession is provided in the Nomination Committee Report on page 129.

## **AUDIT, RISK AND INTERNAL CONTROL**

### *RISK MANAGEMENT AND INTERNAL CONTROL*

The Board is responsible for maintaining the Company's system of internal control to safeguard shareholder investment and the Company's assets and for reviewing its effectiveness. The system is designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss. An ongoing process for identifying, evaluating and managing the significant risks faced by the Company has been in place throughout the year and up to the date of the approval of this Annual Report and Accounts and is regularly reviewed by the Board.

The Company's system of internal control is consistent with the FRC's 'Guidance on Risk Management, Internal Control and Related Financial and Business Reporting' (FRC Internal Control Guidance).

The Board confirms that it applies procedures in accordance with the UK Code and the FRC Internal Control Guidance which brings together elements of best practice for risk management and internal control by companies. The Group's internal audit function undertakes specific risk assessments to identify vulnerable risk areas in the Company. The Board's risk framework described on page 70 of the strategic report provides for the identification of key risks, including ESG risks, in relation to the achievement of the business objectives of the Company, monitoring of such risks and ongoing and annual evaluation of the overall process. ESG risks identified and assessed by the Board cover areas such as health and safety, climate change and tax compliance. Details of the key risks affecting the Company are set out in the strategic report on pages 70 to 85.

KPIs are in place to enable the Board to measure the Company's ESG performance, including agreed regulatory performance commitments in respect of ODIs, and a number of these are linked to remuneration incentives (see page 148). A full breakdown of performance during the year against these KPIs is provided in South West Water's Annual Performance Report, which is published in July (see [www.southwestwater.co.uk/report2022](http://www.southwestwater.co.uk/report2022)).

As part of the review of the effectiveness of the system of risk management and internal control under the Company risk management policy, all Executive Directors and senior managers are required to certify on an annual basis that they have effective controls in place to manage risks and to operate in compliance with legislation and Company procedures.

The processes and policies serve to ensure that a culture of effective control and risk management is embedded throughout the Company and that the Company is in a position to react appropriately to new risks as they arise.

### **CODE OF CONDUCT AND POLICIES**

South West Water has adopted the Pennon Group's Code of Conduct and related policies which set out the commitment to promoting and maintaining the highest level of ethical standards. The Code of Conduct was refreshed in March 2021. Areas covered in the Code of Conduct include our impact on the environment and our communities, our workplace and our business conduct.

The Code of Conduct sets out the values and principles by which we operate and provides a framework for ethical business practices. It is further supported by a number of policies that guide our workforce and suppliers, so that we may identify and deal with suspected wrongdoing, fraud or malpractice, maintain the highest standards of compliance, and to apply consistently high standards of ethics. We aim to maintain a culture that fosters the reporting of any concerns and trust that we will act on them.

### ***ANTI-BRIBERY AND ANTI-CORRUPTION***

The policy on anti-bribery and anti-corruption strictly prohibits employees from offering or accepting bribes, facilitation payments and kickbacks. The policy requires that due diligence checks third-party suppliers and contractors doing business with the Company, including a corruption risk assessment to examine the nature of the proposed work or transaction. The policy provides a framework that requires everyone who works with or for the Company to act honestly and with integrity at all times. The policy has been rolled out comprehensively into all parts of the Company, with online training arranged by the legal compliance team. The Company ensures compliance with the policy in line with our risk-based approach by conducting planned and ad hoc checks, providing both general and specific training, and carrying out detailed investigations into allegations of potential wrongdoing (whistleblows) received from employees, customers and suppliers.

In order to mitigate risk, targeted authorisation and oversight processes are applied to the areas that have been identified as being more vulnerable and additional training is provided.

The legal compliance team likewise actively assesses high risk areas based on information gained through their close working with business functions and Pennon Group internal audit. Assessments are undertaken using a number of entry points, including using the output of reviews with the executive teams, during and following face-to-face training, and analysing whistleblowing reports. Foreign trading operations, procurement activities and business development/commercial back-office areas continue to be specifically reviewed for compliance with anti-bribery and anti-corruption requirements. Comprehensive operating procedures are in place to address risks in those areas, with regular reviews taking place to ensure the assessment of risk remains up to date.

The anti-corruption and anti-bribery policy also sets out the employment consequences for its breach and potential legal sanctions under bribery laws. Any breaches or failure to adhere to the Group's strict standards of integrity and honesty will be subject to disciplinary action, up to and including dismissal from the Company. All employees are required to read, understand and comply with the policy and report any circumstances or any suspicions of fraud, bribery, corruption or other irregularities, either to a line manager or by using the Group's confidential whistleblowing service Speak Up. There were no confirmed cases of bribery, corruption, fraud or business ethics violations during the year.

Allegations of bribery or corruption are reported to the Audit Committee together with investigation outcomes and details of any action taken, which are disclosed to our external auditors.

## *TRAINING AND COMMUNICATIONS*

Our comprehensive programme of training and internal communications continues with targeted messaging and interactive training sessions. This programme addresses the business's key compliance risk areas and has been designed to increase resilience, heighten awareness and promote a culture of doing the right thing.

## *WHISTLEBLOWING POLICY – SPEAK UP*

The Speak Up service encourages employees to raise concerns about suspected wrongdoing or unlawful or unethical conduct, explains how any such concerns should be raised and ensures that employees are able to do so without fear of reprisals. The Group's whistleblowing policy specifically includes and encourages reporting of:

- Bribery or corruption
- Stealing or fraud
- Corrupt or dishonest activity
- Anything else contrary to the law.

The Speak Up service comprises telephone and web-based reporting channels operated for Pennon by independent provider Navex Global.

Following receipt of a report, the allegation will be assessed and an investigation started promptly. The investigation process is overseen by the Head of Legal Compliance and will be undertaken fairly, impartially and thoroughly by appropriately trained investigators with strict confidentiality being maintained at all stages of the investigation. After each investigation, a confidential review is undertaken by the Head of Legal Compliance to identify any lessons learnt or organisational improvements or training requirements. Any lessons or other improvements identified are acted upon whilst at all times ensuring the paramount requirement of operating a whistleblowing process that protects the identity of individuals and the independence and integrity of the process. Our whistleblowing process is designed to support our staff, reflect shared responsibility, promote a positive culture, provide unique insights and is central to our system of checks and balances.

# AUDIT COMMITTEE REPORT

## ENSURING SOUND FINANCIAL MANAGEMENT AND ROBUST CONTROLS TO SUPPORT OUR STRATEGY

The purpose of the report is to provide an insight into the work carried out by the Committee, and in doing so, outline our areas of focus.

As in previous years, the Committee continue to be focused on three key areas:

- Firstly, ensuring the quality and integrity of the Company's financial reporting; this is done through the assessment of the application of accounting policies given underlying standards, challenging management and intellectually testing the use of accounting judgements made in preparing financial reporting and the assessment of the reporting of the Company in terms of whether its presentation is fair, balanced and understandable
- Secondly, we seek to review and challenge the ongoing effectiveness of the internal control environment
- And finally, challenging ourselves as to the scope and adequacy of risk management processes across the Company. In doing this, we monitor the expression of the Company's risk appetite and undertake 'deep dive' reviews of higher risk areas.

These responsibilities are discharged throughout the year in accordance with a schedule of business reflecting the annual external reporting cycle of the Company, allowing for appropriate consideration at the right point. This scheduling also allows for consideration on an ad-hoc basis of events as they have arisen.

Monitoring and reviewing the effectiveness of the external auditor and the internal audit function is an equally important ongoing element of the Committee's assurance activities.

In regards to risk, the process starts with the group's executive risk committee formulating their risk appetite as well as their ongoing monitoring of key risks and their mitigation. The Committee considers this formally, as well as honing in on key risk areas.

During the year, these key risk deep dives covered a wide range of topics including the risks to the delivery of capital projects, customer service performance and how that relates to our regulatory targets, supplier resilience, health & safety, water leakage and the risks to the Company from UK macroeconomic demand fluctuation. More detail on our risk management processes, principal risks and their associated mitigations can be found on pages 70 to 85.

As well as this focus on our risk processes, we formally review the output of the Company's financial resilience and health assessments; for a 12-month period through our assessment of the Company's going concern status and over a period to 2030 to assess the Company's continuing viability. Whilst the worst of the COVID-19 pandemic now fortunately appears behind us in the UK, the viability assessment has considered a range of financial projections arising from the current challenging and complex external environment, with most recent developments in relation to economic growth, inflation, and the indirect impact of the Ukraine crisis. These are modelled through internal scenarios around the deployment of cash reserves. South West Water have continued to use a longer assessment period to 2030, since we have a greater visibility of future cash flows, being a regulated business. Our viability statement is reported on page 86.

As part of the half-year and year-end reporting review process, we carefully consider the key financial reporting judgements of management as set out on page 190. Significant matters considered by the Committee both during the year and in relation to the year-end financial statements are laid out in this report.

Looking ahead to 2022/23, we expect the global economy to be volatile reflecting the geopolitical situation in Ukraine with macroeconomic developments compounded by the recovery from the impacts of the COVID-19 pandemic. The Committee remains alert and continues to monitor developments and adapt its approach where necessary, to best support the Company's stakeholders and strategy.

#### *PRIORITIES OF COMMITTEE CHAIR*

The Audit Committee Chair works colleagues to ensure the Committee supports the Board in fulfilling its key responsibilities: the monitoring of the quality and integrity of financial reporting, the adequacy of its risk management processes and its internal controls processes.

The year has been a successful one for the Company. The business carried on against the backdrop of the pandemic, and accelerating macro economic volatility, particularly in regards to energy prices and inflation.

Key considerations for the Committee can be summarised as follows:

#### *COVID-19 PANDEMIC AND THE MACRO-ECONOMIC OUTLOOK*

Throughout the year, the Committee continued to closely monitor the impact of COVID-19 on our financial control environment and on the Company's financial results.

The impacts on the supply chain of the recovery from the pandemic in large parts of the world, allied to continuing lockdowns in China are testing longstanding global logistics structures. Rising power prices and overall higher levels of inflation are becoming a feature, allied to global geopolitical volatility, and this requires careful monitoring.

#### **SOUTH WEST WATER AUDIT COMMITTEE COMPOSITION AND MEETINGS**

Four meetings of the South West Water Audit Committee were held during the year. Membership of the South West Water Audit Committee and their attendance at meetings, was as follows:

<b>Membership</b>	<b>Position</b>	<b>Attendance</b>
Neil Cooper	Chair	4/4
Jon Butterworth	Non-Executive Director	4/4
Iain Evans	Non-Executive Director	4/4
Claire Ighodaro	Non-Executive Director	4/4

All members of the Committee served throughout the year.

Other regular attendees of Committee meetings during the year included: the Chair, Chief Executive Officer; Group Finance Director; Group General Counsel and Company Secretary; South West Water Finance Director, Director of Risk and Assurance; Group Financial Controller and the external auditor.

The Board is satisfied that Neil Cooper, Iain Evans and Claire Ighodaro have recent and relevant financial experience have competence in accounting or auditing. Details of each Director's significant current and prior appointments are set out on pages 97 to 100.

All of the Committee members are also members on the Remuneration Committee, which enables them to provide input to both Committees on any Company performance matters and on the management of any risk factors relevant to remuneration.

**SIGNIFICANT MATTERS CONSIDERED BY THE COMMITTEE**

A calendar of business sets in place a framework for ensuring that the Committee manages its affairs efficiently and effectively throughout the year and is able to concentrate on the key matters that affect the Company.

The most significant matters that the Committee considered and made decisions on during the year and, where appropriate, since the year end, are set out below:

<p><b>Financial reporting</b></p>	<ul style="list-style-type: none"> <li>• Monitored the integrity of the financial statements of the Company and the half-year and full-year results relating to the Company's financial performance, this included reviewing and discussing significant financial reporting judgements contained in the statements, later outlined in this report</li> <li>• Reviewed the internal assessment of Going Concern and longer term viability on behalf of the Board</li> <li>• After a detailed review in accordance with its established process, advised the Board that the presentation of the annual report &amp; accounts is fair, balanced and understandable in accordance with reporting requirements and recommended their approval for publication</li> <li>• Reviewed Internal control processes, systems and levels of compliance</li> <li>• Reviewed internal audit reports on core systems and processes across the Company.</li> </ul>
<p><b>External auditor</b></p>	<ul style="list-style-type: none"> <li>• Considered auditor's report on its audit of the annual results focusing on key findings</li> <li>• Assessed external auditor effectiveness in respect of the previous year's external audit process</li> <li>• Considered the auditor's report on control themes and observations for the year, which did not identify any significant deficiencies.</li> </ul> <p>Note, in line with the structure of the Group, certain activities such as recommending reappointment of the statutory financial auditor and assessment of effectiveness of the statutory financial auditor are performed by the Pennon Group Audit Committee. The responsibilities of the Pennon Group Audit Committee are described in the Pennon Group annual report (pages 148 to 151).</p>
<p><b>Risk management</b></p>	<ul style="list-style-type: none"> <li>• Reviewed the Company's risk management framework and compliance with that framework during the year and after the year end up until the publication of the Company's annual report</li> <li>• Reviewed the assessment of the risks by the Executive Directors and considered risk appetite and risk profile of the Company</li> <li>• Reviewed the Company risk register and considered appropriate areas of focus and prioritisation for the audit work programme for the year</li> <li>• Assessed information security across the Company in mitigating key IT risks, including specific consideration of the potential risk of cyber security breaches or related items that may have any material impact to the financial statements.</li> <li>• Considered the annual report on whistleblowing as part of the risk management review</li> <li>• Carried out deep dives at Committee meetings on principal risk areas.</li> </ul>

<b>Governance</b>	<ul style="list-style-type: none"> <li>• Considered and approved Company accounting policies, including the impact of new accounting standards, used in the preparation of the financial statements</li> <li>• Reviewed and considered internal financial policies</li> <li>• Confirmed compliance with the UK Code</li> <li>• Held regular meetings with the external auditor and the Group Director of Risk and Assurance without members of management being present.</li> </ul>
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In respect of the monitoring of the integrity of the financial statements, which is a key responsibility of the Committee identified in the UK Code, the significant areas of judgement considered in relation to the financial statements for the year ended 31 March 2022, are set out in the following table, together with details of how each matter was addressed by the Committee.

At the Committee's meetings throughout the year the Committee and the external auditor have discussed the significant matters arising in respect of financial reporting during the year, together with the areas of particular audit focus, as reported on in the independent auditor's report on pages 164 to 172. In addition to the significant matters set out in the table below, the Committee considered presentational disclosure matters including the use on non-underlying performance metrics disclosures, and ensuring a fair presentation of statutory and non statutory performance and financial measures.

During the year, the Committee's areas of focus included:

<b>Area of focus</b>	<b>How the matter was addressed by the Committee</b>
<b>Revenue recognition</b>	Given the nature of the Company's revenue, the areas of judgement for continue to be in respect of revenue recognition relating to income from water services. Whilst the Committee relied on South West Water's evolving processes for assessment of water into supply, it scrutinised their track record of accuracy by comparing actual outturns with accruals at previous year ends to form a judgement about the quality of decision making. The Committee also closely considered the work in respect of these areas at year end by the external auditor as well as reviewing disclosures around revenue recognition accounting policies.
<b>Bad and doubtful debts</b>	Regular updates on progress against debt collection targets and other contractual payments due are received by the Board. Performance is monitored regularly against both South West Water's historical collection record and the track record of other companies in the sector. The Committee was particularly mindful of the ongoing impacts of affordability on the assessment of expected credit losses in determining the bad debt provision, noting the significant increases in inflation arising from macro economic developments. At the year end, the external auditor reported on the work it had performed, which, together with the detailed analysis reported, enabled the Committee to conclude that management's assessment of the year-end position and its provisions for expected credit losses was reasonable.
<b>Going concern basis for the preparation of the financial</b>	A report from the Pennon Group Finance Director on the financial performance of both the Pennon Group and South West Water, including forward-looking estimates of covenant compliance and funding levels under different scenarios, is provided to the Board on a periodic basis. Rolling five-year strategy projections and the



<p><b>statements and viability statement</b></p>	<p>resultant headroom relative to borrowings are also regularly reviewed by the Board, including scenarios to enable the Committee to better understand the potential range of outcomes. At the end of each six-month period the Pennon Group Finance Director prepares for consideration by the Committee a report focusing on the Group's liquidity over the 12-month period from the date of signing of either the annual report or half-year results. The Committee also reviewed a report from the Pennon Group Finance Director on the Company's financial viability over an appropriate period, which the Board considers to be up to 2030, in connection with the UK Corporate Governance Code and Ofwat's requirement for a viability statement to be given by the Board.</p> <p>Similarly, this report also considered the viability of the Company the potential manifestation of other adverse events modelled from the Company's principal risks and resultant sensitivity scenarios. Consideration of these reports and constructive challenge on the findings of the reports, including the scenario testing carried out by management, has enabled the Committee to form its assessment and satisfy itself that it remains appropriate for the Company to continue to adopt the going concern basis of accounting in the preparation of the financial statements and in addition advise the Board on providing the viability statement set out on page 86.</p>
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#### **EFFECTIVENESS OF THE EXTERNAL AUDIT PROCESS**

Receiving high-quality and effective audit services is of paramount importance to the Committee. We continue to monitor carefully the effectiveness of our external auditor as well as their independence, while recognising there is a need to use our external auditor's firm for certain non-audit services. We have full regard to the FRC's Ethical Standard and ensure that our procedures and safeguards meet these standards.

The current external auditor, Ernst & Young LLP (EY), was appointed following a comprehensive audit tender process and approval by shareholders at the Company's 2014 AGM. Its reappointment was approved at the 2021 Annual General Meeting. Christabel Cowling is the audit partner and has held the role since 2019.

The external auditor produced a detailed audit planning report in preparation for the year-end financial statements, which has assisted the auditor in delivering the timely audit of the Company's annual report and financial statements and which was shared with, and discussed by, the Committee in advance.

The effectiveness review of the external auditor is undertaken as part of the Committee's annual performance evaluation which also examines the relationship and communications between the Committee and the external auditor. Further details of the performance evaluation are provided on page 130. No issues were raised during that review. The Committee concluded that the auditor was effective during the year and that the relationship and communications were open and constructive.

The Committee considered that it is appropriate that the external auditor be reappointed and has made this recommendation to the Board. The Committee chair has also met privately, with the external auditor to discuss key matters.

## **AUDITOR INDEPENDENCE**

The Committee carefully reviews on an ongoing basis the relationship with the external auditor to ensure that the auditor's independence and objectivity are fully safeguarded.

The external auditor reported on their independence during the year and again since the year end, confirming to the Committee that, based on their assessment, they were independent of the Company.

## **PROVISION OF NON-AUDIT SERVICES**

The Committee continues to have a robust policy for the engagement of the external auditor's firm for non-audit work. The Committee receives a regular report covering the auditor's fees including details of non-audit fees incurred.

Recurrent fees typically relate to agreed procedures in relation to annual regulatory reporting obligations to Ofwat; work which is most efficiently and effectively performed by the statutory auditor. The policy is for non-audit fees not to exceed 70% of the audit fee for statutory work and for the Committee chair to approve all non-audit work performed by the statutory auditor. The policy uses the average of the last three years' audit fees disclosed in the accounts and certain non-audit fees for services that are required to be performed by the auditors are excluded from the assessment. The Committee carefully reviews non-audit work proposed for the statutory auditor, taking into consideration whether it was necessary for the auditor's firm to carry out such work, and only grants approval for the firm's appointment if it was satisfied that the auditor's independence and objectivity would be safeguarded. If another accounting firm could provide the required cost-effective level of experience and expertise in respect of the non-audit services, then such firm would be chosen in preference to the external auditor.

The level of non-audit fees payable to the external auditor for the past year is 11% of the three-year average audit fee, which is within the Company's 70% non-audit fee limit.

The Group Finance Director regularly reports to the Committee on the extent of services provided to the Company by the external auditor and the level of fees paid. The fees paid to the external auditor's firm for non-audit services and for audit services are set out in note 7 to the financial statements on page 192.

## **INTERNAL AUDIT**

The internal audit activities of the Company are a key part of the internal control and risk management framework of the Company. There is a long-standing and effective centralised internal audit service at Pennon Group plc which makes a significant contribution to the ability of the Committee to deliver its responsibilities.

Following the establishment in 2019 of a new directorate of Risk and Assurance, encompassing Group risk reporting and internal audit, the Group's internal audit function has continued to operate effectively. The current Group and Company internal audit plan was approved in March 2021, following a thorough review to ensure it provided adequate coverage over the Company's key risks for the year ahead and was sufficiently flexible to respond to emerging risks. In developing the plan, account is taken of the principal risks, the activities to be undertaken by the external auditor, and the Company's annual and ongoing risk management reviews. This approach seeks to ensure that there is a programme of internal and external audit reviews focused on identified key risk areas throughout the Company. Looking ahead, the intention of the Committee is to establish formal internal audit plans covering each six month period, given the volatility of the operating environment.

The Director of Risk and Assurance reported regularly through the year to the Committee on audit reviews undertaken and their findings of internal audit activity. There were regular discussions, correspondence and private meetings between the Director of Risk and Assurance and the Committee chair.

During the year, following a competitive tender process, the Committee approved the appointment of BDO to perform an external independent assessment of the internal audit function's effectiveness, the last one having been undertaken in 2016. This concluded that the function is fit for purpose and is operating efficiently and effectively, in line with good practice and conforms to IIA (Chartered Institute of Internal Auditors) standards. Where opportunities for continued improvement have been identified, these have been adopted and the success of which will be monitored by the Committee as part of its annual assessment of the effectiveness of the internal audit function. The next cyclical external review of the internal audit function will be undertaken within the next five years, as required by IIA standards.

#### **FAIR, BALANCED AND UNDERSTANDABLE ASSESSMENT**

To enable the Committee to advise the Board in making its statement that it considered that the Company's annual report & accounts is fair, balanced and understandable (FBU) on page 119, the Committee has applied a detailed FBU review framework that takes account of the Company's well-documented verification process undertaken in conjunction with the preparation of the annual report & accounts. This is in addition to the formal process carried out by the external auditor to enable the preparation of the independent auditor's report, which is set out on pages 164 to 172.

In preparing and finalising this annual report & accounts, the Committee considered a report on the actions taken by management in accordance with the FBU process and an FBU assessment undertaken by the Pennon Executive. This assisted the Committee in carrying out its own assessment and being able to advise the Board that it considered that the annual report & accounts taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's performance, business model and strategy.

#### **STATEMENT OF COMPLIANCE WITH CMA ORDER**

Pennon Group plc undertook a competitive audit tender process in 2014, which included the statutory audit engagement for South West Water. The Group is in compliance with the Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014.

Following the rotation of the senior statutory auditor in 2019, the Committee considers a full tender for the Pennon Group's external audit services, including the statutory audit of South West Water, subject to its annual reviews, likely in the year ending March 2024. This allows for any potential new audit firm to take up the role for the year ending March 2025. The Committee believes this approach is in the best interest of shareholders, as over this period the Pennon Group will benefit from an efficient and effective audit, while receiving fresh challenge from a new senior statutory auditor.

#### **LOOKING FORWARD**

During the forthcoming year, the Committee will remain focused on the key areas of responsibility delegated to it by the Board, ensuring that standards of good governance are maintained and that appropriate assurance is

obtained across all areas of the business, with a particular focus on the Company's principal risks, control environment and approach to financial reporting, noting the volatility in the global economy, and taking into account developments in reporting responsibilities including those recommended by the TCFD, the consideration of climate risk in preparation of the financial statements and potential changes in the governance environment.

### **INTEGRATED ASSURANCE FRAMEWORK**

Throughout the year South West Water had in place an effective integrated assurance framework which identifies and monitors all types of assurance to enable a full evaluation of the conclusions drawn by all auditors, inspectors and reviewers from both internal and external providers.

The framework utilises a risk-based approach to ensure an appropriate balance of varied providers of assurance dependent on the assessed risk and complexity of assurance requirements.

#### **(i) Group independent internal audit**

South West Water utilises the Pennon Group's independent Internal Audit function, to provide effective risk-based coverage over the internal control environment. The Audit Committee's interactions and engagement into internal audit, including input into the annual plan is summarised above.

#### **(ii) Annual assurance (financial and technical audit)**

Alongside the statutory external auditor, South West Water also engages a technical auditor to provide assurance over key areas of regulatory performance reporting. This assurance considers our reported performance against key regulatory outputs and measures.

#### **(iii) Quality assurance and ISO Internal Reviews**

The South West Water Audit Committee also considers the resources for carrying out internal audits and reviews in key Company specific areas and endorses and acts on findings from these reviews carried out within the Company. There is a programme of internal audits coordinated by the Risk and Compliance Department as part of the Company's ISO certifications.

South West Water has the following accreditations/certifications:

- ISO 9001: 2015 (quality management)
- ISO 14001: 2015 (environmental management)
- ISO 27001: 2013 (information security)
- ISO 17025: 2005 (laboratories and sampling)
- ISO 50001: 2011 (energy management)
- BS 18477; 2010 (inclusive service provision)

In March 2022, South West Water was successful in being recommended for certification in line with ISO 55001:2014 Asset Management.

These specific areas are also subject to periodic external reviews (such as ISO external reviews).

### **SOUTH WEST WATER'S 2021/22 BOARD ASSURANCE STATEMENT**

In July 2022, South West Water will publish its annual performance report which will detail assurance work which has been performed in areas which it has identified following consultation as significant areas for assurance, which includes annual reporting. This report will be available as part of South West Waters' – available at [www.southwestwater.co.uk/report2022](http://www.southwestwater.co.uk/report2022).

# THE ENVIRONMENTAL, SOCIAL AND GOVERNANCE COMMITTEE REPORT

Sustainability is at the heart of our business and is part of everything that we do. During the year, the Committee considered a wide range of matters in the course of fulfilling its duties in accordance with its terms of reference.

To deliver on our strategy, we have undergone an extensive materiality assessment in partnership with our stakeholders to identify their most important ESG matters. The results have informed our updated ESG targets framework and support us in aligning our approach and priorities for PR24. You can read more on the outcomes of the materiality assessment on page 126.

Over the past year, work to deliver our ESG Capitals programme has continued at pace as we develop ways of measuring our contribution and impact across the ESG agenda.

From a governance perspective, we welcomed the enhanced ESG disclosure for this year’s reporting cycle and we have developed our very first SASB (Sustainability Accounting Standards Board) disclosure as well as our very first ESG data book. We have also made significant progress with the TCFD (Task Force on Climate-Related Financial Disclosures) recommendations after our parent company, Pennon Group plc, produced our first TCFD disclosures voluntarily in 2020/21.

As the global climate agenda increases, South West Water published both their Net Zero plan – Our Promise to the Planet, and a new Climate Change Adaptation plan.

This annual report provides an integrated assessment to show how a responsible approach to sustainability helps us to balance the immediate and longer-term needs of society with the delivery of sustained commercial success.

## ENVIRONMENTAL, SOCIAL AND GOVERNANCE COMMITTEE COMPOSITION AND MEETINGS

Four meetings of the South West Water ESG Committee were held during the year. Members of the Committee and their attendance at meetings, were as follows:

Membership	Role	Attendance
Iain Evans	Chair	4/4
Gill Rider	Non-Executive Director	4/4
Claire Ighodaro	Non-Executive Director	4/4
Neil Cooper	Non-Executive Director	4/4
Jon Butterworth	Non-Executive Director	4/4
Louise Rowe	SWW Finance Director	4/4
Susan Davy	Chief Executive Officer	4/4

## COMMITTEE AGENDA FOR 2021/22

During the year, the Committee reviewed its remit and responsibilities, to ensure they remain appropriate.

### ESG PERFORMANCE

The ESG Committee continues to assess performance against a range of challenging targets for the Company, set as part of the business planning process.

In addition, it provides assessment and oversight of South West Water's performance against sustainability targets that are core to the successful delivery of its five business plan. This is consistent with Ofwat's requirement for independent governance of the regulated business.

As at 31 March 2022, South West Water achieved or is on track for 23 of the 26 targets. We continue to target significant improvements in these areas.

#### *MATERIALITY ASSESSMENT*

During the year, we undertook an extensive materiality assessment in partnership with our stakeholders to identify their most important ESG matters. This involved interviewing a range of external stakeholders to get their views on what matters most as well as undertaking a desktop review, peer comparisons, activity mapping and horizon scanning in addition to one-to-ones with some of our internal teams.

#### *CAPITALS PROGRAMME*

The focus of our Capitals programme this year has been to continue developing appropriate performance measures, benchmarking our approach, and identifying tools and methodologies to help us value these metrics. These Capitals measures will form part of our investment decision-making framework to ensure the total value and positive impact of our investments is captured. Our first Capitals Net Impact report will be published in Autumn 2022.

#### *KEY ACTIVITIES AND ACHIEVEMENTS DURING THE YEAR*

During 2021/22, the Committee has considered a wide range of matters in the course of fulfilling its duties in accordance with its terms of reference

- Successfully achieved majority of 2021/22 ESG targets
- Delivery of ESG Capitals plan as we look towards our first Capitals report to be published in Autumn 2022.
- Completion of updated materiality assessment to inform our future ESG targets
- Continued delivery of TCFD recommendations including detailed appraisal of transition risks and opportunities and scenario analysis
- Enhanced ESG reporting including our first disclosures aligned to the Sustainability Accounting Standards Board (SASB) reporting framework and new ESG DataBook
- Improvements across external ESG ratings including our Sustainalytics ESG rating
- Implementation of new community impact tool (B4SI) across our key community programmes and activities
- Approval of updated Sustainable Financing Framework and Impact Report

#### **ENHANCED REPORTING AND ASSURANCE**

With a growing focus on ESG reporting, South West Water's ESG reporting is integrated throughout the strategic report and specifically in the following sections:

<b>Section</b>	<b>Page</b>
Chair's letter	6
Business model	7

Strategy overview	7
ESG performance 2021/22	45
Stakeholder overview	13
Our People	24
Our Operations	37

South West Water's sustainability performance and reporting has been audited by Jacobs (a global provider of technical, professional and scientific services, including engineering, architecture, construction, operations and maintenance) as part of its audit of performance data contained within the Annual Performance Report. Jacobs utilise water industry specialists in the audit of our non-financial data.

South West Water considers that Jacobs's method of verification – which includes testing the assumptions, methods and procedures that are followed in the development of data and auditing that data to ensure accuracy and consistency – complements the best practice insight gained through South West Water's membership of Business in the Community.

Jacobs will provide a technical auditor's report within the Annual Performance Report and Regulatory Reporting outlining its opinion and key findings (published in July and available at [www.southwestwater.co.uk/report2022](http://www.southwestwater.co.uk/report2022)).

## **BENCHMARKING**

It's important to us to ensure we are regularly benchmarked against the expected industry standards. This ensures we are continuing to provide up to date disclosure for our stakeholders. These leading indices assess companies on their disclosures relating to stringent environmental, social and governance criteria, and their position to capitalise on the benefits of responsible business practice. The Pennon Group (including South West Water) is a constituent within the FTSE4Good Index, Sustainalytics, CDP Climate Change, Dow Jones Sustainability Index and a number of other leading external ESG assessments. FTSE4Good and similar leading indices are designed to facilitate investment in companies that meet globally recognised corporate responsibility standards.

## **FOCUS AREAS FOR 2022/23**

- Develop and publish first Capitals net impact report in Autumn 2022
- Validation of Group Science Based Targets (SBTs)
- Further integration of ESG across entire Company
- Expansion of community impact evaluation and reporting
- Preparatory work on upcoming ESG reporting including TNFD (Taskforce on Nature-related Financial Disclosures) and SDR (Sustainability Disclosure Requirements).

# THE NOMINATION COMMITTEE REPORT

## PROMOTING DIVERSITY AND ENSURING ONGOING LEADERSHIP EFFECTIVENESS AND STEWARDSHIP

This year, the Committee has focused on reviewing the effectiveness, size and composition of the Board to meet future requirements, in line with the strategy and in advance of the Audit Chair's end of tenure planned for 2023.

Additionally, the Committee has taken an active interest in championing diversity, whether gender, ethnicity, or social mobility.

The Nomination Committee met four times during the year to fulfil the duties set out in its terms of reference.

Only the members of the Committee are entitled to attend the Nomination Committee meetings, although other regular invitees to Committee meetings during the year included the Chief Executive Officer, the Chief People Officer and the General Counsel and Company Secretary. Committee members are also excluded from participating when their own positions are under discussion.

Further information on the Board leadership biographies, can be found on pages 97 to 100.

## NOMINATION COMMITTEE COMPOSITION AND MEETINGS

Director	Role	Attendance
Gill Rider	Chair	4/4
Neil Cooper	Non-Executive Director	4/4
Claire Ighodaro	Non-Executive Director	4/4
Iain Evans	Non-Executive Director	4/4
Jon Butterworth	Non-Executive Director	4/4

Also in attendance were the Chief Executive Officer, the Chief People Officer and the Group General Counsel and Company Secretary.

## MATTERS CONSIDERED BY THE COMMITTEE DURING THE YEAR

- Overseeing the effectiveness of the Board's internal succession plan, ensuring that the board has the appropriate mix of skills, experience and diversity
- Reviewing terms of reference for the Committee to ensure they continue to be appropriate
- Overseeing the annual review of Board Effectiveness and Board composition
- The annual review and approval of the Company policy on Diversity, Respect and Inclusion and the Group's progress on diversity in line with the Parker review, including the outcome of the FTSE Leaders Survey and the Group's position on Gender Pay
- Ongoing review, development and evolution of the Executive Leadership team, including succession planning
- Overseeing the appointment process of an external search consultancy, to assist in future non-executive appointments



## **BOARD DIVERSITY**

At South West Water we believe that a diverse and inclusive culture is a strategic imperative, treating it in the same way as we do each strategic priority - setting the tone from the top, holding leaders accountable and delivering against a clear action plan.

We know that balanced teams are better at solving complex problems, delivering innovative solutions, spotting new opportunities as well as being a powerful driver of resilience.

As at the 31 March 2022, the Board's gender diversity stood at 57% female with Executive gender diversity at 100% and for senior management at 18%. This focus on diversity throughout the company, resulted in our parent company, Pennon, being ranked 10th in the most recent FTSE Women Leaders report (FTSE 250) and 1st in the Utility Category.

As advocates of Sir John Parker's review for ethnic board diversity, meeting the target ahead of the required date, we were also early signatories of the Change the Race Ratio and we have published diversity targets in line with this. We will be publishing our ethnicity pay gap during 2022. The Company wider workforce diversity is currently 1.23%. Championing Diversity, Equity and Inclusion will remain an important priority of the Nomination Committee.

## **BOARD DIVERSITY POLICY**

The Committee is required by the Board to review and monitor compliance with the Board's diversity policy and report on the targets, achievement against those targets and overall compliance in the annual report each year.

The Board's diversity policy confirms that the Board is committed to:

- The search for Board candidates being conducted, and appointments made, on merit, against objective criteria whilst promoting the widest forms of diversity, including gender, social and ethnicity. In this context, the Board with endeavour to achieve and maintain:
  - A minimum of 40% female representation on the Board
  - A minimum of 40% female representation on the Company's senior management team
  - At least one member of diverse ethnicity on the Board
- Satisfying itself that plans are in place for orderly succession of appointments to the Board and to senior leadership
- maintain an appropriate balance of skills and experience within the Company and on the Board.

## **TALENT MANAGEMENT AND SUCCESSION PLANNING**

During 2020/21, a review was carried out of the capability and potential of the members of the Executive, supported by leadership advisory Heidrick and Struggles. This will be used to help inform development plans, aid succession planning and execute strategy.

The Committee, supported by the Chief People Officer, reviews both the executive and Non-Executive leadership as part of a regular agenda. External horizon scanning externally has also become a more frequent activity, to ensure that the Board remains flexible to respond to changing priorities.

## BOARD EFFECTIVENESS REVIEW

The Board undertakes a formal and rigorous review of its performance and that of its Committees and Directors each year. This ensures that they continue to operate effectively and are identifying opportunities for improvement and best practice, as well as helping to inform future agenda items and areas of focus.

This year's evaluation was conducted internally, via an online questionnaire created by the Group General Counsel and Company Secretary in consultation with the Chair and respective Committee Chairs, in February 2022.

This year, there was greater focus on treating the evaluation as a strategic health check and forward-looking review, whilst also including questions that enabled the Board to reflect on its performance. However, specific focus was also on the following:

- The processes that enable the business to meet its new challenges
- How the Board can best respond to and lead the strategic direction of the Company
- The maturity of, and appropriate flex within, our current governance
- Board composition, numbers, and attributes required for new appointments
- The ways in which the Board can equip itself to respond to and lead in the context of increased complexity, uncertainty, opportunity and risk in the UK water business environment
- How we can better achieve and explain current and long-term corporate performance
- How we can operate more effectively and strategically.

The questionnaire focused on the ongoing effectiveness of the Board during the year in setting the strategy, promoting the Company's culture and values, ensuring that the Company's obligations to its stakeholders were understood and met, overseeing the use of the Company's resources, managing the risks inherent in the strategy, plans and the operating environment, and ensuring that the Executive had managed all the activities of the Company well.

The outcome of the review concluded that the Board, its Committees and individual Directors continued to demonstrate a high degree of effectiveness and collaboration, and that the Board had a good understanding of opportunities for growth and risks facing the business, with the following positives, negatives and/or actions suggested:

### SUMMARY OF EVALUATION

Area of assessment	Feedback	Commentary and related actions
Board	<b>Board operation</b> <ul style="list-style-type: none"> <li>• The Board works well, with open collaboration, with potential for further NED support.</li> </ul>	<ul style="list-style-type: none"> <li>• Assess need for further NED and progress accordingly.</li> </ul>
	<b>Board leadership</b> <ul style="list-style-type: none"> <li>• The Board provides entrepreneurial leadership.</li> <li>• There are constructive relationships between executive /</li> </ul>	<ul style="list-style-type: none"> <li>• Continue to focus on driving improved Health &amp; Safety performance.</li> </ul>

Area of assessment	Feedback	Commentary and related actions
	<p>senior management and Non-Executive Directors.</p> <ul style="list-style-type: none"> <li>The Board takes the lead in driving a strong health and safety culture throughout the Company.</li> <li>The Board is strong, diverse, supportive, well-structured and appropriately positioned.</li> <li>On H&amp;S matters, it was commented that, whilst the Board drives this, H&amp;S performance can always be improved.</li> </ul>	
	<p><b>Board oversight</b></p> <ul style="list-style-type: none"> <li>Good oversight of the Company's business.</li> <li>Develop and maintain increased visibility around pollutions.</li> </ul>	<ul style="list-style-type: none"> <li>Continue to ensure appropriate processes for monitoring, reporting and addressing pollution incidents.</li> </ul>
	<p><b>Company strategy and governance</b></p> <ul style="list-style-type: none"> <li>The Board continues to provide helpful support to management.</li> <li>The Board offers good strategic direction and governance.</li> </ul>	<ul style="list-style-type: none"> <li>Key themes are strategic reviews of climate, delivering for the environment, growth.</li> </ul>
<p><b>Audit Committee</b> (operation and effectiveness)</p>	<ul style="list-style-type: none"> <li>The Audit Committee provides useful support to the Board and management.</li> <li>The Committee operates good governance, is up to date with changing legislation and has a strong relationship with financial management.</li> <li>Overall, it was felt that the Audit Committee functions well, with multiple members with deep finance experience.</li> </ul>	<ul style="list-style-type: none"> <li>Continue with existing processes.</li> </ul>
<p><b>ESG Committee</b> (operation and effectiveness)</p>	<ul style="list-style-type: none"> <li>Relationships and communication between the ESG Committee and key executives are open and constructive.</li> <li>The Committee makes effective use of KPIs and benchmarking to understand ESG performance, with external sustainability</li> </ul>	<ul style="list-style-type: none"> <li>Ensure sufficient flexibility to further improve net zero activities and outcomes.</li> <li>Continue the vital focus on environmental issues and CSOs.</li> <li>Continue to review and assess processes in this area.</li> </ul>

Area of assessment	Feedback	Commentary and related actions
	<p>performance reported on regularly.</p> <ul style="list-style-type: none"> <li>• Overall the Committee provides good direction in an ever-evolving area and has developed well over the last 18 months.</li> <li>• Environmental issues particularly around CSOs have emerged more prominently this year.</li> <li>• The Committee and the Board have work to do, to deal with the pollutions and CSO challenges, with the right executive support.</li> </ul>	
<p><b>Remuneration Committee</b> (operation and effectiveness)</p>	<ul style="list-style-type: none"> <li>• The Remuneration Committee has performed well, with well-honed processes.</li> </ul>	<ul style="list-style-type: none"> <li>• To continue to evolve the framework as required, and build on existing processes.</li> </ul>
<p><b>Nomination Committee</b> (operation and effectiveness)</p>	<ul style="list-style-type: none"> <li>• The Nomination Committee has performed well and needs to continue its track of Board succession planning and Executive succession activities.</li> </ul>	<ul style="list-style-type: none"> <li>• Continue with existing processes.</li> </ul>
<p><b>Health and Safety Committee</b> (operation and effectiveness)</p>	<ul style="list-style-type: none"> <li>• The H&amp;S Committee provides effective support to both the Board and management.</li> <li>• The Committee is now well established and focused on supporting the Board's aspirations with recent reports on investigations felt excellent.</li> </ul>	<ul style="list-style-type: none"> <li>• A developing Committee that should continue its deep dive into H&amp;S performance and incidents.</li> </ul>

A key area for focus in 2022/23 will be recruiting up to two new Non-Executive Directors as part of ongoing Board succession and effectiveness. To support this activity, Russell Reynolds Associates have been appointed following a robust selection process and to ensure that an extensive and robust search can be made for suitable candidates.

# HEALTH & SAFETY COMMITTEE REPORT

## DRIVING A ROBUST HEALTH AND SAFETY CULTURE

The key to ensuring we keep employees safe and well in the workplace, is through empowering everyone to take responsibility for the health, safety and wellbeing of each other and for themselves. Simply put, it's about culture, leadership and accountability.

Establishing a separate Board Committee focused purely on Health and Safety was an important step forward in South West Water's journey as part of our HomeSafe strategy and to support the Company's vision to ensure that everyone goes home safe every day. We aim to be a leader of Health and Safety by 2025 in our sector, and leadership from the top is critical. The Board now has dedicated time to discuss and review performance, offer support, encourage learning and meet leaders and employees from across the business.

Reviewing the Company's health and safety performance, effectiveness of health and safety policies and procedures, including the continued roll-out of the HomeSafe strategy, has been core, with significant improvements already noted.

Importantly, the Committee reviews deep dives of High Potential Incidents with a particular focus on lessons learned, getting to the root cause, encouraging a learning mindset. We also reviewed external benchmarking of our performance against water peers, the results from our Engagement survey and employees' perception of Health and Safety as well as share good practice.

## H&S COMMITTEE COMPOSITION AND MEETINGS

All Board members are attendees and served throughout the year, with support from the Chief People Officer and Pennon's H&S Director.

Membership	Position	Attendance
Jon Butterworth	Chair	4/4
Gill Rider	Non-Executive Director	4/4
Susan Davy	Chief Executive Officer	4/4
Claire Ighodaro	Non-Executive Director	4/4
Neil Cooper	Non-Executive Director	4/4
Iain Evans	Non-Executive Director	4/4
Paul Boote	Pennon Group Finance Director	4/4

## MATTERS CONSIDERED BY THE COMMITTEE DURING THE YEAR

During the year, the Committee considered a wide range of matters in the course of fulfilling its duties in accordance with its terms of reference:

- Six monthly comprehensive reviews of the Company's Health & Safety performance
- A review of the next phase of the HomeSafe strategy through to 2025
- A deep dive into the wellbeing strategy with a focus on mental health
- A review and challenge of potential near miss events to ensure lessons are learnt
- Visiting operational sites to engage with front line staff and the wider Health and Safety teams

## **REPORTING**

In addition to the regular board report by the Chief Executive Officer, detailed performance is reviewed six monthly, focusing on performance, benchmarking, and lead activities such as leadership and engagement, hazard rectification, asset health and working environment. The corresponding improvements in outcome metrics has been noted, with the actual number of LTI's reducing consistently across the period, with a 24% reduction in the year.

The HomeSafe strategy has been reviewed for the next 3 years, to support significant year on year reductions required in injury rates. The committee will continue to review and challenge plans and performance to support our HomeSafe ambitions, with a detailed roadmap to 2025 built on six key pillars.

## **HOMESAFE STRATEGY**

The Company's flagship health and safety programme, HomeSafe, continues to provide the framework for driving significant improvements in all health and safety activities and impacts. HomeSafe is built on the six strategic pillars; Managing Risk, Sharing & Learning, Working Together, Protecting Health, Enabling Leaders and Being Resilient.

# REMUNERATION COMMITTEE REPORT

## ENSURING EXECUTIVE REWARD SUPPORTS RESILIENT PERFORMANCE, SUSTAINABLE GROWTH AND THE STEP CHANGE NEEDED IN ENVIRONMENTAL OUTCOMES FOR THE BENEFIT FOR ALL

Delivering on our latest environmental investment in fifteen years, as well as achieving 100% coastal bathing water quality for the first time, we acknowledge there is more to do to protect our environment, and our rivers and coastal waters. Our pollutions reduction plan has achieved our best performance for ten years, reducing pollutions by one third. However it's not yet where we need to be and there is more to do. And in line with our planned trajectory to achieve EPA 4 star status by 2024 we recognise there is much more to continue to focus on. We have therefore reflected this in the annual bonus revised outturns, applying downward discretion.

In a year when rising living costs are front of mind, South West Water announced average bill reductions for 2022, lower now than ten years ago, as well as unlocking over £18 million of affordability support and expanding the number of customers on social tariffs.

We are reporting resilient performance, thanks to the hard work and commitment of our teams. South West Water is on track or ahead of ODI delivery.

A key focus for the Company has been to continue to support colleagues during the pandemic, including a commitment to provide full pay during periods of illness or self-isolation. In addition, following a comprehensive review of our wellbeing strategy, a rounded package of measures, designed to support both the physical and mental wellbeing of our colleagues was introduced.

The continued implementation of our reward strategy means that employees now have greater flexibility in the benefits that matter to them most, with a more dynamic and flexible approach to pension arrangements and the ability to buy and sell holiday. During the year, we held a number of employee reward focus groups as part of engaging colleagues to help inform our 2021/22 pay award decision, and more can be read on page 24. Importantly, to recognise and reward colleagues for their ongoing support and dedication to our customers, the 2021 employee bonus was significantly enhanced. In addition, our parent company, Pennon became a Living Wage Foundation accredited employer.

We continue to promote the benefits of employee share ownership with 51.1% of our colleagues participating in HMRC approved schemes.

## REMUNERATION COMMITTEE COMPOSITION AND MEETINGS

The Remuneration Committee met three times during the year to fulfil the duties set out in its terms of reference. Members of the Committee and their attendance were as follows:

Membership	Position	Attendance
Claire Ighodaro	Chair	4/4
Gill Rider	Chair of Pennon Board	4/4
Neil Cooper	Non-Executive Director	4/4
Iain Evans	Non-Executive Director	4/4
Jon Butterworth	Non-Executive Director	4/4

All Committee members served throughout the year.

In accordance with the Code, all of the Committee members are independent Non-Executive Directors. The Chief Executive Officer also attends meetings when invited except for such part of a meeting when matters concerning her own remuneration are to be discussed.

The Committee is advised by Deloitte, an independent remuneration consultant, to ensure remuneration is determined impartially. Aside from the provision of tax services to the Group, Deloitte has no other connection with the Company or any Director. The Committee is also supported by the Group Chief People Officer and the Group General Counsel and Company Secretary.

#### *PERFORMANCE METRICS FOR INCENTIVES*

No changes were made to the incentive arrangements for the South West Water Finance Director, with environmental and customer measures remaining at 70% of the bonus weighting.

The performance measures for the annual bonus for the Group Chief Executive Officer were reviewed and simplified. Operational objectives, including pollutions and bathing water quality were upweighted with personal objectives removed and replaced with a scorecard of ESG goals weighted to 20%. The financial measures were weighted to 50%.

Modest changes were made to the financial measures shifting from RoCE to RoRE and the introduction of a basket of customer experience metrics. The RoRE targets were set taking into account the parameters set by Ofwat for the 2020 to 2025 review cycle. Inclusion of customer experience measures aligns with the expectations and demands of Ofwat and trends in the water sector. The aspirational objectives target a market leading position. Investor feedback to the changes were generally positive.

#### **INCENTIVE OUTCOMES**

In line with normal practice, the Committee reviewed annual bonus outcomes from various perspectives, including the impact of macroeconomics on final results. The Committee opted against making any adjustment to the original targets. Therefore, no payment was made under the profit element of the annual bonus.

Robust performance was delivered across a range of operational, customer and ESG elements of the bonus scorecard. Despite delivering on our largest environmental investment in fifteen years, as well as achieving 100% coastal bathing water quality for the first time, we acknowledge there is more to do to protect our environment and our rivers and coastal waters. Although the EPA score was reflected in the formulaic outcome, the Committee opted to exercise downward discretion to reduce the formulaic result by a further 10% of the overall bonus outcome.

The net impact of the above decisions was that the bonus outcome for the year was 31% of maximum for the Group Chief Executive Officer and 36% for the South West Water Finance Director. Although the business has outperformed in a number of regards, arguably warranting a higher bonus outcome for the year, the Committee concluded that it was appropriate to cap outcomes at this level.

Share awards granted under the long-term incentive plan (LTIP) in 2019 will be eligible for vesting in 2022. This award was made prior to the sale of Viridor for £3.7bn in net cash proceeds in 2020 and adjusted to reflect the changing Group structure. This award was based on EPS growth (40%), dividend growth and cover (40%) and



RoCE (20%), as well as an 'underpin' evaluation, including consideration of safety, ESG factors and financial performance.

Awards are expected to vest at 88.2% of maximum as shown on page 149. This level of vesting is reflective of performance over the three year performance period. The Committee is satisfied that the outcomes are fully warranted based on performance. Vested shares for Executive Directors will remain subject to an additional two-year holding period.

#### **POLICY REVIEW**

No major changes in approach are proposed for the coming year and the policy continues to operate as intended. During the course of 2022/23 a key focus will be reviewing the policy, to ensure it continues to align with the strategy, takes account of best practice, including consulting with shareholders ahead of seeking approval at the 2023 AGM. Further detail on pay arrangements is provided in the main body of the remuneration report and in the Pennon annual report.

#### **COMMITTEES FOCUS FOR 2022/23**

- Consider the remuneration and terms of engagement of the Executive Directors, senior executives and Chair of the Company and the remuneration of the wider workforce.
- Determine targets that remain stretching, relevant to the Company's strategy and values and reflect best practice and wider stakeholders' views.
- Undertake the review of the remuneration policy, taking into consideration the Company's strategic goals, stakeholders views, regulatory commitments and evolving best practice.

# DIRECTORS' REMUNERATION REPORT

## OUR STRATEGY



### REMUNERATION ALIGNED TO DELIVERY FOR OUR CUSTOMERS

Significant portion of executive remuneration is linked to performance:

- Incentive linked to underlying performance
- Performance pay – appropriately aligned with customer interests with bonus and LTIs having a substantial link to stretching performance delivery for customers
- Focus on customer and operational metrics assessed by Ofwat, our customer, communities, and wider stakeholders
- Incentives designed to motivate delivery of sustainable performance
- Safeguard mechanisms in place to ensure outcomes reflect underlying performance.

# ANNUAL REPORT ON REMUNERATION

## SUMMARY OF DIRECTORS' REMUNERATION POLICY AND IMPLEMENTATION IN 2022/23

The Pennon Group's remuneration policy was approved by shareholders at the Company's AGM held on 22 July 2020. The full policy is displayed in its entirety on the Company's website at [www.pennon-group.co.uk/about-us/governance-and-remuneration](http://www.pennon-group.co.uk/about-us/governance-and-remuneration) and is available upon request from the Group Company Secretary. A summary of the policy is set out below alongside detail on how we intend to implement the policy in 2022/23.

Susan Davy is Chief Executive Officer of South West Water and Pennon Group plc. Her remuneration is based on a combination of financial and customer / operational metrics relating to South West Water Limited as well as additional metrics relating to the performance of Pennon Group and other Pennon Group companies in her capacity as Chief Executive Officer of Pennon Group:

Pennon Plc

Pennon Water Services

South West Water

Bournemouth Water

Bristol Water

Water2business (30% stake)

The Group Chief Executive Officer's remuneration has therefore been apportioned as

- South West Water 50%
- Bristol Water 20%
- Pennon Water Services 5%

As the Group Chief Executive Officer of a publicly listed company, Susan Davy's remuneration must be set in accordance with the Pennon Group Remuneration Policy, approved by shareholders, at yearly AGMs. For 2021/22, the Group level was based on a combination of financial metrics (50% weighting), customer and operational metrics (30% weighting) and ESG metrics (20% weighting). ESG metrics were introduced as a direct replacement for personal objectives in line with best practise and the Corporate Governance Code.

The multi-faceted role of a Group CEO – in particular for a group which has a number of distinct and independent business activities – along with the components that make up remuneration for that role mean that the performance metrics of the annual bonus apply in different proportions to the relevant businesses.

For example, in 2021/22, a significant part of Susan Davy's activities as Group CEO were focussed on the successful execution of the acquisition of Bristol Water, and phase one clearance with the CMA and with it the focus on additional shareholder value for Pennon Group shareholders created by that transaction (and therefore a disproportionate part of the financial performance metrics in the overall bonus would be related to wider Pennon Group activity either related to activities for Pennon Group or Pennon Water Services Limited, but in any case unrelated to South West Water or Bristol Water).

In relation to customer and operation metrics (including measures relating to customer service scores, bathing water failures, leakage and wastewater pollution incidents, interruptions to supply and asset reliability) and ESG (including targets relating to carbon emission reduction goals, the working environment for our employees and diversity) are significantly, or in some cases exclusively, weighted towards the performance of the South West Water and (following its acquisition) the Bristol Water businesses.

The Company recognises the important focus placed by the regulator on customer and environmental outcomes. When assessed in the reasonable manner as described above, the Group considers that the element of group remuneration for Susan Davy as it relates to the regulated business activities carried on by South West Water and Bristol Water is in accordance with Ofwat 'best practice' of 60% of annual variable remuneration being linked to positive customer outcomes.

Full details of the Group Chief Executive Officer's remuneration can be found on pages 160 to 180 of the Pennon Group Annual Report 2022.

Element	Operation	Implementation in 2022/23
<b>Base Salary</b>		
Set at a competitive level to attract and retain high calibre people to meet the Company's strategic objectives in an increasingly complex business environment.	Salaries are generally reviewed annually, and any changes are normally effective from 1 April each year. In normal circumstances, salary increases will not be materially different to general employee pay increases.	<p>The Finance Director received an increase of 4.6%, effective from 1 April 2022:</p> <p>Finance Director<sup>(1)</sup> – £180,269            Group Chief Executive Officer<sup>(2)</sup> – £475,000</p> <ol style="list-style-type: none"> <li>An increase of 1% was reported in the 2020/21 annual report for the Finance Director. The final pay settlement agreed in November 2021 for all colleagues was 2% increasing the pay for the FD to £172,341.</li> <li>The Group Chief Executive Officer was awarded an increase of 3% for 2022/23, which she respectfully declined.</li> </ol>
<b>Benefits</b>		
Benefits provided are consistent with the market and level of seniority to aid retention of key skills to assist in meeting strategic objectives.	Benefits currently include the provision of a Company vehicle, fuel, health insurance, income protection and life assurance. Other benefits may be provided if the Committee considers it appropriate.	Benefits remain unchanged for 2022.
<b>Pension-related benefits</b>		
Provides funding for retirement and aids retention of key skills to assist in meeting the Company's strategic objectives.	The maximum annual pension contribution or cash allowance is in line with the contribution available to the wider population.	The Chief Executive Officer receives benefit of 10% of salary, which is aligned with the maximum rate available to the wider workforce. The Finance Director receives benefits of 15% of salary.
<b>Annual bonus</b>		
Incentivises the achievement of key performance objectives aligned to the strategy of the Company.	<p>The maximum bonus potential is 125% of salary.</p> <p>A portion of any bonus is deferred into shares in the Company which are normally released after three years. Normally 50% is deferred. Malus and clawback provisions apply.</p>	<p>Maximum opportunity of 75% of salary for the Finance Director and 125% for the Group Chief Executive Officer. Deferral of 50% of any bonus into shares for three years.</p> <p>For the Finance Director, customer and operational measures and ESG measures will account for 70% of the bonus weighting</p> <p>The annual bonus for 2022/23 will be based on a combination of customer and operational measures, financial measures and environmental, social and governance measures (ESG).</p> <p>Given the planned merger of SWW and BRW, consideration will also be given to the appropriate bonus construct for the combined water business in consultation with wider stakeholders.</p>

### Long-Term Incentive Plan (LTIP)

<p>Provides alignment to the achievement of the Company's strategic objectives and the delivery of sustainable long-term value.</p>	<p>Annual grant of conditional shares (or equivalent). Share awards vest subject to the achievement of specific performance conditions measured over no less than three years. In addition, a two-year holding period will apply in respect of any shares which vest at the end of the three-year performance period.</p> <p>An underpin applies which allows the Committee to reduce or withhold vesting if the Committee is not satisfied with the underlying operational and economic performance of the Company. Malus and clawback provisions apply.</p>	<p>Maximum award of 80% of salary for the Finance Director and 150% for the Group Chief Executive Officer.</p> <p>The 2022 LTIP award for the Finance Director will be unchanged and based on:</p> <ul style="list-style-type: none"> <li>• 1/3 Return on Regulated Equity (RoRE) – measure based on outperforming the Final Determination (FD) year on year metric</li> <li>• 1/3 sustainable dividend measures (Pennon)</li> <li>• 1/3 C-MeX/D-MeX (median moving to upper quartile)</li> </ul> <p>The performance targets for 2022 LTIP grants for the Chief Executive Officer can be read in the Pennon Group Annual Report on page 164.</p>
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#### Discretion

In line with the 2018 Corporate Governance Code, the Remuneration Committee has ensured that it will maintain the ability to override the formulaic outcomes for future awards under the annual bonus and LTIP where the outcomes are not considered by the Committee to be appropriate (e.g., unreflective of underlying performance). The Committee will disclose the use of any such discretion.

### Shareholding requirements

<p>Create alignment between executives and shareholder and promote long-term stewardship</p>	<p>During the course of their tenure, Executive Directors are expected to build up a shareholding equivalent to a percentage of salary.</p>	<p>Shareholding guideline of 100% of salary for the Finance Director and 200% of salary for the Chief Executive Officer</p>
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### All-employees share plans

<p>Align the interests of all employees with Company share performance.</p>	<p>Executive Directors may participate in HMRC approved all-employee plans on the same basis as employees.</p> <p>The maximum is as prescribed under the relevant HMRC legislation governing the plans.</p>	<p>No changes.</p>
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## Non-Executive Director fee policy

<p>Set at a market level to attract Non-Executive Directors who have appropriate experience and skills to assist in determining the Group's strategy.</p>	<p>Non-Executive Directors normally receive a basic fee and an additional fee for any specific Board responsibility such as Chair of a Committee or occupying the role of Senior Independent Director.</p> <p>Expenses incurred in the performance of non-executive duties for the Company may be reimbursed or paid for directly by the Company (including any tax due on the expenses). The Chair's benefits include the provision of a driver and vehicle, when appropriate for the efficient carrying out of her duties.</p> <p>The Non-Executive Directors' fees are set by Pennon Group plc and 50% of these fees are recharged to South West Water through Group recharges. The fee structure was amended in 2020.</p>	<p>A 3% uplift to the fee policy will be implemented in 2022/23 as shown below:</p> <p>Chair fee £115,875 Basic Non-Executive fee £31,183</p> <p><b>Additional fees</b> Senior Independent Director £5,150 Chair of Audit Committee £7,725 Chair of Remuneration Committee £6,700 Chair of ESG Committee £6,700 Chair of Health and Safety Committee £2,575</p>
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### REMUNERATION APPROACH FOR WIDER EMPLOYEES

Consistent with best practice, the Remuneration Committee spends considerable time on matters relating to remuneration arrangements across the wider workforce. This provides important context when making decisions regarding remuneration for the Executive Directors as well as ensuring that consistent approaches are being adopted across the organisation.

To provide greater transparency of remuneration for the wider workforce we have provided expanded disclosure. The Remuneration Committee is kept informed of wider workforce remuneration through the Pennon Group Pay Dashboard, which incorporates South West Water and is reviewed twice a year. This has evolved during 2021/22 to provide oversight of how the Reward Strategy is being implemented and more insight to colleague remuneration.

Our well-established People Strategy across the Group is centred around talented people doing great things for customers and each other and creating the best place to work. Responsible and trusted businesses today have a duty to make a positive societal contribution – whether that's through promoting social mobility, addressing racial and gender inequality, or in providing secure and meaningful employment where all employees are paid fairly for the work they do.

During 2020 a specific Reward Strategy was created for the Group to complement the People Strategy. The Reward Strategy had three aims:

- To deliver a broad reward package to engage and motivate employees to want to perform at their best
- To ensure that reward decisions support business delivery and promote long-term wealth creation, in line with our People Strategy and values
- To communicate to stakeholders our approach to rewarding and recognising employees and their contribution

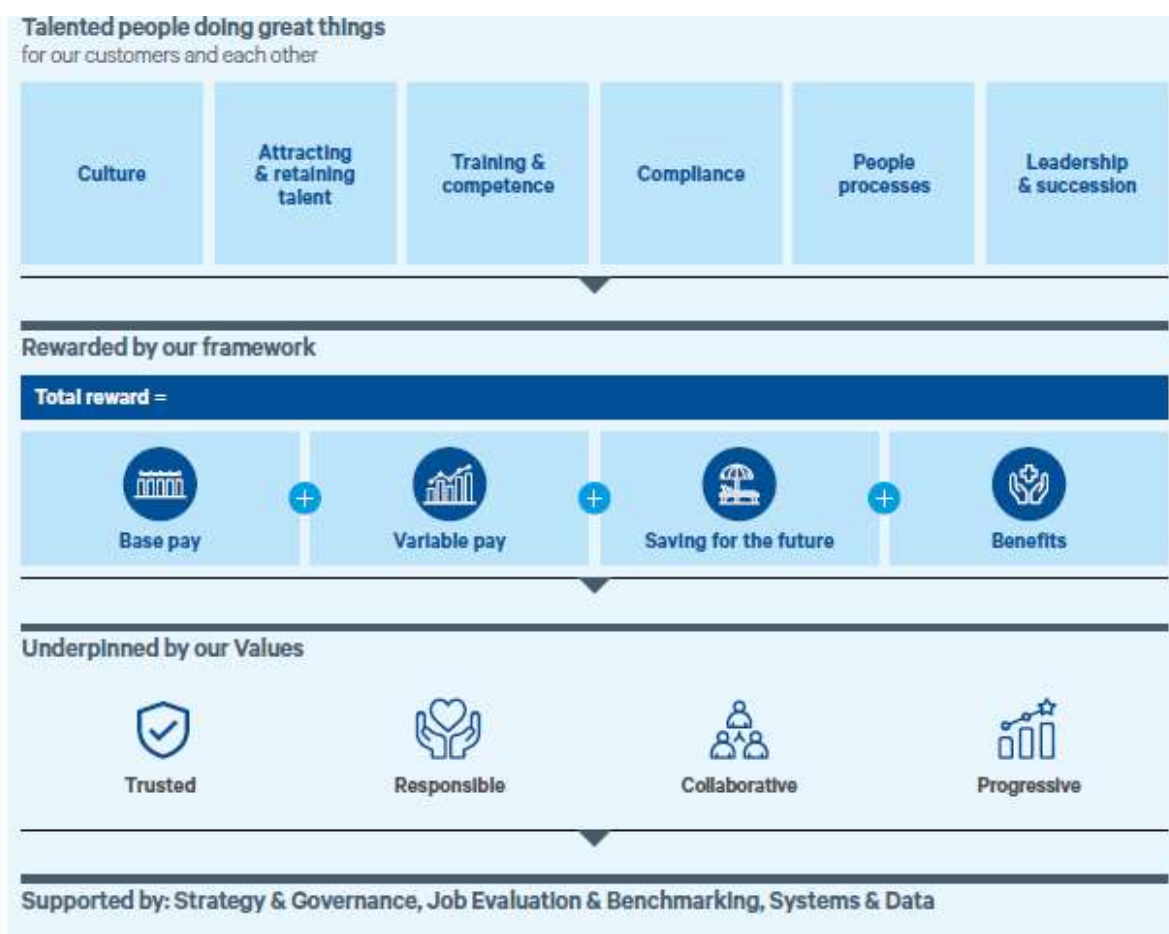
A critical aspect of the design work was in understanding employees' view of reward, the benefits most valued and what aspects could be improved. Listening sessions and focus groups were held during this process as well as incorporating themes from the engagement survey.

The Reward framework is centred around four key pillars which build into a Total Reward proposition, ensuring a mix for employees at every stage of their career lifecycle.

The framework was reviewed and endorsed by the Pennon People Committee and Remuneration Committee and the success of the strategy measured through the engagement survey and colleagues' feedback. This is regularly reviewed and shared with the Remuneration Committee.

## REWARD FRAMEWORK

Our reward framework supports our people strategy.



Pillar	Progress
<p><b>Base pay</b></p>	<p>Importantly, the Pennon Group (including South West Water) has formalised its approach to adopting the Living Wage Foundation standards by becoming an accredited employer in April 2021.</p> <p>The Group's overarching principles for basic pay are that it should:</p> <ul style="list-style-type: none"> <li>• Be competitive to support attraction and retention</li> <li>• Be fair, meeting all legislative requirements</li> <li>• Reflect the market and region in which the role operates</li> </ul>

Pillar	Progress
	<ul style="list-style-type: none"> <li>• Be reviewed annually – we engage with employee forums and trades unions as appropriate.</li> </ul> <p>Employee feedback on the 2021 pay increase was sought during the pay discussions through a series of focus groups alongside the traditional negotiations with the trades unions. The feedback was influential in setting reward priorities for the year as well as an increase pay settlement in 2021. The pay settlement for 2022 is 5% for employees and 4.6% for the South West Water Finance Director. The Group Chief Executive Officer respectfully declined her award of 3%. During the first quarter of 2022, we have implemented changes in our base pay for many of our lower paid roles, lifting the minimum hourly rate further above the Living Wage Foundation rate by circa 6%. This supports our reward strategy and our focus on building the reward for our wider workforce, particularly those who operate in essential customer facing roles.</p>
<b>Variable pay</b>	<p>The Company operates a number of variable pay schemes and all employees and temporary workers are eligible to participate. Throughout the main bonus schemes, there is strong correlation in the targets, to align the whole organisation on customer, quality, service and ESG goals.</p> <p>All employees in South West Water are entitled to participate in annual bonus arrangements. The maximum bonus levels are based on seniority and level of responsibility.</p> <p>In July 2021, we applied positive discretion to the annual bonus for colleagues below leadership paying at an enhanced level in recognition of the dedication colleagues have continued to show in delivering our essential services to our customers, during the pandemic.</p> <p>From 2021, colleagues below senior management in South West Water have had their bonus opportunity increase, bringing the opportunity to receive a greater share of company success. Local incentives are also paid to drive specific operational targets.</p>
<b>Saving for the future</b>	<p>Membership of the Group pensions scheme remains strong with c.95% participation rate in our Defined Contribution (DC) scheme. Within the scheme a great number of employees access the full 10% employer contribution available. During 2022 we have increased flexibility to adjust contributions during the year providing the opportunity for colleagues to build on their pension savings as and when they have additional funds to do so.</p> <p>As part of our Saving for the future, all employees are able to participate in our HMRC approved ShareSave and Share Incentive Plan, with a strong emphasis on employee buy-in and ownership. We continue to have strong take-up of this benefit with c.51% of South West Water colleagues having an in-flight scheme during 2021/22. Following shareholder approval at a General Meeting on 5 July 2021, Pennon's share capital was consolidated into shares of 61.05p each on a 3:2 basis, reducing direct holdings by one third. Shareholders received a special dividend of £3.55 per share on 16 July as a return of capital. As many employees are currently participating in an in-flight ShareSave and Share Incentive Plan arrangements as well as those who are an employee shareholder, we felt it important that we provided employees with an understand of the rationale for these transactions, what it meant for their share interests and reassurance for their in-flight schemes. Dedicated web pages, literature and booklets were created and the Group Finance Director chaired focus meetings to explain the details, impact for tax and to hold Q&amp;A sessions. These were well attended with over 300 employees accessing a session and</p>



Pillar	Progress
	<p>many more receiving 1:1 response to individual questions.</p> <p>Not only do our share schemes provide a mechanism for sharing in the long term success of the Group but they mean that colleagues have a say and stake in the business.</p> <p>We will continue to run the popular ShareSave in 2022 with the maximum discount permitted.</p>
<b>Benefits</b>	<p>The fourth pillar of our framework covers the benefits available to employees. During 2021, a number of additional benefits were implemented to support employees' physical and mental wellbeing in line with our reward strategy and in response to the challenging environment the pandemic has brought.</p> <ul style="list-style-type: none"> <li>• We have launched an online health programme providing self-assessment and guidance for a healthy life plan</li> <li>• Total reward statements are now available through our online Reward Hub</li> <li>• We have implemented our buy and sell holiday scheme giving employees the opportunity to either have more holiday to suit their lifestyle or have more cash reward to use as they prefer.</li> <li>• Building on our wellbeing offering has been a particular focus for 2021. There are now nine colleague-led wellbeing support groups in place, bringing those with shared experiences and characteristics together to support and learn from one another. We also positive support colleague attendance to our Time to Talk sessions with wellbeing experts. This is a key focus for our leadership calls, so they have the skills to support their teams.</li> </ul>

## PENNON GROUP PAY DASHBOARD

In accordance with the 2018 UK Corporate Governance Code, the Committee has also reviewed the level of information provided on pay matters in the wider organisation. Key activity in this regard included the Pennon Group pay dashboard:

- The Pennon Group (incorporating South West Water) has established a pay dashboard to help support the Committee in reviewing workforce remuneration and related policies and this has been developed to provide greater insight for 2022
- The dashboard provides an overview of pay arrangements across the business and provides key statistics on pay in different areas of the business and progress on our planned framework implementation
- The dashboard covers information on workforce demographics, employee engagement, gender pay, pay ratios, pension and benefits and incentive outcomes in different areas of the business
- The Committee intends to keep the content of the dashboard under review to ensure that it continues to provide suitable information for the Committee.

## GENDER PAY GAP

South West Water's gender pay gap stood at 6.7% for 2021. During 2021, we recognised colleagues' loyalty and dedication to customers with an additional discretionary bonus. This was not subjected to pro-rating for part-time employees and has contributed to the negative mean bonus pay gap of -28.4%. The Company continues to build on the pipeline to improve gender alignment in middle manager and senior positions and is seeing strong progress in this area. We have been delighted with the successful recruitment of our female graduates and apprentices who will bring diverse thinking to our operations. We remain an active supporter of the Women in Water Initiative.

During the year Pennon Group has been recognised in gender equality by external bodies. South West Water is the largest employer within the Group, and so makes a valuable contribution to these results. In early 2022, Pennon was recognised in the FTSE Women Leaders report (previously the Hampton Alexander survey). Pennon was placed 1st in the Utilities sector, placed 10th overall in the FTSE 250 group compared with 23rd in 2021, and

positioned 16th as a Best Workplace for women. Our performance in the Bloomberg Gender Equality Index also showed improvement. The index measures gender equality across five key areas. The report showed the Group had built on its performance in 2021 with an overall score of 64.87% up from 59.9% in 2021. Within the European Women in Boards survey, our ranking within the UK improved to 41st up from 44th in 2021.

### *EMPLOYEE ENGAGEMENT*

Across Pennon we endorse the principle of strengthening opportunities for employees to engage in two-way dialogue at all levels. We have launched our new people panel RISE, replacing the South West Water Employee Engagement Forum. We are very excited that the new panel will build on the solid foundations to extend open, two-way communication between senior managers and our people. Colleagues have been invited to RISE to the challenge as one of 50 representatives with over 70 applications to stand in this capacity. This group will be a key source of dialogue and employee views for shaping future reward developments.

We have been keen to ensure we are able to reflect on feedback we receive from employees. This year, we were pleased to see the high participation rate continue with a response rate of 85% in our annual engagement survey. As a Group we maintain our accreditation as a Great Place to Work. We have welcomed the feedback that has been provided through these routes and employees' openness in participating in these activities.

### *LOOKING AHEAD*

We will be awarding our highest employee pay award, for recent years of 5% in 2022, as we support employees during the current financial challenges of high inflation and additional National Insurance contributions. For 2022/23 we will continue to review and refine our approach to reward, continuing our development of the roll out of Total Reward Statements in the summer and enhancing our recognition platform and launch of the discount portal. We will be working to ensure our core proposition for our family friendly policies remain relevant and attractive to colleagues.

## SINGLE TOTAL FIGURE OF REMUNERATION TABLES (AUDITED INFORMATION)

	Louise Rowe (£000)		Susan Davy <sup>(1)</sup> (£000)	
	2021/22	2020/21	2021/22	2020/21
<b>Base salary</b>	172	169	238	228
<b>Benefits<sup>(3)</sup></b> (including Sharesave)	18	18	15	15
<b>Pension-related benefits<sup>(4)</sup></b>	26	26	28	40
<b>Total fixed pay</b>	<b>216</b>	<b>213</b>	<b>280</b>	<b>283</b>
<b>Annual bonus</b> (cash and deferred shares)	47	53	91	219
<b>Long-Term Incentive Plan<sup>(2,5)</sup></b>	186	200	431	464
<b>Total variable pay</b>	<b>233</b>	<b>253</b>	<b>522</b>	<b>683</b>
<b>Total remuneration</b>	<b>449</b>	<b>466</b>	<b>802</b>	<b>966</b>

- (1) Susan Davy was appointed as Chief Executive Officer of Pennon Group plc and South West Water as of 31 July 2020. The figures provided reflect 50% of her remuneration, which is rechargeable to SWW through Group recharges. Reflecting the nature of Susan's position as Chief Executive of the Group, all subsidiaries receive a cross-charge. The full single total figure of remuneration tables are shown on page 169 of the Pennon Group plc Annual Report and Accounts 2021.
- (2) For 2021/22 the 2019 LTIP has been valued based on the average share price during the three-month period to 31 March 2022 of 1063.96 pence and a vesting outcome of 88.2%, as referred to on page 149, together with an estimate of the accrued dividends payable on the vesting shares. Of the vested amount, 29.25% relates to share price appreciation over the performance period.
- (3) Benefits comprise a car allowance, fuel allowance and medical insurance.
- (4) See page 149 for further information.
- (5) For 2020/21, the 2018 LTIP has been valued based using the share price at the date of vesting of 1176.98 pence and a vesting outcome of 89.9%, together with the value of the accrued dividends payable on the vesting shares. The 2019/20 LTIP value for 2017/18 reflects the share price at the date of vesting of 1,008.5p, a vesting outcome of 86.6%. The Committee did not exercise any discretion in relation to share price changes. Both LTIP awards are subject to a two-year holding period.

## NOTES TO THE SINGLE FIGURE TABLE

### FIXED PAY

The Remuneration Committee recognises the market positioning against FTSE peers and intends to keep salary levels for both Executive Directors under review in future years, to ensure that they suitably reflect both development and experience in the role and the evolving size and nature of the Group's operations.

The Finance Director continues to receive 15% of salary. Retirement benefit for the Chief Executive Officer were set at 10% of salary on appointment in 2020. This is aligned to the rate of the wider workforce. Previously, Susan received an overall pension benefit of 25% of salary. Further detail on pension arrangements is set out in the Pennon Group Annual Report on page 172.

### ANNUAL BONUS OUTTURN FOR 2021/22

#### LOUISE ROWE

For 2021/22, the Finance Director participated in the annual bonus plan which was based on a combination of operational and ESG measures, which were weighted to 70% of the bonus. Financial targets accounted for the remaining 30%.

In line with the Committee's policy, 50% of any bonus is payable in shares, the release of which is deferred for a three-year restricted period. The performance targets set, and performance achieved have been set out below:

*South West Water Annual bonus scheme measures*

Financial	Target	Actual	Range	Bonus outturn (% of max)
PBT	£155.0m	£137.5m	-2% - + 5%	0%
Net Debt	£2,204.3m	£2,305.2m	-2% - + 5%	0%

Service and Customer Service Metrics	Target	Actual	Achieved	Bonus outturn
Bathing water quality improvements	2 Cumulative	8 Cumulative	Yes	44%
Wastewater pollution incidents, per 10,000km sewer	23.74	86.58	No	
Internal Sewer Flooding no./10k connections	1.63	0.76	Yes	
Sewer Collapses per 1000km	16.27	6.72	Yes	
Leakage (3 year rolling average) Megalitres per day	116.7	116.7	Yes	
Environment Agency EPA*	3 star	1/2 star	No	
CRI (water quality score)*	2	3.86	No	
Interruptions to supply per property	6 mins 08 seconds	6 mins 47 seconds	No	
C-Mex	Median (9 <sup>th</sup> )	12 <sup>th</sup>	No	

\*Subject to Regulator confirmation in July

ESG metrics	Target	Actual	Achieved	Bonus outturn
Reduce carbon emissions in support of our strategy to meet net zero by 2030	3% reduction	4%	Yes	89%
Increase renewable generation	10%	8%	No	
Reduce onsite water usage	6MI/d	6MI/d	Yes	
Great Place to Work Accreditation	Maintain	Maintained	Yes	
Reduce lost time injuries	23 LTIs (18% reduction)	22 (24% reduction)	Yes	
Achieve FTSE Women Leaders rating (previously Hampton Alexander survey)	23 <sup>rd</sup>	10 <sup>th</sup>	Yes	
Achieve a Sustainalytics ESG	75	78	Yes	
New debt through Sustainable Financing Framework	50%	100%	Yes	
Fair Tax Accreditation	Maintain	Maintained	Yes	

**SUMMARY OF BONUS OUTCOME**

When reviewing performance in the year, the Committee noted there have been strong improvements in our pollutions record and the achievement of 100% coastal bathing water quality, in a year which continued to be challenged by the pandemic.

Given it will take time to achieve 4 star EPA score, with a planned trajectory to 2024, we have reflected on this. Although the EPA score was already reflected in the formulaic scorecard, the Group Chief Executive Officer agreed with the Committee to exercise downward discretion to reduce the formulaic result by a further 10% of the overall bonus outcome.

	Weighting	Bonus outturn
		Finance Director
South West Water financial measure	30%	0%
South West Water service measures	50%	22.2%
Group ESG measures	20%	17.8%
Downward Discretion		(4.0%)
<b>Total outturn</b>	<b>100%</b>	<b>36.0%</b>

### LONG-TERM INCENTIVE OUTTURN FOR 2021/22

The LTIP targets for the South West Water Executive were reviewed for the 2020 and subsequent awards as shown in the policy table on page 141.

The awards in the single figure table relate to the awards granted on 4 July 2019, which are due to vest on 3 July 2022. These share awards were subject to Pennon performance targets previously set as relating to Earnings per Share, a sustainable dividend measure and Return on Capital Employed (RoCE).

Full details can be read in the Pennon Group Annual Report.

		Threshold (25% of maximum vests) <sup>(2)</sup>	Maximum (100% of maximum vests)	Achievement <sup>(3)</sup>	Vesting outcome (% of max)
EPS growth (40% of award)	Combined Group (Period to FY20)	57.2p	61.6p	61.7p	100%
	Continuing Group (Period to FY21)	45.3p	47.0p	50.2p	
Sustainable dividend measure (dividend growth and dividend cover) (40% of award)	Combined Group (Period to FY20)	2.6x	3.6x	3.2x	87.5%
	Continuing Group (Period to FY21)			3.8x	
RoCE (average) <sup>(1)</sup> (20% of award)	Combined Group (Period to FY20)	8%	10%	9.5%	65.9%
	Continuing Group (Period to FY21)			8.8%	
<b>Total</b>					<b>88.2%</b>

<sup>(1)</sup> Average of opening and closing capital employed

<sup>(2)</sup> For below threshold performance for any of the performance conditions, 0% vests in respect of that performance condition

<sup>(3)</sup> Straight-line vesting between points.

Vesting of the award is subject to an 'underpin' relating to overall Company performance. The Committee has determined, to the date of this report, that this underpin has been satisfied.

### RETIREMENT BENEFITS AND ENTITLEMENTS (AUDITED INFORMATION)

Details of Directors' pension entitlements and pension related benefits during the year are as follows. Effective 1 August 2021, the maximum pension contribution made by the Company to newly appointed Directors is 10% of salary:

	Value of defined benefit pension <sup>(2)</sup>	Contributions to defined contribution arrangements (£000)	Cash allowances in lieu of pension (£000)	Total value for the year	Normal retirement age and date (for pension purposes)	Accrued pension at 31 March 2022 <sup>(4)</sup>
Louise Rowe <sup>(1)</sup>	-	2	24	26	65 (15 January 2047)	-
Susan Davy <sup>(3)</sup>	12	3	40	55	65 (17 May 2034)	30

- (1) Louise Rowe is a member of Pennon Group's defined contribution arrangement and received an overall pension benefit from the Company equivalent to 15% of her salary.
- (2) The value of the defined benefit pension accrued over the period comprises the total pension input amount (which has been calculated in line with regulatory requirements) less the pension contributions paid by the Director.
- (3) Susan Davy received an overall pension benefit from the Company equivalent to 10% of her salary. For 2021/22 this comprised an employer's contribution of £11,737 and a cash sum of £40,353. She is a member of Pennon Group's defined contribution pension arrangements and is entitled to access the retirement fund in the Master Trust from age 55. Accrual in the defined benefit scheme ceased from 1 July 2021.
- (4) Accrued pension is based on service to the year-end final pensionable salary at that date.

## NON-EXECUTIVE DIRECTORS' REMUNERATION

### SINGLE FIGURE OF REMUNERATION (AUDITED)

	2021/22			2020/21		
	Fees <sup>(1)</sup> (£000)	Taxable benefits (£000)	Total fees (£000)	Fees (£000)	Taxable benefits (£000)	Total fees (£000)
Gill Rider	113	-	113	88	-	88
Neil Cooper	43	-	43	40	-	40
Iain Evans	37	-	37	37	-	37
Claire Ighodaro	37	-	37	34	-	34
Jon Butterworth	33	-	33	39	-	39

(1) 50% of fees are recharged through Pennon Group plc

### NON-EXECUTIVE DIRECTORS' FEES AND BENEFITS

The fee for the Chair and Non-Executive Directors were increased by 3% from 1 April 2022. No increases were accepted by any member of the Board in 2021. When appropriate for the efficient carrying out of her duties the Chair is provided with a driver and a vehicle. She is entitled to expenses on the same basis as for other Non-Executive Directors.

The fee structure is set out in full on page 142.

### DIRECTORS' SERVICE CONTRACTS AND LETTERS OF APPOINTMENT

The dates of Directors' service contracts and letters of appointment and details of the unexpired term are shown below:

Executive Directors	Date of Appointment	Notice Period
Louise Rowe	1 February 2015	12 months
Susan Davy <sup>(2)</sup>	31 July 2020	12 months
Non-Executive Directors	Date of Appointment	Expiry date of Appointment
Gill Rider <sup>(1)</sup>	1 April 2016	31 August 2024 <sup>(1)</sup>
Neil Cooper	1 April 2016	31 August 2023
Iain Evans	31 July 2020	31 August 2024
Claire Ighodaro	31 July 2020	31 August 2022
Jon Butterworth	28 September 2017	31 July 2023

(1) Gill Rider was appointed as Chair of the Board as of 31 July 2020 and as such is providing ongoing strategic support and continuity of the Board for up to three years.

(2) Susan Davy held a previous service contract dated 1 February 2015 in respect of her appointment as Chief Financial Officer, Pennon.

The policy is for Executive Directors' service contracts to provide for 12 months' notice from either side.

The policy is for Non-Executive Directors' letters of appointment to contain a three-month notice period from either side. All Non-Executive Directors are subject to annual re-election and letters of appointment are for an initial three-year term.

Copies of Executive Directors' service contracts and Non-Executive Directors' letters of appointment are available for inspection at the Company's registered office.

## OUTSIDE APPOINTMENTS

Executive Directors may accept one board appointment in another company. Board approval must be sought before accepting an appointment. Fees may be retained by the Director. Susan Davy remained a Non-Executive Director of Restore plc throughout 2021/22. No other outside Company appointments are held by the Executive Directors other than with industry bodies or governmental or quasi-governmental agencies.

## ADDITIONAL CONTEXTUAL INFORMATION

### HISTORICAL CHIEF EXECUTIVE REMUNERATION

The table below provides historical single figure information based on the most appropriate senior executives of the Company. From 2014/15 to 2016/17, this reflected the remuneration of the South West Water CEO, Chris Loughlin. From 2017/18 to 2019/20, the remuneration reflected the Managing Director of South West Water. From 2020/21, this reflects the Chief Executive Officer.

	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21 <sup>(1)</sup>		2021/22
	CEO	CEO	CEO	MD	MD	MD	CEO	CEO	CEO
<b>Chief Executive Officer single figure remuneration (£000)</b>	666	761	660	493	663	1,094	669 <sup>(1)</sup>	966 <sup>(1)</sup>	802
<b>Annual Bonus pay out (% of maximum)</b>	78.2%	84.0%	84.1%	85%	90%	78.0%	79.2%	78.1%	30.7%
<b>LTIP (PCP) vesting (% of maximum)</b>	0%	34.5%	43.7%	0%	44%	86.6%	89.9%	89.9%	88.2%

(1) Chris Loughlin stepped down as Chief Executive Officer on 31 July 2020 and was succeeded by Susan Davy. Consistent with the single figure, the figures for Susan Davy relate to the whole of 2020/21, including the portion of the year when she was Chief Financial Officer.

## PERCENTAGE CHANGE IN DIRECTORS' REMUNERATION

### Comparison of Directors' remuneration to employee remuneration

The table below shows the percentage change between 2020/21 and 2021/22 in base salary, benefits, and annual bonus of all Directors, including both Executive Directors and Non-Executive Directors, and all employees.

	Percentage change in salary/fees		Percentage change in benefits		Percentage change in pensions		Percentage change in annual bonus	
	2021/22	2020/21	2021/22	2020/21	2021/22	2020/21	2021/22	2020/21
<b>Executive Directors</b>								
Louise Rowe	1.8%	1.5%	-	-	-	2.1%	-11.3%	-40.4%
Susan Davy <sup>(1)</sup>	4.4%	10.7%	-	-	-30%	-32.2%	-58.4%	34.8%
<b>Non-Executive Directors</b>								
Gill Rider <sup>(2)</sup>	27.8%	126.0%	-	-	-	-	-	-
Neil Cooper <sup>(3)</sup>	7.5%	16.0%	-	-	-	-	-	-
Iain Evans	1.4%	4.0%	-	-	-	-	-	-
Claire Ighodaro <sup>(4)</sup>	8.8%	97%	-	-	-	-	-	-
Jon Butterworth <sup>(5)</sup>	-15.4%	-	-	-	-	-	-	-
South West Water	2.2%	4.28%	-10.1%	4.38%	-11.8%	2.2%	2.8%	-0.08%
UK employees	2.0%	1.22%	-19.5%	5.7%	-11.4%	2.5%	-14.3%	-17.8%

(1) The remuneration for Susan Davy for 2021/22 is for the full year as Chief Executive Officer, having been appointed to the role on 31 July 2020. The year on year change in salary and benefits from 2021/22 reflects the pro-rated remuneration for Susan's current and previous role as Chief Financial Officer for the Group in 2020/21.

(2) The remuneration for Gill Rider for 2021/22 is for the full year as Chair having been appointed on 31 July 2020. The year on year change reflects that the remuneration in 2020/21 was pro-rated for Gill's current role as Chair and previous service as a Non-Executive Director and Chair of the Remuneration Committee.

(3) The fee for Neil Cooper for 2021/22 is for the full year as Senior Independent Director, having been appointed on 31 July 2020. The year on year change reflects that the remuneration in 2020/21 was pro-rated for Neil's current role as Senior Independent Director and previous service, prior to his appointment as Senior Independent Director.

(4) The fee for Claire Ighodaro for 2021/22 is for the full year as Chair to the Remuneration Committee having been appointed on 31 July 2020. The year on year change reflects that the remuneration in 2020/21 was pro-rated for Claire's current role and previous service, prior to her appointment as Chair to the Remuneration Committee.

(5) The fee for Jon Butterworth for 2021/22 has reduced reflecting the cross charge to South West Water from Pennon plc. Prior to Jon's appointment to the Pennon Board, Jon served on the South West Water Board for which 100% of his fees were charged.

## RELATIVE IMPORTANCE OF SPEND ON PAY

	2021/22 £m	2020/21 £m	Percentage change (%)
<b>Overall expenditure on pay<sup>(1)</sup></b>	69	69.8	(1.1%)
<b>Distributions to Parent Company (excluding special dividend)<sup>(2)</sup></b>	88	100.4	(12.4%)
<b>Net interest charges</b>	76.8	56.5	35.9%
<b>Purchase of property, plant, and equipment (cash flow)</b>	197.3	161.1	22.5%

(1) Excludes employer's social security costs and non-underlying items.

(2) 2021/22 includes payment of the outperformance dividend based on the cumulative outperformance for 2020/21 of £43.0 million that has been deferred to August 2022 (2020/21 includes payment of the outperformance dividend based on the cumulative outperformance for 2019/20 of £58.1 million that was deferred to August 2021). 2020/21 excludes dividend payment of £1.2 million to parent in October 2020 as part of the WaterShare+ customer rebate scheme.



The above table illustrates the relative importance of spend on pay compared with distributions to shareholders and other Company outgoings. The distributions to Parent Company, interest charges and the purchase of property, plant, and equipment (cash flow) have been included as these were the most significant outgoings for the Company in the last financial year.

### CHIEF EXECUTIVE OFFICER PAY RATIO

Our CEO pay ratio stands at 43:1 for the median employee. This is considerably lower than the ratio in preceding years and reflects the lower remuneration of the Group Chief Executive Officer compared to her predecessor. This is the first year the ratio has reflected Susan's remuneration alone as the 2021 calculation reflected the pro-rated remuneration of the two CEOs in post over the year.

Year	Method	25th percentile (P25) pay ratio	50th percentile (P50) pay ratio	75th percentile (P50) pay ratio
2021/22	Option A	56:1	43:1	36:1
2020/21	Option A	93:1	69:1	55:1
2019/20	Option A	91:1	64:1	53:1

Option A has been used for the calculations as per the disclosure regulations. The employees at the lower quartile, median and upper quartile (P25, P50, and P75, respectively) have been determined based on a calculation of total remuneration for the financial year 1 April 2020 to 31 March 2022.

- Basic salary for part-time employees and new joiners within the applicable period have been converted to full-time equivalents for the purpose of the calculations.
- Estimated values for employee P11d data have been used in the calculation to establish the ordering of employees, given the timing of publication. This will be validated and amended in due course to account for any variances.

The total remuneration of 2021/22 for the employees identified at P25, P50 and P75 is £28,467, £37,165, and £45,196, respectively. The base salary of 2021/22 for the employees identified at P25, P50 and P75 is £25,164, £25,662, and £40,185, respectively.

The CEO pay ratio calculation on the same compensation elements as the wider workforce, (i.e., excluding LTIP) would be:

P25	26:1
P50	20:1
P75	17:1

### SHARE AWARD AND SHAREHOLDING DISCLOSURES (AUDITED INFORMATION)

#### Share awards granted during 2021/22

The table below sets out details of share awards made in the year. Details of the Group Chief Executive Officer's share awards are included in the Pennon Annual Report on pages 176 to 178.

Executive Director	Type of interest	Basis of Award	Face value £000	Percentage vesting at threshold performance	Performance / restricted period end date
Susan Davy	LTIP	150% of salary	713	25% of maximum	30 June 2024
Louise Rowe		80% of salary	137		
Susan Davy	Deferred bonus	50% of bonus awarded	219	N/A	29 June 2024
Louise Rowe			27		

LTIP awards were calculated using the Pennon Group plc share price of £11.408p (being the average closing price over the five dealing days preceding the date of grant, which was 1 July 2021). LTIP awards are subject to an additional two-year holding period. Deferred bonus awards were calculated using the average Pennon Group share price at which shares were purchased on the market on 28 June 2021 to satisfy the award, which was £11.5045.

The targets for the Pennon 2022 LTIP award are detailed in the Pennon Annual Report on page 164.

#### Directors' shareholding and interest in shares

The Remuneration Committee believes that the interests of Executive Directors and senior management should be closely aligned with the interests of Pennon Group plc shareholders.

To support this, the Committee operates shareholding guidelines. For 2020/21, this guideline was 100% of salary for the Finance Director and 200% for the Group Chief Executive Officer. In line with best practice guidelines, deferred bonuses and LTIP awards subject to a holding period may only count towards the guidelines on a net tax basis.

The Executive Directors are expected to build up a shareholding in the Company within the first five years of joining the Company, or appointment to a new role.

The beneficial interests of the Executive Director in the ordinary shares (61.05p each) of Pennon Group plc as at 31 March 2022 and 31 March 2021, together with their shareholding guideline obligation and interest are shown in the table below. Following shareholder approval at a General Meeting on 5 July 2021, the Company's share capital was consolidated into shares of 61.05p each, on a 3:2 basis, so direct holdings were reduced by a third, compared with the position prior to this date:

	Share interests (including connected parties) at 31 March 2022	Share interests (including connected parties) at 31 March 2021	Vested LTIP awards in holding period <sup>(1)</sup>	Deferred Bonus shares	SAYE	Performance shares (subject to performance conditions)	Share-holding guideline	Share-holding guideline met?
Susan Davy	77,486	86,206	152,920	38,967	2,047	208,330	200%	Yes
Louise Rowe	18,396	15,799	32,964	9,160	2,047	45,364	100%	Yes

<sup>(1)</sup>These share awards are not subject to further performance criteria and may therefore count towards the guideline on a net-of-tax basis.

Since 31 March 2022, 28 additional ordinary shares in Pennon Group have been acquired by Louise Rowe as a result of participation in the Pennon Group's Share Incentive Plan.

## Non-Executive Directors' shareholding

The beneficial interests of the Non-Executive Directors, including the beneficial interests of their spouses, civil partners, children, and step-children, in the ordinary shares of the Pennon Group, are shown in the table below. Following shareholder approval at a General Meeting on 5 July 2021, the Company's share capital was consolidated into shares of 61.05 pence each, on a 3:2 basis, so direct holdings were reduced by a third, compared with the position prior to this.

Director	Shares held at 31 March 2022	Shares held at 31 March 2021
Gill Rider	2,407	3,612
Neil Cooper	-	-
Iain Evans	-	-
Claire Ighodaro	-	-
Jon Butterworth	-	-

There have been no changes in the beneficial interests or the non-beneficial interests of the above Directors in the ordinary shares of the Company between 1 April 2022 and 30 May 2022. There is no formal shareholding guideline for the Non-Executive Directors; however, they are encouraged to purchase shares in the Company.

### Details of share awards

The Group Chief Executive Officer's share awards can be seen on pages 176 to 178 of the Pennon Annual Report.

#### (a) Long-term incentive plan

In addition to the above beneficial interests, the following Directors has or had a contingent interest in the number of ordinary shares (61.05p each) of Pennon Group plc shown below, representing the maximum number of shares to which they would become entitled under the plan should the relevant criteria be met in full:

Director and date of award	Vested awards held at 1 April 2021 <sup>(1)</sup>	Conditional awards held at 1 April 2021	Conditional awards made in year	Market price of each share upon award in year	Vesting in year <sup>(2)</sup>	Value of shares upon vesting (before tax) £000	Vested awards held at 31 March 2022 <sup>(3)</sup>	Vesting awards released in year <sup>(5)</sup>	Conditional awards held at 31 March 2022	Date of end of restricted period	Expected date of release <sup>(4)</sup>
<b>Susan Davy</b>											
01/07/16	15,557	-	-	920.00p	-	115	-	17,258	-	30/06/19	30/06/21
25/08/17	74,045	-	-	802.70p	-	747	74,045	-	-	24/08/20	24/08/22
02/07/18	-	76,653	-	790.12p	78,875	928	78,875	-	-	01/07/21	01/07/23
04/07/19	-	82,062	-	752.72p	-	-	-	-	82,062	03/07/22	03/07/24
03/08/20	-	63,812	-	1071.9p	-	-	-	-	63,812	02/08/23	02/08/25
01/07/21	-	-	62,456	1140.8p	-	-	-	-	62,456	30/06/24	30/06/26
<b>Louise Rowe</b>											
01/07/16	4,467	-	-	920.00p	-	33	-	4,955	-	30/06/19	30/06/21
25/08/17	15,961	-	-	802.70p	-	161	15,961	-	-	24/08/20	24/08/22
02/07/18	-	16,524	-	790.12p	17,003	200	17,003	-	-	01/07/21	01/07/23
04/07/19	-	17,692	-	752.72p	-	-	-	-	17,692	03/07/22	03/07/24
03/08/20	-	15,705	-	1075.49p	-	-	-	-	15,705	13/07/23	13/07/25
01/07/21	-	-	11,967	1140.8p	-	-	-	-	11,967	30/06/24	30/06/26

(1) 32% of the award shares granted on 1 July 2016 vested on 1 July 2019 at a market price of £7.412 per share.  
86.86% of the award shares granted on 25 August 2017 vested on 25 August 2020 at a market price of £10.085 per

share.

(2) 89.9% of the award shares granted on 02 July 2018 vested on 1 July 2021 at a market price of £11.7698 per share. In respect of (1) and (2) above, the total number of shares that vested included additional shares equivalent in value to such number of shares as could have been acquired by reinvesting the dividends which would otherwise have been received on the vested shares during the three-year performance period. The balance of the award lapsed.

(3) Vested award; no longer subject to performance conditions.

(4) Awards granted from 2015 onwards are subject to a two-year holding period following vesting.

(5) Awards released in year at a market price of £13.04 per share, inclusive of additional shares equivalent in value to such number of shares as could have been acquired by reinvesting the dividends which would otherwise have been received on the vested shares during the two-year holding period.

#### (b) Annual incentive bonus plan – deferred bonus shares (long-term incentive element)

The following Director has or had a contingent interest in the number of ordinary shares (40.7p each) of Pennon Group plc shown below, representing the total number of shares to which they have or would become entitled under the deferred bonus element of the annual incentive bonus plan (the bonus plan) at the end of the relevant restricted period:

Director and date of award	Restricted awards held at 1 April 2021	Restricted awards made in year	Market price of each share upon award in year	Restricted awards post-share consolidation (restated) <sup>(2)</sup>	Released in year <sup>(1)</sup>	Value of shares upon vesting (before tax) £000	Restricted awards held at 31 March 2022	Date of end of restricted period
<b>Susan Davy</b>								
25/07/18	22,746	-	761.36p	15,163	15,163	194	-	24/07/21
24/07/19	24,449	-	755.5386p	16,299	-	-	16,229	23/07/22
14/07/20	15,011	-	1,079.47p	10,007	-	-	10,007	13/07/23
30/06/21	-	18,993	1150.45p	12,661	-	-	12,661	29/06/24
<b>Louise Rowe</b>								
25/07/18	6,803	-	761.36p	4,535	4,535	58	-	24/07/21
24/07/19	7,317	-	755.5386p	4,877	-	-	4,877	23/07/22
14/07/20	4,102	-	1,079.47p	2,734	-	-	2,734	13/07/23
30/06/21	-	2,325	1150.45p	1,549	-	-	1,549	29/06/24

<sup>(1)</sup> These shares were released on 6 August 2021 at 1278.0p per share

<sup>(2)</sup> All shares under the AIBP were adjusted on 5 July to reflect the share consolidation activity at a ratio of 3:2 into shares of 61.05 pence each. A special dividend of £3.55 per share was paid on 16 July 21 as follows: Louise Rowe £72,941

During the year the Directors received dividends on the above shares in accordance with the conditions of the bonus plan as follows: Louise Rowe £4,309.

### (c) Sharesave scheme

Details of options to subscribe for ordinary shares (61.05p each) of Pennon Group plc under the all-employee Sharesave scheme were:

Date of award	Options held at 1 April 2021	Granted in year	Exercised in year	Exercise price per share	Market price of each share on exercising	Market value of each share at 31 March 2022	Options held at 31 March 2022	Exercise period/maturity date
<b>Susan Davy</b>								
03/07/18	2,834	-	2,834	635.00p	1133.00p	-	-	
06/07/21	-	2,047	-	879.00p	-	1075.0p	2,047	01/09/24-28/02/2025
<b>Louise Rowe</b>								
03/07/18	2,834	-	2,834	635.00p	1133.00p	-	-	
06/07/21	-	2,047	-	879.00p	-	1075.0p	2,047	01/09/24-28/02/2025

### THE REMUNERATION COMMITTEE AND ITS ADVISERS

Claire Ighodaro, Gill Rider, Neil Cooper, Iain Evans and Jon Butterworth were members of the Remuneration Committee for the full year.

During the year the Committee received advice or services which materially assisted the Committee in the consideration of remuneration matters from Adele Barker (Pennon Group Chief People Officer) and from Deloitte LLP. During 2018/19, Deloitte LLP was reappointed directly by the Committee with a refreshed advisory team, following a comprehensive retendering process. Deloitte LLP is a member of the Remuneration Consultants Group and as such voluntarily operates under the code of conduct in relation to executive remuneration consulting in the UK. The Committee is satisfied that the advice it has received from Deloitte LLP has been objective and independent.

## BOARD OF DIRECTORS AND COMPANY INFORMATION

<b>CHAIR</b>	G Rider CB
<b>CHIEF EXECUTIVE OFFICER</b>	S Davy
<b>FINANCE DIRECTOR</b>	L F Rowe
<b>SENIOR INDEPENDENT DIRECTOR</b>	N Cooper (Non-Executive)
<b>NON-EXECUTIVE DIRECTORS</b>	C Ighodaro CBE I Evans CBE J Butterworth MBE
<b>COMPANY SECRETARIES</b>	S Pugsley
<b>REGISTERED OFFICE</b>	Peninsula House Rydon Lane Exeter Devon EX2 7HR
<b>INDEPENDENT AUDITOR</b>	Ernst & Young LLP 1 Bridgewater Place Water Lane Leeds LS11 5QR
<b>COMPANY'S REGISTERED NUMBER</b>	02366665
<b>PRINCIPAL ACTIVITIES</b>	The principal activities of the Company are the provision of water and sewerage services. The Company holds the water and sewerage appointments for Cornwall and Devon and parts of Somerset and Dorset. It also provides water supply services to parts of Dorset, Hampshire and Wiltshire.

# DIRECTORS' REPORT – OTHER STATUTORY DISCLOSURES

## INTRODUCTION

This Directors' report is prepared in accordance with the provisions of the Companies Act 2006 and regulations made thereunder. It comprises pages 159 to 161 as well as the following matters which the Board considers are of strategic importance and, as permitted by legislation, has chosen to include in the strategic report rather than the Directors' report:

- Likely future developments of the Company (pages 4 to 5 of the strategic report)
- Risk management systems (pages 70 to 85 of the strategic report)
- Certain employee and employee engagement matters (pages 24 to 33 of the strategic report and pages 95 to 96 of the governance statement), as well as the disclosures below
- Business relationships/engagement with suppliers, customers and others (pages 34 to 36 of the strategic report and pages 95 to 96 of the governance statement).

In addition, there are a number of disclosures which are included in the Directors' report by reference, including:

- Financial risk management (note 3 of the notes to the financial statements)
- Financial instruments (pages 63 to 69) of the strategic report and notes 15 and 19 of the notes to the financial statements).

This Directors' report (including pages 159 to 161, which form part of this report) fulfils the requirements of the corporate governance statement for the purposes of the FCA's Disclosure Guidance and Transparency Rules.

## CAUTIONARY STATEMENT

This Annual Report has been prepared for, and only for the members of the Company, as a body, and no other persons. The Company, its directors, employees, agents or advisers do not accept or assume responsibility to any other person to whom this document is shown or into whose hands it may come and any such responsibility or liability is expressly disclaimed. By their nature, the statements concerning the risks and uncertainties facing the Company in this Annual Report involve uncertainty since future events and circumstances can cause results and developments to differ materially from those anticipated. The forward-looking statements reflect knowledge and information available at the date of preparation of this Annual Report and the Company undertakes no obligation to update these forward-looking statements. Nothing in this Annual Report should be construed as a profit forecast.

## BOARD OF DIRECTORS

The Directors in office as at the date of this report are named on pages 97 to 100 and there were no other persons in office during the year.

## FINANCIAL RESULTS AND DIVIDEND

A total dividend for the year of £103.1 million was paid during the year (2020/21: £43.5 million). A further £43 million was declared and approved during the year and payment is being deferred to 2022/23. The Report of the Finance Director on pages 63 to 69 analyses the Company's financial results in more detail and sets out other financial information.

## **DIRECTORS' INSURANCE AND INDEMNITIES**

The Company has maintained throughout the year Directors' and officers' liability insurance for the benefit of the Company, the Directors and its officers. The Company has entered into qualifying third-party indemnity arrangements for the benefit of all its Directors in a form and scope which comply with the requirements of the Companies Act 2006 and which were in force throughout the year and remain in force.

## **EMPLOYMENT POLICIES AND EMPLOYEE INVOLVEMENT**

South West Water has a culture of continuous improvement through investment in people at all levels within the Company. It is committed to pursuing equality and diversity in all its employment activities including recruitment, training, career development and promotion and ensuring there is no bias or discrimination in the treatment of people. In particular, applications for employment are welcomed from persons with disabilities, and special arrangements and adjustments as necessary are made to ensure that applicants are treated fairly when attending for interview or for pre-employment aptitude tests. Wherever possible the opportunity is taken to retrain people who become disabled during their employment in order to maintain their employment within the Company.

The Company has policies in place covering health & safety, equal opportunities, diversity and inclusion, ethics and employee relations. In addition, the Board has a diversity policy, details of which are set out in the report of the Nomination Committee on page 128. Information regarding the diversity of the workforce is provided on pages 30 to 33.

South West Water respects the right to freedom of association and employees are consulted regularly about changes which may affect them either through their trade union-appointed representatives, through consultation groups or by means of their elected representatives at the Employee Engagement Forum. These forums, together with regular meetings with particular groups of employees, are used to ensure that employees are kept up to date with the business performance of their employer and the financial and economic factors affecting the performance of the Company as a whole. South West Water also cascades information monthly to all employees to provide them with important and up to date information about key events and to obtain feedback from them. Further information about workforce engagement and employment matters relating to the Company is set out on pages 24 to 33 of the Strategic report.

South West Water and the Pennon Group as a whole encourages share ownership among its employees in Pennon Group plc by operating an HM Revenue & Customs approved ShareSave scheme and Share Incentive Plan. Following Pennon shareholder approval at the 2014 AGM, these were amended to provide for the increased savings limits approved by Government. At 31 March 2022, 51.1% of South West Water's employees were participating in these plans.

## **MODERN SLAVERY ACT**

Our people are fundamental to our business, and we remain committed and passionate about supporting our staff, customers and communities to thrive in creating an environment where everyone can feel safe and supported. We have a clear zero-tolerance approach to modern slavery and are committed to playing our part in helping eradicate it by having systems and processes to monitor, assess and reduce the risk of forced labour and human trafficking.

Our focus this year has been on improving our risk assessment and the widening of our engagement. We have continued to engage and raise awareness, through internal training, and by continuing as a member of Slave Free Alliance. We are part of a utilities sector working group which shares best practice across our industry. We



will continue to work hard to tackle this issue collaboratively with our partners, employees, suppliers and peers, to evolve our approach to ensure it remains effective.

Our latest Modern Slavery Statement, which is completed at a Group level, can be found here: [www.pennon-group.co.uk/sites/default/files/attachments/pdf/pennon-modern-slavery-statement-2021-16-09-21-v1.pdf](http://www.pennon-group.co.uk/sites/default/files/attachments/pdf/pennon-modern-slavery-statement-2021-16-09-21-v1.pdf)

### **GREENHOUSE GAS EMISSIONS**

The Company has taken advantage of the exemption offered under the Companies Act 2006 and has not reported details of Greenhouse gas emissions during the financial year. Details of South West Water's greenhouse gas emissions can be found in the Annual Performance Report and Regulatory Reporting, published in July 2022 ([www.southwestwater.co.uk/report2022](http://www.southwestwater.co.uk/report2022)).

### **RESEARCH AND DEVELOPMENT**

Research and development expenditure involving water and wastewater treatment processes amounted to £0.1 million during the year (2020/21: £0.1 million).

### **OVERSEAS BRANCHES**

The Company has no overseas branches.

### **DONATIONS**

During 2021/22 the Company provided a total of £252,000 in charitable donations (2020/21: £291,000).

No political donations were made or political expenditure incurred and no contributions were made to a non-EU political party (2020/21: nil).

### **GOING CONCERN**

The going concern basis has been adopted in preparing the financial statements as stated by the Directors on page 120. At 31 March 2022, the Company had access to undrawn committed funds and cash and cash deposits totalling £193 million (excluding restricted cash of £161.7 million). Having considered the Company's strong funding position and prudent financial projections, which take into account a range of possible impacts, as described in this report, from the COVID-19 pandemic, the Directors have a reasonable expectation that the Company has adequate resource to continue in operational existence for a period of at least 12 months from the date of approval of the financial statements and that there are no material uncertainties to disclose. For this reason they continue to adopt the going concern basis in preparing the financial statements.

# STATEMENT OF DIRECTORS' RESPONSIBILITIES

The Directors are responsible for preparing the annual report, the Directors' remuneration report and the financial statements in accordance with applicable law and regulations. Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have prepared the Company financial statements in accordance with UK adopted international accounting standards in conformity with the Companies Act 2006.

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 the year.

In preparing these financial statements, the Directors are required to:

- Select suitable accounting policies in accordance with IAS 8 Accounting Policies, Changes in Estimates and Errors and then apply them consistently;
- Make judgements and accounting estimates that are reasonable and prudent;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements of IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions of the Company's financial position and financial performance;
- prepare the financial statements on the going concern basis unless it is appropriate to presume that the Company will not continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Under applicable law and regulations, the Directors are also responsible for preparing a Strategic Report, Directors' Report, Directors' Remuneration Report and Corporate Governance Statement that comply with the law and those regulations. The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website.

Each of the Directors, whose names and functions are listed on pages 110 and 158, confirms that, to the best of his or her knowledge:

- i) The financial statements, which have been prepared in accordance with UK adopted international accounting standards in conformity with the Companies Act 2006, give a true and fair view of the assets, liabilities, financial position and profit of the Company.
- ii) The Annual Report, including the Strategic Report (pages 97 to 100), includes a fair review of the development and performance of the business during the year and the position of the Company, together with a description of the principal risks and uncertainties it faces.

- iii) They consider that the Annual Report, taken as a whole, is fair, balanced and understandable, and provides the information necessary for shareholders to assess the Company's position, performance, business model and strategy.

The Directors are responsible for the maintenance and integrity of the Company's website [www.southwestwater.co.uk](http://www.southwestwater.co.uk). Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

**STATEMENT AS TO DISCLOSURE OF INFORMATION TO THE COMPANY'S AUDITOR**

a) So far as each of the Directors in office at the date of signing of the report is aware, there is no relevant audit information of which the Company's auditor is unaware; and

b) each of the Directors has taken all the steps that each Director ought to have taken as a Director in order to make himself or herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

The Directors' report consisting of pages 159 to 163, was approved by the Board on 5 July 2022.

By Order of the Board

SIMON A F PUGSLEY

Group General Counsel and Company Secretary

5 July 2022.

# INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF SOUTH WEST WATER LIMITED

## OPINION

We have audited the financial statements of South West Water Limited for the year ended 31 March 2022 which comprise the Income Statement, the Statement of Comprehensive Income, the Balance Sheet, the Statement of Changes in Equity, the Cash Flow Statement and the related notes 1 to 37, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and UK adopted International Accounting Standards in conformity with the requirements of the Companies Act 2006.

In our opinion, the financial statements:

- ▶ give a true and fair view of the company's affairs as at 31 March 2022 and of its profit for the year then ended;
- ▶ have been properly prepared in accordance with UK adopted International Accounting Standards; and
- ▶ have been prepared in accordance with the requirements of the Companies Act 2006.

## BASIS FOR OPINION

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

## INDEPENDENCE

We are independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to other entities of public interest, and we have fulfilled our other ethical responsibilities in accordance with these requirements. The non-audit services prohibited by the FRC's Ethical Standard were not provided to the company and we remain independent of the company in conducting the audit.

## CONCLUSIONS RELATING TO GOING CONCERN

In auditing the financial statements, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate. Our evaluation of the directors' assessment of the company's ability to continue to adopt the going concern basis of accounting included the following procedures:

- ▶ We have obtained management's going concern assessment, including the cash forecast, liquidity requirements and forecast covenant calculations for the going concern period which covers the period from approval of the 2022 financial statements through to 31 July 2023, and have tested this for arithmetical accuracy. Management has modelled a downside scenario in their cash forecasts and covenant calculations in order to incorporate unexpected changes to the forecasted liquidity of the company.
- ▶ We have reviewed the forecasts used for the going concern assessment period for reasonableness and, where applicable, corroborated the data with audit information from other areas. We have evaluated the appropriateness of the key assumptions in management's forecasts including revenue growth, by comparing these to year to date performance and through consideration of historical forecasting accuracy.
- ▶ The company has an agreed business plan with Ofwat for the five year price period from 1 April 2020 to 31 March 2025, setting out the basis of allowed tariff changes. We have compared the key assumptions in the company forecasts to the agreed business plan for consistency.
- ▶ We have evaluated management's stress test modelling including management's downside scenario, to understand the impact on the company's liquidity and covenant ratios. We assessed the reasonableness of management's stress test scenarios by performing our own sensitivity analysis for severe but plausible scenarios.
- ▶ We have compared facilities assumed in the forecasts to supporting documentation.

- ▶ We have compared the risks identified and modelled in the cash flow forecasts of management’s downside scenario to the company’s risk register and evaluated the quantification by management. We have considered whether there are other alternative risks that should be taken into consideration based on our knowledge of the business.
- ▶ We performed testing to consider the likelihood of a scenario causing a liquidity issue or breach of covenants.
- ▶ We have read the company’s going concern disclosures included in the annual report in order to assess whether the disclosures were appropriate and in conformity with the reporting standards.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the company’s ability to continue as a going concern for a period to 31 July 2023.

In relation to the company’s reporting on how they have voluntarily applied the UK Corporate Governance Code, we have nothing material to add or draw attention to in relation to the directors’ statement in the financial statements about whether the directors considered it appropriate to adopt the going concern basis of accounting.

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

#### OVERVIEW OF OUR AUDIT APPROACH

Key audit matters	<ul style="list-style-type: none"> <li>• Revenue recognition in respect of accrued income</li> <li>• Valuation of the expected credit loss provision for customer balances</li> </ul>
Materiality	<ul style="list-style-type: none"> <li>• Overall materiality of £6.9 million which represents 5% of the group’s profit before taxation and non-underlying items.</li> </ul>

#### AN OVERVIEW OF THE SCOPE OF OUR AUDIT

##### TAILORING THE SCOPE

Our assessment of audit risk, our evaluation of materiality and our allocation of performance materiality determine our audit scope for the Company. This enables us to form an opinion on the financial statements. We take into account size, risk profile, the organisation of the Company and effectiveness of controls, including controls and changes in the business environment when assessing the level of work to be performed. All audit work was performed directly by the engagement team.

##### CHANGES FROM THE PRIOR YEAR

There were no changes to the scope of the audit from the prior year.

##### CLIMATE CHANGE

There has been increasing interest from stakeholders as to how climate change will impact the company. The company has determined that the most significant future impacts from climate change on its operations will be from physical and transitional climate-related risks. These are explained on pages 46 to 49 and on page 81 in the principal risks and uncertainties, which form part of the “Other information,” rather than the audited financial statements. Our procedures on these disclosures therefore consisted solely of considering whether they are materially inconsistent with the financial statements or our knowledge obtained in the course of the audit or otherwise appear to be materially misstated.

As explained in the basis of preparation note to the financial statements, governmental and societal responses to climate change risks are still developing, and are interdependent upon each other, and consequently financial statements cannot capture all possible future outcomes as these are not yet known. The degree of certainty of these changes may also mean that they cannot be taken into account when determining asset and liability valuations and the timing of future cash flows under the requirements of UK adopted International Accounting Standards in conformity with the requirements of the Companies Act 2006.

As part of our audit, we made enquiries of management to understand the extent of climate change risks to the company, including reviewing management's climate change risk assessment, which was prepared with support from external consultants. Our audit effort in considering climate change was focused on ensuring that the effects of material climate risks disclosed on pages 46 to 49 have been appropriately reflected in asset values and associated disclosures where values are determined through modelling future cash flows, as explained in the basis of preparation note. Our procedures did not identify any material impact on our key audit matters for the year ended 31 March 2022. We also challenged the Directors' considerations of climate change in their assessment of going concern and viability and associated disclosures.

The company has stated its commitment to the aspirations of the Paris Agreement to achieve net zero emissions by 2030. Governmental and societal responses to climate change risks are still developing, and, as a result, the group is currently unable to fully determine the future economic impact on their business model, operational plans and customers to achieve this. Therefore, as set out above, the potential impacts are not fully incorporated in these financial statements.

## KEY AUDIT MATTERS

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

Risk	Our response to the risk	Key observations communicated to the Audit Committee
<p><b>Revenue recognition in relation to accrued income relating to measured supplies (2022: £90.3 million, 2021: £87.7 million)</b></p> <p><i>Refer to the Audit Committee Report (pages 120); Accounting policies (page 179); and Note 4 of the Financial Statements (page 191)</i></p> <p>The company's revenue stream relates to the provision of water and sewerage services.</p> <p>ISAs (UK &amp; Ireland) presume there is a risk of fraud relating to revenue recognition. For the company, given the targets associated with financial performance and potential pressures to meet market expectations, there is an incentive to overstate revenue.</p> <p>This risk over revenue recognition specifically arises in the following areas of estimation, where there is an opportunity to overstate revenue:</p>	<p>We obtained an understanding of the process for the supply of measured services, meter reading and related billing in order to assess the completeness of adjustments to reflect the accrual or deferral of revenue at the year end;</p> <p>We tested key controls linked to system generated information and around the estimation process for measured revenue;</p> <p>We obtained internal and external data on factors that influence demand from customers, weather patterns and leaks in infrastructure networks and formed an expectation of the impact of these matters on revenue to compare to assumptions used in management's estimate;</p> <p>Given the changes in customer consumption patterns (increase in household consumption and decrease in non-household consumption) arising since the onset of the Covid-19 pandemic, we used evidence from actual meter readings throughout the prior and current year to compare to the assumptions used to estimate revenue recognised for</p>	<p>We concluded that the estimation process undertaken by management to calculate the measured income accrual reflected latest operational factors in the key assumptions and that the income accrual was appropriately determined.</p>

<p>Income from measured water services requires an estimation of the amount of unbilled charges at the period end. This is calculated using a combination of system generated information, based on previous customer volume usage, together with management adjustments for a number of different factors not included in the system-generated accrual, such as seasonality and operational data trends.</p> <p>In 2020/21, the assessment of consumption was impacted by the Covid-19 pandemic, which resulted in an increase in household consumption (both as a result of lockdown and then increased visitors over the summer months as more holidays were taken in the UK than overseas) and a decrease in the non-household consumption. These patterns of consumption continued to impact 2021/22 due to the reduced level of overseas holidays and the increased visitors to the South West, together with continued high levels of home working.</p>	<p>metered customers without a recent meter reading;</p> <p>We obtained a system report of invoices raised post year end based on actual meter readings taken since the year end. We selected a sample of items from the report to compare to supporting evidence. We compared this report to the year end assumptions used to accrue income for these customer accounts, to assess the reliability of the assumptions used to determine accrued income;</p> <p>We performed analytical procedures by comparing revenue balances for the year against expectations and obtained support for significant variances; and</p> <p>In performing our journal testing, we paid increased attention to entries impacting revenue, focusing on non-system postings and those raised in the last two weeks of the year.</p>	
<p><b>Valuation of the expected credit loss provision for customer balances (£84.5 million, PY comparative £88.4 million)</b></p> <p><i>Refer to the Audit Committee Report (page 120); Accounting policies (page 182); Note 18 of the Financial Statements (page 200)</i></p> <p>The expected credit loss provision is calculated using a combination of system generated information on historic debt recovery rates and management's judgement of the future likely recovery rates.</p> <p>There is a risk that the assumptions, used by management in calculating the expected credit loss provision, may not be appropriate and the valuation of the provision against customer balances may be misstated.</p>	<p>We performed a walkthrough of the process for calculating the expected credit loss provision and assessed the design effectiveness of the key controls;</p> <p>We tested the operating effectiveness of key controls over the billing systems and tested the integrity of data and the reports utilised to generate the ageing and categorisation of debt within each component's billing systems;</p> <p>We tested latest information on collection rates and evaluated how this data was used in the preparation of the expected credit loss provision;</p> <p>We utilised collection trends to determine our own range of the likely ultimate collection of debts existing at the balance sheet date, including performing several scenario analyses and compared these to the provision recorded by management, including assessing</p>	<p>We concluded that the expected credit loss provision is within an acceptable range and appropriately reflects the recent history of collection of outstanding debts and considerations of the impact on future collections from the macro-economic environment.</p>

<p>Management's key assumptions include:</p> <ul style="list-style-type: none"> <li>○ that the historic level of collections is indicative of the ability to collect at the same levels in the future; and</li> <li>○ that the risk of non-recovery from customers varies, depending on factors such as whether the household customer no longer occupies a property in the area, has previously paid/not paid, is/is not on a payment plan etc., and for non-household customers depends on the general economic performance of the business sector they operate within.</li> </ul>	<p>assumptions for evidence of management bias;</p> <p>We assessed the assumptions used by management in determining the amounts provided against the different categories and age of debt, by comparing these assumptions to historic collection rates and by considering the impact of changes in the methods adopted operationally by management to collect debt, and in the external environment;</p> <p>We considered whether the historic collection performance evidenced the behaviour patterns assumed by management depending on categorisation of household customer and business sector for non-household customers;</p> <p>For debt relating to household customers, we utilised collection information over previous periods, with sensitivities to consider the impact of a deterioration which might arise from a downturn in the economy, to determine an acceptable range of the likely ultimate collection of debts existing at the balance sheet date and compared this to the provision recorded by management;</p> <p>For debt relating to non-household customers, we tested management's segmentation by business sector and the risk factors considered for each sector, regarding non-recovery of debt. We compared this analysis with information on actual collections, by sector, in the current year and since the balance sheet date;</p> <p>We tested the appropriateness of journal entries and adjustments impacting the expected credit loss provision, particularly those raised close to the balance sheet date.</p>	
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## OUR APPLICATION OF MATERIALITY

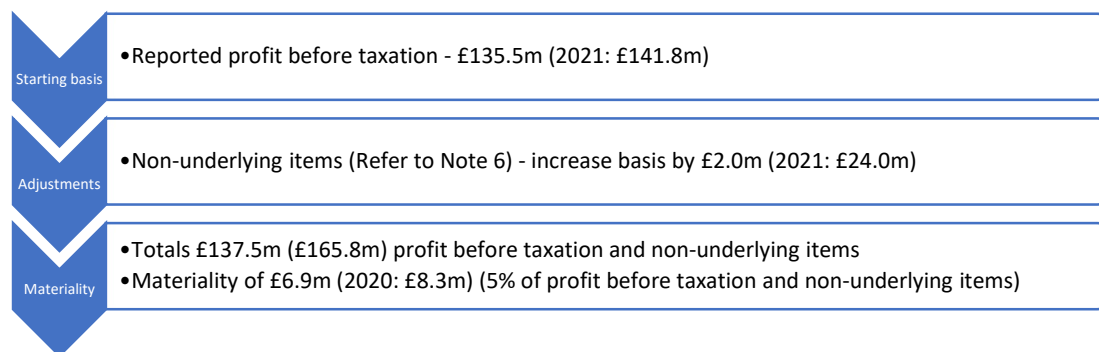
We apply the concept of materiality in planning and performing the audit, in evaluating the effect of identified misstatements on the audit and in forming our audit opinion.

### Materiality



*The magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures.*

We determined materiality for the Company to be £6.9 million (2021: £8.3 million), which is 5% (2021: 5%) of profit before taxation and non-underlying items. We believe that profit before taxation and non-underlying items provides us with an appropriate measure of the underlying performance of the company. We excluded non-underlying items on the basis that profit before taxation after non-underlying items is not indicative of the underlying performance of the company. We also note that market and analyst commentary on the performance of the company uses the same measure.



### **Performance materiality**

*The application of materiality at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.*

On the basis of our risk assessments, together with our assessment of the Company's overall control environment, our judgement was that performance materiality was 75% (2021: 75%) of our planning materiality, namely £5.2m (2020: £6.2m). We have set performance materiality at this percentage based on our assessment of the company's internal control environment and the extent and nature of audit findings identified in the prior period. This basis is consistent with the prior year.

### **Reporting threshold**

*An amount below which identified misstatements are considered as being clearly trivial.*

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £0.35m (2020: £0.4m), which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

### **Other information**

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

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

Our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the course of the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements themselves 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 the other information, we are required to report that fact.

We have nothing to report in this regard.

## **OPINIONS ON OTHER MATTERS PRESCRIBED BY THE COMPANIES ACT 2006**

In our opinion, the part of the directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006

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

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

## **MATTERS ON WHICH WE ARE REQUIRED TO REPORT BY EXCEPTION**

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

We have nothing to report in respect of the following matters in relation to which the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit

## **VOLUNTARY REPORTING MATTERS**

### ***Directors' remuneration report***

The Company voluntarily prepares a Report of the directors on remuneration in accordance with the basis of preparation set out in the Directors' Remuneration Report. The directors have requested that we audit the part of the Report of the directors on remuneration specified by the Companies Act 2006 to be audited as if the Company were a quoted company.

In our opinion, the part of the directors' remuneration report to be audited has been properly prepared in accordance with the basis of preparation set out in the Directors' Remuneration Report.

ISAs (UK) require us to review the directors' statement in relation to going concern, longer-term viability and that part of the Corporate Governance Statement relating to the company's voluntary compliance with the provisions of the UK Corporate Governance Code specified for our review.

Based on the work undertaken as part of our audit, we have concluded that each of the following elements of the Corporate Governance Statement is materially consistent with the financial statements or our knowledge obtained during the audit:

- Directors' statement with regards to the appropriateness of adopting the going concern basis of accounting and any material uncertainties identified set out on page 161;
- Directors' explanation as to its assessment of the company's prospects, the period this assessment covers and why the period is appropriate set out on pages 86 to 89;
- Directors' statement on fair, balanced and understandable set out on page 123;
- Board's confirmation that it has carried out a robust assessment of the emerging and principal risks set out on page 74;
- The section of the annual report that describes the review of effectiveness of risk management and internal control systems set out on page 71; and;
- The section describing the work of the audit committee set out on pages 117 to 124.

## RESPONSIBILITIES OF DIRECTORS

As explained more fully in the directors' responsibilities statement set out on page 162, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

## AUDITOR'S RESPONSIBILITIES FOR THE AUDIT OF THE FINANCIAL STATEMENTS

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

### ***Explanation as to what extent the audit was considered capable of detecting irregularities, including fraud***

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect irregularities, including fraud. The risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion. The extent to which our procedures are capable of detecting irregularities, including fraud is detailed below.

However, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the company and management.

- We obtained an understanding of the legal and regulatory frameworks that are applicable to the company and determined that the most significant are:
  - Companies Act 2006
  - Financial Reporting Council (FRC) and the UK Corporate Governance Code
  - Tax legislation (governed by HM Revenue & Customs)
  - Health and Safety legislation
  - Environment Agency environmental permits
  - Ofwat regulations
- We understood how South West Water Limited is complying with those frameworks by reading internal policies and codes of conduct and assessing the entity level control environment, including the level of oversight of those charged with governance. We made enquiries of the company's legal counsel, regulatory team and internal audit of known instances of non-compliance or suspected non-compliance with laws and regulations. We corroborated our enquiries through review of correspondence with regulatory bodies. We designed our audit procedures to identify non-compliance with such laws and regulations identified in the paragraph above. As well as enquiry and attendance at meetings, our procedures involved a review of the reporting to the above committees and a review of board meetings and other committee minutes to identify any non-compliance with laws and regulations. Our procedures also involved journal entry testing, with a focus on journals meeting our defined risk criteria based on our understanding of the business.
- We assessed the susceptibility of the company's financial statements to material misstatement, including how fraud might occur by making enquiries of senior management, including the Chief Executive Officer, Chief Financial Officer, Head of Internal Audit and Audit Committee Chair. We planned our audit to identify risks of management override, tested higher risk journal entries and performed audit procedures to address the potential for management bias, particularly over areas involving significant estimation and judgement. Further discussion of our approach to address the identified risks of management override are set out in the key audit matters section of our report.
- Based on this understanding we designed our audit procedures to identify non-compliance with such laws and regulations. Our procedures involved making enquiries of key management and legal counsel, reviewing key policies, inspecting legal registers and correspondence with regulators and reading key management meeting minutes. We also completed procedures to conclude on the compliance of significant disclosures in the Annual Report and Accounts with the requirements of the relevant

accounting standards, UK legislation and the company's voluntary compliance with the UK Corporate Governance Code.

- We attended key meetings with management and legal counsel in order to identify and communicate any instances of non-compliance with laws and regulations.
- The company operates in the water sector which is highly regulated. As such the Senior Statutory Auditor reviewed the experience and expertise of the engagement team to ensure that the team had the appropriate competence and capabilities, which included the use of an expert where appropriate.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at <https://www.frc.org.uk/auditorsresponsibilities>. This description forms part of our auditor's report.

#### **OTHER MATTERS WE ARE REQUIRED TO ADDRESS**

- Following the recommendation from the Pennon Group plc audit committee, we were appointed by the company on 31 March 2014 to audit the financial statements for the year ending 31 March 2015 and subsequent financial periods.

The period of total uninterrupted engagement including previous renewals and reappointments is 8 years, covering the years ending 31 March 2015 to 31 March 2022.

#### **USE OF OUR REPORT**

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

*Christabel Cowling (Senior statutory auditor)  
for and on behalf of Ernst & Young LLP, Statutory Auditor  
Leeds  
5 July 2022*

# INCOME STATEMENT

## FOR THE YEAR ENDED 31 MARCH 2022

	Notes	Before non-underlying items 2022 £m	Non-underlying items (note 6) 2022 £m	Total 2022 £m	Before non-underlying items 2021 £m	Non-underlying items (note 6) 2021 £m	Total 2021 £m
Revenue	5	584.6	-	584.6	564.3	(20.5)	543.8
<b>Operating costs</b>	7						
Employment costs		(56.9)	(1.7)	(58.6)	(53.9)	(3.5)	(57.4)
Raw materials and consumables		(20.5)	-	(20.5)	(18.1)	-	(18.1)
Other operating expenses		(175.9)	(0.3)	(176.2)	(151.7)	-	(151.7)
<b>Earnings before interest, tax, depreciation and amortisation</b>		<b>331.3</b>	<b>(2.0)</b>	<b>329.3</b>	<b>340.6</b>	<b>(24.0)</b>	<b>316.6</b>
Depreciation and amortisation	7	(117.0)	-	(117.0)	(118.3)	-	(118.3)
<b>Operating profit</b>		<b>214.3</b>	<b>(2.0)</b>	<b>212.3</b>	<b>222.3</b>	<b>(24.0)</b>	<b>198.3</b>
Finance income	8	1.2	-	1.2	0.7	-	0.7
Finance costs	8	(78.0)	-	(78.0)	(57.2)	-	(57.2)
<b>Net finance costs</b>		<b>(76.8)</b>	<b>-</b>	<b>(76.8)</b>	<b>(56.5)</b>	<b>-</b>	<b>(56.5)</b>
<b>Profit before tax</b>		<b>137.5</b>	<b>(2.0)</b>	<b>135.5</b>	<b>165.8</b>	<b>(24.0)</b>	<b>141.8</b>
<b>Taxation (charge)/credit</b>	9	<b>(12.7)</b>	<b>(98.3)</b>	<b>(111.0)</b>	<b>(31.6)</b>	<b>4.6</b>	<b>(27.0)</b>
<b>Profit/(loss) for the year</b>		<b>124.8</b>	<b>(100.3)</b>	<b>24.5</b>	<b>134.2</b>	<b>(19.4)</b>	<b>114.8</b>

The notes on pages 178 to 216 form part of these financial statements.

# STATEMENT OF COMPREHENSIVE INCOME

## FOR THE YEAR ENDED 31 MARCH 2022

	Notes	Before non-underlying items 2022 £m	Non-underlying items (note 6) 2022 £m	Total 2022 £m	Before non-underlying items 2021 £m	Non-underlying items (note 6) 2021 £m	Total 2021 £m
<b>Profit /(loss) for the year</b>		<b>124.8</b>	<b>(100.3)</b>	<b>24.5</b>	<b>134.2</b>	<b>(19.4)</b>	<b>114.8</b>
<b>Other comprehensive income/(loss)</b>							
<b>Items which will not be reclassified to profit or loss</b>							
Re-measurement of defined benefit obligations	24	31.5	-	31.5	13.9	-	13.9
Income tax on items that will not be reclassified	9, 26	(0.7)	-	(0.7)	(2.6)	-	(2.6)
<b>Total items that will not be reclassified to profit or loss</b>		<b>30.8</b>	<b>-</b>	<b>30.8</b>	<b>11.3</b>	<b>-</b>	<b>11.3</b>
<b>Items that may be reclassified subsequently to profit or loss</b>							
Cash flow hedges		40.6	-	40.6	8.9	-	8.9
Income tax credit on items that may be reclassified	9, 26	(6.4)	-	(6.4)	(1.6)	-	(1.6)
<b>Total items that may be reclassified subsequently to profit or loss</b>		<b>34.2</b>	<b>-</b>	<b>34.2</b>	<b>7.3</b>	<b>-</b>	<b>7.3</b>
<b>Other comprehensive Income for the year net of tax</b>		<b>65.0</b>	<b>-</b>	<b>65.0</b>	<b>18.6</b>	<b>-</b>	<b>18.6</b>
<b>Total comprehensive income for the year</b>		<b>189.8</b>	<b>(100.3)</b>	<b>89.5</b>	<b>152.8</b>	<b>(19.4)</b>	<b>133.4</b>

The notes on pages 178 to 216 form part of these financial statements.

# BALANCE SHEET

## AS AT 31 MARCH 2022

	Notes	2022 £m	2021 £m
<b>Assets</b>			
<b>Non-current assets</b>			
Property, plant and equipment	13	3,228.0	3,138.8
Goodwill	14	51.3	51.3
Derivative financial instruments	19	13.9	1.5
Investment in subsidiary undertakings	16	3.3	3.3
Retirement benefit asset	24	47.1	14.3
		<b>3,343.6</b>	<b>3,209.2</b>
<b>Current assets</b>			
Inventories	17	5.8	5.4
Derivative financial instruments	19	5.0	0.2
Trade and other receivables	18	198.9	164.3
Current tax asset	25	5.9	3.9
Cash and cash deposits	20	189.3	414.9
		<b>404.9</b>	<b>588.7</b>
<b>Liabilities</b>			
<b>Current liabilities</b>			
Borrowings	22	(213.1)	(91.5)
Derivative financial instruments	19	-	(6.1)
Trade and other payables	21	(161.2)	(159.1)
Provisions	27	(1.0)	(0.3)
		<b>(375.3)</b>	<b>(257.0)</b>
<b>Net current assets</b>			
		<b>29.6</b>	<b>331.7</b>
<b>Non-current liabilities</b>			
Borrowings	22	(2,281.4)	(2,597.0)
Other non-current liabilities	23	(137.2)	(128.2)
Derivative financial instruments	19	-	(17.4)
Deferred tax liabilities	26	(380.1)	(271.2)
		<b>(2,798.7)</b>	<b>(3,013.8)</b>
<b>Net assets</b>			
		<b>574.5</b>	<b>527.1</b>
<b>Equity</b>			
Called up share capital	28	295.9	250.9
Retained earnings and other reserves	30	278.6	276.2
<b>Total Equity</b>		<b>574.5</b>	<b>527.1</b>

The notes on pages 178 to 216 form part of these financial statements.

The financial statements on pages 173 to 177 were approved and authorised for issue by the Board of Directors on 5 July 2022 and were signed on its behalf by:

**S Davy**  
Chief Executive Officer

Registered office: Peninsula House, Rydon Lane, Exeter, Devon, England EX2 7HR  
Registered Number: 02366665

# STATEMENT OF CHANGES IN EQUITY

## FOR THE YEAR ENDED 31 MARCH 2022

	Notes	Called up share capital (note 28) £m	Retained earnings and other reserves (note 30) £m	Total Equity £m
<b>At 31 March 2020</b>		<b>250.9</b>	<b>242.7</b>	<b>493.6</b>
Profit for the year		-	114.8	114.8
Other comprehensive income for the year		-	18.6	18.6
Total comprehensive income for the year		-	133.4	133.4
<i>Transactions with owners</i>				
Dividends paid	10	-	(43.5)	(43.5)
Dividends deferred	10	-	(58.1)	(58.1)
Share based payments (net of tax)		-	0.5	0.5
Watershare+ reserves adjustment		-	1.2	1.2
Total transactions with owners		-	(99.9)	(99.9)
<b>At 31 March 2021</b>		<b>250.9</b>	<b>276.2</b>	<b>527.1</b>
Profit for the year		-	24.5	24.5
Other comprehensive income for the year		-	65.0	65.0
Total comprehensive income for the year		-	89.5	89.5
<i>Transactions with owners</i>				
Share capital issue		45.0	-	45.0
Dividends paid	10	-	(45.0)	(45.0)
Dividends deferred	10	-	(43.0)	(43.0)
Share based payments (net of tax)		-	0.9	0.9
Total transactions with owners		45.0	(87.1)	(42.1)
<b>At 31 March 2022</b>		<b>295.9</b>	<b>278.6</b>	<b>574.5</b>

The notes on pages 178 to 216 form part of these financial statements.



# CASH FLOW STATEMENT

## FOR THE YEAR ENDED 31 MARCH 2022

	Notes	2022 £m	2021 £m
<b>Cash flows from operating activities</b>			
Cash generated from operations	31	307.7	314.6
Interest paid		(62.8)	(46.3)
Tax paid		(11.2)	(24.7)
<b>Net cash generated from operating activities</b>		<b>233.7</b>	<b>243.6</b>
<b>Cash flows from investing activities</b>			
Interest received		0.3	0.2
Purchase of property, plant and equipment		(197.3)	(161.1)
Receipt of grants and contributions		3.2	3.3
Proceeds from sale of property, plant and equipment		1.4	0.2
<b>Net cash used in investing activities</b>		<b>(192.4)</b>	<b>(157.4)</b>
<b>Cash flows from/(used in) financing activities</b>			
Proceeds from issue of ordinary share capital	28	45.0	-
Deposit of restricted funds	20	89.6	(24.3)
Proceeds from new borrowing		50.0	130.0
Repayment of borrowings		(40.4)	(35.0)
Repayments of intercompany borrowings		(2.5)	(3.7)
Finance lease sale and lease back		15.0	15.0
Finance lease principal repayments		(231.4)	(18.8)
Dividends paid	10	(103.1)	(43.5)
<b>Net cash used in financing activities</b>		<b>(177.8)</b>	<b>19.7</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>		<b>(136.5)</b>	<b>105.9</b>
<b>Cash and cash equivalents at beginning of the year</b>		<b>164.1</b>	<b>58.2</b>
<b>Cash and cash equivalents at end of the year</b>	20	<b>27.6</b>	<b>164.1</b>

The notes on pages 178 to 216 form part of these financial statements.

# NOTES TO THE FINANCIAL STATEMENTS

## 1. GENERAL INFORMATION

South West Water Limited is a company registered in the United Kingdom under the Companies Act 2006. The address of the registered office, the nature of the Company's operations and its principal activities are set out on page 158.

## 2. PRINCIPAL ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to the years presented.

### (a) Basis of preparation

These financial statements have been prepared on the historical cost accounting basis (except for fair value items, principally transfers of assets from customers and certain financial instruments as described in accounting policy note (u) and (n) respectively and in accordance with UK adopted international accounting standards in conformity with the requirements of the Companies Act 2006. A summary of the principal accounting policies is set out below, together with an explanation where changes have been made to previous policies on the adoption of new accounting standards and interpretations in the year.

A summary of the principal accounting policies is set out below, together with an explanation where changes have been made to previous policies on the adoption of new accounting standards and interpretations in the year.

The going concern basis has been adopted in preparing the financial statements as stated by the Directors on page 120. At 31 March 2022, the Company had access to undrawn committed funds and cash and cash deposits totalling £193 million (excluding restricted cash of £161.7 million). Having considered the Company's strong funding position and prudent financial projections, which take into account a range of possible impacts, as described in this report, the Directors have a reasonable expectation that the Company has adequate resource to continue in operational existence for the period from approval of the 2022 financial statements through to 31 July 2023 and that there are no material uncertainties to disclose. For this reason they continue to adopt the going concern basis in preparing the financial statements.

In preparing the financial statements management has considered the impact of climate change, taking into account the relevant disclosures in the Strategic Report, including those made in accordance with the recommendations of the Taskforce on Climate-related Financial Disclosure. The expected environmental impact of climate change on the water business has been modelled noting that the physical risks are increasing. It is likely that the Company will need to invest to protect certain assets such as sewage works and pumping stations against sea level inundation and these considerations form part of the planning process for new capital expenditure. Longer term investment, outlined in the strategic plans, will be needed to manage future risks. To achieve this, combined regulatory and government support within their policy frameworks will be essential. Whilst it is estimated additional spend will be required to manage future risks, the current available information and assessment did not identify any risks that would require the useful economic lives of assets to be reduced in the year or identify the need for impairment that would impact the carrying values of such assets or have any other impact on the financial statements. The impact assessments will be continuously updated to reflect the latest available information on the impact of climate change.

New standards or interpretations which were mandatory for the first time in the year beginning 1 April 2021 did not have a material impact on the net assets or results of the Company. Although the IASB's interest rate benchmark reform amendments IFRS 7 'Financial Instrument (FI) disclosures' and IFRS 9 'FI recognition and measurement' came into effect from 1 January 2020, these had already been early adopted by the Company in its 2020 financial statements as explained in the accounting policy for financial instruments.

New standards or interpretations due to be adopted from 1 April 2022 are not expected to have a material impact on the Company's net assets or results. Existing borrowing covenants are not impacted by changes in accounting standards.

### (b) Exemption from consolidation

The Company is exempt under the provisions of section 400 of the Companies Act 2006 from the requirement to produce group financial statements as it is a wholly-owned subsidiary of Pennon Group plc which is registered within the United Kingdom and which itself produces consolidated financial statements. Accordingly consolidated financial statements have not been prepared and the financial information presented is for the Company as an individual undertaking. Group financial statements are included in the Annual Report of Pennon

## 2. PRINCIPAL ACCOUNTING POLICIES (CONTINUED)

### (b) Exemption from consolidation (continued)

Group plc which is available from Peninsula House, Rydon Lane, Exeter, EX2 7HR.

### (c) Revenue recognition

Revenue is recognised following delivery of performance obligation and an assessment of when control over the product or service is transferred to the customer. Revenue is only recognised when collection of consideration is highly probable.

Revenue is recognised either when the performance obligation in the contract has been performed (point in time) or 'over time' as the performance obligations to the customer are satisfied. For each obligation satisfied over time, the Company applies a revenue recognition method that accurately reflects performance in transferring control to the customer.

Where a contract with a customer includes more than one performance obligation, revenue is allocated to each obligation in proportion to a fair value assessment of the total contract sales value split across the services provided.

At the inception of a contract, the total transaction price is estimated, being the fair value to which the Company expects to be entitled under the contract, including any variable consideration. Variable consideration is based on the most likely outcome of the performance obligations.

Revenue excludes value added tax, trade discounts and revenue arising from transactions between Group companies.

For most of the services provided to domestic customers, contract terms are implied through statute and regulation in the absence of formal, written contracts. South West Water has a duty under legislation to provide domestic customers with services regardless of payment and is not permitted to disconnect domestic customers for non-payment of bills. Charges are set via the periodic review price-setting process, regulated by Ofwat.

In respect of ongoing, continuous services to customers, such as the provision of drinking water and wastewater services, revenue is recognised over time in line with customer usage of those services.

Customers with an unmeasured supply are billed at the start of the year for the full amount of the annual charge but typically take advantage of a choice of payment arrangements to pay by regular instalments.

Customers with a metered supply are sent up to four bills per year, based either on actual meter readings or estimated usage. For these customers, revenue includes an estimation of the amount of unbilled usage at the period end. Payment options for domestic customers include an annual Meter Payment Plan where customers agree to pay a fixed amount per month which is adjusted to reflect actual consumption at the end of the year.

A range of regulated services is offered to property developers and owners who require connection to the water and sewerage networks or need the networks to be extended or altered. Typically, these customers pay an estimate of the charges in advance as a deposit, which is treated as a contract liability and are billed or refunded the difference between the estimate and actual costs on completion of the work.

Where the performance obligation relates solely to a connection to the network, revenue is recognised at the point of connection when the customer is deemed to obtain control.

Where assets are constructed or provided by the Company or assets transferred to the Company, it is considered that there is an explicit or implied performance obligation to provide an ongoing water and / or wastewater service, with the result that revenue is recognised over a time no longer than the economic life of assets provided by or transferred to the Company.

#### *Contract assets and liabilities*

A trade receivable is recognised when the Company has an unconditional right to receive consideration in exchange for performance obligations already fulfilled. A contract asset is recognised when the Company has fulfilled some of its performance obligations but has not yet obtained an unconditional right to receive consideration. The amounts of contract assets is disclosed within note 18 (Trade and other receivables - current) if applicable. A contract liability is recognised when consideration is received in advance of the Company performing its performance obligations to customers, including, when appropriate, transfers of assets from customers (per paragraph (u) below). The value of contract liabilities is disclosed within note 21 (Trade and other payables - current) and note 23 (Other non-current liabilities) as appropriate.

## 2. PRINCIPAL ACCOUNTING POLICIES (CONTINUED)

### (d) Segmental reporting

The Directors believe that the whole of the Company's activities constitute one single segment. Operating segments are reported in the manner consistent with internal reporting to the Chief Operating Decision Maker, which has been identified as the Board of Directors.

The Company's country of domicile is the United Kingdom and is the country in which it generates all of its revenue. The Company's non-current assets are all located within the United Kingdom.

In accordance with IFRS 15, revenue has been disaggregated based on the services of supplying clean water, removal and treatment of wastewater and retail and other services. Further details are contained in note 5.

### (e) Goodwill

Goodwill arising on consolidation from the acquisition of subsidiary undertakings represents the excess of the purchase consideration over the fair value of net assets acquired, less any subsequent impairment charges.

Goodwill is recognised as an asset and reviewed for impairment at least annually. Any impairment is recognised immediately in the income statement and is not subsequently reversed. For the purpose of impairment testing, goodwill acquired in a business combination is allocated to each of the cash generating units (CGUs) or group of CGUs, that is expected to benefit from the synergies of the combination. Each unit or group of units to which goodwill is allocated represents the lowest level within the entity at which the goodwill is monitored for internal reporting purposes. Goodwill is allocated and monitored at the reportable operating segment level. Further details are contained in accounting policy (i).

When a subsidiary undertaking is sold, the profit or loss on disposal is determined after including the attributable amount of goodwill.

### (f) Other intangible assets

Other intangible assets include assets acquired in a business combination and are capitalised at fair value at the date of acquisition. Following initial recognition, finite life intangible assets are amortised on a straight-line basis over their estimated useful lives, with the expense charged to the income statement through operating costs.

### (g) Property, plant and equipment

Infrastructure assets were included at fair value on transition to IFRS and subsequent additions at cost, less accumulated depreciation. Expenditure to increase capacity or enhance infrastructure assets is capitalised where it can be reliably measured and it is probable that incremental future economic benefits will flow to the Company. The cost of day to day servicing of infrastructure components is recognised in the income statement as it arises.

Infrastructure assets are depreciated evenly over their estimated useful economic lives and are principally:

Dams and impounding reservoirs	200 years
Water mains	40 – 120 years
Sewers	40 – 120 years

Assets in the course of construction are not depreciated until commissioned.

#### ii) Other assets (including property, overground plant and equipment)

Other assets are included at cost less accumulated depreciation.

Freehold land is not depreciated. Other assets are depreciated evenly over their estimated useful economic lives to their residual value and are principally:

Land and buildings - freehold buildings	30 – 60 years
Land and buildings - leasehold buildings	Over the estimated useful life or the lease period, whichever is shorter
Operational properties	40 – 100 years
Fixed plant	20 – 40 years
Vehicles, mobile plant and computers	4 – 10 years

Assets in the course of construction are not depreciated until commissioned.

## **2. PRINCIPAL ACCOUNTING POLICIES (CONTINUED)**

### **(g) Property, plant and equipment (continued)**

The cost of assets includes directly attributable labour and overhead costs which are incremental to the Company. Borrowing costs directly attributable to the construction of a qualifying asset (an asset necessarily taking a substantial period of time to be prepared for its intended use) are capitalised as part of the asset. Assets transferred from customers are recognised at fair value as set out in accounting policy (u).

The assets residual value and useful lives are reviewed annually.

Gains or losses on disposals are determined by comparing the proceeds of sale with the carrying amount and are recognised within the income statement.

### **(h) Leased assets**

All are accounted for by recognising a right-of-use-asset and a lease liability except for:

- Low value assets; and
- Leases with a duration of 12 months or less.

Contracts are initially measured at the present value of contractual payments due to the lessor over the lease term, with the discount rate determined by reference to the rate inherent in the lease unless this is not readily determinable, in which case the Company's incremental borrowing rate on commencement of the lease is used. After initial measurement, lease payments are allocated between the liability and finance cost. The finance cost is charged to profit and loss over the lease period to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The interest element of cash payments in respect of these leases is included within interest payments in determining net cash generated from operating activities. The capital element of the cash payment is included within cash flows from financing activities. Right-of-use assets are amortised on a straight line basis over the remaining term of the lease or the remaining economic life of the asset if shorter. When the Company revisits its estimate of lease term (because, for example, it reassesses an extension option), it adjusts the carrying amount of the lease liability to reflect the payments to make over the revised term, which is discounted at the same discount rate that applied on lease commencement. In these circumstances an equivalent adjustment is made to the carrying value of the right-of-use asset, with the revised carrying amount being amortised over the remaining (revised) lease term.

Assets are included as property, plant and equipment as right-of-use assets at the present value of the minimum lease payments and are depreciated over their estimated economic lives or the lease period, whichever is the shorter. The corresponding liability is recorded as borrowings. The interest element of the rental costs is charged against profits using the actuarial method over the period of the lease.

The Company regularly uses sale and lease back transactions to finance its capital programme. A sale and leaseback transaction is where the Company sells an asset and immediately reacquires the use of the asset by entering into a lease with the buyer. Each transaction is assessed as to whether it meets the criteria within IFRS 15 'Revenue from contracts with customers' for a sale to have occurred. As a result, a lease liability is recognised, the associated property, plant and equipment asset is derecognised, and a right-of-use asset is recognised at the proportion of the carrying value relating to the right retained. Any gain or loss arising relates to the rights transferred to the buyer. If the criteria for a sale under IFRS 15 have not been met the asset is not derecognised and no sale is recorded.

### **(i) Impairment of non-financial assets**

Assets with an indefinite useful life are not subject to amortisation and are tested annually for impairment, or whenever events or changes in circumstance indicate that the carrying amount may not be recoverable.

Assets subject to amortisation or depreciation are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

An impairment loss is recognised for the amount by which an asset's carrying amount exceeds its recoverable value. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (CGUs). Value in use represents the present value of projected future cash flows expected to be derived from a CGU, discounted using a pre-tax discount rate which reflects an assessment of the market cost of capital of the CGU. Impairments are charged to the income statement in the year in which they arise.

## **2. PRINCIPAL ACCOUNTING POLICIES (CONTINUED)**

### **(i) Impairment of non-financial assets (continued)**

Non-financial assets other than goodwill that have been impaired are reviewed for possible reversal of the impairment at each reporting date.

Where a previously impaired asset or CGU's recoverable amount is in excess of its carrying amount, previous impairments are reversed to the carrying value that would have been expected to be recognised had the original impairment not occurred.

### **(j) Grants and contributions**

Grants and contributions receivable in respect of property, plant and equipment are deducted from the cost of those assets. Grants and contributions receivable in respect of expenditure charged against profits in the year have been included in the income statement.

### **(k) Investment in subsidiary undertakings**

Investments in subsidiary undertakings are initially recorded at cost, being the fair value of the consideration paid, including associated acquisition costs. Subsequently, investments are reviewed for impairment on an individual basis annually or if events or changes in circumstances indicate that the carrying value may not be fully recoverable.

### **(l) Inventories**

Inventories are stated at the lower of cost and net realisable value. The cost of finished goods and work in progress includes raw materials and the cost of bringing stocks to their present location and condition. It excludes borrowing costs. Net realisable value is the estimated selling price less cost to sell. The costs of items of inventory are determined using weighted average costs.

### **(m) Cash and cash deposits**

Cash and cash deposits comprise cash in hand and short-term deposits held at banks. Bank overdrafts are shown within current borrowings.

### **(n) Financial instruments**

Financial instruments are recognised and measured in accordance with IFRS 9. The Company classifies its financial instruments in the following categories:

#### **i) Debt instruments at amortised cost**

All loans and borrowings are initially recognised at fair value, net of transaction costs incurred. Following initial recognition interest-bearing loans and borrowings are subsequently stated at amortised cost using the effective interest method. Gains and losses are recognised in the income statement when the instruments are derecognised or impaired. Premia, discounts and other costs and fees are recognised in the income statement through amortisation.

Borrowings are classified as current liabilities unless the Company has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

#### **ii) Trade receivables**

Trade receivables do not carry any interest receivable and are recognised initially at fair value and subsequently at amortised cost using the effective interest method, less provision for expected credit losses (ECLs). In accordance with the terms and conditions of IFRS 9, the Company performs an impairment analysis at each reporting date to measure the ECLs. The Company does not track changes in credit risk but instead recognises a loss allowance based on lifetime ECLs at each reporting date. The Company has established a provision matrix that is based on its historical credit loss experience, adjusted for forward-looking factors specific to the receivables and the economic environment.

#### **iii) Receivables due from fellow subsidiary undertakings**

Amounts owed by fellow subsidiaries are classified and recorded at amortised cost and reduced by allowances for ECLs. Estimated future credit losses are first recorded on initial recognition of a receivable and are based on estimated probability of default.

Individual balances are written off when management deems them not to be collectible.

## 2. PRINCIPAL ACCOUNTING POLICIES (CONTINUED)

### (n) Financial instruments (continued)

#### iv) Trade payables

Trade payables are not interest-bearing and are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

#### v) Derivative financial instruments and hedging activities

The Company uses derivative financial instruments, principally interest rate swaps, to hedge risks associated with interest rate and exchange rate fluctuations. Derivative instruments are initially recognised at fair value on the date the derivative contract is entered into and subsequently remeasured at fair value for the reported balance sheet.

The Company designates certain hedging derivatives as either:

- a hedge of a highly probable forecast transaction or change in the cash flows of a recognised asset or liability (a cash flow hedge); or
- a hedge of the exposure to change in the fair value of a recognised asset or liability (a fair value hedge).

The gain or loss on re-measurement is taken to the income statement except for cash flow hedges which meet the conditions for hedge accounting, when the portion of the gain or loss on the hedging instrument which is determined to be an effective hedge is recognised directly in equity, and the ineffective portion in the income statement. The gains or losses deferred in equity in this way are subsequently recognised in the income statement in the same period in which the hedged underlying transaction or firm commitment is recognised in the income statement.

To qualify for hedge accounting, the Company is required to document in advance the relationship between the item being hedged and the hedging instrument. The Company is also required to document and demonstrate an assessment of the relationship between the hedged item and the hedging instrument which shows that the hedge will be highly effective on an ongoing basis. This effectiveness testing is reperformed at the end of each reporting period to ensure that the hedge remains highly effective.

The full fair value of a hedging derivative is apportioned on a straight-line basis between non-current and current assets or liabilities based on the remaining maturity of the hedging derivative.

Derivative financial instruments deemed held for trading which do not qualify for hedge accounting are classified as a current asset or liability with any change in fair value recognised immediately in the income statement.

The Company uses cross-currency swaps for some of its foreign currency denominated private placement borrowings. The swaps either have the effect of (i) converting variable rate foreign currency borrowings into fixed rate sterling borrowings, (ii) converting fixed rate foreign currency borrowings into fixed rate sterling borrowings, or (iii) converting fixed rate foreign currency borrowings into floating rate sterling borrowings.

In January 2020, the IASB's interest rate benchmark reform amendments to IFRS 7 'Financial Instrument (FI) disclosures' and to IFRS 9 'FI recognition and measurement' (the 'Phase 1 amendments') were endorsed by the EU. The amendments modified hedge accounting requirements to allow hedge accounting to continue for affected hedges during the period of uncertainty before the hedged items or hedging instruments are affected when current interest rate benchmarks are amended due to the ongoing interest rate benchmark reforms. The Group chose to early adopt the Phase 1 amendments, which were mandatory for annual reporting periods commencing after 1 January 2020, for its reporting period ended 31 March 2020.

In August 2020, Phase 2 of interest rate benchmark reform was published, effective from 1 January 2021. The amendments address issues that arise from the implementation of the reforms including the replacement of one benchmark with an alternative one. The Phase 2 amendments provide additional temporary reliefs from applying specific IAS 39 Financial Instruments: Recognition and Measurement and IFRS 9: Financial Instruments hedge accounting requirements to hedging relationships directly affected by benchmark reform.

During the year ended 31 March 2022, the Company continued with its interest rate benchmark reform transition project to assess and implement changes to systems, processes, risk and valuation models, as well as managing related tax and accounting implications. The Company's risk exposure that is directly affected by the interest rate benchmark reform is its floating rate debt, linked to the UK's benchmark rate GBP London Inter-Bank Offered Rate (GBP LIBOR) and a number of its foreign exchange contracts. The floating rate debt is fixed through cash flow hedges using interest rate swaps. Cross currency interest rate swaps are also used to hedge foreign

## **2. PRINCIPAL ACCOUNTING POLICIES (CONTINUED)**

### **(n) Financial instruments (continued)**

currency risk within the Company's financial instruments. The Company has made amendments to the contractual terms of LIBOR-referenced floating-rate debt, swaps and foreign exchange contracts, and updated the relevant hedge designations. During 2021/22 the Company completed the conversion of all its LIBOR based debt instruments to the Sterling Overnight Index Average (SONIA).

### **(o) Taxation including deferred tax**

The tax charge 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 the statement of comprehensive income or directly in equity. In this case the tax is also recognised in the statement of comprehensive income or directly in equity as appropriate.

Current tax is calculated on the basis of tax laws enacted or substantively enacted at the balance sheet date. Management periodically evaluates tax items subject to interpretation and establishes provisions on individual tax items, where in the judgement of management, the position is uncertain.

The Company is part of the Pennon Group for tax purposes and accordingly may use the tax group relief provisions whereby current tax liabilities can be offset by current tax losses arising in other Group companies. Payments for group relief are included within the current tax disclosures.

Deferred tax is provided in full on temporary differences between the carrying amount of assets and liabilities in the financial statements and the tax base, except where they arise from initial recognition of an asset or liability in a transaction, other than a business combination, that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred tax assets are recognised only to the extent that it is probable that future taxable profits will be available against which the assets can be realised. Deferred tax is determined using the tax rates enacted or substantively enacted at the balance sheet date, and expected to apply when the deferred tax liability is settled or the deferred tax asset is realised.

### **(p) Provisions**

Provisions are made where there is a present legal or constructive obligation as a result of a past event and it is probable that there will be an outflow of economic benefits to settle this obligation and a reliable estimate of this amount can be made. Where the effect of the time value of money is material, the current amount of a provision is the present value of the expenditures expected to be required to settle obligations. The unwinding of the discount to present value is included as notional interest within finance costs.

Provisions for restructuring costs are recognised when a detailed formal plan for the restructuring has been communicated to affected parties.

### **(q) Contingent liabilities**

The Company is subject to litigation from time to time as a result of its activities. The Company establishes provisions in connection with litigation where it has a present legal or constructive obligation as a result of past events and where it is more likely than not an outflow of resources will be required to settle the obligation and the amount can be reliably estimated.

There are contingent liabilities that arise in the normal course of business which, if realised, are not expected to result in a material liability to the Company.

### **(r) Dividend distributions**

Dividend distributions are recognised as a liability in the financial statements in the period in which the dividends are approved by the Company's shareholder. Interim dividends are recognised when paid; final dividends when approved by the shareholder at the Annual General Meeting.

### **(s) Employee benefits**

#### **i) Retirement benefit obligations**

The Company operates defined benefit and defined contribution pension schemes through its parent company.

#### **Defined benefit pension schemes**

The liability recognised in the balance sheet in respect of defined benefit pension plans is the present value of the defined benefit obligation at the end of the year less the fair value of plan assets. If the value of the plans assets exceeds the present value of its obligations, the resulting surplus is only realised if the Company has an unconditional right to that surplus.



## **2. PRINCIPAL ACCOUNTING POLICIES (CONTINUED)**

### **(s) Employee benefits (continued)**

The defined benefit obligation is calculated by independent actuaries who advise on the selection of Directors' best estimates, using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high quality corporate bonds, and that have terms to maturity approximating to the terms of the related pension obligation. The increase in liabilities of the Company's defined benefit pension schemes, expected to arise from employee service in the year, is charged against operating profit.

Changes in benefits granted by the employer are recognised immediately as past service cost in the income statement.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to equity in the statement of comprehensive income in the period to which they arise.

### ***Defined contribution scheme***

Costs of the defined contribution pension scheme are charged to the income statement in the period in which they arise. The Company has no further payment obligations once the contributions have been paid.

### **ii) Share-based payment**

The Company participates in a number of equity-settled share-based payment plans for employees operated by its parent company Pennon Group plc. The fair value of the employee services acquired in exchange for the grant is recognised as an expense over the vesting period of the grant.

Fair values are calculated using an appropriate pricing model. Non market-based vesting conditions are adjusted for in assumptions as to the number of shares which are expected to vest.

### **(t) Fair values**

The fair value of the interest rate swaps is based on the market price to transfer the asset or liability at the balance sheet date in an ordinary transaction between market participants.

The fair values of short-term deposits, loans and overdrafts with a maturity of less than one year are assumed to approximate to their book values. In the case of non-current bank loans and other loans, the fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate available to the Company for similar financial instruments.

### **(u) Transfers of assets from customers**

Where an item of property, plant and equipment that must be used to connect customers to the network is received from a customer, or where cash is received from a customer for the acquisition or construction of such an item, that asset is recorded and measured on initial recognition at its fair value. The credit created by the recognition of the asset is recognised as a contract liability on the balance sheet. The contract liability reduces and revenue is recognised in the income statement as the performance obligations are satisfied. The period over which the credit is recognised depends upon the nature of the service provided, as determined by the agreement with the customer. Where the service provided is solely a connection to the network, the credit is recognised at the point of connection. If the agreement does not specify a period, revenue is recognised over a period no longer than the economic life of the transferred asset used to provide the ongoing service.

The fair value of assets on transfer from customers is determined using a cost valuation approach allowing for depreciation.

### **(v) Non-underlying items**

Non-underlying items are those that in the Directors' view should be separately disclosed by virtue of their size, nature or incidence to enable a full understanding of the Company's financial performance.

### **(w) Foreign exchange**

Transactions denominated in foreign currencies are translated at the exchange rate at the date of the transaction. Monetary assets and liabilities denominated in a foreign currency are translated at the closing balance sheet rate. The resulting gain or loss is recognised in the income statement.

### **3. FINANCIAL RISK MANAGEMENT**

#### **(a) Financial risk factors**

The Company's activities expose it to a variety of financial risks; market risk (interest rate risk), liquidity risk and credit risk.

The Company receives treasury services from the treasury function of Pennon Group plc, the parent company, which seeks to ensure that sufficient funding is available to meet foreseeable needs and to maintain reasonable headroom for contingencies and manages inflation and interest rate risk.

The principal financial risks faced by the Company relate to interest rate and credit counterparty risk.

These risks and treasury operations are managed in accordance with policies established by the Board. Major transactions are individually approved by the Board. Treasury activities are reported to the Board and are subject to review by internal audit.

Financial instruments are used to raise finance, manage risk, optimise the use of surplus funds and manage overall interest rate performance. The Company does not engage in speculative activity.

#### **i) Liquidity risk**

The Company actively maintains a mixture of long-term and short-term committed facilities which are designed to ensure the Company has sufficient available funds for operations and planned expansions equivalent to at least one year's forecast requirements at all times. Details of undrawn committed facilities and short-term uncommitted facilities are provided in note 22.

The Company has entered into covenants with lenders. While terms vary, these typically provide for limits on gearing (primarily based on the business's regulatory capital value and unregulated EBITDA) and interest cover. Existing covenants are not impacted by subsequent changes to accounting standards.

### 3. FINANCIAL RISK MANAGEMENT (CONTINUED)

#### (a) Financial risk factors (continued)

Contractual undiscounted cash flows including interest payments, at the balance sheet date were:

<b>31 March 2022</b>	<b>Due within 1 year £m</b>	<b>Due between 1 and 2 years £m</b>	<b>Due between 2 and 5 years £m</b>	<b>Over 5 years £m</b>	<b>Total £m</b>
<b>Non-derivative financial liabilities</b>					
Borrowings excluding finance lease liabilities	43.1	46.5	172.6	1,021.9	1,284.1
Interest payments on borrowings	35.3	36.0	32.1	390.7	494.1
Lease liabilities including interest	191.4	48.5	233.9	1,173.9	1,647.7
Trade and other payables	156.3	-	-	-	156.3
<b>Derivative financial liabilities</b>					
Derivative contracts – net payments	(3.6)	(6.5)	(7.9)	(2.2)	(20.2)
<b>31 March 2021</b>	<b>Due within 1 year £m</b>	<b>Due between 1 and 2 years £m</b>	<b>Due between 2 and 5 years £m</b>	<b>Over 5 years £m</b>	<b>Total £m</b>
<b>Non-derivative financial liabilities</b>					
Borrowings excluding finance lease liabilities	40.1	40.2	135.8	965.2	1,181.3
Interest payments on borrowings	26.7	28.3	89.4	595.7	740.1
Lease liabilities including interest	55.3	37.8	267.3	1,543.1	1,903.5
Trade and other payables	159.1	-	-	-	159.1
<b>Derivative financial liabilities</b>					
Derivative contracts – net payments	9.3	6.7	3.9	(2.4)	17.5

#### ii) Market risk

The Company has both interest bearing assets and interest bearing liabilities. The Company has a policy of maintaining, after the effect of interest rate swaps, at least 60% of interest bearing liabilities at fixed rates. At the year end, 59% (31 March 2021: 63%) of net borrowings were at fixed rates and 26% (31 March 2021: 25%) were index-linked. The Company uses a combination of fixed rate and index-linked borrowings and fixed rate interest swaps as cash flow hedges of future variable interest payments to achieve this policy. The notional principal amounts of the interest rate swaps are used to determine settlement under those swaps and are not, therefore, an exposure for the Company. These instruments are analysed in more detail in note 19.

The interest rate for index-linked debt is based upon a CPI or an RPI measure provides an approximation to the index used in determining the amount of income from customers.

During 2021/22 the Company completed the conversion of all its LIBOR based debt instruments to SONIA. Below are the details of the hedging instruments and hedged items which are now based on SONIA rather than LIBOR rates, by hedge type. The terms of the hedged items listed match those of the corresponding hedging instruments.

### 3. FINANCIAL RISK MANAGEMENT (CONTINUED)

#### (a) Financial risk factors (continued)

Hedge type	Instrument type	Maturing	Nominal £m	Hedged item
Cash flow hedges	Receive three-month UK benchmark rate (GBP SONIA), pay GBP fixed interest rate swap	2024-2030	701	UK benchmark rate (GBP SONIA) issued financial instruments of the same nominals as the swaps
	Receive six-month UK benchmark rate (GBP SONIA), pay GBP fixed interest rate swap	2025	100	UK benchmark rate (GBP SONIA) issued financial instruments of the same nominals as the swaps

The Company has accounted for the conversion from LIBOR to SONIA interest rates in accordance with Phases 1 and 2 of the amendments to IFRS 9. Further details are disclosed in note 2 (n) v). The Company considers that the uncertainty arising from the interest rate benchmark reforms with respect to the timing and the amount of the underlying cash flows that the Company is exposed has ended as at 31 March 2022.

The Company has no significant interest-bearing assets upon which the net return fluctuates from market risk. Deposit interest receivable is expected to fluctuate in line with interest payable on floating rate borrowings. Consequently the Company's income and cash generated from operations (note 31) are independent of changes in market interest rates.

For 2022 if interest rates on variable net borrowings had been on average 1% higher/lower with all other variables held constant, post-tax profit for the year and equity would have increased/decreased by £1.4 million (2021: £3.8 million), for the equity sensitivity fair value, derivative impacts are excluded.

For 2022 if RPI on index-linked borrowings had been on average 1% higher/lower with all other variables held constant, post-tax profit for the year and equity would have decreased/ increased by £4.3 million (2021: £4.0 million).

Foreign currency risk occurs at transactional and translation level from borrowings and transactions in foreign currencies. These risks are managed through forward contracts, which provide certainty over foreign currency risk.

#### iii) Credit risk

Credit counterparty risk arises from cash and cash deposits, derivative financial instruments and exposure to customers, including outstanding receivables. Further information on the credit risk relating to trade and other receivables is given in note 18.

Counterparty risk arises from the investment of surplus funds and from the use of derivative financial instruments. The Board has agreed a policy for managing such risk, which is controlled through credit limits, counterparty approvals, and rigorous monitoring procedures.

The Company has no other significant concentration of credit risk. Surplus funds of the Company are usually placed in short-term fixed interest deposits or the overnight money markets. Deposit counterparties must meet a board approved minimum criteria based on their short-term credit rating and therefore be of good credit quality,

The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to minimise the cost of capital.

The Company's policy is to have a minimum of 12 months pre-funding of projected capital expenditure. At 31 March 2022 the Company had cash and committed facilities excluding restricted funds of £193 million (31 March 2021: £389 million), meeting this objective.

The Company monitors capital on the basis of the gearing ratio, which is calculated as net borrowings divided by total capital. Net borrowings is analysed in note 32 and is calculated as total borrowings less cash and cash deposits. Total capital is calculated as equity plus net borrowings.

### 3. FINANCIAL RISK MANAGEMENT (CONTINUED)

#### (b) Capital risk management

The gearing ratios at the balance sheet date were:

	Note	2022 £m	2021 £m
Net borrowings	32	2,305.2	2,273.6
Total equity		574.5	527.1
<b>Total capital</b>		<b>2,879.7</b>	<b>2,800.7</b>
<b>Gearing Ratio</b>		<b>80.0%</b>	<b>81.2%</b>

Consistent with the industry peer group, the Company is also monitored on the basis of the ratio of its net debt to Regulated Capital Value (RCV). South West Water's net debt to RCV has decreased to 63.6%. Ofwat's notional gearing target for the K7 (2020-25) regulatory period is set at 60.0%.

	Note	2022 £m	2021 £m
Regulatory Capital Value		3,623.2	3,387.5
Net borrowings	32	2,305.2	2,273.6
<b>Net borrowings / Regulatory Capital Value</b>		<b>63.6%</b>	<b>67.1%</b>

The Company has entered into covenants with lenders and, whilst terms vary, these typically provide for limits on gearing and interest cover. The Company has been in compliance with its covenants during the year.

#### (c) Determination of fair values

The Company uses the following hierarchy for determining the fair value of financial instruments by valuation technique:

- quoted prices (unadjusted) in active markets for identical assets or liabilities (level 1)
- inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (level 2)
- inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (level 3).

The Company's financial instruments are valued principally using level 2 measures as analysed in note 19.

The fair value of financial instruments traded in active markets (such as trading and available-for-sale securities) is based on quoted market prices at the balance sheet date. The quoted market price used for financial assets held by the Company is the current bid price.

The fair value of financial instruments that are not traded in an active market (for example, over-the-counter derivatives) is determined by using valuation techniques. A variety of methods and assumptions are used based on market conditions existing at each balance sheet date. Quoted market prices or dealer quotes for similar instruments are used for long-term debt. Other techniques, such as estimated discounted cash flows, are used to determine fair value for the remaining financial instruments. The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows.

The carrying value less impairment provision of trade receivables and payables are assumed to approximate their fair values.

#### **4. CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES**

The Company's principal accounting policies are set out in note 2. Management is required to exercise significant judgement and make use of estimates and assumptions in the application of these policies. Estimates are based on factors including historical experience and expectations of future events that management believe to be reasonable. However, given the judgemental nature of such estimates, actual results could be different from the assumptions used:

##### **Estimates**

###### **Provision for expected credit losses**

The Company has a material level of exposure to collection of trade receivables. Provisions in respect of these balances are calculated based on assumptions of historical credit loss experience, adjusted for forward-looking factors which by their nature are subject to uncertainty. Analysis of actual recovery compared with provisioning levels have not, to date, resulted in material variances.

Under its regular review procedures, at the balance sheet date, the Company applies a simplified approach in calculating expected credit losses (ECLs) for trade receivables and contract assets. Therefore, the Company does not track changes in credit risk but instead recognises a loss allowance based on lifetime ECLs at each reporting date. South West Water has established a provision matrix that is based on its historical credit loss experience, adjusted for forward-looking factors specific to the receivables and the economic environment.

In the year ended 31 March 2020 an additional assessment of ECLs was focused on the potential impact from the COVID-19 pandemic. The COVID-19 pandemic continues to impact on society and the economy around the world. Pressure on the UK economy continues from the COVID-19 pandemic with global commodity shortages pushing up prices leading to higher inflation which in turn impacts on the ability of households to pay their bills in what is being termed the 'cost of living crisis'. This additional pressure on households in the UK alongside the continued impacts of the pandemic are still being felt and as such the specific COVID-19 provision has now been included as part of the provision matrix calculation.

The actual level of debt collected may differ from the estimated levels of recovery. As at 31 March 2022 the Company's current trade receivables were £227.5 million (2021: £216.2 million), against which £84.5 million (2021: £88.4 million) had been provided for ECLs (note 18).

###### **Retirement benefit obligations**

The Company operates defined benefit pension schemes, through its parent company, for which actuarial valuations are carried out as determined by the trustees at intervals of not more than three years. The most recent triennial valuation of the main scheme was as at 31 March 2019, the outcome of which is summarised in note 24.

The pension cost and liabilities under IAS 19 are assessed in accordance with Directors' best estimates using the advice of an independent qualified actuary and assumptions in the latest actuarial valuation. The assumptions are based on member data supplied to the actuary and market observations for interest rates and inflation, supplemented by discussions between the actuary and management. The mortality assumption uses a scheme-specific calculation based on CMI 2019 actuarial tables with an allowance for future longevity improvement. The principal assumptions used to measure schemes' liabilities, sensitivities to changes in those assumptions and future funding obligations are set out in note 24.

##### **Judgements**

###### **Non-underlying items**

In establishing which items are disclosed separately as non-underlying, to enable a full understanding of the Company's financial performance, the Directors exercise their judgement in assessing the size, nature or incidence of specific items. See note 6 for further details.

#### 4. CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES (CONTINUED)

##### Other estimates

During the year, management reassessed the critical estimates and resolved that the level of estimation for revenue recognition of accrued revenue is still not considered critical as the estimates are largely calculated on a systematic basis and have not, to date, resulted in a material adjustment within the following 12-month period. However, management consider the total level of estimation of accrued revenue relating to water, waste and sale of electricity to be material and highlight this as a material other estimate.

The property, plant and equipment of the Company relates primarily to infrastructure assets (being water mains and sewers, impounding and pumped raw water storage reservoirs, dams, pipelines and sea outfalls) as well as other assets which include fixed plant and operational properties. The useful economic lives of these types of asset vary from 20 to 200 years. Asset lives are reviewed annually and amended where changes are made to assumptions relating to the expected life of the asset from judgement around usage and performance experience, technological advancement and other relevant factors. Overall assessments on the impact of climate change on long life assets have been completed and will be continuously updated for the latest available information. The most recent assessment of the impact on climate change, which includes the potential to mitigate adverse impacts, has not identified any specific impact on the useful economic lives of long life assets. Environmental factors and climate change form part of the planning process for new capital expenditure. The depreciation charge is sensitive to amendments of the useful economic lives of these assets, a significant change in the estimated life of these assets could have a material impact on depreciation, this is therefore noted as a material other estimate.

#### 5. REVENUE

Revenue has been disaggregated based on the services of supplying clean water, removal and treatment of wastewater and other services.

	2022 £m	2021 £m
Water	267.0	257.0
Wastewater	281.0	261.4
Other services	36.6	25.4
<b>Total</b>	<b>584.6</b>	<b>543.8</b>

#### 6. NON-UNDERLYING ITEMS

Non-underlying items are those that in the Directors' view are required to be separately disclosed by virtue of their size or incidence to enable full understanding of the Company's financial performance in the year and business trends over time. The presentation of results is consistent with internal performance monitoring.

	Note	2022 £m	2021 £m
<b>Revenue</b>			
Watershare+ <sup>1</sup>		-	20.5
<b>Operating Costs</b>			
Pension curtailment charge <sup>2</sup>	24	-	3.5
Restructuring cost <sup>3</sup>		2.0	-
<b>Earnings before interest, tax, depreciation and amortisation</b>		<b>2.0</b>	<b>24.0</b>
Tax credit arising on non-underlying items	9	(0.4)	(4.6)
Deferred tax change in rate <sup>4</sup>	9	98.7	-
<b>Net non-underlying charge</b>		<b>100.3</b>	<b>19.4</b>

1. In September 2020, the Company offered its WaterShare+ scheme to its customers whereby customers could choose to accept a credit on their bill or take shares in Pennon Group plc. The value of the rebate equates to £20 per customer and the total value of £20.5 million was been recognised in full as a non-underlying reduction to revenue in the prior financial year. £19.3 million of the WaterShare+ credits were taken as credits on customers' bills, with the balance of £1.2 million being taken as shares in Pennon Group Plc. This item is non-underlying in nature given its individual size and its non-recurring nature.

## 6. NON-UNDERLYING ITEMS (CONTINUED)

2. Pennon Group completed its employee consultation to modernise its ongoing pension arrangements. The outcome of the consultation resulted in a decision to close Pennon's principal defined benefit pension scheme to future accrual with effect from 30 June 2021. This resulted in a curtailment charge for South West Water of £3.5 million in the prior financial year.
3. During the year a one-off charge of £2.0m was made to the restructuring provision reflecting announced reorganisation across the Company.
4. Following the Chancellor's budget on in March 2021, the UK headline corporation tax rate will remain at 19% until April 2023 and thereafter is will increase to 25%. These changes were substantively enacted on 24 May 2021, as a result any deferred tax assets and liabilities have been remeasured to the rate at which they are expected to crystallise. These changes are considered non-underlying due to it arising from a material legislative change, and its treatment is consistent with that applied in relation to previous corporation tax rate changes.

## 7. OPERATING COSTS BEFORE NON-UNDERLYING ITEMS

	Note	2022 £m	2021 £m
Employment costs before non-underlying items	11	56.9	53.9
Raw materials and consumables		20.5	18.1
<i>Other operating expenses include</i>			
Profit on disposal of property, plant and equipment		(1.1)	(0.2)
<i>Operating lease rentals payable:</i>			
Short term/low value asset lease expense		1.6	1.4
Research and development expenditure		-	0.1
Provision for expected credit losses before non-underlying items	18	3.1	2.8
<i>Depreciation of property, plant and equipment:</i>			
Owned assets		79.7	86.6
Under leases		37.3	31.7
Total Depreciation		<u>117.0</u>	<u>118.3</u>

Fees payable to the Company's auditor's in the year were:

	2022 £000	2021 £000
Fees payable to the Company's auditors and its associates for the audit of the financial statements	335	307
Fees payable to the Company's auditors and its associates for other services:		
Audit related assurance	40	39
All other services	33	32
<b>Total fees</b>	<b><u>408</u></b>	<b><u>378</u></b>

Expenses reimbursed to the auditors in relation to the audit of the Company were £nil (2020/21: £nil).

A description of the work of the Audit Committee is set out in its report on page 117 to 124 which includes an explanation of how the auditor's objectivity and independence are safeguarded when non-audit services are provided by the auditor's firm.



## 8. NET FINANCE COSTS

	Finance cost £m	2022 Finance income £m	Total £m	Finance cost £m	2021 Finance income £m	Total £m
<b>Cost of servicing debt</b>						
Bank borrowings and overdrafts	(22.4)	-	(22.4)	(13.9)	-	(13.9)
Interest element of finance lease rentals	(19.1)	-	(19.1)	(24.5)	-	(24.5)
Interest element of operating lease rentals	(1.1)	-	(1.1)	(1.2)	-	(1.2)
Other finance costs	(0.8)	-	(0.8)	(3.4)	-	(3.4)
Interest receivable	-	0.8	0.8	-	0.7	0.7
Intercompany interest to subsidiaries	(34.6)	-	(34.6)	(13.8)	-	(13.8)
<b>Working capital adjustment</b>	<b>(78.0)</b>	<b>0.8</b>	<b>(77.2)</b>	<b>(56.8)</b>	<b>0.7</b>	<b>(56.1)</b>
<b>Notional interest</b>						
Retirement benefit obligations (note 24)	-	0.4	0.4	(0.4)	-	(0.4)
<b>Finance (costs)/income</b>	<b>(78.0)</b>	<b>1.2</b>	<b>(76.8)</b>	<b>(57.2)</b>	<b>0.7</b>	<b>(56.5)</b>

In addition to the above, finance costs of £1.0 million (2020/21: £0.9 million) have been capitalised on qualifying assets included in property, plant and equipment.

## 9. TAXATION

	Before non- underlying items 2022 £m	Non- underlying items (note 6) 2022 £m	Total 2022 £m	Before non- underlying items 2021 £m	Non- underlying items (note 6) 2021 £m	Total 2021 £m
<b>Analysis of charge in year</b>						
Current year tax charge/(credit)	9.6	(0.4)	9.2	28.2	(3.9)	24.3
Deferred tax charge/(credit)	3.1	-	3.1	3.4	(0.7)	2.7
Deferred tax arising on change of rate of corporation tax	-	98.7	98.7	-	-	-
Total deferred tax charge/(credit)	3.1	98.7	101.8	3.4	(0.7)	2.7
<b>Tax charge/(credit) for year</b>	<b>12.7</b>	<b>98.3</b>	<b>111.0</b>	<b>31.6</b>	<b>(4.6)</b>	<b>27.0</b>

UK Corporation tax is calculated at 19% (2020/21 19%) of the estimated assessable profit for the year.

UK corporation tax is stated after a credit relating to prior year current tax of £2.2 million (2020/21 credit of £0.2m) and a prior year deferred tax credit of £9.7 million (2020/21 charge of £0.3 million).

These items arise following discussions with and the subsequent submission of tax computations to HMRC. The largest adjustment relates to qualifying assets acquired in prior years, which are now being recognised.

The tax for the year differs from the theoretical amount that would arise using the standard rate of corporation tax in the UK of 19% (2020/21: 19%). The differences are explained below:

## 9. TAXATION (CONTINUED)

	2022 £m	2021 £m
<b>Reconciliation of total tax charge</b>		
Profit before tax	135.5	141.8
Profit before tax multiplied by the standard rate of corporation tax in the UK of 19% (2020/21: 19%)	25.7	26.9
<i>Effects of:</i>		
Expenses not deductible for tax purposes	0.2	-
Change in rate of corporation tax	98.7	-
Adjustments to tax charge in respect of prior years	(11.9)	0.1
Depreciation charged on non-qualifying assets	0.4	0.4
Other	(2.1)	(0.4)
<b>Tax charge for year</b>	<b>111.0</b>	<b>27.0</b>

The current tax charge for the year differs from the theoretical amount that would arise using the standard rate of corporation tax in the UK of 19% (2020/21: 19%). The differences are explained below:

	2022 £m	2021 £m
<b>Reconciliation of current tax charge</b>		
Profit before tax	135.5	141.8
Profit before tax multiplied by the standard rate of corporation tax in the UK of 19% (2020/21: 19%)	25.7	26.9
<i>Effects of:</i>		
Relief for capital allowances in place of depreciation	(32.1)	(21.4)
Disallowance of depreciation charged in the accounts	19.6	20.1
Expenses not deductible for tax purposes	0.2	-
Adjustments to tax charge in respect of prior years	(2.2)	(0.2)
Depreciation charged on non-qualifying assets	0.4	0.4
Relief for capitalised interest and foreign exchange gains/losses	(0.2)	(0.2)
Group relief received not paid	(1.8)	-
Other timing differences	(0.4)	(1.3)
<b>Current Tax charge for year</b>	<b>9.2</b>	<b>24.3</b>

South West Water's current tax charge is lower than the UK headline rate of 19%, primarily due to the availability of capital allowances. Capital allowances provide tax relief when a business incurs expenditure on qualifying capital items such as plant and machinery used by the business. As an infrastructure business, these allowances help the Company to plan major investment and consequentially to maintain lower customer bills, as corporation tax relief is given against the investments made.

From 1 April 2021, a "super-deduction" on qualifying plant and machinery equivalent to 130% of spend on expenditure relating to contracts entered into after 3 March 2021 is available in respect of qualifying expenditure. The Company incurs significant capital expenditure each year as it maintains and enhances its assets for the benefit of its customers, communities and the environment. The first year allowance on certain other types of assets, including long-life was boosted to 50% for the same period, again for contracts entered into after 3 March 2021. These enhanced allowances have increased capital allowance claims for the year and hence reduce the current tax charge for the year. The same will apply for the year ended 31 March 2023. There is also a consequently higher deferred tax liability and charge due to the additional capital allowance deductions together with the increase in the rate of corporation tax to 25% from April 2023.

Other differences relate to the timing of relief for items including pensions, general provisions and financial derivatives. The reduction in the year relates mainly to additional pension contributions made to fund deficits in the scheme.

### Factors affecting future tax charges

Following the Chancellor's budget in March 2021 the rate of UK corporation tax will remain at 19% until April 2023 and thereafter will increase to 25%.

## 9. TAXATION (CONTINUED)

These changes were substantively enacted on 24 May 2021, as a result any deferred tax assets and liabilities have been remeasured to the rate at which they are expected to crystallise.

These changes are considered non-underlying due to it arising from a material legislative change, and its treatment is consistent with that applied in relation to previous corporation tax rate changes.

In addition to the amounts recognised in the income statement the following tax charges and credits were also recognised:

	2022 £m	2021 £m
<b>Amounts recognised directly in other comprehensive income</b>		
Deferred tax charge/(credit) on defined benefit pension schemes	0.7	2.6
Deferred tax charge/(credit) on cash flow hedges	6.4	1.6
<b>Amounts recognised directly in equity</b>		
Deferred tax charge/(credit) on share based payments	-	0.4

## 10. DIVIDENDS

	2022 £m	2021 £m
<b>Amounts recognised as distributions to equity holders in the year:</b>		
Base dividend of 15.2p per ordinary share in respect of 2021/22 paid 31 March 2022	45.0	-
Base dividend of 16.9p per ordinary share in respect of 2020/21 paid 29 March 2021	-	42.3
Watershare+ dividend	-	1.2
<b>Declared and approved:</b>		
Outperformance dividend of 14.5p per ordinary share in respect of 2020/21	43.0	-
Outperformance dividend of 23.2p per ordinary share in respect of 2019/20	-	58.1
	<b>88.0</b>	<b>101.6</b>

Payment of the outperformance dividend based on cumulative outperformance for 2020/21 of £43.0m has been deferred to August 2022. The Company is obligated to pay the dividend therefore £43.0m has been recognised as a transaction with owners during the year ended 31 March 2022.

## 11. EMPLOYMENT COSTS

The average number of persons (including Executive Directors) employed by the Company was 1,700 (2021: 1,567).

	Note	2022 £m	2021 £m
Wages and salaries		62.8	56.2
Social security costs		6.0	5.6
Pension costs	24	6.9	12.6
Share-based payments		1.0	1.0
<b>Total employment costs</b>		<b>76.7</b>	<b>75.4</b>
Charged as follows:			
Employee costs		56.9	53.9
Capital schemes		18.1	18.0
Non-underlying restructuring costs	6	1.7	-
Non-underlying pension curtailment charge	6	-	3.5
<b>Total employment costs</b>		<b>76.7</b>	<b>75.4</b>

Details of Directors' emoluments are set out in note 12. There are no personnel other than Directors, who as key management exercise authority and responsibility for planning, directing and controlling the activities of the Company.

## 12. DIRECTORS' EMOLUMENTS

	<b>2022</b>	<b>2021</b>
	<b>£000</b>	<b>£000</b>
Executive Directors:		
Salary	408	488
Performance-related bonus paid or payable	121	208
Share-based payments	386	541
Other emoluments, including payments in lieu of pension provision	77	113
Non-Executive Directors (including Chairman)	262	325
<b>Total emoluments</b>	<b>1,254</b>	<b>1,675</b>

More detailed information concerning Directors' emoluments (including pensions and the highest paid Director) and share interests is shown in the Annual Report on Remuneration on pages 139 to 157. This report also details arrangements with Pennon Group plc for the payment and recharging of emoluments relating to Directors who serve as Directors of both Pennon Group and South West Water. In the prior year one of the directors received compensation for loss of office which has been borne in full by Pennon Group plc. The cost of share-based payments represents the amount charged to the income statement, as described in note 29.

The aggregate gains on vesting of Directors' share-based awards amounted to a total of £112,000 (2021: £87,000).

At 31 March 2022 there were no Directors accruing retirement benefits under defined benefit pension schemes (2021: none). At 31 March 2022 there was one Directors (2021: one) accruing benefits under defined contribution pension schemes with contributions of £2,000 made during the year (2021: £3,000). At 31 March 2022 one Director received payments in lieu of pension provision (2021: one).

### 13. PROPERTY, PLANT AND EQUIPMENT

	Freehold land and buildings £m	Infrastructure assets £m	Operational properties £m	Fixed and mobile plant, vehicles and computers £m	Construction in progress £m	Total £m
<b>Cost:</b>						
<b>At 31 March 2020</b>	<b>85.4</b>	<b>1,945.0</b>	<b>769.6</b>	<b>1,953.6</b>	<b>119.0</b>	<b>4,872.6</b>
Additions	0.1	17.0	2.7	49.1	99.2	168.1
Assets adopted at fair value	-	7.5	-	-	-	7.5
Grants & contributions	-	-	-	-	(3.7)	(3.7)
Disposals	-	-	-	(0.7)	-	(0.7)
Transfers/reclassifications	0.4	13.5	12.6	70.2	(96.7)	-
<b>At 31 March 2021</b>	<b>85.9</b>	<b>1,983.0</b>	<b>784.9</b>	<b>2,072.2</b>	<b>117.8</b>	<b>5,043.8</b>
Additions	-	25.9	1.8	65.1	109.7	202.5
Assets adopted at fair value	-	11.0	-	-	-	11.0
Grants & contributions	-	-	-	-	(3.2)	(3.2)
Disposals	(0.3)	(1.2)	-	(0.9)	-	(2.4)
Transfers/reclassifications	0.6	17.1	3.7	43.9	(65.3)	-
<b>At 31 March 2022</b>	<b>86.2</b>	<b>2,035.8</b>	<b>790.4</b>	<b>2,180.3</b>	<b>159.0</b>	<b>5,251.7</b>
<b>Accumulated depreciation:</b>						
<b>At 31 March 2020</b>	<b>15.9</b>	<b>296.0</b>	<b>285.5</b>	<b>1,186.2</b>	<b>-</b>	<b>1,783.6</b>
Charge for year	2.9	23.2	13.8	82.2	-	122.1
Disposals	-	-	-	(0.7)	-	(0.7)
<b>At 31 March 2021</b>	<b>18.8</b>	<b>319.2</b>	<b>299.3</b>	<b>1,267.7</b>	<b>-</b>	<b>1,905.0</b>
Charge for year	2.8	25.2	9.6	83.1	-	120.7
Disposals	-	(1.2)	-	(0.8)	-	(2.0)
<b>At 31 March 2022</b>	<b>21.6</b>	<b>343.2</b>	<b>308.9</b>	<b>1,350.0</b>	<b>-</b>	<b>2,023.7</b>
<b>Net book value:</b>						
<b>At 31 March 2020</b>	<b>69.5</b>	<b>1,649.0</b>	<b>484.1</b>	<b>767.4</b>	<b>119.0</b>	<b>3,089.0</b>
<b>At 31 March 2021</b>	<b>67.1</b>	<b>1,663.8</b>	<b>485.6</b>	<b>804.5</b>	<b>117.8</b>	<b>3,138.8</b>
<b>At 31 March 2022</b>	<b>64.6</b>	<b>1,692.6</b>	<b>481.5</b>	<b>830.3</b>	<b>159.0</b>	<b>3,228.0</b>

Out of the total depreciation charge for the Company of £120.7 million (2020/21: £122.1 million), the sum of £1.7 million (2020/21: £1.7 million) has been charged to capital projects, £2.0 million (2020/21: £2.1 million) has been offset by deferred income and £117.0 million (2020/21: £118.3 million) against profits.

Asset lives and residual values are reviewed annually.

During the year borrowing costs of £1.0 million (2020/21: £0.9 million) have been capitalised on qualifying assets, at an average borrowing rate of 3.8% (2020/21: 2.7%).

Groups of assets forming cash generating units are reviewed for indicators of impairment. No indicators of impairment were identified during the year.

### 13. PROPERTY, PLANT AND EQUIPMENT (CONTINUED)

The Company leases many assets as a lessee, across several categories of asset. Right-of-use assets held under leases included in property, plant and equipment above were:

	Freehold land and buildings £m	Infrastructur e assets £m	Operational properties £m	Fixed and mobile plant, vehicles and computers £m	Construction in progress £m	Total £m
<b>Cost:</b>						
<b>At 31 March 2021</b>	<b>35.3</b>	<b>413.6</b>	<b>482.2</b>	<b>524.4</b>	-	<b>1,455.5</b>
Additions	-	-	7.7	7.9	-	15.6
Disposals	-	(14.2)	(114.3)	(152.6)	-	(281.1)
<b>At 31 March 2022</b>	<b>35.3</b>	<b>399.4</b>	<b>375.6</b>	<b>379.7</b>	-	<b>1,190.0</b>
<b>Accumulated depreciation:</b>						
<b>At 31 March 2021</b>	<b>2.7</b>	<b>77.9</b>	<b>142.8</b>	<b>304.2</b>	-	<b>527.6</b>
Charge for year	1.2	5.1	8.0	23.1	-	37.4
Disposals	-	(3.5)	(48.1)	(143.2)	-	(194.8)
<b>At 31 March 2022</b>	<b>3.9</b>	<b>79.5</b>	<b>102.7</b>	<b>184.1</b>	-	<b>370.2</b>
<b>Net book value:</b>						
At 31 March 2021	32.6	335.7	339.4	220.2	-	927.9
<b>At 31 March 2022</b>	<b>31.4</b>	<b>319.9</b>	<b>272.9</b>	<b>195.6</b>	-	<b>819.8</b>

When the Company enters into sale and leaseback arrangements, the accounting for the arrangement depends on whether the transaction meets the criteria within IFRS 15 for a sale to have occurred. If the sale criteria are met, the associated property, plant and equipment asset is derecognised, and a right-of-use asset is recognised at the proportion of the carrying value relating to the right retained. If the criteria for a sale under IFRS 15 have not been met the asset is not derecognised, but is reclassified to right-of-use assets (within property, plant and equipment). Right of use assets includes assets held under sale and leaseback arrangements with a carrying value of £793.7 million.

During 2021 the depreciation on leased infrastructure assets included a credit of £5.1 million in respect of depreciation on owned assets which had been treated as relating to leased assets in the 2020 financial statements. There was a corresponding charge to depreciation on owned infrastructure assets in 2021.

### 14. GOODWILL

	2022 £m	2021 £m
<b>Cost</b>		
At 1 April	51.3	51.3
<b>At 31 March</b>	<b>51.3</b>	<b>51.3</b>

The goodwill of £51.3 million was recognised on acquisition of Bournemouth Water in 2016/17. It is attributable to synergies and outperformance arising from the merger of operating activities.

#### Impairment testing of goodwill

The Company tests goodwill for impairment annually or more frequently if there are any indications that impairment may have arisen.

The recoverable amount, for which goodwill was recognised on the acquisition of Bournemouth Water in 2016, is assessed using level 2 fair value hierarchy techniques, with reference to the market value of the merged water business, using a market based observable premium to Regulated Capital Value.

The results of tests performed during the year demonstrate significant headroom in the recoverable amount of goodwill, and it is judged that no reasonable change in the key assumptions would cause the carrying amount of the goodwill to exceed the recoverable amount.

## 15. FINANCIAL INSTRUMENTS BY CATEGORY

The accounting policies for financial instruments have been applied to the line items as below:

		Fair value Derivatives used for cash flow hedging £m	Loans and receivables £m	Amortised cost Trade receivables and trade payables £m	Total £m
<b>31 March 2022</b>					
<b>Financial assets</b>					
Trade and other receivables	18	-	13.1	143.0	156.1
Cash and cash deposits	20	-	189.3	-	189.3
Derivatives	19	18.9	-	-	18.9
		<b>18.9</b>	<b>202.4</b>	<b>143.0</b>	<b>364.3</b>
<b>Financial liabilities</b>					
Borrowings	22	-	(2,494.5)	-	(2,494.5)
Trade and other payables	21	-	(54.5)	(70.2)	(124.7)
		-	<b>(2,549.0)</b>	<b>(70.2)</b>	<b>(2,619.2)</b>
<b>31 March 2021</b>					
<b>Financial assets</b>					
Trade and other receivables	18	-	10.7	127.8	138.5
Cash and cash deposits	20	-	414.9	-	414.9
Derivative financial instruments	19	1.7	-	-	1.7
		<b>1.7</b>	<b>425.6</b>	<b>127.8</b>	<b>555.1</b>
<b>Financial liabilities</b>					
Borrowings	22	-	(2,688.5)	-	(2,688.5)
Derivative financial instruments	19	(23.5)	-	-	(23.5)
Trade and other payables	21	-	(62.2)	(62.1)	(124.3)
		<b>(23.5)</b>	<b>(2,750.7)</b>	<b>(62.1)</b>	<b>(2,836.3)</b>

## 16. INVESTMENTS

	2022 £m	2021 £m
At 31 March:		
Subsidiary undertakings	3.3	3.3

The Company has three wholly-owned trading subsidiaries, Peninsula Properties (Exeter) Limited, South West Water Finance plc and South West Water Customer Services Limited. The Company also has eight wholly-owned dormant subsidiaries, Bournemouth Water Investments Limited and its subsidiaries, BWH Enterprises Limited, Bournemouth Water Limited, Alderney Water Limited, West Hampshire Water Limited, Avon Valley Water Limited and Aquacare (BWH) Limited.

All of these subsidiaries are registered at Peninsula House, Rydon Lane, Exeter, Devon, England, EX2 7HR and are also incorporated and operate in England. The Company also has a minority shareholding in Landlord Tap Limited, which is incorporated, registered and operates in England.

Consolidated financial statements have not been prepared, as explained in note 2(b).

## 16. INVESTMENTS (CONTINUED)

In the opinion of the Directors, the total value of the investments in subsidiaries is not less than the amount at which they are shown in the balance sheet.

## 17. INVENTORIES

	2022 £m	2021 £m
Raw materials and consumables	5.8	5.4

## 18. TRADE AND OTHER RECEIVABLES – CURRENT

	2022 £m	2021 £m
Amounts receivable from customers	227.5	216.2
Less: provision for expected credit losses	(84.5)	(88.4)
<b>Net trade receivables</b>	<b>143.0</b>	<b>127.8</b>
Amounts owed by fellow subsidiary companies	13.1	10.7
Other receivables	35.3	16.9
Prepayments and accrued income	7.5	8.9
<b>Trade and other receivables – current</b>	<b>198.9</b>	<b>164.3</b>

Trade receivables include accrued income relating to customers with metered budget plans. Due to the impact on demand patterns caused by the COVID-19 pandemic, overall demand has increased in the business, causing increased levels of receivables despite the resilient cash collection performance.

The Directors consider that the carrying amounts of trade and other receivables approximate to their fair value. There is no concentration of credit risk in trade receivables. The Company has a large number of customers who are dispersed and there is no significant loss on trade receivables expected that has not been provided for. The Company applies the simplified approach in calculating the expected credit losses for trade receivables allowing a provision matrix to be used which is based on the expected life of trade receivables, default rates for different customer categories within the collection process and forward looking information. As at 31 March, an analysis of the aging of gross trade receivables is as follows:

	2022 £m	2021 £m
Not due	35.9	31.6
Past due 1 - 30 days	10.4	12.3
Past due 31 - 120 days	12.4	11.9
More than 120 days	168.8	160.4
<b>Total trade receivables</b>	<b>227.5</b>	<b>216.2</b>

The Company specifically reviews separate categories of debt to identify an appropriate allowance for expected credit losses as outlined in note 2(n). South West Water has a duty under legislation to continue to provide domestic customers with services regardless of payment. The expected credit loss rate applied ranges from 0% (not due) to 100% (>120 days and untraced previous occupier). No expected credit loss provision has been recognised in respect of amounts owed by fellow subsidiary undertakings.

The movement in the allowance for expected credit losses in respect of trade receivables was:

	2022 £m	2021 £m
<b>At 1 April</b>	<b>88.4</b>	<b>91.6</b>
Provision for expected credit losses	3.1	2.8
Net Receivables written-off during the year as uncollectable	(7.0)	(6.0)
<b>At 31 March</b>	<b>84.5</b>	<b>88.4</b>



## 18. TRADE AND OTHER RECEIVABLES – CURRENT (CONTINUED)

Receivables in respect of wholesale water and wastewater services retailed by fellow group subsidiaries are included as amounts owed by fellow subsidiary companies.

## 19. DERIVATIVE FINANCIAL INSTRUMENTS

	2022 £m	2021 £m
Derivatives used for cash flow hedging:		
<b>Assets</b>		
Current assets	5.0	0.2
Non-current assets	13.9	1.5
<b>Total assets</b>	<b>18.9</b>	<b>1.7</b>
<b>Liabilities</b>		
Current liabilities	-	(6.1)
Non-current liabilities	-	(17.4)
<b>Total liabilities</b>	<b>-</b>	<b>(23.5)</b>

The Company's financial risks and risk management policies are set out in note 3. The fair value of hedging derivatives is split between current and non-current assets or liabilities based on the maturity of the cash flows. The ineffective portion recognised in the income statement arising from cash flow hedges was £nil (2020/21 £nil).

Interest rate swaps and fixed rate borrowings are used to manage the mix of fixed and floating rates to ensure at least 60%, after the effect of interest rate swaps, of net borrowings is at fixed rate. At 31 March 2022, 59% (31 March 2021: 63%) of net borrowings were at fixed rates.

At 31 March 2022 interest rate swaps to swap from floating to fixed rate and hedge financial liabilities with a notional value of £718 million existed, with a weighted average maturity of 3.5 years (31 March 2021: £801 million, with 4.4 years). The weighted average interest rate of the swaps was 1.14% (31 March 2021: 1.29%).

The periods for which cash flow hedges are expected to affect future profit or loss as follows:

	<1 year £m	1-2 years £m	2-5 years £m	Over 5 years £m	Total £m
<b>31 March 2022</b>					
Assets	5.0	4.9	7.0	2.0	18.9
Liabilities	-	-	-	-	-
<b>31 March 2021</b>					
Assets	0.2	0.2	0.6	0.7	1.7
Liabilities	(6.1)	(6.1)	(11.3)	-	(23.5)

### Valuation hierarchy

The amounts of financial instruments carried at fair value by valuation method were:

	2022 £m	2021 £m
<b>Level 2 inputs</b>		
<b>Assets</b>		
Derivatives used for cash flow hedging	18.9	1.7
<b>Liabilities</b>		
Derivatives used for cash flow hedging	-	23.5

The Company uses the following hierarchy for determining the fair value of financial instruments by valuation technique:

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (level 1)
- Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (level 2)
- Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (level 3)

## 19. DERIVATIVE FINANCIAL INSTRUMENTS (CONTINUED)

The fair value of financial instruments not traded in an active market (level 2, for example over-the-counter derivatives) is determined by using valuation techniques. A variety of methods and assumptions are used based on market conditions existing at each balance sheet date. Quoted market prices or dealer quotes for similar

instruments are used for long-term debt. Other techniques, such as estimated discounted cash flows, are used to determine fair value for the remaining financial instruments. The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows.

## 20. CASH AND CASH DEPOSITS

	2022	2021
	£m	£m
Cash at bank and in hand	27.6	17.1
Short-term bank deposits	-	147.0
Other deposits	161.7	250.8
<b>Cash and cash deposits</b>	<b>189.3</b>	<b>414.9</b>

Overnight deposits have an average maturity of one working day. Other short-term bank deposits have an average maturity of 92 days.

Other deposits include £161.7 million (31 March 2021: £250.8 million) of restricted funds to settle long-term lease liabilities (note 22). Restricted funds are available for access, subject to being replaced by an equivalent valued security.

For the purposes of the cash flow statement, cash and cash equivalents comprise:

	2022	2021
	£m	£m
Cash and cash deposits as above	189.3	414.9
Less: deposits with a maturity of three months or more (restricted funds)	(161.7)	(250.8)
<b>Cash and cash equivalents</b>	<b>27.6</b>	<b>164.1</b>

## 21. TRADE AND OTHER PAYABLES – CURRENT

	2022	2021
	£m	£m
Trade payables	70.2	62.1
Amounts owed to subsidiary companies	9.0	6.1
Amounts owed to parent undertaking	45.5	56.1
Other tax and social security	2.3	1.8
Other payables	15.2	9.9
Accruals	17.0	21.1
Contract liabilities	2.0	2.0
	<b>161.2</b>	<b>159.1</b>

The Directors consider that the carrying amount of trade and other payables approximates to their fair value.

Included in amounts owed to parent undertaking is £43.0m relating to payment of the outperformance dividend based on cumulative outperformance for 2020/21 that has been deferred to August 2022.

The movement in the current and non-current contract liabilities was:

	2022	2021
	£m	£m
<b>Contract liabilities</b>		
At 1 April	130.2	124.9
Revenue recognised in the year	(2.0)	(1.0)
Consideration received in advance of completion of performance obligations	11.0	6.3
At 31 March	<b>139.2</b>	<b>130.2</b>

## 21. TRADE AND OTHER PAYABLES – CURRENT (CONTINUED)

The analysis of contract liabilities between current and non-current is:

	2022 £m	2021 £m
Current	2.0	2.0
Non-current (note 23)	137.2	128.2
	<b>139.2</b>	<b>130.2</b>

Performance obligations related to the current contract liabilities closing balance above are expected to be satisfied, and revenue will be recognised, within the financial year ended 31 March 2023.

## 22. BORROWINGS

	2022 £m	2021 £m
<b>Current</b>		
Bank and other external loans	40.1	40.1
Loan from subsidiary company (note 35)	3.0	3.2
	<b>43.1</b>	<b>43.3</b>
Leases	170.0	48.2
<b>Total current borrowings</b>	<b>213.1</b>	<b>91.5</b>
<b>Non-current</b>		
Bank and other external loans	727.7	711.3
Loan from subsidiary company (note 35)	512.6	494.6
	<b>1,240.3</b>	<b>1,205.9</b>
Leases	1,041.1	1,391.1
<b>Total non-current borrowings</b>	<b>2,281.4</b>	<b>2,597.0</b>
<b>Total borrowings</b>	<b>2,494.5</b>	<b>2,688.5</b>

In the current year, European Investment bank loans, which were previously included as a separate line item in the table above, have been aggregated with Bank and other loans. The change has been made as EIB loans are less significant now and share similar characteristics to bank loans. Comparative figures have been restated for consistency.

The loan from subsidiary company represents loans from South West Water Finance plc, a UK company whose purpose is to raise borrowings for South West Water Limited. The fair value of the non-current borrowings were:

	2022 Book value £m	2022 Fair value £m	2021 Book value £m	2021 Fair value £m
Bank and other external loans	727.8	778.3	711.3	762.6
Loan from subsidiary company	512.6	608.3	494.6	603.2
	<b>1,240.4</b>	<b>1,386.6</b>	<b>1,205.9</b>	<b>1,365.8</b>
Leases	1,041.0	-	1,391.1	-
	<b>2,281.4</b>	<b>1,386.6</b>	<b>2,597.0</b>	1,365.8

Under IFRS 16 the disclosure relating to the fair value of leases is not required.

Where market values are not available, fair values of borrowings have been calculated by discounting expected future cash flows at prevailing interest rates.

## 22. BORROWINGS (CONTINUED)

The maturity of non-current borrowings was:

	2022	2021
	£m	£m
Between 1 and 2 years	68.2	68.7
Over 2 and less than 5 years	331.5	362.4
Over 5 years	1,881.7	2,165.9
	<b>2,281.4</b>	<b>2,597.0</b>

The weighted average maturity of non-current borrowings was 14.7 years (31 March 2021: 18.6 years).

The Company has leases for various assets as shown in note 13.

The maturity of lease liabilities was:

	2022	2021
	£m	£m
Within 1 year	170.0	48.2
Over 1 year and less than 5 years	180.6	243.2
Over 5 years	860.4	1,147.9
	<b>1,211.1</b>	<b>1,439.3</b>

For the purposes of calculating debt or borrowings under the Company's financing agreements, all of which were negotiated under IFRS prior to the implementation of IFRS 16, borrowings that were previously categorised as operating leases under IAS 17 are excluded from the definition of debt. As at 31 March 2022 the carrying value of leases previously categorised as IAS 17 operating leases was £36.9 million (2021: £35.4 million).

The Company does not face a significant liquidity risk with regard to its lease liabilities. Lease liabilities are monitored by the treasury function.

The discount rate used to calculate the lease liabilities above involves estimation. Where the Company cannot readily determine the rate implicit in the lease the Company uses an estimated incremental borrowing rate (IBR). At 31 March 2022, the range of IBRs used was between 2.6% and 3.9% (2021 between 2.9% and 4.5%) and the weighted average IBR across all leases was 3.3% (2021 3.8%). If the weighted average rate used increased or decreased by 10bps this would result in a c.1.1% increase or reduction in the present value of lease liabilities recognised at 31 March 2022 (2021 1.2%).

The period for repayment of certain leases includes an agreement to deposit with the lessor group amounts equal to the difference between the original and revised payments due. The accumulated deposits, £161.7 million at 31 March 2021 (2021 £250.8 million), are currently being held to settle the lease liability subject to rights to release by negotiation with the lessor. The deposits are subject to a registered charge given as security to the lessor for the balance outstanding.

Cash outflows in respect of leasing relate to principal repayments of £231.4 million (2021 £28.4 million) and interest repayments of £17.2 million (2021 £19.1million), in addition to inflows from lease financing arrangements of £15 million (2021 £15.0 million).

Other information required to be disclosed under IFRS 16 is included in note 13.

Undrawn committed borrowing facilities at the balance sheet date were:

	2022	2021
	£m	£m
Floating rate:	-	-
Expiring within one year:	25.0	-
Expiring after one year:	140.0	180.0
	<b>165.0</b>	<b>180.0</b>

In addition, the Company has undrawn uncommitted short-term bank facilities of £nil (31 March 2021: £nil).

## 23. OTHER NON-CURRENT LIABILITIES

	2022 £m	2021 £m
Contract liabilities	137.2	128.2

Non-current contract liabilities relate to consideration received in advance of the Company performing its performance obligations to customers where performance obligations will not be completed within twelve months of the balance sheet date. The overall movement in total contract liabilities is disclosed in note 21. Contract liabilities reflect the fair value of assets transferred from customers. The majority of the contract liabilities included above are expected to unwind after five years.

## 24. RETIREMENT BENEFIT OBLIGATIONS

The Company's employees are eligible to participate in a defined contribution scheme, operated by the parent company, Pennon Group plc. The Company is also a member of the Pennon Group defined benefit scheme which was closed to new members on or before 1 April 2008.

The assets of the Pennon Group's pension schemes are held in separate trustee-administered funds. The trustees of the funds are required to act in the best interest of the funds' beneficiaries. The appointment of the schemes' trustees is determined by the schemes' trust documentation. The Pennon Group has a policy for the main fund that one-half of all trustees, other than the Chairman, are nominated by members of the schemes, including pensioners.

### Defined contribution schemes

Pension costs for defined contribution schemes were £4.5 million (2020/21: £3.3 million).

### Defined benefit schemes

The principal actuarial assumptions at 31 March were:

	2022 %	2021 %	2020 %
Rate of increase in pensionable pay	3.0	3.2	2.7
Rate of increase for current and future pensions	3.1	2.0	2.0
Rate used to discount schemes' liabilities and expected return on scheme assets	2.75	2.05	2.30
Inflation	3.6	3.2	2.7

### Mortality

Assumptions regarding future mortality experience are set based on actuarial advice in accordance with published statistics and experience. The mortality assumption uses a scheme-specific calculation based on CMI 2019 actuarial tables with an allowance for future longevity improvement.

The average life expectancy in years of a member having retired at age 62 on the balance sheet date is projected at:

	2022	2021	2020
Male	24.8	24.7	24.7
Female	27.1	27.0	26.9

The average life expectancy in years of a future pensioner retiring at age 62, 20 years after the balance sheet date, is projected as:

	2022	2021	2020
Male	25.6	25.5	25.4
Female	27.1	27.9	27.9

## 24. RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)

The sensitivities regarding the principal assumptions used to measure the schemes' liabilities are:

	Change in assumption	Impact on schemes' liabilities
Rate of increase in current and future pensions	+/- 0.5%	+/- 6.2%
Rate used to discount schemes' liabilities	+/- 0.5%	+/- 9.0%
Inflation	+/- 0.5%	+/- 6.6%
Life expectancy	+/- 1 year	+/- 4.1%

The sensitivity analysis shows the effect of changes in the principal assumptions used for the measurement of the pension liability. The method used to calculate the sensitivities is approximate and has been determined taking into account the duration of the liabilities and the overall profile of each scheme's membership. This is the same approach as has been adopted in previous years.

The amounts recognised in the balance sheet were:

	2022 £m	2021 £m
Present value of financial obligations	(645.2)	(695.9)
Fair value of plan assets	692.3	710.2
<b>Net asset recognised in the balance sheet</b>	<b>47.1</b>	<b>14.3</b>

The movement in the net defined benefit obligation over the accounting period is as follows:

	2022			2021		
	Present value of obligation £m	Fair value of plan assets £m	Total £m	Present value of obligation £m	Fair value of plan assets £m	Total £m
<b>At 1 April</b>	<b>(695.9)</b>	<b>710.2</b>	<b>14.3</b>	<b>(636.0)</b>	<b>643.1</b>	<b>7.1</b>
Current service cost	(2.4)	-	(2.4)	(5.8)	-	(5.8)
Interest (expense)/income	(13.9)	14.3	0.4	(12.5)	12.1	(0.4)
Past service cost and gains and losses on settlements	(0.2)	-	(0.2)	(3.5)	-	(3.5)
	<b>(712.4)</b>	<b>724.5</b>	<b>12.1</b>	<b>(21.8)</b>	<b>12.1</b>	<b>(9.7)</b>
<b>Remeasurements:</b>						
(Loss)/return on plan assets excluding amounts included in interest expense	-	4.1	4.1	-	83.0	83.0
(Loss)/gain from change in demographic assumptions	(0.7)	-	(0.7)	-	-	-
Gain/(loss) from change in financial assumptions	41.1	-	41.1	(73.9)	-	(73.9)
Experience gain/(loss)	(13.0)	-	(13.0)	4.8	-	4.8
	<b>27.4</b>	<b>4.1</b>	<b>31.5</b>	<b>(69.1)</b>	<b>83.0</b>	<b>13.9</b>
<b>Contributions:</b>						
Employers	-	3.5	3.5	-	3.0	3.0
<b>Payments from plans:</b>						
Benefit payments	38.4	(38.4)	-	29.2	(29.2)	-
Administration costs	1.4	(1.4)	-	1.8	(1.8)	-
	<b>39.8</b>	<b>(36.3)</b>	<b>3.5</b>	<b>31.0</b>	<b>(28.0)</b>	<b>3.0</b>
<b>At 31 March</b>	<b>(645.2)</b>	<b>692.3</b>	<b>47.1</b>	<b>(695.9)</b>	<b>710.2</b>	<b>14.3</b>

## 24. RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)

Employer contributions are made into the scheme by South West Water and other companies within the Pennon Group based upon pensionable pay of employees in each section of the scheme. Full details of the scheme are included within the Pennon Group plc financial statements (see note 30).

The Pennon Group completed its employee consultation to modernise its ongoing pension arrangements. The outcome of the consultation resulted in a decision to close the Pennon's principal defined benefit pension scheme to future accrual with effect from 30 June 2021. This resulted in a curtailment charge of £3.5 million in the prior year, which was included within non-underlying items for the Company (see note 6).

The assets in the schemes and the expected long-term rates of return at year end were:

	2022		2021	
	Quoted prices in active market £m	Fund %	Quoted prices in active market £m	Fund %
Equities	169.3	24	131.1	19
Property	62.6	9	49.7	7
Bonds	344.5	50	369.1	52
Diversified Growth Fund	52.4	8	109.9	15
Insurance linked securities	60.5	9	41.6	6
Other	3.0	0	8.8	1
	<b>692.3</b>	<b>100</b>	<b>710.2</b>	<b>100</b>

Other assets principally represent cash contributions received from the Company towards the year-end which are invested during the subsequent financial year.

Through the Pennon Group defined benefit pension plan, the Company is exposed to a number of risks, the most significant of which are detailed below:

**Asset volatility:** The liabilities are calculated using a discount rate set with reference to corporate bond yields; if assets underperform this yield, this will create a deficit. The scheme holds a significant proportion of growth assets (equities and diversified growth funds) which are expected to outperform corporate bonds in the long-term while providing volatility and risk in the short-term. As the funding of the schemes improves, an increasing proportion of the schemes' assets are invested in less volatile asset classes such as cash and bonds which more closely reflect market movements in the schemes' liabilities. The allocation to growth assets is monitored such that it is aligned with the scheme's long-term objectives.

**Changes in bond yields:** A decrease in corporate bond yields will increase the value placed on the scheme's liabilities for accounting purposes, although this will be partially offset by an increase in the value of the scheme's bond holdings.

**Inflation risk:** The majority of the scheme's benefit 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 against extreme inflation). The majority of the assets are either unaffected by or loosely correlated with inflation, meaning that an increase in inflation will also increase the deficit.

**Life expectancy:** The majority of the scheme's obligations are to provide benefits for the life of the member, so increases in life expectancy will result in an increase in the liabilities.

In conjunction with its investment advisors, the trustees have structured the scheme's investments with the objectives of balancing investment returns and levels of risk. The asset allocation has three principal elements:

- holding of cash funds and bonds which is expected to be less volatile than most other asset classes and reflects market movements in the scheme's liabilities;
- A proportion of assets with fund managers having freedom in making investment decisions to maximise returns
- Investment of a proportion of the schemes' assets in alternative asset classes which give the potential for diversification (currently property, insurance linked securities and diversified growth).

## 24. RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)

The liabilities of the defined benefit schemes are measured by using the projected unit credit method which is an accrued benefits valuation method in which the scheme liabilities make allowance for projected increases in pensionable pay.

The future cash flows arising from the payment of the defined benefits are expected to be settled primarily in the period between 15 and 40 years from the balance sheet date.

The 2019 triennial actuarial valuation of the principal defined benefit scheme was agreed in the previous financial year with an actuarial valuation deficit of £53 million. The Company made a deficit recovery contribution of £nil (2021 £nil; 2020: £28.5 million reflecting three years of contributions for 2020-22) to the main scheme. This is in line with our regulatory commitments. Pennon Group plc monitors funding levels on an annual basis, the Company expects to pay total contributions of around £1.5 million during the year ending 31 March 2023, with this amount being adjusted for inflation. The schedule of contributions in the 2019 valuation is in line with the 2016 triennial actuarial valuation. These ceased when the scheme closes to future accrual on 30 June 2021. The 2022 triennial actuarial valuation is underway.

## 25. CURRENT TAX ASSET

	2022	2021
	£m	£m
Current year asset/(liability)	1.4	(0.8)
Prior year tax items	4.5	4.7
<b>At 31 March</b>	<b>5.9</b>	<b>3.9</b>

## 26. DEFERRED TAX LIABILITIES

Deferred tax is provided in full on temporary differences under the liability method using enacted tax rates. Movements on deferred tax were:

	2022	2021
	£m	£m
<b>Liabilities at 1 April</b>	<b>271.2</b>	<b>263.8</b>
Charged to the income statement	3.1	3.5
Charged/(credited) to equity/other comprehensive income	7.1	4.6
Non underlying charge/(credit) to the income statement	98.7	(0.7)
<b>Liabilities at 31 March</b>	<b>380.1</b>	<b>271.2</b>

Deferred tax assets have been recognised in respect of all temporary differences giving rise to deferred tax assets because it is probable that these assets will be recovered.

The majority of the Company's deferred tax asset is expected to be recovered over more than one year. All deferred tax assets and liabilities within the same jurisdiction are offset.



## 26. DEFERRED TAX LIABILITIES (CONTINUED)

The movements in deferred tax assets and liabilities were:

### Deferred tax liabilities

	Accelerated tax depreciation £m	Retirement benefit obligations £m	Derivatives £m	Total £m
<b>At 31 March 2020</b>	<b>274.4</b>	<b>(2.2)</b>	-	<b>272.2</b>
Charged to the income statement	2.0	1.0	-	3.0
Non-underlying charge to the income statement	-	(0.7)	-	(0.7)
(Credited) to other comprehensive income/equity	-	2.6	-	2.6
<b>At 31 March 2021</b>	<b>276.4</b>	<b>0.7</b>	-	<b>277.1</b>
Charged to the income statement	1.4	1.5	-	2.9
Non-underlying charge/(credit) to the income statement	88.1	8.1	-	96.2
Charged to other comprehensive income/equity	-	0.7	-	0.7
Reclassification from deferred tax asset	-	-	4.7	4.7
<b>At 31 March 2022</b>	<b>365.9</b>	<b>11.0</b>	<b>4.7</b>	<b>381.6</b>

### Deferred tax (assets)

	Provisions £m	Derivatives £m	Share based payments £m	Total £m
<b>At 31 March 2020</b>	<b>(1.4)</b>	<b>(5.8)</b>	<b>(1.2)</b>	<b>(8.4)</b>
Charged/(credited) to the income statement	0.5	-	-	0.5
Charged/(credited) to other comprehensive income/equity	-	1.6	0.4	2.0
<b>At 31 March 2021</b>	<b>(0.9)</b>	<b>(4.2)</b>	<b>(0.8)</b>	<b>(5.9)</b>
Charged/(credited) to the income statement	0.2	-	-	0.2
Non-underlying charge/(credit) to the income statement	-	2.5	-	2.5
Charged/(credited) to other comprehensive income/equity	-	6.4	-	6.4
Reclassification to deferred tax liability	-	(4.7)	-	(4.7)
<b>At 31 March 2022</b>	<b>(0.7)</b>	-	<b>(0.8)</b>	<b>(1.5)</b>

Deferred tax (charged)/credited to other comprehensive income/equity during the year was:

	2022 £m	2021 £m
Remeasurement of defined benefit obligations	(0.7)	(2.6)
Share-based payments	-	(0.4)
Cash-flow hedges	(6.4)	(1.6)
	<b>(7.1)</b>	<b>(4.6)</b>

Capital allowances are available when a business incurs qualifying expenditure on capital items such as infrastructure assets. Capital allowances provide tax relief on these items in place of accounting depreciation which is not tax deductible. Over the period of ownership of an asset, cumulative depreciation and capital allowances will equalise. Capital allowance rates are set by the UK Government and every business receives the same rate of allowance. Capital allowance rates typically vary from 3% up to 100% in certain instances, with most items qualifying at either 6% or 18% per annum. Given the Company's continuing capital expenditure programme, it is unlikely that the deferred tax liability will crystallise in the near future.

## 26. DEFERRED TAX LIABILITIES (CONTINUED)

The different accounting treatment of property, plant and equipment for tax and accounting purposes means that the taxable income of the Company is not the same as the profit reported in the financial statements. The adjustments for this are reflected in the current tax reconciliation. As explained in note 9, the Government has introduced capital expenditure super-deduction allowance incentives for the two year period to April 2023 which increases the rate of capital allowances to up to 130% for expenditure on qualifying plant and machinery. This provides an increase in current tax relief for the Company with a consequently higher deferred tax liability and charge due to the additional capital allowance deductions and the increase in the rate of corporation tax to 25% from April 2023.

Short term temporary differences arise on items such as retirement benefit obligations, derivatives, fair value adjustments and share based payments because the treatment of such items are different for tax and accounting purposes. These differences reverse over future years following that in which they arise, as is reflected in the deferred tax charge in these financial statements. Specifically, retirement benefit obligations will crystallise over the life of the pension scheme and/or the period when spreading applies (this can be up to three years for spreading purposes), whilst share based payments will crystallise over the remaining life of the share schemes which are up to 5 years. Short term liabilities including provisions will typically crystallise in the following year.

Where interest charges or other costs are capitalised in the accounts, tax relief is either given as the charges are incurred or when the costs are taken to the income statement.

Derivatives reflect the fair value movements on treasury derivatives, these can fluctuate considerably each year. The balance will crystallise when derivative items are either terminated or mature, the life of these items can be up to ten years.

## 27. PROVISIONS

	2022 £m	2021 £m
<b>Restructuring</b>		
<b>At 1 April</b>	<b>0.3</b>	<b>0.6</b>
Additions	1.0	-
Utilised during year	(0.3)	(0.3)
<b>At 31 March</b>	<b>1.0</b>	<b>0.3</b>

The restructuring provision is expected to be utilised within one year.

## 28. CALLED UP SHARE CAPITAL

	2022 £m	2021 £m
Authorised		
500,000,000 Ordinary shares of £1 each	500.0	500.0
Allotted and fully paid		
295,923,000 Ordinary shares of £1 each	<b>295.9</b>	<b>250.9</b>

During the year the Company issued 45,000,000 shares at nominal value of £1 per share.

## 29. EMPLOYEE SHARE SCHEMES

The Company participates in a number of share plans for the benefit of employees operated by Pennon Group plc. Details of each plan are:

### i) Sharesave Scheme

An all-employee savings related plan is operated that enables employees to invest up to a maximum of £500 per month for three or five years. These savings can then be used to buy Ordinary shares, at a price set at either a 17% or 20% discount to the market value at the start of the savings period, at the third or fifth anniversary of the option being granted. Options expire six months following the exercise date and, except for certain specific circumstances such as redundancy, lapse if the employee leaves the Pennon Group before the option exercise period commences.

Outstanding options to subscribe for Pennon Group plc Ordinary shares of 61.05p each under the Sharesave scheme are:

Date granted	Subscription price fully paid	Period when options normally exercisable	Thousands of shares in respect of which options outstanding at 31 March	
			2022	2021
24 June 2015	683p	2018 – 2020	-	2
29 June 2016	709p	2019 – 2021	-	34
28 June 2017	767p	2020 – 2022	27	30
03 July 2018	635p	2021 – 2023	105	593
09 July 2019	620p	2022 – 2024	393	429
16 July 2020	928p	2023 – 2025	206	229
06 July 2021	879p	2024 – 2026	418	-
			<b>1,149</b>	<b>1,317</b>

The number and weighted average exercise price of Sharesave options are:

	2022		2021	
	Number of Ordinary shares (thousands)	Weighted average exercise price per share (p)	Number of Ordinary shares (thousands)	Weighted average exercise price per share (p)
At 1 April	1,317	686	1,355	651
Granted	448	879	245	928
Forfeited	(35)	695	-	-
Exercised	(510)	641	(230)	729
Expired	(71)	803	(53)	730
<b>At 31 March</b>	<b>1,149</b>	<b>774</b>	<b>1,317</b>	<b>686</b>

The weighted average share price at the date of exercise of Sharesave options during the year was 1,219p (2020/21: 1,021p). The options outstanding at 31 March 2022 had a weighted average exercise price of 774p (31 March 2021: 686p) and a weighted average remaining contractual life of 1.76 years (31 March 2021: 1.5 years). The number of exercisable Sharesave options at 31 March 2022 was 2,000 (2021 3,000) and the weighted average exercise price of exercisable Sharesave options was 635 pence (2021: 698 pence).

## 29. EMPLOYEE SHARE SCHEMES (CONTINUED)

The aggregate fair value of Sharesave options granted during the year was £1.3 million (2020/21: £0.4 million), determined using the Black-Scholes valuation model. The significant inputs into the valuation model, at the date of issue of the options, were:

	2022	2021
Weighted average share price	1,187p	1,089p
Weighted average exercise price	879p	928p
Expected volatility	26.5%	21.0%
Expected life	3.4 years	3.5 years
Risk free rate	0.1%	0.1%
Expected dividend yield	3.0%	4.0%

Expected volatility was determined by calculating the historical volatility of the Pennon Group's share price over the previous three years.

### ii) Long Term Incentive Plan

Executive Directors and Senior Management receive a conditional award of Ordinary shares in Pennon Group plc. Share awards vest subject to the achievement of specific performance conditions measured over a performance period of not less than three years.

The number and price of shares in the LTIP are:

	2022		2021	
	Number of Ordinary shares (thousands)	Weighted average exercise price per share (p)	Number of Ordinary shares (thousands)	Weighted average exercise price per share (p)
At 1 April	202	893	136	780
Granted	64	1,141	78	1,074
Lapsed	(3)	790	(12)	803
<b>At 31 March</b>	<b>263</b>	<b>954</b>	<b>202</b>	<b>893</b>

The awards outstanding at 31 March 2022 had a weighted average exercise price of 954p (31 March 2021: 893p) and a weighted average remaining contractual life of 2.6 years (31 March 2021: 3.1 years).

The aggregate fair value of awards granted during the year was £0.3 million (2021: £0.3 million), determined from market value. No option pricing methodology is applied since the vesting of the shares depend on non-market performance vesting conditions.

### iii) Annual Incentive Bonus Plan – Deferred Shares

Awards under the plan to Executive Directors and Senior Management involve the release of Ordinary shares in Pennon Group plc to participants. There is no performance condition since vesting is conditional upon continuous service with the Pennon Group for a period of three years from the award.

## 29. EMPLOYEE SHARE SCHEMES (CONTINUED)

The number and weighted average price of shares in the Incentive Bonus Plan are:

	2022		2021
	Number of Ordinary shares (thousands)	Weighted average exercise price per share (p)	Number of Ordinary shares (thousands)
			Weighted average exercise price per share (p)
At 1 April	112	845	126
Granted	18	1,141	31
Vested	(26)	761	(44)
Lapsed	(1)	853	(1)
Cancelled	(45)	886	-
<b>At 31 March</b>	<b>58</b>	<b>944</b>	<b>112</b>
			<b>845</b>

The awards outstanding at 31 March 2022 had a weighted average price of 944p (31 March 2021: 845p) and a weighted average remaining contractual life of 1.0 years (31 March 2021: 1.3 years). The Group's share price at the dates of the awards ranged from 756p to 1,141p (2021: 762p to 1,079p).

The aggregate fair value of awards granted during the year was £0.2 million (2020/21: £0.3 million), determined from market value. No option pricing methodology is applied since dividends declared on the shares are receivable by the participants in the scheme.

Further details of the plans and options granted to Directors, included above, are shown in the Directors' remuneration report.

## 30. RETAINED EARNINGS AND OTHER RESERVES

	Note	Hedging reserve £m	Retained earnings £m	Total £m
<b>At 31 March 2020</b>		<b>(24.8)</b>	<b>267.5</b>	<b>242.7</b>
Profit for the year		-	114.8	114.8
Other comprehensive income for the year		7.3	11.3	18.6
Dividends paid/payable	10	-	(101.6)	(101.6)
Watershare+ reserves adjustment		-	1.2	1.2
Share-based payments (net of tax)		-	0.5	0.5
<b>At 31 March 2021</b>		<b>(17.5)</b>	<b>293.7</b>	<b>276.2</b>
Profit for the year		-	24.5	24.5
Other comprehensive loss for the year		34.2	30.8	65.0
Dividends paid/payable	10	-	(88.0)	(88.0)
Share-based payments (net of tax)		-	0.9	0.9
<b>At 31 March 2022</b>		<b>16.7</b>	<b>261.9</b>	<b>278.6</b>

The hedging reserve is used to record the portion of the gain or loss on a hedging instrument in a cash flow hedge that is determined to be an effective hedge.

The Watershare+ reserves adjustment relates to the shares in Pennon issued through Company's rebate scheme (see note 6).

### 31. CASH FLOWS FROM OPERATING ACTIVITIES

Reconciliation of profit for the year to cash generated from operations:

	2022 £m	2021 £m
Continuing operations		
Profit for the year	24.5	114.8
Adjustments for:		
Share based payments	1.0	1.0
Profit on disposal of property, plant and equipment	(1.1)	(0.2)
Depreciation charge	117.0	118.3
Amortisation of intangible fixed assets	-	-
Finance income	(0.8)	(0.7)
Finance costs	77.6	57.2
Taxation	111.0	27.0
Non-underlying Pension curtailment charge	-	3.5
Non-underlying Watershare+ rebate revenue adjustment	-	20.5
Non-underlying Watershare+ rebate retained earnings adjustment	-	1.2
Changes in working capital:		
Increase in inventories	(0.4)	(0.5)
Increase in trade and other receivables	(34.5)	(39.6)
Increase/(Decrease) in trade and other payables	13.5	9.3
Decrease in retirement benefit obligations	(0.8)	3.1
Decrease in provisions	0.7	(0.3)
<b>Cash generated from operations</b>	<b>307.7</b>	<b>314.6</b>

During the year, the Company completed a number of sale and leaseback transactions in respect of its infrastructure assets as part of its ongoing financing arrangements. Cash proceeds of £15 million (2021: £15.0 million) were received and a gain of nil (2021: nil) was recognised. These assets are primarily being leased back over an initial 10-year lease term at market rentals.

### 32. NET BORROWINGS

	2022 £m	2021 £m
<b>Cash and cash deposits</b>	<b>189.3</b>	<b>414.9</b>
<b>Borrowings – current</b>		
Other current borrowings	(43.1)	(43.3)
Lease obligations	(170.0)	(48.2)
<b>Total current borrowings</b>	<b>(213.1)</b>	<b>(91.5)</b>
<b>Borrowings – non-current</b>		
Other non-current borrowings	(1,240.3)	(1,205.9)
Lease obligations	(1,041.1)	(1,391.1)
<b>Total non-current borrowings</b>	<b>(2,281.4)</b>	<b>(2,597.0)</b>
<b>Total net borrowings</b>	<b>(2,305.2)</b>	<b>(2,273.6)</b>

The movement in net borrowings during the periods presented were as follows:

	Net borrowings at 1 April 2020 £m	Cash flows £m	Transfer between non-current and current £m	Other non- cash movements £m	Net borrowings at 31 March 2021 £m
Cash and cash deposits	284.1	130.2	-	0.6	414.9
Bank and other current borrowings	(38.7)	38.7	(43.0)	(0.3)	(43.3)
Current lease obligations	(19.2)	34.4	(63.6)	0.2	(48.2)
Bank and other non-current borrowings	(1,114.1)	(130.0)	43.0	(4.8)	(1,205.9)
Non-current lease obligations	(1,419.3)	(15.0)	63.6	(20.4)	(1,391.1)
<b>Total net borrowings</b>	<b>(2,307.2)</b>	<b>58.3</b>	<b>-</b>	<b>(24.7)</b>	<b>(2,273.6)</b>

### 32. NET BORROWINGS (CONTINUED)

	Net borrowings at 1 April 2021 £m	Cash flows £m	Transfer between non-current and current £m	Other non-cash movements £m	Net borrowings at 31 March 2022 £m
Cash and cash deposits	414.9	(226.1)	-	0.5	189.3
Bank and other current borrowings	(43.3)	42.9	(42.7)	-	(43.1)
Current lease obligations	(48.2)	54.8	(176.5)	(0.1)	(170.0)
Bank and other non-current borrowings	(1,205.9)	(50.0)	42.7	(27.1)	(1,240.3)
Non-current lease obligations	(1,391.1)	190.4	176.5	(16.9)	(1,041.1)
<b>Total net borrowings</b>	<b>(2,273.6)</b>	<b>12.0</b>	<b>-</b>	<b>(43.6)</b>	<b>(2,305.2)</b>

### 33. CONTINGENT LIABILITIES

	2022 £m	2021 £m
Guarantee of borrowings of subsidiary undertaking	465.9	443.4

Guarantees in respect of performance bonds, the last of which expire in 2057 and which will be reduced in line with repayments of the borrowings of the subsidiary undertaking, are entered into in the normal course of business.

Ofwat and the Environment Agency announced an industry-wide investigation into sewage treatment works on 18 November 2021. Since that time, Ofwat announced enforcement actions against certain companies. South West Water was not one of those companies but Ofwat have stated that their industry-wide investigation continues. The Environment Agency investigation is ongoing. Please refer to note 37 for subsequent events in relation to this matter. The potential outcome of these investigations remains unknown.

The Company is subject to litigation from time to time as a result of its activities. The Company establishes provisions in connection with litigation where it has a present legal or constructive obligation as a result of past events and where it is more likely than not an outflow of resources will be required to settle the obligation and the amount can be reliably estimated. Where it is uncertain that these conditions are met, a contingent liability is disclosed unless the likelihood of the obligation arising is remote or the matter is not deemed material.

### 34. CAPITAL COMMITMENTS

	2022 £m	2021 £m
Contracted but not provided	52.6	76.2

### 35. RELATED PARTY TRANSACTIONS

	2022 £m	2021 £m
<b>Parent company</b>		
Purchase of goods and services		
– Group expenses	6.6	7.0
Payment for provision of finance		
- Loan interest	-	-
Sale of goods and services		
– Administrative services	0.5	3.3
Dividends paid	103.1	43.5
<b>Subsidiaries of the Company</b>		
Purchase of goods and services		
– Property consultancy	0.2	0.1
– Billing and collection services	11.6	11.2
Payment for provision of finance		
– Loan interest	34.6	13.8
Sale of goods and services (administrative services)	1.5	1.3
<b>Fellow subsidiaries of the Pennon Group</b>		
Purchase of goods and services		
– Management charges	0.2	0.3
– Waste disposal	-	0.2
Sale of goods and services		
– Non-household services	90.4	81.6
– Tankered waste and trade effluent charges	-	-
<b>Year end balances</b>		
Borrowings		
– Loan from subsidiary	515.6	497.8
Receivables		
– Subsidiaries	0.8	-
– Fellow subsidiaries	12.3	10.7
Payables		
– Parent company	45.5	56.1
– Subsidiaries	9.0	6.1

The receivables due from related parties are unsecured and will be settled in cash. No guarantees have been given or received. No provisions have been made, or are considered necessary, for doubtful debts in respect of these amounts due.

### 36. PARENT COMPANY

The parent company, and ultimate controlling party, is Pennon Group plc which is registered in England. Group financial statements are included in the Annual Report of Pennon Group plc which is available from Peninsula House, Rydon Lane, Exeter, Devon, England, EX2 7HR.

### 37. EVENTS AFTER THE REPORTING PERIOD

Ofwat and the Environment Agency announced an industry-wide investigation into sewage treatment works on 18 November 2021. Prior to the balance sheet date, Ofwat announced enforcement actions against certain companies. South West Water was not one of those companies but Ofwat stated that their industry-wide investigation was continuing. On 27 June 2022, as part of its ongoing investigation, Ofwat informed South West Water that the Company will now be included alongside the five companies which received formal notices in March 2022. The Company will continue to work openly and constructively with Ofwat to comply with the formal issued notice as part of this ongoing investigation. The potential outcome of these investigations remains unknown.