



ANNUAL PERFORMANCE REPORT 2016

CONTENTS

2.	Introduction
3.	Corporate Governance
4.	Financial Performance
6.	Risk Management
8.	Report on Remuneration
15.	Viability Statement
17.	Directors' Statements and Responsibilities
SECTION 1 REGULATORY FINANCIAL REPORTING	
19.	Income Statement
20.	Statement of Comprehensive Income
21.	Statement of Financial Position
22.	Statement of Cashflows
23.	Net Debt Analysis
24.	Reconciliation between Statutory Accounts and Regulatory Accounts
25.	Notes to the Accounts
SECTION 2 PRICE REVIEW AND OTHER SEGMENTAL REPORTING	
43.	Segmental Income Statement
44.	Totex Analysis – Wholesale Water
45.	Operating Cost Analysis - Retail
46.	Historic Cost Analysis of Fixed Assets
47.	Analysis of Capital Contributions and Land Sales
48.	Revenues by Customer Type (Household and Non-Household)
49.	Revenue Analysis
50.	Notes on the Current Cost Accounts
SECTION 3 PERFORMANCE SUMMARY	
51.	Outcome Performance Table

CONTENTS

SECTION 4 ADDITIONAL REGULATORY INFORMATION

- 53.** Non-Financial Information
- 54.** Wholesale Totex Analysis
- 56.** Forecast Impact of Performance on RCV
- 57.** Totex Analysis
- 58.** Operating Cost Analysis – Household Retail
- 59.** Wholesale Current Cost Financial Performance
- 60.** Notes on the Wholesale Current Cost Financial Performance
- 61.** Financial Metrics
- 62.** Disclosure of Transactions and Associates
- 63.** Report of the Independent Auditor

INTRODUCTION

INTRODUCTION

Portsmouth Water Limited is a water supplier operating under an Instrument of Appointment granted by the Secretary of State for the Environment under the Water Industry Act 1991. In accordance with the requirements of the Company's licence conditions and Ofwat guidance the Company both operates and prepares its statutory Annual Report and Accounts ('ARA') having regard to the requirement of Disclosure and Transparency Rules and the relevant elements of the UK Corporate Governance Code. This Annual Performance Report ('APR') has been prepared in accordance with the requirements of Regulatory Accounting Guidelines published by Ofwat. The Company does not prepare a combined document covering both ARA and APR but, as permitted and where appropriate, cross references to the published ARA. Copies of the ARA can be obtained from the Company Secretary at PO Box 8, West Street, Havant, PO9 1LG and on the Company's website at www.portsmouthwater.co.uk.



The area supplied by the Company extends through South East Hampshire and West Sussex from the River Meon in the West to the river Arun in the East, encompassing 868sq. kilometres.

We provide high quality public water supplies to a domestic population exceeding 698,000, as well as many important industries, large defence establishments and varied commercial businesses.

CORPORATE GOVERNANCE

The Board of Portsmouth Water Limited comprises three Executive Directors and three independent Non-Executive Directors. The Executive Directors are Neville Smith who is the Managing Director, Rod Porteous Engineering Director and Helen Orton (appointed 12th October 2015) who is the Finance and Regulation Director. The Non-Executive Directors are Mike Kirk, Heather Benjamin and Martin Johnson.

Portsmouth Water are committed to high standards of corporate governance and take the lead from those set out in the UK Corporate Governance Code and guidance issued by Ofwat. That guidance highlighted Ofwat’s principles by which they believe Water Companies should deal with Board Leadership, transparency and governance.

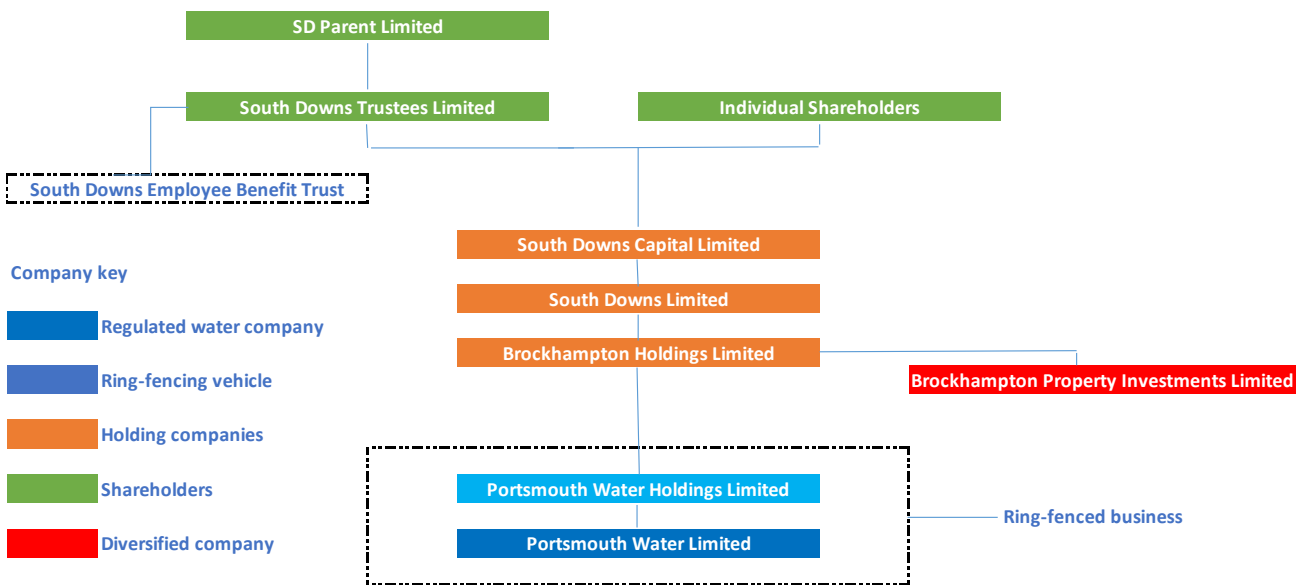
Detailed information in connection with the Company’s Corporate Governance processes and compliance, including operation of the Board, Risk Management and Internal Control is set out on pages 34-47 of the Company’s ARA.

Compliance

In 2014 Ofwat published the principles by which water companies should deal with Board leadership, transparency and governance. In March 2014 the Company adopted its own Governance Code which can be found on the Portsmouth Water website. The Board complies with the Ofwat principles in all areas with the exception of Board Composition.

The Ofwat principles suggest that independent Non-Executives should constitute the largest proportion of Directors. The Portsmouth Water Board currently consist of three independent Non-Executive Directors and three Executive Directors. The Chairman has the casting vote and therefore compliance with the spirit of the proposal remains. In addition, discussion and approval of dividends is solely carried out by the Non-Executive Directors as the Executives are Directors of the Ultimate Parent and are prevented, by the Instrument of Appointment, from voting. The Non-Executives carefully considered this issue and believe the structure is appropriate. To increase the number would be an unnecessary expense and it is considered important to have an Engineering and Finance Executive on the Board. Ofwat have confirmed that they are satisfied with this position.

Group Structure



Portsmouth Water Limited is the primary trading company in the group and is included within the regulatory ring-fence as established by the Instrument of Appointment. The immediate parent of Portsmouth Water is Portsmouth Water Holdings, a company established in 2002 to protect the interest of Bond holders by exercising control over distributions.

We consider South Downs Capital Limited to be Portsmouth Water’s ultimate holding company and ultimate controlling entity. Although the South Downs Employee Benefit Trust, through South Downs Trustee Limited, holds the majority of the equity shares and hence the majority of the voting rights, they are not considered to be in a position to exercise a ‘dominant influence’ over South Downs Capital Limited and nor can they appoint or remove the majority of the Board. Accordingly consolidated Group Financial Statements are prepared at the level of South Downs Capital Limited.

The corporate vehicle for South Downs Employee Benefit Trust is South Downs Trustee Limited. SD Parent Limited is a dormant company purely set up to hold and protect the shares of South Downs Trustee Limited. As such the financial results reported in the consolidated Group Financial Statements of South Downs Capital Limited would be no different if consolidated Group Financial Statements were prepared at the level of SD Parent Limited.

FINANCIAL PERFORMANCE

Set out below is a summary of key elements of the Company's overall financial performance. Further information in relation to the Company's Business Model, Strategy, performance against Key Performance Indicators and overall business performance is set out on pages 6 to 27 of the ARA. In addition further explanation required by the Regulatory Accounting Guidelines is set out as part of the reporting within the body of this APR.

Review of Statutory trading performance

Operating Profit

Operating profit at £7.6m shows a significant £0.9m increase on the prior period of £6.7m. This was primarily driven by a £1m increase in turnover and a reduction in infrastructure renewals charged to the income statement of £1.9m. This was offset by a number of one off costs and is discussed further below;

The £1m total increase in turnover was largely driven by average tariff increases of 2% and 2,300 new properties. Total operating costs fell by £0.6m which resulted from a number of movements;

- During 2015 the infrastructure mains renewals contract was re-tendered and transferred to a new contractor. As a result of this change the Company anticipates significant savings over the 5 year AMP. As is normal in these cases, the change-over of contractor resulted in a slow-down in renewals activity during 2015/16. This, together with the lower cost per kilometre of mains renewed, resulted in a £1.9m reduction of renewals expenditure from £5.4m, in the Final Determination, to £1.8m.
- Under the Outcome Delivery Incentive Mechanism we have provided £0.3m in connection with penalties as a result of a failure to meet a water quality metric. This is discussed further on page 52.
- Two activities in the period have resulted in additional one off accelerated depreciation charges of £0.7m. In preparation for the implementation of the Company's new ERP IT system (in 2016/17) we have undertaken a review of the fixed asset register. In addition the two UV plants developed during the year will result in a number of redundant assets once commissioned, on which depreciation has been accelerated.
- Headcount in the business has increased from 246 to 251 reflecting operational requirements, the increased effort required to meet the requirements of the Retail Competition and the development of and preparation for the new IT system. This, together with the annual salary increase of 2.3% and increased pension costs of £0.2m have resulted in increased employee costs of £0.6m. These have been partially offset by business wide operational savings.

Interest & other finance income

Interest payable shows an overall reduction of £1.3m which is primarily due to £1.4m lower indexation on the £66.5m index linked loan driven by RPI levels. Other finance income reflects movements in the net pension scheme position.

Taxation

The tax charge in the period of £0.7m includes a current tax charge of £1.2m and deferred tax credit of £0.5m. The increase in current tax in the period of £0.8m is as a result of higher profit chargeable to corporation tax. This was primarily driven by lower infrastructure renewals spend of £1.8m (2015 - tax deduction of £5.3m) with a tax effected impact of £0.7m. Deferred tax charges reversed primarily as a result of the cumulative reduction of the effective rate of tax from 21% to 18%.

Dividends

The dividends paid during the year totalled £1.2m (2015 - £0.8m). Dividends are paid up to the parent company with part of the payment being used to service interest payments on an inter-company loan of £0.7m (2015 - £0.4m) with the balance being paid as a dividend to the Group's shareholders. The Company's dividend policy aims to show sustainable growth in real terms and is based on a 1.65% growth rate. The final dividend proposed for the year is £0.6m.

Capital investments

Gross capital investment in the year was £9.3m (2015 - £5.8m).

Cash and Cash Flow

Cash generated from operations of £13.7m is higher than the prior year (2015 - £11.9m). This was driven by lower infrastructure renewals expensed of £1.9m. Year on year payments in connection with fixed assets increased by £3.0m, dividend payments increased by £0.4m, net repayments of loans fell by £2.3m. The year end cash balance was £9.2m (2015 - £6.8m).

Pensions

The Company is the principal employer of the Brockhampton Pension Scheme, a defined benefit scheme. The latest actuarial valuation as at 31 March 2016 was carried out in accordance with FRS 102 and shows a net pension asset (after deferred tax) of £14.6m (2015 - £9.0m). The overall increase in the surplus on actuarial valuation has largely been driven by improvements in AA corporate bonds.

Financial Viability

The Viability Statement on pages 30 and 31 of the ARA sets out the factors considered and the conclusions reached by the Board in assessing both the going concern of the business over the period of 12 months from the balance sheet date and the prospects over a longer period of just under 4 years to the end of the current AMP.

The Company's current bankers are Lloyds who provide a committed £4m overdraft facility and a £10m revolving credit facility details of which are set out above. The Company's financial projections, taking into account expected trading expectations, indicate that the company is forecast to operate comfortably within the levels of our current facilities. Accordingly the Directors have concluded that there is a reasonable expectation that the Company has adequate resources to continue in operation for the foreseeable future. Accordingly they continue to prepare the accounts on a Going Concern basis. Further detailed information in relation to the assessment process undertaken by the Board is set out in the Viability Statement on pages 30 and 31 of the ARA.

FINANCIAL PERFORMANCE

Covenant compliance

Gearing (net debt to regulatory capital value) is a key covenant defined by the Company's index linked loan documents. At 70.2% (2015 - 72.4% restated for midnight adjustment) this remained comfortably within the 86% ceiling imposed by the bond covenants.

The interest cover ratio, defined by the covenants, of 1.96 times (2015 - 1.80 times) remains comfortably above the 1.4 times covenant required. The improvement reflects improved operating profit due to lower infrastructure renewals spend in the year which is expected to reverse in 2016/17.

Financing

Portsmouth Water Limited is financed by way of an RPI indexed linked loan secured upon the assets of the company. This thirty year £66.5m index linked loan was issued in June 2002 and is repayable on 30 September 2032. The loan interest is calculated by adjusting the value of the loan by RPI and then charging interest on this amount at 3.635%. The current value of the loan is £97.7m (2015 - £96.7m).

New UK GAAP

During the year the company adopted FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland" (typically referred to as "new UK GAAP". Detailed information in respect of the adjustments made as a result of this standard are set out in note 1 and note 30 of the ARA. The most significant impact is as a result of the removal of "infrastructure renewals accounting" previously permitted by FRS 15. This had a net impact on fixed assets of £21.3m at 31 March 2015 of which £0.8m reduced operating profit in the period, the balance being treated as a prior year adjustment.

RISK MANAGEMENT

Effective risk management is critical to the achievement of our strategic aims and customer Outcomes. As a Company risk management is embedded in our day to day activities and use a range of formal and informal processes to keep risk at the heart of what we do. Further information in respect of how the Board reviews and manages risk is set out in the ARA on page 39.

The Board is responsible for the Company's system of internal control and risk management and considers this to be fundamental to the achievement of the Company's strategic objectives. These systems and procedures are designed to identify, manage and, where practicable, reduce and mitigate the effects of the risk of failure to achieve business objectives. They are not designed to eliminate such risk recognising that any system can only provide reasonable and not absolute assurance against material misstatement or loss. The Board is of the view that there is an ongoing process for identifying, evaluating and managing the Company's significant risks, that it has been in place for the year ended 31 March 2016 and up to the date of approval of the APR that it is regularly reviewed by the Directors. The Board have also set the Risk Appetite for the business and it is reviewed annually.

Set out in the table below is a summary of the significant business risks together with a description of their potential impact and mitigating actions;

Risk Category	Description	Potential Impacts	Nature
Operational	The significant loss of treatment works or failure of critical parts of the mains network	Failure to supply customers over an extended period.	Operational Reputational Financial
Mitigation/Control			
<ul style="list-style-type: none"> - The supply network has been developed to connect different supply areas, such that in most situations water can be transferred to compensate for a failure at a treatment works or in the network. - A fully documented Emergency Plan which is initiated in the event of a major incident. - Employment of modelling, telemetry and monitoring to assess the resilience of the network. 			
Water Quality	Failure against drinking water quality standards	Water not fit to drink.	Operational Reputational
Mitigation/Control			
<ul style="list-style-type: none"> - A Drinking Water Safety Plan which identifies the potential risks throughout the supply process. - A rigorous sampling regime in accordance with statutory legislation, together with 24 hour monitoring and response. - Maintain two days storage of treated water in service reservoirs to provide sufficient time for any water quality issues at treatment works to be addressed. - Membrane filtration at five treatment works considered most at risk from cryptosporidium. Ultra violet treatment plants currently being built at two higher risk sites. 			
Business Continuity	Scenarios for loss of major business elements such as key operational sites, power, telecoms, IT, personnel.	Adverse impact on ability to carry out normal business activities. Potential impact on ability to supply services to customers and ultimately potential impact on business viability.	Operational Reputational Financial
Mitigation/Control			
<ul style="list-style-type: none"> - Defined and documented Emergency Plan in place which utilises Drinking Water Safety Plan (DWSP) risk assessments - Business continuity planning processes. See also IT risk mitigations. - Appropriate insurance cover. 			
Human Resources	Loss or shortage of critical skills, company knowledge or operational capacity. Possible over reliance on key individuals.	Adverse impact on ongoing operational activities. Poor business decision making due to lack of knowledge or experience.	Operational Reputational
Mitigation/Control			
<ul style="list-style-type: none"> - Investment in a programme of employee development and cross training and collaborative working with other water companies. - Regular succession planning reviews at the Board level and Non-Executive Directors with appropriate, relevant skills mix. - Control procedures and policies in place to ensure that all relevant legislation is complied with. - Appropriate use of contractors and consultants to support the business needs. 			
Health and Safety	Failure to maintain appropriate health and safety standards.	Serious injury or death of employee or contractor. Prosecution by HSE.	Reputational
Mitigation/Control			
<ul style="list-style-type: none"> - Culture of health and safety awareness and 'zero tolerance' policy lead from the Board down including a Health and Safety Committee. - Risk assessment, training and inspections embedded in the business. All incidents reviewed for lessons learned. 			
Environment	Reduction in water abstraction licences due to Government reform. Climate change and population growth increases demand. Damage to the environment.	Inability to provide a sustainable supply of water to the population. Impact on habitats and biodiversity.	Operational Reputational Financial
Mitigation/Control			
<ul style="list-style-type: none"> - Detailed modelling studies in order to assess and understand the future balance of supply and demand. - Monitoring and modelling in order to identify the impact of abstraction at certain sites, identification and implementation of mitigating solutions - Biodiversity surveying and specific schemes to support and enhance biodiversity. 			

RISK MANAGEMENT

Financial Liquidity	Liquidity, solvency, capital risk and credit risk.	Insufficient funds or facilities to finance capital programme, service debt or for day to day operating cash flow requirements. Breach or financial covenants and or breach of licence conditions for financial viability. Inability to pay dividends. Inability to recover revenue due to increasing bad debt driven by socio economic conditions.	Financial
Mitigation/Control <ul style="list-style-type: none"> - An appropriate capital structure with a mixture of cash, debt and equity, together with appropriate credit facilities. - Effective processes of budgeting for costs and cash flows. This includes close monitoring of headroom against financial covenants and stress testing. - Mitigation of significant costs or claims (see below). - Utilisation of all appropriate means of debt collection, including the use of a dedicated debt recovery section and collection agencies. - Plans for the implementation of a "social tariff" for our financially vulnerable customers. 			
Financial Cost Base	Exposure to increasing costs or other financial loss reduce the financial viability of the company.	Significant costs, such as power or interest expense, cannot be controlled and result in trading losses. Unexpected events, such as significant claims against the company result in significant costs.	Financial
Mitigation/Control <ul style="list-style-type: none"> - An effective system of internal controls, together with a process of budgeting and forecasting to manage the underlying cost base. - Energy represents around 9% of operating costs. An energy broker was used in order to manage exposure to power costs and price fluctuations. - Both interest payments and revenue are currently linked to RPI and therefore provide a natural hedge. - The contract for mains renewals activities was recently re-negotiated to manage this significant cost and service. - Comprehensive insurance cover for a range of risks, including damage to property, public and employee liability, fraud and terrorism. 			
Regulatory	Regulators' actions have an adverse impact on the business. DWI and EA related regulatory impacts are considered under Water Quality and Environmental risks.	Failure to meet customer service standards or outcomes agreed with Ofwat may result in penalties. Unexpected changes in the Ofwat regulatory approach.	Reputational Financial
Mitigation/Control <ul style="list-style-type: none"> - The 5 year price review is conducted in an open and transparent manner and the Company actively participates in the process. - Performance against regulatory targets is reviewed on a monthly basis by the Board or the Executive Directors. - Close engagement with Ofwat through consultation processes, workshops and industry groupings. - External assurance given to Board on ODI performance. 			
Legal and Governance	Failure to meet our legal obligations particularly licence conditions and data protection. Lack of appropriate Governance.	Prosecution or fines as a result of company failure. Significant adverse publicity and loss of reputation.	Reputational Financial
Mitigation/Control <ul style="list-style-type: none"> - Corporate Governance Code and authorisation framework which is reviewed annually. Monitoring of legal and governance areas. - Appropriate levels of insurance cover such as Public Liability insurance. - Close monitoring of performance against licence conditions through KPIs. A clear data protection policy. 			
Competition 'Open Water'	Adverse impact on business performance due to the introduction of competition.	Inability to meet the requirements of the competitive market before or after market opening. Adverse financial impact due to increased compliance costs.	Reputational Financial
Mitigation/Control <ul style="list-style-type: none"> - A transparent Governance process around the Company's strategy for "Open Water". This includes Board sponsorship, an Open Water Steering group and clear managerial responsibility. Strategic decision to exit the Non-Household retail market, reduces compliance burden and costs. - Open Water risk register and traffic lights and actions prepared and reviewed monthly at Steering Group and Board level. - External assurance in relation to Open Water progress. 			
IT	Significant successful cyber-attack on the company.	Loss of critical computer systems result in failure to operate the business as usual.	Operational Reputational Financial
Mitigation/Control <ul style="list-style-type: none"> - Third party end to end threat monitoring and alert services are used to promptly identify and respond to cyber threats. - Standard operating procedures such as regular back-ups held off site. Duplicate IT infrastructure held in a secure off-site location. - A clear disaster recovery programme in place to enable us to continue working should the systems fail. 			

REPORT ON REMUNERATION

The report sets out information on directors' remuneration for the year ended 31 March 2016. The Company is not required to comply with the rules for quoted companies contained within Schedule 8 of The Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 but sets out certain additional information which the Directors consider to be relevant and in line with best practice.

Remuneration Committee

The Remuneration Committee met two times during the year to consider and approve, on behalf of the Board, the conditions of service of the Executive Directors of the Company. It comprises the three independent Non-Executive Directors, Mr. M. P. Johnson (Chair of the Remuneration Committee), Mr. M. P. Kirk and Mrs. H. V. Benjamin.

Statement of the Chairman of the Remuneration Committee

The principles of our remuneration policy remain unchanged from previous years. During the current financial year the Remuneration Committee have not taken any major decisions to make changes to the directors' remuneration.

Role of Committee

The primary objective of the Committee is to set a policy to ensure that competitive reward packages are offered that will attract, retain and motivate talented senior executives to run the business effectively and to promote the success of the Company. Within these arrangements, a proportion of reward is based on performance against demanding targets. These targets are set by the Committee based on key strategic priorities benefiting customers, investors and other stakeholders and consistent with a Board approved level of risk.

Activities during the Year

During the year the Committee dealt with the following matters:

- Annual executive salary review and achievement of performance targets
- Determining performance targets in respect of 2015/16 annual incentive bonus plan and also the longer term five year targets for 2015-2020

Remuneration Report

Remuneration Policy

The objective is to attract, retain and motivate high calibre Senior Executives through pay arrangements which are competitive and fair and reasonable for the responsibilities involved. In addition to individual performance, reference is made to pay levels in companies of similar size and within the same industry.

The remuneration packages of the Executive Directors, as reported in the accounts, includes a performance related element. The performance related element is based upon the achievement of agreed financial, customer service and personal targets for the whole of the previous year.

Service Contracts

All Executive Directors appointed to the Board are employed on service contracts of no fixed term with a notice period of one year, both by the Company and the Director. Each Executive Director is entitled to pension provision and certain contractual benefits, details of which are summarised below. Each Executive Director also participates in bonus or incentive arrangements at the sole discretion of the Remuneration Committee which are also described later in this Report. All Executive Directors are subject to retirement by re-election at the AGM.

None of the Executive Directors serves as a Non-Executive Director for another Company.

The Chairman and other Non-Executive Directors have service contracts but these can be terminated without compensation. All Non-Executive Directors are subject to re-election at the AGM.

Revisions to Directors' Remuneration Policy

The Company is not proposing any changes to the current Policy.

REPORT ON REMUNERATION

Future remuneration policy table

Element, purpose and link to strategy	Operation, performance measures, deferral	Maximum opportunity	Performance metric
<p>Base Salary (Fixed Pay)</p> <p>To pay a fair salary, commensurate with the individual's role, responsibilities and experience, and having regard to the market rates for similar roles in the water/utility sector and other comparable companies.</p>	<p>Reviewed annually, taking account of market salary levels, Company performance, individual performance, changes in responsibility and levels of increase for the broader employee population.</p> <p>The remuneration committee considers the impact of any base salary increase on the total remuneration package.</p>	<p>There is no prescribed maximum salary or maximum rate of increase.</p> <p>The remuneration committee is guided by the general increase for the broader employee population but on occasions may need to recognise, for example, development in role, change in responsibility, specific retention issues, market practice or changes in regulatory requirements.</p> <p>Details of the outcome of the most recent salary review are provided in the annual report on remuneration.</p>	None
<p>Benefits (Fixed Pay)</p> <p>To provide cost-effective taxable benefits and to support the wellbeing of employees.</p>	<p>The Company currently provides a range of taxable benefits such as medical insurance; life insurance and paid holiday.</p> <p>Specific benefits provision may be subject to minor change from time to time, within this policy.</p>	<p>Taxable benefits are not subject to a specific cap, but represent only a small element of total remuneration.</p> <p>The costs associated with benefits provision are closely monitored and controlled.</p>	None
<p>Pension (Fixed Pay)</p> <p>To provide market competitive pension arrangements, to assist with recruitment and retention.</p>	<p>Employer contributions are made to appropriate pension schemes.</p> <p>10% of salary into a defined contributions scheme.</p>	<p>Under the defined benefits scheme a maximum future accrual of 1/80th of career averaged earnings for each year of service.</p>	None
<p>Annual bonus (Variable Pay)</p> <p>To reward performance by linking to achievement of key performance objectives aligned to the strategy of the Company.</p>	<p>Bonus awards to Executive Directors are made each year and are approved by the remuneration committee. Executive bonus awards take account of the Company's key financial and service performance indicators for the relevant financial year.</p> <p>Details of the performance indicators for the most recent financial year and performance against them are provided in the annual report on remuneration.</p>	<p>The maximum bonus potential for each Director is 20% of base salary.</p>	<p>The incentive scheme is split between three distinct areas as follows:</p> <ul style="list-style-type: none"> 5% customer service measures 5% personal objective 10% key performance objectives
<p>Long-term incentive bonus (Variable Pay)</p> <p>To incentivise Executive Directors to deliver sustained long-term performance</p>	<p>Long term bonus awards to Executive Director calculated on an annual basis but paid out at the end of the five year performance period, subject to the achievement of performance conditions.</p>	<p>10% of salary per year paid at the end of year five.</p>	<p>Awards at the end of the five year performance period, based on achievement of eight specified performance conditions.</p>
<p>Employment contracts, and loss of office</p> <p>To facilitate recruitment and retention, and support pay for performance, by providing fair but not excessive contract features.</p>	<p>Notice periods from the Company are limited to 12 months.</p>	N/A	N/A
<p>New Executive Director appointments</p> <p>To facilitate recruitment of necessary talent.</p>	<p>Remuneration for new appointments will be set in accordance with the policy detailed in this table.</p>	N/A	N/A

REPORT ON REMUNERATION

Approach to Recruitment Remuneration

The remuneration package for a newly appointed Executive Director is set in accordance with the terms of the Company's approved remuneration policy in force at the time of appointment. The variable remuneration for a new Executive Director is determined in the same way as for existing Executive Directors.

Service Contracts

The Executive Directors have one year service contracts with the Company. None of the Executive Directors serves as a Non-Executive Director for another company. The Non-Executive Directors do not have service contracts.

The service contracts of the Executive Directors include notice periods of one year, both by the Company and by the Director. There are no provisions for termination payments, other than payments for the period of notice.

The Remuneration Committee periodically reviews the contractual terms for new Executive Directors to ensure that these reflect best practice.

Statement of Consideration of Employment Conditions Elsewhere in the Company

The remuneration approach for the Executive Directors is broadly consistent with that for employees across the Company as a whole. However, the exception is that general employees do not receive an annual performance related bonus. However all employees, apart from the Managing Director, do receive their twice annual payment from the Employment Benefit Trust (EBT). The EBT owns a controlling interest in the Company's shares on behalf of the employees. Payments are made to all employees in June and November each year.

Remuneration is analysed by Director below:

	Salary/Fees £000	Benefits £000	Bonus Scheme £000	EBT £000	Pension £000	Total 2016 £000	Total 2015 £000
Executive:							
R. C. Porteous	102	14	14	16	62	208	183
H. M. G. Orton (appointed 12 October 2015)	57	6	-	-	5	68	-
N. Smith	143	19	-	-	-	162	223
Non-Executive:							
H. V. Benjamin	24	-	-	-	-	24	24
M. Johnson (appointed 1 July 2014)	24	-	-	-	-	24	18
M. P. Kirk	37	-	-	-	-	37	30
	387	39	14	16	67	523	478

Long-term bonus schemes

The Company operates a long-term performance linked bonus scheme. This element of bonus is linked to five year targets and is based upon achievements at the end of that five year period.

Share options

The Company does not operate an Executive Share Option Scheme.

Directors' interests (Audited information)

The Directors' beneficial holdings of shares in South Downs Capital Limited, the ultimate parent undertaking, are detailed below and, in total, represent 8% of the issued share capital of this holding Company. They have no direct interests in the shares of Portsmouth Water Limited.

	'C' Ordinary Shares
N. Smith	450

There have been no changes to this shareholding between the 31 March 2016 and the date of this report.

Directors' emoluments waived during the year

There were no Directors' emoluments waived during the year.

Taxable benefits

Benefits comprise company cars and medical insurance.

REPORT ON REMUNERATION

The table below provides a breakdown of taxable benefits provided to directors in the period.

	2016 £000	2015 £000
Car and Fuel benefit	30	36
Medical insurance	9	5
Total	39	41

Variable pay/performance measured pay for Executive Directors

Short term annual bonus scheme

The remuneration package of the Executive Directors, as reported in the accounts, includes a performance related element. The performance related element is based upon the achievement of agreed financial, customer service and personal targets and is paid in the form of a payment at the end of the year.

The Executive Directors can earn up to 20% of basic salary for the annual performance related element. The assessment of this element is based upon:

- 25% based on Customer Service performance including meeting the outcomes agreed at the Final Determination 2014 and being a top performer in the Service Incentive Mechanism. Also includes water quality achievement, interruption to supply, leakage, complaints and abandoned calls.
- 25% Personal Objectives individually set by the Remuneration Committee.
- 50% Financial and Business Objectives such as cost efficiency, reduction in gearing, being top performing SIM company, KPI delivery and zero reportable accidents.

The achievements were:	% of salary (out of possible 20%)	Bonus £000
R. C. Porteous	14%	14

The Managing Director does not receive a performance related element. This has been waived due to his shareholding in the holding company, South Downs Capital Limited. The Finance and Regulation Director was not employed by the Company during 2014/15.

Relative weighting of performance measures as described above for variable pay.

	Customer Service <i>Measure 1</i> %	Personal Objectives <i>Measure 2</i> %	Financial/ Business Objectives <i>Measure 3</i> %	Total %
R. C. Porteous	25	25	50	100
H M G Orton	25	25	50	100
N. Smith	N/A	N/A	N/A	N/A

The above weightings convert into maximum percentages of salary payable as follows:

	Customer Service <i>Measure 1</i> %	Personal Objectives <i>Measure 2</i> %	Financial/ Business Objectives <i>Measure 3</i> %	Total %
R. C. Porteous	5%	5%	10%	20%
H M G Orton	5%	5%	10%	20%
N. Smith	N/A	N/A	N/A	N/A

REPORT ON REMUNERATION

Summary of directors' performance targets and maximum variable pay achievable.

	Customer Service Measure 1		Personal Objectives Measure 2		Financial/Business Objectives Measure 3		Maximum Variable Pay Achievable		
	Target %	Value £	Target %	Value £	Target %	Value £	Target %	2016	2015
R. C. Porteous	5	5,100	5	5,100	10	10,200		20,400	20,000
H M G Orton	5	2,100	5	2,100	10	4,200		8,400	N/A
N. Smith	N/A	-	N/A	-	N/A	-	N/A	-	-

Summary of directors' performance against measures set for the period.

	Customer Service Measure 1		Personal Objectives Measure 2		Financial/Business Objectives Measure 3		Variable Pay Achieved		
	Achieved	Value £	Achieved	Value £	Achieved	Value £	Achieved	2016	2015
R. C. Porteous	3%	3,000	5%	5,000	8%	8,000	-	16,000	14,000
H M G Orton	3%	1,500	4%	2,000	8%	4,000	-	7,500	N/A
N. Smith	N/A	-	N/A	-	N/A	-	N/A	-	-

All variable pay has been awarded in accordance with the remuneration policy and criteria outlined at the commencement of the period. No discretion has been exercised over any variable pay awarded.

Mr. R. C. Porteous also received payment from the Employee Benefit Trust on the same basis as other employees. Mr. N. Smith, as a shareholder of the Parent Company, is not entitled to payments from the Employee Benefit Trust.

Long term bonus scheme

The Directors can earn up to 10% per annum of basic salary for achieving long term objectives over the 5 years of the regulatory period. This long term bonus scheme commenced on 1 April 2015. This payment is made at the end of a five year performance period, subject to the achievement of performance conditions.

The long term objectives, paid in 2020 if achieved include the delivery of a comprehensive Open Water plan, achieving culture change targets, being the top performing company in SIM, refinancing, reducing leakage and per capita consumption, improving credit ratings and migration from the current IT mainframe system.

The maximum percentages of salary payable as follows:

	Long –Term Objectives per annum		5 Year Total
	Objectives	per annum	
	%	%	%
R. C. Porteous	10	10	50
H. M. G. Orton	10	10	50
N. Smith	10	10	50

Summary of directors' performance targets and maximum variable pay achievable.

	Long-Term Objectives		Maximum Variable Pay Achievable	Maximum Variable Pay Achievable
	Target %	Value £	2016	2015
R. C. Porteous	10	10,200	10,200	N/A
H. M. G. Orton	10	4,700	4,700	N/A
N. Smith	10	14,300	14,300	N/A

REPORT ON REMUNERATION

Summary of directors' performance against measures set for the period.

	Achieved	Long-Term Objectives Value £	Maximum Variable Pay Achievable	Maximum Variable Pay Achievable
			2016	2015
R. C. Porteous	7%	7,000	7,000	N/A
H. M. G. Orton	7%	3,300	3,300	N/A
N. Smith	7%	10,000	10,000	N/A

All variable pay has been awarded in accordance with the remuneration policy and criteria outlined at the commencement of the period.

Pension Entitlements (Audited Information)

The Company participates in the Brockhampton Pension Scheme to provide pension benefits for its employees, including two of the Executive Directors - Mr. N. Smith and Mr. R. C. Porteous.

Mrs. H. M. G. Orton is a member of the defined contribution scheme. Contributions amounting to £4,861 were made on her behalf by the Company in the year. The Non-Executive Directors are not members of either of the pension schemes.

Benefits in kind relating to company cars are considered to be part of pensionable pay for all employees under both Schemes.

The Executive Directors who have accrued pension benefits under the Brockhampton Pension Scheme, which is a defined benefit scheme, during the year are detailed below:

	Value of increase in scheme benefit			Total included in single figure remuneration table	Value of increase in scheme benefit			Total included in single figure remuneration table	Accrued Pension 31/03/2016	Accrued Pension 31/03/2015
	2015/16	Directors contributions 2015/16	2015/16		2014/15	Directors Contributions 2014/15	2014/15			
	£000	£000	£000	£000	£000	£000	£000	£000pa	£000pa	
R. C. Porteous ¹	67	5	62	52	5	47	54	50		
N. Smith ²	-	8	-	71	8	63	90	88		

The value of the increase in accrued pension in excess of inflation, less each Directors' own contributions is included in the Directors' single figure remuneration table above. There was no post inflation increase in accrued pension benefit for Mr. N. Smith during the year.

The accumulated accrued pension is the leaving service benefit to which the Director would be entitled to if he were to leave service at the end of the year. It includes any benefits earned as an employee prior to becoming a Director, as well as those earned for qualifying services after becoming a Director.

¹The pensionable salary used to calculate Mr. R. C. Porteous' accrued pension excludes £18,328 (2014/15 - £21,215) of non-pensionable salary.

²The pensionable salary used to calculate Mr. N. Smith's accrued pension excludes £1,420 (2014/15 - £nil) of non-pensionable salary.

No additional benefits will become available to directors who retire early.

Payments to Past Directors

No payments requiring disclosure were made to past directors during the period.

Remuneration of the Managing Director

The table below summarises the remuneration of the Managing Director for each of the last six financial years. The Managing Director does not receive a performance related element of remuneration. These figures do not include amounts accruing under defined benefit pension arrangements as the figures for historic years are not readily available.

Year ending 31 March:	2011	2012	2013	2014	2015	2016
Total remuneration excluding pension (£000)	166	137	153	157	160	162

The above figures for Managing Directors remuneration are all in respect of Mr. N. Smith except for 2012 which represents only part of the year for Mr. N. Smith as he was appointed as Managing Director in December 2011.

REPORT ON REMUNERATION

Percentage Change in Remuneration of the Managing Director

The following table shows the percentage change in the base salary, benefits and annual bonus of the Managing Director between the current and previous financial year compared to the average for all employees of the Company.

¹This increase represents the annual pay award.

²There were no changes made to the underlying value of benefit payments provided during the year.

³This does not include payments made to employees from the Employee Benefit Trust.

% change in:	Managing Director	Average for all employees
Base salary ¹	1.0%	2.3%
Benefits ²	0%	0%
Annual bonus ³	N/A	N/A

Statement of Implementation of Remuneration Policy in the Following Financial Year

The Remuneration Committee intends to continue to apply broadly the same key performance metrics as in the previous year and to assess performance taking account of strategic and annual expectations for the Company.

VIABILITY STATEMENT

The Board has assessed the prospects of the Company over a period greater than one year.

Background information

The Company's business model and strategy are central to an understanding of its prospects, further explanation can be found on page 6 of the ARA. As a regulated, capital intensive, utility provider the nature of the Company's activities are long-term and, although subject to some regulatory changes, the business model is generally stable. The Company's current overall strategy, budget and cash flow projections are intrinsically linked to the Ofwat 5 year regulatory review cycle. Consequently, the 5 year regulatory Business Plan (which runs from 1 April 2015 to 31 March 2020) and the related Ofwat Final Determination are the primary drivers for the Company's future prospects. The Final Determination sets out the allowed revenue, operating expenditure, capital expenditure and agreed business Outcomes for the 5 year period. More information in respect of the regulatory regime is set out in pages 25 to 27 of the ARA.

The Board continues to take a conservative approach to the Company's strategy. The business' focus is largely on delivering the agreed regulatory Outcomes within the costs set out in the Ofwat Final Determination. Decisions relating to major capital schemes, water quality, resilience of supply and changes to the business strategy are made with a low tolerance for risk. In particular, the Board has considered the changes in the risk profile of the Company resulting from the introduction of retail competition in the non-household market from 1 April 2017. It has approved a change in business strategy, to dispose of the non-household retail business, in order to manage the business risk in respect of this change.

The assessment process of the Company prospects

The Company's prospects are assessed, primarily, through its budget process and performance against regulatory Outcomes. These are both closely linked to the 5 year financial position set out in the Ofwat Final Determination for the period 2015/16 to 2019/20 which drives the key budget assumptions.

The budget prepared included;

- Detailed budget analysis by department for the forthcoming (2016/17) financial period.
- Five year budget projections to 2019/20 comprising 1 year actuals, 1 year detailed budget and 3 years projections. These are compared against the Final Determination.
- Cash flow projections to 2019/20 (2 year detailed monthly and 3 year annual)
- Projection of key financial ratios including those required for banking covenants and to maintain an investment grade credit rating.

It also has regard to committed funding & liquidity positions and future funding requirements.

This assessment process involves an annual review of the budget (including financial projections through to the end of the current regulatory period) and related objectives, led by the Managing Director and Finance Director, through the Management Board. All Company departmental heads are involved in this review. A key part of this review is a comparison of the projected total operating and capital expenditure ("Totex") against that set out in the Ofwat Final Determination for the 5 year period. The Board participates fully in the annual process by means of the budget review and approval process, setting annual business objectives and the Board strategy day. The annual budget process was completed and approved by the Board during February 2016.

The key business assumptions in the budget related to;

- Increase in RPI (which drives tariffs and costs)
- Levels of capital and renewals spend and related efficiency and cost savings
- Salary increases
- Interest rates and loan indexation rates
- Levels of targeted cost savings

Alongside this, the Company also updates the analysis of significant risks that could prevent the budget and Outcomes from being delivered. The Board performs regular reviews of the principal risks and uncertainties and a formal annual review and a robust assessment was completed and approved in April 2016. Details of the principal risks and uncertainties are set out on pages 28 to 29 of the ARA and details of the Board risk assessment process are set out on page 39 of the ARA. The purpose of the principal risks table is, primarily, to summarise those matters that could prevent the group from delivering on its strategy. A number of other aspects of the principal risks – because of their nature or potential impact – could also threaten the Company's ability to continue in business in its current form if they were to occur. This was considered as part of the assessment of the Company's viability, as explained further below.

The period of assessment

As set out above the Board conducted the assessment for a period to 31 March 2020; a period of just under 4 years. The Board considers that this period of 4 years to be most appropriate as it aligns to the end of the current Ofwat regulatory period. As set out above the Ofwat Final Determination and Outcomes are significant drivers of the business strategy & performance and accordingly also align to the Company's budgeting period. Whilst the Board considers 4 years to be an appropriate horizon to consider the continuing viability of the Company, they do consider the viability over a longer term beyond this period.

VIABILITY STATEMENT

Assessment of viability

Although the budget reflects the Directors' best estimate of the future prospects of the business, they have also stress tested the potential impact on the Company of a number of scenarios. This has been performed by quantifying their financial impact and overlaying this on the financial forecasts. The potential impact has been considered in relation to operating profit, cash flow, liquidity and the key financial ratios needed for banking covenants and the retention of an investment grade credit rating.

These scenarios, which are based on aspects of principal risks and uncertainties set out in pages 28 to 29 of the ARA, represent 'severe but plausible' circumstances that the Company could experience.

The scenarios tested included combinations of the following:

- The loss of a combination of two critical strategic assets resulting in an in year unexpected cost increase of £8m.
- An in year unexpected capital outlay of £10m together with a £12m pension deficit arising.
- An upper limit capital expenditure test.
- Loss of a critical IT system for one month in combination with two different scenarios; i) loss of a significant treatment works; and ii) an in year unexpected capital outlay of £10m together with a £12m pension deficit arising.

In addition the Directors also tested a number of broad sensitivities including increase in interest rates, increase in costs and adverse movements in Retail Price Index.

In each case the availability and effectiveness of mitigating actions that could reasonably be taken to reduce the impact was taken into account. The primary mitigating actions relate to the use of available credit facilities, levels of insurance cover, the ability to defer capital and renewals spend and the discretion not to pay dividends.

The results of this stress testing showed that, due to the stability of the business, the Company would be able to withstand the impact of these scenarios occurring over the period of the financial forecasts by making adjustments to its operating plans within the normal course of business.

Viability statement

Based on their assessment of prospects and viability above, the Directors confirm that they have a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due over the four year period ending 31 March 2020.

DIRECTORS STATEMENTS AND RESPONSIBILITIES

Statement of Directors' Responsibilities

The Directors are responsible for preparing the Annual Performance Report and the financial statements in accordance with applicable law and regulations.

The Directors responsibilities are in accordance with the requirements;

Under Condition F of the Instrument of Appointment by the Secretary of State for the Environment, Food and Rural Affairs (Defra) and as a water undertaker under the Water Industry Act 1991; and

Under Company law in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law).

For preparing financial statements for each financial year. 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 the profit and loss of the Company for that period. In preparing those financial statements, the

Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business

The Directors are also responsible for:

- keeping proper accounting records, which disclose with reasonable accuracy at any time the financial position of the Company and which enable them to ensure that the financial statements comply with the Companies Act 2006;
- safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities; and
- the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

We confirm that to the best of our knowledge that the accounts are prepared in accordance with the applicable set of accounting standards and give a true and fair view of the assets, liabilities, financial position and profit of the Company;

Confirmation of disclosure of information to auditors

In so far as the Directors are aware:

- there is no relevant audit information of which the Company's auditors are unaware; and
- the Directors have taken all steps that they ought to have taken as directors to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Statement of Compliance with Licence Condition F6A

Certificate of compliance to the Water Services Regulatory Authority under licence condition F6A.

The Board of Directors certify that in their opinion;

- The Company will have available to it sufficient financial resources and facilities to enable it to carry out, for at least the next 12 months, the Regulated Activities (including the investment programme necessary to fulfil the Appointee's obligations under the Appointment); and
- The Company will, for at least the next 12 months, have available to it management resources which are sufficient to enable it to carry out those functions; and
- That all contracts entered into with any Associated Company include all necessary provisions and requirements concerning the standard of service to be supplied to/by the Appointee.

In providing this Certificate the Board of Directors have taken into account the following;

- acceptance of the Final Determination by the Board;
- the latest financial position as set out in the Company's Annual Report and Accounts and the most recent management accounts;
- the results of analysis carried out in relation to the Company Viability Statement;
- the approved budget and capital expenditure programme for the year ended 31 March 2017;

DIRECTORS STATEMENTS AND RESPONSIBILITIES

- cash balances of £9.2m and committed undrawn loan facilities of £14m as at 31 March 2016;
- the current level of gearing together with the projected level of headroom on key covenant ratios through to 31 March 2017;
- a stable and experienced senior management team, with a wide knowledge of the water industry together with a skilled and motivated workforce; and
- appropriate risk management and governance arrangements.

Statement of Compliance of Licence Requirement Condition K

In accordance with its Instrument of Appointment under the Water Industry Act 1991, the Directors are of the opinion that the Company is in compliance with paragraph 3.1 of Condition 'K' of that Instrument.

Statement of Compliance with Regulatory Accounting Guideline 5

The Directors hereby certify that, in their opinion, Portsmouth Water Limited complies with the objectives and principals of the above Regulatory Accounting Guideline, in so far as they apply to the Company, that transactions with associated companies are at arm's length and that cross subsidy is not occurring.

Statement on Risk & Compliance

The Directors confirm that the Company, in their opinion:

- has a full understanding of, and is meeting, its statutory obligations and the expectations of its customers;
- has satisfied itself that it has sufficient processes and internal systems of control to fully meet its obligations; and
- has appropriate systems and processes in place to allow it to identify, manage and review its risks.

In preparing this statement, the Directors confirm that the Company is aware of the obligations in legislation and in its licence with which it must comply. In particular, the Directors confirm that the Company:

- has sufficient rights and assets available to enable a special administrator to run the business;
- trade with associates is at arm's length;
- publishes a statement explaining the links between directors' pay and standards of performance; and
- maintains an investment grade credit rating.

The risk management, monitoring and control systems and processes upon which the Directors rely in making this statement are described in the Company's Annual Report and Accounts within the Strategic Report on pages 28 and 29 and the Corporate Governance Report on page 39.

Signed by:

M P Kirk

N Smith

H M G Orton

R C Porteous

M P Johnson

H V Benjamin

SECTION 1 REGULATORY FINANCIAL REPORTING

INCOME STATEMENT

For the 12 months ended 31 March 2016

	Note	Current year				Total appointed activities £'000
		Statutory £'000	Differences between statutory and RAG definitions £'000	Adjustments		
				Non-appointed £'000	Total adjustments £'000	
Revenue	2	39,795	0	72	(72)	39,723
Operating costs	3	(31,593)	967	(58)	1,025	(30,568)
Other operating income	4	(562)	0	0	0	(562)
Operating profit		7,640	967	14	953	8,593
Other income	5	0	92	92	0	0
Interest income	6	1,378	0	0	0	1,378
Interest expense	7	(4,778)	0	0	0	(4,778)
Other interest expense		0	0	0	0	0
Profit before tax and fair value movements		4,240	1,059	106	953	5,193
Fair value gains/(losses) on financial instruments		0	0	0	0	0
Profit before tax		4,240	1,059	106	953	5,193
UK Corporation tax	8	(1,236)	0	(21)	21	(1,215)
Deferred tax	8	524	0	0	0	524
Profit for the year		3,528	1,059	85	974	4,502

STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 March 2016

	Note	Current year			Total appointed activities	
		Statutory	Differences between statutory and RAG definitions	Non-appointed		Total adjustments
		£'000	£'000	£'000	£'000	
Profit for the year		3,528	1,059	85	974	4,502
Actuarial gains/(losses) on post employment plans	22	6,274	0	0	0	6,274
Other comprehensive income	20	(904)	0	0	0	(904)
Total Comprehensive income for the year		8,898	1,059	85	974	9,872

STATEMENT OF FINANCIAL POSITION

As at 31 March 2016

		Current year				
		Adjustments				
Note	Statutory	Differences between statutory and RAG definitions	Non-appointed	Total adjustments	Total appointed activities	
	£'000	£'000	£'000	£'000	£'000	
Non-current assets						
Fixed assets	10	123,003	0	0	123,003	
Intangible assets	11	77	0	0	77	
Investments - loans to group companies	12	55,984	0	0	55,984	
Investment Properties		440	0	0	440	
Retirement benefit assets	22	14,575	0	0	14,575	
Total non-current assets		194,079	0	0	194,079	
Current assets						
Inventories		592	0	0	592	
Trade & other receivables	13	7,897	0	0	7,897	
Investments - other	14	2	0	0	2	
Cash & cash equivalents	15	9,206	0	0	9,206	
Total current assets		17,697	0	0	17,697	
Current liabilities						
Trade & other payables	17	(12,797)	0	0	(12,797)	
Capex creditor	17	(1,700)	0	0	(1,700)	
Borrowings	16	(284)	0	0	(284)	
Current tax liabilities	17	(624)	0	0	(624)	
Provisions	17	(1,412)	0	0	(1,412)	
Total current liabilities		(16,817)	0	0	(16,817)	
Net Current assets/(liabilities)		880	0	0	880	
Non-current liabilities						
Borrowings	18	(97,724)	0	0	(97,724)	
Deferred income - G&C's	19	(24,429)	0	0	(24,429)	
Deferred tax	20	(6,386)	0	0	(6,386)	
Total non-current liabilities		(128,539)	0	0	(128,539)	
Net assets		66,420	0	0	66,420	
Equity						
Called up share capital	21	1,078	0	0	1,078	
Retained earnings & other reserves	21	65,342	0	0	65,342	
Total Equity		66,420	0	0	66,420	

STATEMENT OF CASHFLOWS

As at 31 March 2016

	Note	Current year				Total appointed activities £'000
		Statutory	Adjustments			
			Differences between statutory and RAG definitions	Non-appointed	Total adjustments	
£'000	£'000	£'000	£'000	£'000		
Operating profit		7,640	967	14	953	8,593
Other income		0	92	92	0	0
Depreciation		6,109	0	0	0	6,109
Amortisation - G&C's		(582)	0	0	0	(582)
Changes in working capital		(246)	0	0	0	(246)
Pension contributions		168	0	0	0	168
Movement in provisions		0	0	0	0	0
Loss on sale of fixed assets		562	0	0	0	562
Cash generated from operations		13,651	1,059	106	953	14,604
Net interest paid		(3,735)	0	0	0	(3,735)
Tax paid		(287)	0	(21)	21	(266)
Net cash generated from operating activities		9,629	1,059	85	974	10,603
Investing activities						
Capital expenditure		(8,613)	0	0	0	(8,613)
Grants & Contributions		1,194	0	0	0	1,194
Disposal of fixed assets		34	0	0	0	34
Other		1,001	0	0	0	1,001
Net cash used in investing activities		(6,384)	0	0	0	(6,384)
Net cash generated before financing activities		3,245	1,059	85	974	4,219
Cashflows from financing activities						
¹ Equity dividends paid		(1,165)	(1,059)	(85)	(974)	(2,139)
Net loans received		350	0	0	0	350
Cash inflow from equity financing		0	0	0	0	0
Net cash generated from financing activities		(815)	(1,059)	(85)	(974)	(1,789)
Increase (decrease) in net cash		2,430	0	0	0	2,430

¹ Includes Employee Ownership Trust bonus payment for consistency with the Final Determination

NET DEBT ANALYSIS

As at 31 March 2016

	Interest rate risk profile			Total
	Fixed rate	Floating rate	Index linked	
	£'000	£'000	£'000	£'000
Borrowings (excluding preference shares)	284	0	98,662	98,946
Preference share capital				0
Total borrowings	284	0	98,662	98,946
Cash	0	(9,206)	0	(9,206)
Short term deposits				0
Net Debt	284	(9,206)	98,662	89,740
Gearing				70.2%
Adjusted Gearing				N/A
Full year equivalent nominal interest cost	0.01	0.04	4.56	4.61
Full year equivalent cash interest payment	0.01	0.04	3.56	3.61
Indicative interest rates				
Indicative weighted average nominal interest rate	3.5%	1.7%	4.6%	4.6%
Indicative weighted average cash interest rate	3.5%	1.7%	3.6%	3.6%

RECONCILIATION BETWEEN STATUTORY ACCOUNTS AND REGULATORY ACCOUNTS

For the year ended 31 March 2016

	Statutory FRS 102 £m	Regulatory £m	Commentaries
PROFIT AND LOSS ACCOUNT			
Revenue	39,795	39,795	See a) below
Operating profit	7,640	8,607	See b) and c) below
	<u> </u>	<u> </u>	
BALANCE SHEET			
Tangible fixed assets (net book value)	123,003	123,003	See d) below
	<u> </u>	<u> </u>	

a) N/A.

b) The difference relates to the way these figures have been presented in both sets of accounts. In the Statutory Accounts, this figure includes other income of £0.092m, but this is reported after operating profit in the Regulatory Accounts.

c) The cash payment in connection with the Employee Ownership Trust is not shown in operating costs in the Regulatory Accounts. It is shown below the Profit after Taxation line. The amount for 2016 is £1.059m. This is consistent with the treatment in the Business Plan for PR14 and the Final Determination.

d) N/A

NOTES TO THE ACCOUNTS

1 ACCOUNTING POLICIES

The statutory financial statements of Portsmouth Water Limited have been prepared in compliance with UK Accounting Standards, including Financial Reporting Standard 102 "The Financial Reporting Standard applicable in the United Kingdom and Republic of Ireland" ("FRS 102") and the Companies Act 2006. This Annual Performance Report has been prepared on the basis of these statutory financial statements and have been presented and, where applicable, modified in accordance with the requirements of the Regulatory Accounting Guidelines ('RAGs') published by Ofwat and in force at the date of these accounts. The principal accounting changes in respect of the application of RAGs relate to the treatment of non-appointed business and the Employee Ownership Trust payments, which are not included in the operating costs, as in the Statutory Accounts.

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied, unless otherwise stated. Details of the transition to FRS 102 are set out in note 30 to the ARA. The prior year figures have been restated to reflect material adjustments on adoption of FRS 102 in the current year. The financial statements are presented in pounds sterling

The Company is a wholly owned subsidiary undertaking and the results have been consolidated into the accounts of South Downs Capital Limited, copies of which are available from the registered office.

In view of the licence conditions under which the Company operates as a water supplier, it is required to publish information about its annual results as if it were a company covered by the listing Rules of the Financial Conduct Authority, except where it is considered inappropriate to do so. Earnings per share disclosures are not presented as the Company is a wholly owned subsidiary. Segmental reporting has not been presented as, in the opinion of the Directors, the Company undertakes a single activity.

The principal accounting policies, which have been applied consistently, are as follows:

(a) Revenue

Revenue, which excludes value added tax, represents the income receivable for goods and services provided to external customers in the ordinary course of business.

Revenue from the regulated water business includes amounts billed for the year, together with an estimation of amounts used but unbilled at the year end, for measured water customers. Where an invoice has been raised or payment received but the service has not been provided in the year this will be treated as a payment in advance. This will not be recognised within the current year's turnover but will instead be included within creditors as deferred income.

Unmeasured income bills are generally based on the rateable value of properties. Unmeasured customers are billed annually in advance on 1 June and amounts invoiced in advance are not recognised in turnover until earned.

Measured income arises from customers who have meters fitted at their premises therefore amounts billed are based on actual water consumption. In addition a 'measured income accrual' is calculated in order to estimate of the value of water used but unbilled at the year end. The estimation of the amounts unbilled at the year end uses a defined methodology based upon valuing an estimate of unbilled water consumed. This is calculated using known factors such as the date of the customers' last bill and the customer tariff rate together with an estimate of the water consumed. The estimated water consumed is calculated from various factors including; the number of days elapsed since the last meter read, historical consumption levels for each premises (which is calculated from historical customer billing data) or estimated average consumption per property type (where a historic actual is not available). The assumptions reflect historic experience and current data. Management review both the data sets used, the outcome of the calculation and quarterly trends in determining the year end position. There has been no change in the methodology for calculating the measured income accrual during the year.

Charges on income arising from court, solicitors and debt recovery agency fees are credited to operating costs and added to the relevant customer account. They are not recognised within turnover.

Differences between Statutory and Regulatory accounts

Non-appointed income is included within turnover in the statutory accounts but is excluded from turnover in the APR.

Void Properties

Empty properties are classed as "voids" and no bill is raised. There is a defined process for determining if a property is unoccupied. The first stage is that an Occupation Form is posted to the property, requesting details of the occupier. If there is no reply a reminder is sent. The meter continues to be read and monitored and, if consumption is present, further steps are taken. The next stage involves a Visit Notice being raised and given to an Inspector. The Inspector will then go to the property and confirm if the property is void or not, and will turn off the water supply if appropriate. Accordingly revenue is only recognised if the property can be shown not to be void.

NOTES TO THE ACCOUNTS

Charging Policy

Charges are payable if premises are furnished unless the Company is asked to turn off the supply. No retrospective allowances are given. If the premises do not have a separate supply pipe it may not be possible for the Company to turn off the supply.

Where turn-off is required pending the sale of a property, or for a planned period of more than six months, no charge will be made to turn the water off and back on, provided this is undertaken within normal working hours and sufficient notice has been given.

No charges are payable in respect of unoccupied unfurnished premises, where no water is being used. No retrospective allowances are given.

Where a property is unoccupied following the death of the owner/occupier, the Executors/Administrators can decide whether a supply is maintained to furnished premises, with charges accruing, or the supply is turned off. In either case, the bill outstanding will only become payable upon Probate or Letters of Administration having been obtained.

All new properties are metered. Charges accrue from the date at which the meter is installed. The developer is billed between the date of connection and first occupancy and this is recognised as turnover.

If the developer is no longer responsible for the property and no new occupier has been identified the process referred to above, for void properties, is followed to identify the new occupier. Until the new occupier has been identified the property is treated as unoccupied and is not billed.

(b) Fixed assets

Tangible fixed assets

The Company holds both above ground assets and a below ground infrastructure network of mains. This classification, together with the value and nature of items, drives both the approval process and the accounting treatment of tangible fixed assets.

As part of the annual budgeting process a detailed capital programme is drawn up for the forthcoming financial year. This categorises capital schemes between mains infrastructure and above ground assets. This is approved by the Company's Board. Following Board approval individual schemes are programmed for the coming year by Project Managers responsible for delivering the schemes. The Project Managers are responsible for the control of expenditure on the schemes and authorise each individual item of expenditure incurred. The Financial Controller reviews the scheme expenditure in order to ensure that the correct accounting treatment has been applied. For small plant, equipment and vehicles a list is drawn up and also approved by the Company's Board. Purchases made are reviewed for correctness of treatment and to ensure that these are all capital items. The policy adopted by the Company is that only items above £500 are capitalised.

Mains infrastructure (below ground assets)

Infrastructure assets comprise a network of mains, communications pipes and boundary boxes. The company undertakes expenditure on this network in order to maintain it in an ongoing serviceable condition. Where this expenditure meets certain criteria (set out below) it is capitalised. All other expenditure is expensed as incurred.

Expenditure on infrastructure assets relating to increases in capacity or other economic enhancement is capitalised. Other economic enhancements relate primarily to the installation of new boundary boxes, schemes addressing specific water quality issues or areas where mains have been diverted to avoid damage. Such items are treated as additions and included in property, plant and equipment at cost.

The cost of infrastructure assets is their purchase cost, together with incidental expenses of acquisition and directly attributable labour costs which are incremental to the Company. The assets are depreciated over their useful lives of between 40 and 100 years on a straight line basis. There are no expected residual values.

Other fixed assets (above ground assets)

Other assets comprise buildings and reservoirs, pumping plant, vehicles, mobile plant and office equipment. The cost of other assets is the purchase cost, together with incidental expenses of acquisition and directly attributable labour costs which are incremental to the Company. Depreciation is provided on all tangible fixed assets, with the exception of freehold land. It is calculated to write off the cost of assets over their estimated useful economic lives using the straight line method. There are no expected residual values. Those lives are estimated as follows:

Building and reservoirs	100 years
Pumping and other plant (including solar panels)	15-25 years
Office equipment	5-10 years
Vehicles and mobile Plant	5-7 years

Assets in the course of construction

Assets in the course of construction are included in tangible fixed assets at cost but are not depreciated until they come into use.

NOTES TO THE ACCOUNTS

Impairment

The values of fixed assets are reviewed regularly to determine whether their carrying amounts exceed their fair values in use. Where such an excess is believed to exist, it is treated as an impairment loss and charged to the profit and loss account.

Intangible fixed assets other than goodwill

Intangible assets acquired separately from a business are recognised at cost and are subsequently measured at cost less accumulated amortisation and accumulated impairment losses. Amortisation is recognised so as to write off the cost or valuation of assets over their useful lives on the following basis:

Software	3 years
Consultancy and internal staff costs	3 years

Intangible assets in the course of construction

Intangible assets in the course of construction are included in intangible fixed assets at cost but are not amortised until they come into use.

(c) Investment properties

The Directors consider certain holdings of freehold land and buildings to be investment properties. In accordance with FRS 102, they are included in the statement of financial position at their open market value. The surplus or deficit on revaluation is recognised in the profit or loss for the year, along with the related deferred tax charge or credit. Depreciation is not provided in respect of these holdings. It is the Company's policy to obtain an external third party valuation of 1/5th of the property portfolio on a rolling basis with the remainder being valued based on a management review and using relevant indices.

(d) Capital contributions

Mains contributions

In certain circumstances third parties make non-returnable contributions towards the cost of specific infrastructure assets. In accordance with the Companies Act 2006 and FRS 102 requirements to include fixed assets at cost, such contributions are treated as deferred income and released to the income statement over the useful economic life of the corresponding assets.

Infrastructure charges

Infrastructure charges are made in respect of new connections in accordance with Condition 'C' of the Instrument of Appointment. These charges are treated as mains contributions as explained above.

(e) Stocks

Stocks of raw materials are valued on a weighted average cost basis at the lower of cost or net realisable value. In accordance with established practice in the water industry, no value is placed upon the water in reservoirs, mains or in the course of treatment.

(f) Taxation

Current tax, including UK corporation tax and foreign tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the statement of financial position date.

Deferred tax is recognised on all timing differences where the transactions or events that give the company an obligation to pay more tax in the future, or the right to pay less tax in the future, have occurred by the statement of financial position date. Deferred tax assets are recognised when it is more likely than not that they will be recovered. Deferred tax is measured using rates of tax that have been enacted or substantively enacted by the statement of financial position date.

Deferred tax is recognised when assets are revalued and the gain or loss expected to arise on sale has been recognised in the financial statements.

(g) Leases

All leases are regarded as operating leases. Operating lease payments are charged to the income statement on a straight line basis over the lease term. Lease income is recognised on a straight line basis over the lease term.

(h) Pension costs and other post-retirement benefits

Portsmouth Water Limited is the principal employer and its parent company, Brockhampton Holdings Limited, is the participating employer in the Brockhampton Pension Scheme. This scheme is a defined benefit scheme. The assets of the scheme are held in a separate trustee administered fund. As principal employer Portsmouth Water includes the pension asset in its financial statements.

NOTES TO THE ACCOUNTS

The current service costs are charged to the income statement and included as staff employment costs. The interest cost and interest income are shown as a net amount within other finance income. Re-measurements of the net defined benefit asset are recognised immediately in other comprehensive income.

Pension scheme liabilities are measured on an actuarial basis using the projected unit method and are discounted to their present value using the AA corporate bond rate.

Pension scheme assets are valued at fair value at the statement of financial position date. The pension scheme surplus is recognised in full on the statement of financial position.

The deferred tax relating to a defined benefit asset is offset against the defined benefit asset and not included with other deferred tax liabilities.

Detailed information regarding the surplus and actuarial position of the scheme is given in note 22.

The Company also operates a defined contribution pension scheme. The charge to the income statement amounts to the contributions payable to the scheme in respect of the accounting period.

(i) Financial instruments

Financial assets and financial liabilities are recognised when the company becomes party to the contractual provisions of the instrument.

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the company after deducting all of its liabilities.

All financial assets and liabilities are initially measured at transaction price (including transaction costs), except for financial assets classified as fair value through profit and loss, which are initially measured at fair value (normally transaction price excluding transaction cost).

If an arrangement constitutes a financing transaction, the financial asset or financial liability is measured at the present value of the future payments discounted at a market rate of interest for a similar debt instrument.

Debt instruments which meet the applicable conditions are recognised as basic financial instruments and subsequently measured at amortised costs using the effective interest rate method. Instruments that are payable or receivable within one year of initial recognition and meet the applicable conditions are measured at the undiscounted amount of consideration expected to be paid or received, net of impairment.

Financial assets are derecognised when and only when the contractual rights to the cash flows from the financial assets expire or are settled, or the company transfers substantially all of the risks and rewards of ownership of the financial asset.

Financial liabilities are derecognised only when the obligation specified in the contract is discharged, cancelled or expires.

The Company subsequently categorises financial instruments as follows:

- Fixed asset investments consist of loans to Group undertakings, which earn interest based on London Interbank rates and are classified as loans and receivables.
- Other financial assets consist of short term bank deposits and debtors and are classified as loans and receivables.

The Company's financial liabilities consist of fixed rate borrowings in the form of perpetual debentures and an index linked loan.

Investments

Investments consist of non-current and current investments.

Non-current investments are in respect of loans to group companies. They are measured at amortised cost using the effective interest rate method.

Current asset investments are held at cost less impairment since fair value cannot be measured reliably.

(j) Provisions

A provision is recognised when the Company has a legal or constructive obligation as a result of past events and it is probable that an outflow of economic benefits will be required to settle the obligation. The effect of the time value of money is not material and therefore the provisions are not discounted.

NOTES TO THE ACCOUNTS

(k) Cost allocation policies

Accounting Separation

The tables which relate to the PR14 price controls have been completed in accordance with RAG 2 - Guideline for classification of costs across the price controls. The details of this classification are included in the separately published Accounting Separation Methodology Statement, which can be located on the Company website at www.portsmouthwater.co.uk.

The Methodology Statement details the systems in place and the sources of information used to populate the relevant tables in the Annual Performance Report. The detailed nominal ledger management information reports allow costs to be identified for each cost centre of the Company, and the direct costs of Business Units, for example Retail, can be readily identified.

The Company has used the guidance issued by Ofwat in the separating of costs and assets between the Wholesale and Retail business units. It has followed the prescribed hierarchy of cost drivers when deciding upon the most appropriate basis for allocation of both costs and assets. Where the Company has opted to base the allocation of a number of costs and assets on a management estimate, it is satisfied that this was the only valid option given the time and costs involved in other methods.

A summary of the bases of allocation for the operating costs, excluding depreciation, is included below:

ANNUAL PERFORMANCE REPORT - BUSINESS UNIT TABLES

2015/16

BASIS OF ALLOCATION

DIRECT COSTS

Employment Costs	Direct and management estimate
Power	Pumping Head
Hired & Contracted Services	Direct
Materials & Consumables	Direct
Service Charges	Direct
Other Direct Costs	Direct

GENERAL & SUPPORT ACTIVITIES

Land & Property	Direct and prorata on direct
Mechanical & Electrical	Direct and prorata on direct
Supply Engineer	M&E basis
Supply General	Direct
Distribution General & Admin	Direct
Personnel Services	FTE's
Legal & Property	FTE's
Financial Services	FTE's
Directors	Time on activities and Board Agenda
Data processing	No. of computers & mobile devices
Operational / Technical Support	GMEAV of assets
Vehicles & Plant	NBV of assets
Stores	Direct material costs

GENERAL ADMIN

Directly identifiable items	Direct
Employers NI	Salaries by department
Other General Admin	Direct/Floor space/FTE's

Other Business Activities	1/5 per Business Unit
Scientific Services	Quality samples
Doubtful Debts	Direct
General Rates	Floor space
Bulk Supply	Direct
Third Party Costs (RCW)	Direct
Renewals Expensed	Direct

The allocation of shared assets and the associated depreciation is based on the same methodology. Assets are grouped into categories, such as IT or Scientific Services, and allocated on the same basis as the corresponding operating costs.

NOTES TO THE ACCOUNTS

Major Changes in Cost Allocation Methodology

The major changes in allocation methodology, from 2014/15, are as follows:

Wholesale/Retail split:

- General Rates are allocated on a floor space basis (GMEAV in 2014/15)
- Directors' costs are allocated on the basis of time spent on each activity, with time on Board Meetings further allocated on Board Agenda content. (FTE's in 2014/15)
- IT costs are allocated on the numbers of computers and mobile devices (Number of computers in 2014/15)
- General Administration costs are allocated on the basis of FTE's, where there is no direct allocation or a more cost-reflective basis. (Some costs were allocated on direct costs, excluding abstraction, in 2014/15)

Wholesale split:

- Direct Supply labour is allocated on a management estimate, with 90% of the costs being allocated to Water Treatment. (Pumping Head in 2014/15)

The transition effect of FRS102 for the Statement of Changes in Other Comprehensive Income and for Changes in Equity is shown below:

Statement of Changes in Other Comprehensive Income (Year ended 31 March 2015)	As previously stated	Effect of transition	FRS 102 as Restated
Profit for the Financial Year	2,338	(427)	1,911
Remeasurement of net defined benefit obligation	(10,825)	1,464	(9,361)
Deferred tax on remeasurement of defined benefit obligation	2,165	(293)	1,872
Other comprehensive income for the year net of tax	(8,660)	1,171	(7,489)
Total comprehensive income for the year	(6,322)	744	(5,578)

Statement of Changes in Equity (Year ended 31 March 2015)	As previously stated	Effect of transition	FRS 102 as Restated
Balance as at 1 April 2014	66,011	(973)	65,038
Profit for the year	2,338	(427)	1,911
Other comprehensive income for the year	(8,660)	1,171	(7,489)
Total comprehensive income for the year	(6,322)	744	(5,578)
Dividend	(773)	-	(773)
Balance as at 31 March 2015	58,916	(229)	58,687

NOTES TO THE ACCOUNTS

	Appointed	Non	Total	Appointed	Non	Total
	2016	Appointed 2016	2016	2015	Appointed 2015	2015
	£000	£000	£000	£000	£000	£000
				Restated		Restated
2. REVENUE						
Unmeasured supplies	21,446	-	21,446	21,322	-	21,322
Measured supplies	14,098	-	14,098	13,171	-	13,171
Measured large users	2,028	-	2,028	1,980	-	1,980
SWS Bulk Supply	107	-	107	226	-	226
Third party services	1,363	72	1,435	1,407	70	1,477
Other sources	99	-	99	95	-	95
Amortisation of Developer Contributions	582	-	582	567	-	567
	<u>39,723</u>	<u>72</u>	<u>39,795</u>	<u>38,768</u>	<u>70</u>	<u>38,838</u>

Measured Income Accrual

For the year 2014/15 the measured income accrual was £3,051,182, and the corresponding actual billed revenue was £3,115,654. This is a difference of £64,472.

3. ANALYSIS OF OPERATING COSTS

This note has been prepared in accordance with Condition 'F' of the Company's Instrument of Appointment.

	Appointed	Non	Total	Appointed	Non	Total
	2016	Appointed 2016	2016	2015	Appointed 2015	2015
	£000	£000	£000	£000	£000	£000
				Restated		Restated
Manpower costs	8,992	14	9,006	8,642	14	8,656
Other costs of employment	356	-	356	334	-	334
Power	2,063	-	2,063	2,073	-	2,073
Rates	2,118	-	2,118	2,019	-	2,019
Hired and contracted services	4,765	4	4,769	4,748	23	4,771
Materials and consumables	1,544	40	1,584	1,568	33	1,601
Service charges	1,323	-	1,323	1,327	-	1,327
Renewals expensed	1,752	-	1,752	5,261	-	5,261
Provision for bad and doubtful debts	810	-	810	1,125	-	1,125
Other operating costs	736	-	736	343	-	343
Depreciation	6,109	-	6,109	5,078	-	5,078
	<u>30,568</u>	<u>58</u>	<u>30,626</u>	<u>32,518</u>	<u>70</u>	<u>32,588</u>

Manpower costs include a notional pension charge and should not be included for efficiency purposes. The notional pension charge is excluded from the price determination. A comparison of these costs are shown below:

	2016	2015
	£000	£000
Manpower as reported	9,135	8,642
Notional Pension Cost	(168)	(374)
	<u>8,967</u>	<u>8,268</u>

	Appointed	Non	Total	Appointed	Non	Total
	2016	Appointed 2016	2016	2015	Appointed 2015	2015
	£000	£000	£000	£000	£000	£000
4. OPERATING INCOME						
(Loss)/profit arising on disposal of fixed assets	(562)	-	(562)	3	-	3

NOTES TO THE ACCOUNTS

	Appointed 2016 £000	Non Appointed 2016 £000	Total 2016 £000	Appointed 2015 £000	Non Appointed 2015 £000	Total 2015 £000
5. OTHER INCOME						
Rents	-	91	91	-	66	66
Home Assistance Service	-	1	1	-	2	2
	-	92	92	-	68	68
6. INTEREST RECEIVABLE				2016 £000		2015 £000
Loan to Group Company				967		955
Interest on short term deposits				26		9
Other interest receivable				3		10
Other Finance Income (see note 22)				382		859
				<u>1,378</u>		<u>1,833</u>
7. INTEREST PAYABLE AND SIMILAR CHARGES				2016 £000		2015 £000
£66.5m loan						
- interest				3,564		3,517
- indexation				994		2,400
- amortisation of fees				57		57
- administration expenses				110		44
				<u>4,725</u>		<u>6,018</u>
Other bank loans and overdraft				41		75
Debenture stocks				10		10
Other interest payable				2		3
				<u>4,778</u>		<u>6,106</u>
8. TAXATION (APPOINTED BUSINESS ONLY)				2016 £000		2015 £000
Current tax						Restated
United Kingdom corporation tax at 20% (2015 - 21%)				1,151		402
Adjustment in respect of prior periods				64		-
				<u>1,215</u>		<u>402</u>
Deferred tax						
Origination and reversal of timing differences				132		40
Effect of change to corporation tax rate				(695)		-
Difference between pension cost charge and pension cost relief				39		96
				<u>(524)</u>		<u>136</u>
Tax on profit on ordinary activities				<u>691</u>		<u>538</u>

NOTES TO THE ACCOUNTS

8. TAXATION (APPOINTED BUSINESS ONLY) (continued)	2016 £000	2015 £000
The tax charge for the year is lower (2015 - lower) than the standard rate of corporation tax in the UK of 20% (2015 - 21%). The difference is explained as follows:		
Profit on ordinary activities before tax	4,134	2,449
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 20% (2015 - 21%)	827	514
Effect of:		
Expenses not deductible for tax purposes	68	4
Depreciation on assets not qualifying for capital allowances	64	93
Other tax adjustments	151	
Difference between pension cost charged and relieved	(108)	
Prior year adjustment – current tax	64	-
Payments for group relief	149	-
Current tax charge for the year	1,215	402

The difference between the current tax charge above of £1.2m and the current tax charge set out in the Final Determination £0.3m of £0.9m relates to two elements. Higher profit of £0.9m with a tax effect of £0.2m and the change in accounting treatment for infrastructure renewals expenditure under FRS 102 with a tax effect of £0.7m.

9. DIVIDENDS	2016 £000	2015 £000
Equity: Ordinary/'A' Ordinary		
- First interim paid	585	578
- Second interim paid	-	-
- Final paid	580	195
	1,165	773

The Directors are proposing the payment of a final dividend of £0.6m for the year ended 31 March 2016. This dividend has not been accounted for within the current year financial statements, as it has yet to be approved.

Dividend Policy

The Company's dividend policy covers two elements. The first is a dividend payment and the second is to cover the servicing of intercompany debt.

The policy on the dividend element is to show real growth of 1.65% (i.e. RPI + 1.65%) on the previous year's payment. The second part of the dividend is the payment to cover interest due from South Downs Limited on the loan from Portsmouth Water. This payment is made net of any group tax relief surrendered. This element is subsequently repaid by South Downs Limited to Portsmouth Water Limited to cover the next interest payment.

A breakdown of this dividend is shown below:

	2016 £000	2015 £000
Dividend ultimately for group shareholders	397	391
Servicing of intercompany debt net of group relief	768	382
	1,165	773

In addition to the above, payments to employees, as beneficiaries under the Employee Ownership Trust, amounting to £1.059m are charged to operating profit in the Statutory Accounts as an employee cost. For the regulatory accounts they are treated as a distribution to shareholders. This is consistent with the PR14 Business Plan and the F.D.14, in that they are funded through the return on capital element of the Price Control building blocks.

NOTES TO THE ACCOUNTS

10. TANGIBLE FIXED ASSETS

	Freehold land, buildings & reservoirs Restated £'000	Mains Restated £'000	Pumping Plant £'000	Vehicles, mobile plant & office equipment £'000	Total Restated £'000
COST					
At 1st April 2015 (as previously stated)	52,958	145,522	42,049	20,915	261,444
FRS 102 adjustments	(195)	(91,975)	-	-	(92,170)
At 1st April 2015 (restated)	52,763	53,547	42,049	20,915	169,274
Additions	522	1,712	4,635	2,474	9,343
Disposals	(171)	(88)	-	(3,494)	(3,753)
Reclass to intangible fixed assets				(127)	(127)
At 31st March 2016	53,114	55,171	46,684	19,768	174,737
DEPRECIATION					
At 1st April 2015 (as previously stated)	11,818	90,300	22,056	13,767	137,941
FRS 102 adjustments	(43)	(89,066)	-	-	(89,109)
At 1st April 2015 (restated)	11,775	1,234	22,056	13,767	48,832
Charge for year	528	1,483	2,121	1,977	6,109
Disposals during year	(44)	-	-	(3,113)	(3,157)
Reclass to intangible fixed assets				(50)	(50)
At 31st March 2016	12,259	2,717	24,177	12,581	51,734
CAPITAL CONTRIBUTIONS					
At 1st April 2015 (as previously stated)	-	24,384	-	-	24,384
FRS 102 adjustments	-	(24,384)	-	-	(24,384)
At 1st April 2015 (restated)	-	-	-	-	-
NET BOOK VALUE					
At 31st March 2016	40,855	52,454	22,507	7,187	123,003
At 1st April 2015 (Restated)	40,990	52,313	19,993	7,148	120,444

NOTES TO THE ACCOUNTS

TANGIBLE FIXED ASSETS IN THE COURSE OF CONSTRUCTION

	Freehold land, buildings & reservoirs £'000	Mains £'000	Pumping Plant £'000	Vehicles, mobile plant & office equipment £'000	Total £'000
COST					
At 1st April 2015	178	-	497	1,207	1,882
Additions	61	-	3,210	1,042	4,313
Transferred to Intangible fixed assets	-	-	-	(127)	(127)
At 31st March 2016	239	-	3,707	2,122	6,068
DEPRECIATION					
At 1st April 2015	-	-	-	39	39
Charge for year	-	-	-	(50)	(50)
Transferred to Intangible fixed assets	-	-	-	144	144
At 31st March 2016	-	-	-	133	133
NET BOOK VALUE					
At 31st March 2016	239	-	3,707	1,989	5,935
At 1st April 2015	178	-	497	1,168	1,843

No depreciation has so far been provided on the above cost, with the exception of certain elements of the Works and Asset Management System, part of which has now been brought into use.

Included within freehold land, buildings and reservoirs at cost was an amount of £0.611m relating to a capital project involving the design and construction of a winter storage reservoir at Havant Thicket. Costs incurred to date were in respect of initial design, planning application and environmental impact studies. This project is unlikely to start in the foreseeable future and therefore the expenditure is considered to have no economic benefit. An impairment provision was therefore made in the year 2014. An earlier impairment provision of £1.086m had been made as at the 31 March 2011, therefore the total costs to date relating to this project of £1.697m have been taken as impaired and provided for.

NOTES TO THE ACCOUNTS

11. INTANGIBLE FIXED ASSETS

	INTANGIBLE FIXED ASSETS £000
At 1 April 2015	-
Amounts reclassified for tangible fixed assets	127
Amortisation	(50)
As 31 March 2016	77

	SOFTWARE,CONSULTANCY AND INTERNAL STAFF COSTS £000
Cost	
At 1 April 2015	-
Transferred from fixed assets	127
Additions	-
As 31 March 2016	127
Amortisation	
At 1 April 2015	-
Transferred from fixed depreciation	50
Charge for year	-
As 31 March 2016	50
Net book value	
At 1 April 2015	-
As 31 March 2016	77

Intangible fixed assets primarily comprise software costs and the in house development of bespoke software and related IT solutions.

12. FIXED ASSET INVESTMENT

	Loan to Group Undertakings £000
At 1 April 2015	56,334
Repayment	(350)
	55,984
At 31 March 2016	55,984

NOTES TO THE ACCOUNTS

13. DEBTORS	2016 £000	2015 £000
Trade debtors	3,631	3,368
Amounts owed by Group companies	14	15
Prepayments and accrued income	3,845	3,190
Other debtors	407	457
	7,897	7,030

All of the above amounts fall due within one year

As at 31 March 2016, trade debtors had a carrying value of £7.176m (2015 - £6.723m) before provision for bad debt. Trade debtors in arrears are provided for on a sliding scale depending on age of debt. The amount of the provision was £3.545m as at 31 March 2016 (2015 - £3.355m).

The ageing of these debtors was as follows:

	2016 £000	2015 £000
Up to 12 months	4,040	4,061
Over 12 months	3,136	2,662
	7,176	6,723

The debtors provided for are mainly in respect of water charges for household customers where experience in the water industry has shown over time that it is likely that there will be difficulties in recovering the water charges for the periods concerned.

Movement on the provision for bad debt are as follows:

	2016 £000	2015 £000
As at 1 April 2015	3,355	2,779
Provision for bad debt required in the year	809	1,125
Debt written off in the year as uncollectable	(619)	(549)
	3,545	3,355
As at 31 March 2016	3,545	3,355

The other classes within debtors do not contain balances that may be irrecoverable. The maximum exposure to credit risk at the reporting date is the fair value of each class of debtor mentioned above. The Company does not hold any collateral as security.

	2016 £000	2015 £000
Total Revenue Outstanding > 30 days		
- Household	4,883	4,806
- Non-household	197	541
	5,080	5,347

NOTES TO THE ACCOUNTS

Write Off Policy

Our bad debt write off policy has not changed within the period under review.

Customers who remain within our area of supply;

Commercial – written off upon Receivership/Liquidation.

Domestic – written off upon Bankruptcy or the granting of a Debt Relief Order.

Customers who have moved outside of our area of supply;

Debt less than £50 – limited automated credit control and then periodic automatic write off.

Debt greater than £50 – credit control process then passed to a Debt Collection Agency (DCA) for recovery on a no success, no fee basis. Periodic write off exercise for accounts returned by DCA, following internal review.

Differences in amounts written off from year to year are generally the result of differences in the timing of write off exercises rather than as a result of any particular trends.

Provisioning policy

The provisioning policy has been consistently applied as follows:-

Unmeasured Customers: All debt

Provide for 100% of the outstanding balances over four years old

Provide for 80% of the outstanding balances that are one to four years old

Provide for 60% of the outstanding balances that are up to one year old

Measured Customers: Household debt

Provide for 80% of the outstanding balances relating to current occupiers that are over one year old

Provide for 60% of the outstanding balances relating to current occupiers that are up to one year old

Provide for 100% of the outstanding balances relating to former occupiers

Measured Customers: Non Household debt

Provide for 10% of the outstanding balances relating to current occupiers

Provide for 75% of the outstanding balances relating to former occupiers

The measured arrears are taken to be balances that are over 8 weeks old

NOTES TO THE ACCOUNTS

14. INVESTMENTS		2016	2015
		£000	£000
	Unlisted investments	2	2
		<hr style="width: 50px; margin: 0 auto;"/>	<hr style="width: 50px; margin: 0 auto;"/>

15. CASH AT BANK AND IN HAND

Of the total amount shown of £9.206m, £1.801m (2015 - £1.777m) is held specifically for the payment of the next half yearly loan interest charges.

16. BORROWINGS: DUE WITHIN ONE YEAR		2016	2015
		£000	£000
	3% Perpetual debenture stock	60	60
	3½% Perpetual debenture stock	185	185
	4% Perpetual debenture stock	39	39
	Bank loan	-	-
		<hr style="width: 50px; margin: 0 auto;"/>	<hr style="width: 50px; margin: 0 auto;"/>
		284	284
		<hr style="width: 50px; margin: 0 auto;"/>	<hr style="width: 50px; margin: 0 auto;"/>

The bank loan is part of a three year £10m working capital facility, which was secured upon the assets of the Company and bore interest at London Interbank rates.

	Appointed	Non Appointed	Total	Appointed	Non Appointed	Total
17. OTHER CREDITORS	2016	2016	2016	2015	2015	2015
	£000	£000	£000	Restated	Restated	Restated
Payments received on account	2,414	-	2,414	2,743	-	2,743
Trade creditors	1,800	-	1,800	1,382	-	1,382
Amounts owed to Group companies	1,640	-	1,640	1,522	-	1,522
Social security and other taxation	624	-	624	252	-	252
Other creditors	2,111	-	2,111	1,231	-	1,231
Accruals	1,010	-	1,010	668	-	668
Water rates in advance	6,934	-	6,934	6,592	-	6,592
	<hr style="width: 50px; margin: 0 auto;"/>	<hr style="width: 50px; margin: 0 auto;"/>	<hr style="width: 50px; margin: 0 auto;"/>	<hr style="width: 50px; margin: 0 auto;"/>	<hr style="width: 50px; margin: 0 auto;"/>	<hr style="width: 50px; margin: 0 auto;"/>
	16,533	-	16,533	14,390	-	14,390
	<hr style="width: 50px; margin: 0 auto;"/>	<hr style="width: 50px; margin: 0 auto;"/>	<hr style="width: 50px; margin: 0 auto;"/>	<hr style="width: 50px; margin: 0 auto;"/>	<hr style="width: 50px; margin: 0 auto;"/>	<hr style="width: 50px; margin: 0 auto;"/>

18. CREDITORS: DUE AFTER ONE YEAR		2016	2015
		£000	£000
	In five years or more:		
	Bank loan	98,662	97,668
	Less: deferred arrangement costs	(938)	(995)
		<hr style="width: 50px; margin: 0 auto;"/>	<hr style="width: 50px; margin: 0 auto;"/>
		97,724	96,673
		<hr style="width: 50px; margin: 0 auto;"/>	<hr style="width: 50px; margin: 0 auto;"/>

The thirty year £66.5m index-linked loan was issued on 26 June 2002, is repayable on 30 September 2032, and is secured upon the assets of the Company. The capital value of the loan is adjusted by the change in the Retail Prices Index from year to year. The fees associated with the loan issue of £1.722m are amortised over the life of the loan. The amount owing on the loan is stated net of the unamortised issue fees.

The loan interest is calculated by adjusting the value of the loan by the Retail Prices Index and then charging interest on this inflated amount at 3.635% per annum.

NOTES TO THE ACCOUNTS

19. DEFERRED INCOME: CAPITAL CONTRIBUTIONS

	2016	2015
	£000	£000
Capital Contributions	25,011	24,384
Release of Capital Contribution to Turnover	(582)	(567)
	24,429	23,817

20. PROVISIONS FOR LIABILITIES

	2016	2015
	£000	£000
DEFERRED TAXATION:		(Restated)
At 1 April 2015	6,949	6,909
Charged during the year in profit and loss account	(563)	40
	6,386	6,949

The amount provided for deferred taxation represents timing differences caused by the excess of tax allowances over depreciation.

	2016	2015
	£000	£000
Deferred tax excluding that relating to pension asset:		(Restated)
Accelerated capital allowances	9,905	10,890
Other timing differences	(3,519)	(3,941)
Pension asset (note 22)	3,200	2,257
	9,586	9,206
Total provision for deferred tax	9,586	9,206
At 1 April 2015	9,206	10,942
Deferred tax charge in profit and loss account (note 8)	(524)	136
Deferred tax charged to the statement of total recognised gains and losses	904	(1,872)
	9,586	9,206
At 31 March 2016	9,586	9,206

21. RESERVES

	Called up Share Capital £000	Share Premium £000	Capital Redemption £000	Profit and Loss (Restated) £000	Total (Restated) £000
Balance as at 1 April 2015	1,078	1,539	3,250	52,820	58,687
Profit for financial year	-	-	-	3,528	3,528
Remeasurement of net defined benefit asset	-	-	-	6,274	6,274
Movement on deferred tax relating to pension scheme	-	-	-	(1,129)	(1,129)
Effect of change to corporation tax rate on pension asset	-	-	-	225	225
Total comprehensive income for the year	-	-	-	8,898	8,898
Dividends	-	-	-	(1,165)	(1,165)
Balance as at 31 March 2016	1,078	1,539	3,250	60,553	66,420

NOTES TO THE ACCOUNTS

22. PENSIONS

Portsmouth Water Limited is the principal employer and its parent company, Brockhampton Holdings Limited, is the participating employer in the Brockhampton Pension Scheme. This scheme provides defined benefits based primarily on pensionable earnings. The assets of the scheme are held in a separate trustee administered fund.

The formal actuarial valuation as at 31 March 2013 was updated to the 31 March 2016 accounting date by an independent qualified actuary in accordance with FRS 102. As required by FRS 102, the value of the defined benefit liabilities has been measured using the projected unit method.

The estimated Company contributions expected to be paid to the Scheme for the year commencing 1 April 2016 is £1.4m (2015 actual: £1.3m). Of this amount, £1.1m is contributed directly by the Company and £0.3m is contributed by employees by salary sacrifice under the SMART arrangement.

The key FRS 102 assumptions used for the scheme were as follows:

	2016 % per annum	2015 % per annum	2014 % per annum
RPI inflation	3.0	3.1	3.5
CPI inflation	2.1	2.2	2.6
Discount rate	3.4	3.2	4.3
Pension increases	2.1	2.2	2.6
Salary growth	5.25	5.35	5.75

Life expectancy of a male aged 65 at the accounting date is 23.7 years and for a female is 26 years. Allowances for future improvements in life expectancy mean that life expectancy of a male aged 65 at the accounting date plus 20 years is 26 years and for a female is 27.9 years

The fair value of assets in the scheme, a breakdown of the assets into the main asset classes, the present value of the FRS 102 defined benefit obligation and the surplus of assets over the FRS 102 defined benefit obligation (which equals the gross pension asset) are set out below:

	%	2016 Fair Value £000	%	2015 Fair Value £000	%	2014 Fair Value £000
Equities	34	47,932	44	63,285	49	65,741
Absolute Return Fund	23	33,134	6	8,912	7	9,004
Bonds	-	-	40	58,372	36	48,819
LDI	21	29,557	-	-	-	-
Property	10	14,032	3	4,102	3	4,422
Cash and other	12	17,125	7	9,544	5	6,625
		<hr/>		<hr/>		<hr/>
	100	141,780	100	144,215	100	134,611
		<hr/>		<hr/>		<hr/>

	2016 £000	2015 £000
Total fair value of scheme assets	141,780	144,215
FRS 17 value of scheme liabilities	124,005	132,928
	<hr/>	<hr/>
Gross pension asset	17,775	11,287
Related deferred tax liability	3,200	2,257
	<hr/>	<hr/>
Net pension asset	14,575	9,030
	<hr/>	<hr/>

Under FRS 102, the scheme is represented on the statement of financial position at 31 March 2016 by an asset of £17.775m (2015 - £11.287m), which amounts to £14.575m net of deferred tax (2015 - £9.030m).

The Company paid contributions at a rate of 20.6% of earnings. Members pay contributions at a rate of 5% of earnings via salary sacrifice. The Company also operates a defined contribution pension scheme. The contributions payable by the Company for the year in respect of the defined contribution scheme amounted to £136,433 (2015 - £108,910).

NOTES TO THE ACCOUNTS

The FRS 102 value of scheme liabilities moved over the period as follows:

	2016	2015
	£000	£000
Opening scheme liabilities	132,928	114,448
Employer's part of current service cost	1,495	1,312
Interest cost	4,191	4,864
Contributions by scheme participants	-	-
Benefits paid	(3,971)	(3,987)
Actuarial (gain)/loss	(10,638)	16,291
	<hr/>	<hr/>
Closing scheme liabilities	124,005	132,928
	<hr/>	<hr/>

The FRS 102 value of scheme assets moved over the period as follows:

Opening fair value of scheme assets	144,215	134,611
Expected return on assets	4,573	5,723
Contributions by the Company, including employee contributions under SMART	1,327	938
Benefits paid	(3,971)	(3,987)
Actuarial (loss)/gain	(4,364)	6,930
	<hr/>	<hr/>
Closing fair value of scheme assets	141,780	144,215
	<hr/>	<hr/>

The following amounts have been included within operating profit under FRS 102:

Current service cost (employer's part only)	1,495	1,312
Past service credit	-	-
	<hr/>	<hr/>
Total operating charge	1,495	1,312
	<hr/>	<hr/>

The following amounts have been included as other finance income under FRS 102:

Expected return on pension scheme assets	4,573	5,723
Interest on post retirement liabilities	(4,191)	(4,864)
	<hr/>	<hr/>
Net return	382	859
	<hr/>	<hr/>
Total return recognised in the profit and loss account	(1,113)	(453)
	<hr/>	<hr/>

The following amounts have been recognised within the Statement of Total Recognised Gains and Losses (STRGL) under FRS 102:

Actual return less expected return on scheme assets	4,364	6,930
Experience gains arising on scheme liabilities	(4,398)	285
(Loss)/gain due to changes in assumptions underlying the FRS 102 value of scheme liabilities	(6,240)	(16,576)
	<hr/>	<hr/>
Actuarial (loss) recognised in the STRGL	(6,274)	(9,361)
	<hr/>	<hr/>

The actual return on plan assets was £0.209m in the year to 31 March 2016 (2015 - increase of £12.653m).

The Accounting Standards Board have published guidance relating to best practice for disclosure of pensions information. The Company has decided not to follow the guidance at this time.

SECTION 2 PRICE REVIEW AND OTHER SEGMENTAL REPORTING

SEGMENTAL INCOME STATEMENT FOR THE APPOINTED BUSINESS

For the 12 months ended 31 March 2016

Current year

	Retail		Wholesale	Total
	Household	Non-Household	Water	
	£'000	£'000	£'000	£'000
Revenue - price control	4,522	539	32,511	37,572
Revenue - non-price control	0	0	2,151	2,151
Operating costs	(4,727)	(482)	(25,359)	(30,568)
Other operating income	0	0	(562)	(562)
Operating profit before recharges	(205)	57	8,741	8,593
Recharges from other segments	(100)	(5)	0	(105)
Recharges to other segments	0	0	105	105
Operating profit	(305)	52	8,846	8,593

TOTEX ANALYSIS FOR THE APPOINTED BUSINESS – WHOLESALE WATER

For the 12 months ended 31 March 2016

£'000	Water	Total
Operating expenditure		
Power	1,973	1,973
Service charges/ discharge consents	1,323	1,323
Bulk supply/ Bulk discharge	22	22
Other operating expenditure	13,321	13,321
Local authority rates	1,910	1,910
Total operating expenditure excluding third party services	18,549	18,549
Third party services	844	844
Total operating expenditure	19,393	19,393
Capital expenditure		
Maintaining the long term capability of the assets - infra	430	430
Maintaining the long term capability of the assets - non-infra	2,527	2,527
Other capital expenditure - infra	1,282	1,282
Other capital expenditure - non-infra	5,104	5,104
Total gross capital expenditure (excluding third party)	9,343	9,343
Third party services	0	0
Total gross capital expenditure	9,343	9,343
Grants and contributions	1,194	1,194
Totex	27,542	27,542

OPERATING COST ANALYSIS – RETAIL

For the 12 months ended 31 March 2016

£'000	Household	Non-Household	Total
Operating expenditure			
Customer services	1,389	163	1,552
Debt management	420	43	463
Doubtful debts	803	7	810
Meter reading	89	19	108
Services to developers	0	84	84
Other operating expenditure	1,890	159	2,049
Total operating expenditure excluding third party services	4,591	475	5,066
Third party services operating expenditure	0	0	0
Total operating expenditure	4,591	475	5,066
Depreciation	136	7	143
Total operating costs	4,727	482	5,209
Debt written off	562	57	619

HISTORIC COST ANALYSIS OF FIXED ASSETS - WHOLESALE & RETAIL

£'000	Wholesale	Retail		Total
	Water	Household	Non-Household	
Cost				
At 1 April 2015	167,906	1,299	71	169,276
Disposals	(3,593)	(154)	(8)	(3,755)
Additions	9,296	45	2	9,343
Reclass to intangible fixed assets	(127)	0	0	(127)
At 31 March 2016	173,482	1,190	65	174,737
Depreciation				
At 1 April 2015	48,149	647	36	48,832
Disposals	(3,008)	(141)	(8)	(3,157)
Charge for year	5,966	136	7	6,109
Reclass to intangible fixed assets	(50)	0	0	(50)
At 31 March 2016	51,057	642	35	51,734
Net book amount at 31 March 2016	122,425	548	30	123,003
Net book amount at 1 April 2015	119,757	652	35	120,444

The net book value includes £5.9m in respect of assets in the course of construction.

ANALYSIS OF CAPITAL CONTRIBUTIONS AND LAND SALES

For the 12 months ended 31 March 2016

£'000	Current year			
	Fully recognised in income statement	Capitalised and amortised against depreciation	Fully netted off capex	Total
Grants and contributions - water				
Connection charges (s45) ¹	860	0	0	860
Infrastructure charge receipts (s146)	0	879	0	879
Requisitioned mains (s43, s55 & s56)	0	315	0	315
Diversions (s185)	0	0	0	0
Other Contributions	0	0	0	0
Total	860	1,194	0	2,054

	Current year	
	Water	Total
Balance sheet		
Brought forward	24,384	24,384
FRS 102 adjustment	(567)	(567)
Capitalised in year	1,194	1,194
Amortisation (in income statement)	(582)	(582)
Carried forward	24,429	24,429

	Current year	
	Water	Total
Land sales		
Proceeds from disposals of protected land	0	0

¹ Connection Charges (s45) were included in Revenue in the Business Plan, and not Grants and Contributions.

REVENUES BY CUSTOMER TYPE

HOUSEHOLD

	Wholesale charges revenue	Retail revenue	Total revenue	Number of customers	Average household retail revenue per customer
	£m	£m	£m	000s	£
Unmeasured water only customer	18.140	3.026	21.166	210.156	14
Measured water only customer	6.096	1.496	7.592	78.509	19
Total	24.236	4.522	28.758	288.665	16

NON-HOUSEHOLD

	Wholesale charges revenue	Retail revenue	Total revenue	Number of customers	Average non-household retail revenue per customer
	£m	£m	£m	000s	£
Default tariffs					
Unmeasured Water Customer	0.248	0.032	0.280	1,553	21
Measured Water Customer < 10Ml	4.455	0.404	4.859	14,029	29
Measured Water Customer >10Ml and < 50Ml	1.596	0.051	1.647	132	386
Measured Water Customer > 50Ml	1.976	0.052	2.028	28	1,857
Total default tariffs	8.275	0.539	8.814	15,742	34
Non-Default tariffs					
Total non-default tariffs	0.000	0.000	0.000	0	N/A
Total	8.275	0.539	8.814	15,742	34

REVENUE ANALYSIS AND WHOLESALE CONTROL RECONCILIATION

For the 12 months ended 31 March 2016

£'000	Current year		
	Household	Non-Household	Total
Wholesale charge - water			
Unmeasured	18,140	248	18,388
Measured	6,096	8,027	14,123
Third party revenue	0	0	0
	24,236	8,275	32,511
Wholesale Total	24,236	8,275	32,511
Retail revenue			
Unmeasured	3,026	32	3,058
Measured	1,496	507	2,003
Other third party revenue	0	0	0
Retail Total	4,522	539	5,061
Third party revenue - non-price control			
Bulk supplies	0	107	107
Other third party revenue	0	1,363	1,363
Other appointed revenue	0	681	681
Total appointee revenue	28,758	10,965	39,723

	Current year	
	Water	Total
Wholesale revenue governed by price control	32,511	32,511
Grants and Contributions ¹	1,194	1,194
Total revenue governed by wholesale price control	33,705	33,705
Amount assumed in wholesale determination	33,256	33,256
Difference ²	449	449

¹ Relevant capital contributions as defined in FD

² Cross reference to a narrative explanation

NOTES ON THE PRICE REVIEW AND OTHER SEGMENTAL REPORTING

RETAIL PRICE CONTROL ANALYSIS

Household Retail

Operating expenditure within the household retail business was higher than the business plan assumptions to the point that an operating loss was recorded for the year.

The principal variations were as follows:-

- General Rates. An increase of £145k in cost against that budgeted was due to a change in methodology in respect of the way that this item is apportioned, based on the latest RAG guidance, from GMEAV to an allocation on floor space.
- Doubtful Debts. Since the business plan submission we have revised our provisioning methodology in light of actual bad debt experience. Again this resulted in a £145k increase over the budgeted figure.
- An FRS 102 charge of £48k, in respect of pension charges, has occurred. This was not budgeted for but is a result of actuarial calculations, being driven by the current very low Gilt yields, which impact the liability calculations for those members of staff that are within our Defined Benefits pension scheme.

Non-Household Retail

Whilst remaining within allowed revenue, the non-household retail costs were considerably higher than allowed at the determination. Total operating costs outturn was £475k against a business plan figure of £322k.

The additional costs related to the setting and implementing of our non-household retail strategy, costs for which were not allowed to be included within our business plan under the PR14 methodology. During the period we decided to exit the non-household retail market, subject to the necessary approvals, and as an interim step began migrating the non-household retail activities to Castle Water so that they could operate these accounts under an outsource arrangement until such time that we can exit the market and pass the accounts to them.

In terms of the year in question, staff costs in undertaking this activity were approximately £100k over and above those allowed, and an additional £61k of Director's and Board time.

WHOLESALE CONTROL RECONCILIATION

REVENUE £'000	Actual	FD	Difference
Wholesale Charge:			
Household – Unmeasured	18,140	17,817	323
Household - Measured	6,096	5,670	426
Non-Household - Unmeasured	248	254	(6)
Non-Household - Measured	8,027	8,539	(512)
	32,511	32,280	231
Grants and Contributions	1,194	976	218
TOTAL	33,705	33,256	449

We have compared actual revenue with that implicit in tariff setting for 2015/16, and this complied with the Final Determination.

The Wholesale revenue variance is £0.449m reflecting additional revenue from standard charges of £0.231m and greater capital contributions from developers for mains of £0.218m.

In particular, the household measured wholesale revenue reflects higher per property consumption than assumed, while the household unmeasured wholesale revenue reflects a greater number of properties, partly due to a lower take-up of meter optants than assumed at tariff setting.

Conversely, the actual consumption of our non-household customers is significantly lower than assumed in tariff setting, resulting in lower non-household income.

The level of capital contribution is difficult to establish in advance, as it will be scheme specific. Our assumption was based on the historic five year average, and we will monitor this issue going forward.

The variance of wholesale charges relative to the Final Determination is 0.7%.

The total variance of wholesale revenue relative to the Final Determination is 1.4%.

SECTION 3 PERFORMANCE SUMMARY

OUTCOME PERFORMANCE TABLE

For the 12 months ended 31 March 2016

Row	Performance commitment	Units	2014-15 performance level - actual	2015-16 performance level - actual	2015-16 CPL met?	Notional reward or penalty accrued at 31 March 2016	Notional reward or penalty accrued at 31 March 2016 £m absolute value	Total AMP6 reward or penalty 31 March 2020 forecast	Total AMP6 reward or penalty 31 March 2020 forecast £m absolute value
1	A1: Bursts	Number of burst mains per year	294	219	Yes	blank	0.000	blank	0.000
2	A2: Water quality standards	Mean Zonal Compliance (%)	99.97%	99.94%	No	Penalty	0.319	Penalty	0.319
3	A3: Water quality contacts	Number of contacts per 1,000 population served	0.841	0.570	No	blank	0.000	blank	0.000
4	A4: Temporary usage bans	Number of Temporary Usage Bans per year	0	0	Yes	Not applicable	0.000	Not applicable	0.000
5	B1: Leakage	Megalitres per day (M/d)	28.85	28.06	Yes	blank	0.000	blank	0.000
6	C1: Interruptions to supply	Mins: secs per property per year	8 min 44 secs	3 min 30 secs	Yes	blank	0.000	blank	0.000
7	D1: Biodiversity	% completed of agreed actions	Not applicable	20%	Yes	blank	0.000	blank	0.000
8	D2: Water Framework Directive (WFD)	Programme completion	Not applicable	Progress as planned	Yes	blank	0.000	blank	0.000
9	D3: Carbon	Energy sourced from renewables (% increase)	Not applicable	> 95%	Yes	blank	0.000	blank	0.000
10	E1: RoSPA Health and Safety accreditation	RoSPA Gold award	Awarded	Awarded	Yes	Not applicable	0.000	Not applicable	0.000
11	A1: Service incentive mechanism (SIM)	Service Incentive mechanism (SIM) score ranking	Not applicable	Ranking unknown	Unknown	blank	0.000	blank	0.000
12	B1: Reducing per capita consumption (PCC)	Litres per head per day (l/h/d)	145.55	143.29	Yes	blank	0.000	blank	0.000
13	C1: Survey of developers	Satisfaction rate (%)	Not applicable	89%	Yes	Not applicable	0.000	Not applicable	0.000

OUTCOME PERFORMANCE TABLE

Introduction

Table 3A shows the performance of the Company against its 13 Outcome Delivery Incentives. The performance data has been assured by the Board of Portsmouth Water, who have engaged WS Atkins to undertake an independent third party review of the data reported. This data has also been shared with our Customer Challenge Group and a comprehensive report was discussed with the CCG on 30 June 2016.

Background

The Company has 13 ODIs which apply for the five year period starting 1 April 2015. These were agreed as part the most recent Price Review, PR14. The table below classifies each ODI by division within the business, wholesale or retail and whether the ODI financial and attracts a reward / penalty or is reputational in nature.

	Wholesale	Retail	Total
Financial (Table 3A ID)	7 (A1, A2, A3, B1, C1, D1 and D2)	2 (A1 and B1)	9
Reputational (Table 3A ID)	3 (A4, D3 and E1)	1 (C1)	4
Total	10	3	13

Of our 9 financial ODIs, 5 reflect performance over the 5 year period from 1 April 2015. Therefore at this stage of the monitoring period there is no expectation that a reward or penalty will apply for any of these metrics. Further, 2 of our ODIs are agreed projects with set deadlines in the monitoring period, so again there is no expectation that a reward or penalty will apply. We have one specific ODI that is assessed annually, A2 - Mean Zonal Compliance and thus we can determine whether a penalty should apply or not. Finally we have an ODI which only applies in year 5, which therefore cannot be determined at this stage, given we are only at the end of year one.

2015/16 performance

Table 3A shows the impact of performance in 2015/16 and the determination of rewards and penalties which will apply from 2020.

Given the structure of our 9 Financial ODIs discussed above, the Company has only one entry – a penalty – which is the consequence of the water quality standard (as measured by the mean zonal compliance) being below 99.95% - the threshold for which a penalty applies. This sum of money has been recognised in our regulatory accounts for 2015/16. Further, whilst the number of contacts we receive from customers relating to water quality has been higher than target in 2015/16, we believe there is scope to improve and mitigate the impact of this first year performance as this is a five year target.

All other ODIs have exceeded expectation in 2015/16 and if this performance is maintained for the period rewards will apply. Specifically for 6 of our ODIs which are measured on an on-going basis namely bursts, temporary usage bans, leakage, interruptions to supply, per capita consumption and our survey of developers we have exceeded our performance commitments.

For our 4 project based ODIs, biodiversity, Water Framework Directive, Carbon and RoSPA we are on or ahead of target. For carbon we now buy over 95% of our electricity from a supplier which is totally renewable in nature and thus have met our commitment to increase renewables by 10% over the 5 year period. The only ODI we cannot currently confirm performance is SIM ranking, given it is a relative measure compared to others in the industry. We note however that for the most important factor in the SIM calculation, our qualitative survey score, was the highest in the industry. We will undertake this exercise when all companies publish their ODIs.

The full ODI report will be published on our website on 15 July 2016.

SECTION 4 ADDITIONAL REGULATORY INFORMATION

NON-FINANCIAL INFORMATION

For the 12 months ended 31 March 2016

Retail - Household	Current year	
	Unmeasured	Measured
Number of households billed ('000s)		
Water only connections	210.156	78.509
Total	210.156	78.509
Number of void households ('000s)	5.700	1.283
Per capita consumption (excluding supply pipe leakage) l/h/d	150	119

Wholesale	Current year Water
Wholesale Volume (MI/d)	
Bulk supply export	1.32
Bulk supply import	0.00
Distribution input	166.78

WHOLESALE TOTEX ANALYSIS

£m	Current year	Cumulative
	Water	Water
Actual totex		
Menu totex	27.542	
Items excluded from the menu		
Pension deficit recovery costs	0.000	
Third party costs	0.000	
Other adjustments	0.000	
Total costs excluded from the menu	0.000	0.000
Actual totex	27.542	
Actual totex - base year prices	26.001	0.000
Allowed totex - base year prices	27.186	

TOTEX VARIANCE ANALYSIS

The variance between actual totex, in base year prices, and allowed totex in the Final Determination is £1.185m (£1.255m in 2015/16 prices).

However, the totex menu choice that the Company made, was at the original Business Plan submission level of £26.426m. This gives a variance to actual totex of £0.425m, in base year prices. In 2015/16 prices, the following table shows this variance for each element of totex.

2015/16 Prices	Business Plan 2015/16	Actual 2015/16	Variance 2015/16
Operating Expenditure	16,792	17,641	(849)
Renewals	5,384	1,752	3,632
Capital Expenditure	6,777	9,343	(2,566)
Grants and Contributions	(961)	(1,194)	233
WHOLESALE TOTEX	27,992	27,542	450

WHOLESALE TOTEX ANALYSIS

Operating Expenditure

The increase in operating expenditure of £0.849m, for the Wholesale business only, is due to the following:

- A provision for an ODI penalty of £0.316m. This is for Mean Zonal Compliance (Water Standards) and relates entirely to Wholesale.
- Professional Fees increase of £0.137m relating primarily to assurance required for market opening.
- Market Operator costs of £0.116m, which were not fully recognised in the Final Determination.
- FRS102 pension charge of £0.118m, which was not in the Business Plan.

These increases were partly offset by a reduction in the activity of chargeable works, as compared to the Business Plan.

Renewals

The renewals expenditure for the year was less than the Business Plan by £3.632m. This was due to the following:

- Reduced activity in the year, with only 11.7km of pipe being renewed, compared to 22km in the Business Plan. This was due in part to a change in contractor. For the rest of the AMP, 24km will be renewed each year, to make up for this reduction.
- Lower prices from the new contractor and new installation technology. We have achieved 65% no-dig installations, as compared to 23% in AMP5.
- Capitalisation of some renewals schemes, in line with FRS102. (£0.2m)
- Accrual reversal for previous contractor (£0.3m)

Capital Expenditure

Capital expenditure is higher than the Business Plan by £2.566m. The primary movements are as follows:

- Several capital schemes were brought forward to 2015/16 (from 2016/17 and 2017/18), to comply with the DWI undertakings. The schemes brought forward were for the new Eastergate and Westergate crypto treatment plants. Expenditure on these in the year was £2.9m.
- An amount of £1.3m for 2015/16 was included in the Business Plan for the Farlington Wash Water Recovery Plant. However, only £0.2m was spent in the year on this scheme. The scheme continues in subsequent years.
- New mains was higher than the Business Plan by £0.7m.
- Optional Metering was lower than the Business Plan by £0.5m.
- Expenditure on the new IT system was £0.8m higher than the Business Plan. This was due to a delay in the implementation in our works management system.
- Renewals capitalised (above) of £0.2m under FRS102.
- River Ems augmentation underspend of £0.2m

FORECAST IMPACT OF PERFORMANCE ON RCV

£m	Current Year
RCV determined at FD	127.912
RCV element of Totex over/underspend	(0.305)
Allowance (Rewards/penalties - ODI)	0
Projected 'shadow' RCV	127.607

The Final Determination average PAYG% is 75.7%.
Therefore, the % of Totex underspend that adjusts the RCV is 24.3%.

TOTEX ANALYSIS

For the 12 months ended 31 March 2016

£'000	Water resources		Raw water distribution		Water treatment	Treated water distribution	Total
	Abstraction licences	Raw water abstraction	Raw water transport	¹ Raw water storage	Water treatment	Treated water distribution	
Operating expenditure							
Power	0	387	315	2	233	1,036	1,973
Income treated as negative expenditure	0	0	0	0	0	0	0
Abstraction charges/ discharge consents	1,323	0	0	0	0	0	1,323
Bulk supply/ Bulk discharge	0	22	0	0	0	0	22
Other operating expenditure	0	961	138	5	2,640	9,577	13,321
Local authority rates	0	246	175	0	1,007	482	1,910
Total operating expenditure excluding third party services	1,323	1,616	628	7	3,880	11,095	18,549
Third party services	0	0	0	0	0	844	844
Total operating expenditure	1,323	1,616	628	7	3,880	11,939	19,393
Capital expenditure							
Maintaining the long term capability of the assets - infra	0	0	0	0	0	430	430
Maintaining the long term capability of the assets - non-infra	0	64	34	0	1,418	1,011	2,527
Other capital expenditure - infra	0	0	0	0	0	1,282	1,282
Other capital expenditure - non-infra	0	50	113	0	3,409	1,532	5,104
Total gross capital expenditure (excluding third party)	0	114	147	0	4,827	4,255	9,343
Third party services	0	0	0	0	0	0	0
Total gross capital expenditure	0	114	147	0	4,827	4,255	9,343
Grants and contributions						1,194	1,194
Totex	1,323	1,730	775	7	8,707	15,000	27,542
Cash expenditure							
Pension cash contributions	0	0	0	0	0	0	0
Other cash items	0	0	0	0	0	0	0
Totex including cash items	1,323	1,730	775	7	8,707	15,000	27,542
Unit cost information (operating expenditure)							
	Licenced volume available	Volume abstracted	Volume transported	¹ Average volume stored	Distribution input from Water Treatment	Distribution input from Treated Water	
Volume (Ml)	115,705	62,415	60,882	135	60,882	60,882	
Unit cost (£/Ml)	11.43	25.89	10.32	51.85	63.73	196.10	

¹ The Company does not have any raw water storage reservoirs, with the exception of one facility at the River Itchen, which allows for 3 days of maximum abstraction from the river.

OPERATING COST ANALYSIS – HOUSEHOLD RETAIL

For the 12 months ended 31 March 2016

£'000	Household Unmeasured	Household Measured	Total
	Water only	Water only	
Operating expenditure			
Customer services	993	396	1,389
Debt management	372	48	420
Doubtful debts	522	281	803
Meter reading	0	89	89
Other operating expenditure	1,376	514	1,890
Total operating expenditure excluding third party services	3,263	1,328	4,591
Depreciation	121	15	136
Total operating costs excluding third party services	3,384	1,343	4,727

Other operating expenditure includes the net retail expenditure for the following retail activities which are part funded by wholesale

Household

Demand-side water efficiency - gross expenditure	
Demand-side water efficiency - expenditure funded by wholesale	0
Demand-side water efficiency - net retail expenditure	0
Customer-side leak repairs - gross expenditure	
Customer-side leak repairs - expenditure funded by wholesale	0
Customer-side leak repairs - net retail expenditure	0

**WHOLESALE CURRENT COST FINANCIAL PERFORMANCE
INCOME STATEMENT**

For the 12 months ended 31 March 2016

£'000	Note	Water	Total
Revenue		34,662	34,662
Operating expenditure		(19,393)	(19,393)
Capital maintenance charges	1	(10,494)	(10,494)
Other operating income		(562)	(562)
Current cost operating profit		4,213	4,213
Other income		0	0
Interest income		1,378	1,378
Interest expense		(4,778)	(4,778)
Interest expense related to the unwinding of discounted liabilities		0	0
Current Profit before tax and fair value movements		813	813
Fair value gains/(losses) on financial instruments		0	0
Current Profit before tax		813	813

NOTES ON THE WHOLESALE CURRENT COST FINANCIAL PERFORMANCE

1. CAPITAL MAINTENANCE CHARGES

The Capital Maintenance charges include the Wholesale amount of the Current Cost Depreciation £5.344m and the Infrastructure Renewals Charge £5.150m.

Current Cost Depreciation

£'000	Operational Assets	Infrastructure Assets	Other Tangible Assets	Total
GROSS REPLACEMENT COSTS				
At 1st April 2015	229,731	1,006,031	25,535	1,261,297
Reclassification			(23)	(23)
RPI Adjustment	3,574	15,649	311	19,534
Disposals	(18)	-	(5,564)	(5,582)
Additions	5,157	1,712	2,474	9,343
At 31st March 2016	238,444	1,023,392	22,733	1,284,569
DEPRECIATION				
At 1st April 2015	106,178	-	17,908	124,086
Reclassification	(13)	-	(24)	(37)
RPI Adjustment	1,652	-	202	1,854
Disposals during year	(18)	-	(5,013)	(5,031)
Charge for year	4,209	-	1,331	5,540
At 31st March 2016	112,008	-	14,404	126,412
NET BOOK VALUE				
At 31st March 2016	126,436	1,023,392	8,329	1,158,157
At 1st April 2015	123,553	1,006,031	7,627	1,137,211
DEPRECIATION				
WHOLESALE	4,210	-	1,134	5,344
RETAIL	-	-	196	196
	4,210	-	1,330	5,540

Infrastructure Renewals Charge

Estimation of Infrastructure Renewals Charge at 2016/17 prices

	£'000	
Actual expenditure 15/16	2,021	
Budget 2016/17	5,007	(£5,107k at 15/16 prices)
Business Plan 2017/18 - 2030/31	5,384	
Average Cost over 20 years	<u><u>5,150</u></u>	

FINANCIAL METRICS

For the 12 months ended 31 March 2016

	Units	Metric
Net debt	£m	89.740
Regulated equity	£m	38.172
Regulated gearing	%	70.16
Post tax return on regulated equity	%	10.90
RORE (return on regulated equity)	%	6.19
Dividend yield	%	3.59
Retail profit margin - Household	%	-0.24
Retail profit margin - Non-Household	%	0.73
Credit rating	n/a	BBB
Return on RCV	%	6.15
Dividend cover	dec	3.28
Funds from operations (FFO)	£m	10.849
Interest cover (cash)	dec	3.88
Adjusted interest cover (cash)	dec	2.63
FFO/Debt	dec	0.12
Effective tax rate	%	23.40
Free cash flow (RCF)	£m	8.71
RCF/capex	dec	1.01

Revenue (actual)	£m	37.572
EBITDA (actual)	£m	13.700

Proportion of borrowings which are fixed rate	%	0.29
Proportion of borrowings which are floating rate	%	0.00
Proportion of borrowings which are index linked	%	99.71
Proportion of borrowings due within 1 year or less	%	0
Proportion of borrowings due in more than 1 year but no more than 2 years	%	0
Proportion of borrowings due in more than 2 years but no more than 5 years	%	100
Proportion of borrowings due in more than 5 years but no more than 20 years	%	0
Proportion of borrowings due in more than 20 years	%	0

DISCLOSURE OF TRANSACTIONS WITH ASSOCIATES

The transactions required to be disclosed under Condition F of the Company's Instrument of Appointment are set out below:

Borrowings or Sums Lent

There is a loan outstanding made to a Group Company, South Downs Limited, in June 2002. The balance of the loan, consisting of the principal amount and accrued interest to date, amounts to £55.984m. A repayment of £0.350m was made by South Downs Limited in the year. This loan was made as a part of the refinancing package which was carried out in the financial year 2002/03. The interest rate for the loan is based on LIBOR plus a margin.

Interest Received

A receipt of interest amounting to £967,267 in respect of the inter-company loan made to South Downs Limited in 2002 (as covered above), received from South Downs Limited.

Dividends paid to Associated Undertakings

The dividends paid to the holding company, Portsmouth Water Holdings Limited, are shown in note 9 on page 33 of this Annual Performance Report. The dividend policy is also covered within this note.

Payments for Tax Losses

During the year Portsmouth Water made payments to group companies relating to the surrender of tax losses to Portsmouth Water amounting to £107k (2015 cash received £5k).

Supply of Services

Details of services supplied to the Appointee by associates during the year are disclosed below.

Service	Associate Company	Turnover of Associate (£000's)	Terms of Supply	Value (£000's)
Rent of operational sites	Brockhampton Holdings Limited	303*	Market Tested	85
Solar power income			Market Tested	17

*Brockhampton Holdings Limited accounts do not include any amounts classified as turnover. Amounts relating to rent and solar power income are included within other operating income which totals £303k of which £172k relates to total rental income and £131k relates to total income from solar power.

Directors Remuneration

There is a recharge of Directors salaries amounting to £45,811 paid to Portsmouth Water Limited by Brockhampton Holdings Limited, which represents the time spent by Portsmouth Water Executive Directors on Group matters.

Statement by Board of Directors

To the best of their knowledge, the Directors of the Company declare that all appropriate transactions with associated companies have been disclosed.

Price Control Units

Portsmouth Water has closely followed the Ofwat guidance for the allocation of costs and assets between price control units and therefore believes that there is no cross subsidy between them. Therefore, no market testing has been undertaken in 2015/16.

REPORT OF THE INDEPENDENT AUDITOR

Independent Auditors' report to the Water Services Regulation Authority (the WSRA) and the Directors of Portsmouth Water Limited

Opinion on Annual Performance Report

In our opinion, Portsmouth Water Limited's Regulatory Accounting Statements within the Annual Performance Report:

- fairly present in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA (RAG1.06, RAG2.05, RAG3.08, RAG4.05 and RAG5.06) and the accounting policies set out on page 25 (including the accounting separation methodology), the state of the Company's affairs at 31 March 2016 and its profit and its cash flow for the year then ended; and
- have been properly prepared in accordance with Condition F, the Regulatory Accounting Guidelines and the accounting policies (including the accounting separation methodology).

Basis of preparation

Financial information other than that prepared on the basis of UK GAAP does not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in statutory financial statements prepared in accordance with the Companies Act 2006. The Annual Performance Report is separate from the statutory financial statements of the Company and has not been prepared under the basis of United Kingdom Generally Accepted Accounting Practice ("UK GAAP").

In forming our opinion on the Regulatory Accounting Statements within the Annual Performance Report, which is not modified, we draw attention to the fact that the Annual Performance Report has been prepared in accordance with Condition F, the Regulatory Accounting Guidelines, the accounting policies (including the accounting separation methodology) set out in the statement of accounting policies and under the historical cost convention.

The Regulatory Accounting Statements on pages 19 to 23 have been drawn up in accordance with Regulatory Accounting Guidelines with a number of departures from UK GAAP. A summary of the effect of these departures from Generally Accepted Accounting Practice in the Company's statutory financial statements is included in the tables within section 1.

What we have audited

The sections of/tables within Portsmouth Water Limited's Annual Performance Report that we have audited ("the Regulatory Accounting Statements") comprise:

- the regulatory financial reporting tables within section 1 comprising the income statement (table 1A), the statement of comprehensive income (table 1B), the statement of financial position (table 1C), the statement of cash flows (table 1D) and the net debt analysis (table 1E) and the related notes; and
- the regulatory price review and other segmental reporting tables within section 2 comprising the segmental income statement (table 2A), the totex analysis for wholesale water (table 2B), the operating cost analysis for retail (table 2C), the historical cost analysis of fixed assets for wholesale and retail (table 2D), the analysis of capital contributions and land sales for wholesale (table 2E), the household water revenues by customer type (table 2F), the non-household water revenues by customer type (table 2G) and the revenue analysis by customer type (table 2I) and the related notes; and
- the additional regulatory information tables within section 4 comprising the non-financial information (table 4A), the wholesale totex analysis (table 4B), the forecast impact of performance on RCV (table 4C), the totex analysis (table 4D), the operating cost analysis – household retail (table 4F), the wholesale current cost financial performance income statement (4G) and the related notes along with the financial metrics on page 61.

The financial reporting framework that has been applied in their preparation comprises the basis of preparation and accounting policies set out in the notes to the Annual Performance Report.

In applying the financial reporting framework, the directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

We have not audited the Outcome performance table (table 3A) of section 3.

This report is made, on terms that have been agreed, solely to the Company and the WSRA in order to meet the requirements of Condition F of the Instrument of Appointment granted by the Secretary of State for the Environment to the Company as a water and sewage undertaker under the Water Industry Act 1991 ("Condition F"). Our audit work has been undertaken so that we might state to the Company and the WSRA those matters that we have agreed to state to them in our report, in order (a) to assist the Company to meet its obligation under Condition F to procure such a report and (b) to facilitate the carrying out by the WSRA of its regulatory functions, and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the WSRA, for our audit work, for this report or for the opinions we have formed.

REPORT OF THE INDEPENDENT AUDITOR

Respective responsibilities of the WSRA, the Directors and Auditors

As explained more fully in the Statement of Directors' Responsibilities set out on page 17, the directors are responsible for the preparation of the Annual Performance Report and for their fair presentation in accordance with the basis of preparation and accounting policies. Our responsibility is to audit and express an opinion on the Regulatory Accounting Statements within the Annual Performance Report in accordance with International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)"), except as stated in the section on 'What an audit of the Annual Performance report involves' below, and having regard to the guidance contained in Audit 05/03 'Reporting to Regulators of Regulated Entities' issued by the Institute of Chartered Accountants in England and Wales. Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors

What an audit of the Annual Performance Report involves:

An audit involves obtaining evidence about the amounts and disclosures in the Regulatory Accounting Statements sufficient to give reasonable assurance that the Regulatory Accounting Statements within the Annual Performance Report are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the Annual Performance Report. In addition, we read all the financial and non-financial information in the Annual Performance Report to identify material inconsistencies with the audited sections of the Annual Performance Report and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

We have not assessed whether the accounting policies are appropriate to the circumstances of the Company where these are laid down by Condition F. Where Condition F does not give specific guidance on the accounting policies to be followed, our audit includes an assessment of whether the accounting policies adopted in respect of the transactions and balances required to be included in the Annual Performance Report are consistent with those used in the preparation of the statutory financial statements of the company. Furthermore, as the nature, form and content of Annual Performance Report is determined by the WSRA, we did not evaluate the overall adequacy of the presentation of the information, which would have been required if we were to express an audit opinion under ISAs (UK & Ireland).

The Company has presented the allocation of operating costs and assets in accordance with the accounting separation policy set out in note 1(k) and its Accounting Separation Methodology Statement published on the Company's website on 15th July 2016. We are not required to assess whether the methods of cost allocation set out in the Methodology Statement are appropriate to the circumstances of the Company or whether they meet the requirements of the WSRA, which would have been required if we were to express an audit opinion under International Standards on Auditing (UK & Ireland).

Opinion on other matters prescribed by Condition F

Under the terms of our contract we have assumed responsibility to provide those additional opinions required by Condition F in relation to the accounting records. In our opinion:

- proper accounting records have been kept by the appointee as required by paragraph 3 of Condition F; and
- the Regulatory Accounting Statements are in agreement with the accounting records and returns retained for the purpose of preparing the Annual Performance Report.

Other matters

The nature, form and content of the Annual Performance Report is determined by the WSRA. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the WSRA's purposes. Accordingly we make no such assessment. Our opinion on the Regulatory Accounting Statements within the Annual Performance Report is separate from our opinion on the statutory financial statements of the Company for the year ended 31 March 2016 on which we reported on 13th June 2016, which are prepared for a different purpose. Our audit report in relation to the statutory financial statements of the Company (our "Statutory audit") was made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our Statutory audit work was undertaken so that we might state to the Company's members those matters we are required to state to them in a statutory audit report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume responsibility for any other purpose or to any other person to whom our Statutory audit report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

NICHOLAS KELSEY
Senior Statutory Auditor

For and on behalf of
SAFFERY CHAMPNESS
CHARTERED ACCOUNTANTS
71 QUEEN VICTORIA STREET
LONDON
EC4V 4BE