



PORTSMOUTH WATER LIMITED

RISK AND COMPLIANCE STATEMENT - JUNE 2012

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Executive Summary

For the reporting year 2011/12 Ofwat have replaced the usual June Return report with a requirement that each Company publish a Risk and Compliance Statement.

This statement requires the Company to confirm that it has complied with all the relevant statutory, licence and regulatory obligations during the reporting year, and is taking the appropriate steps to manage the risks it faces.

This document sets out the Risk and Compliance Statement for Portsmouth Water.

In preparing this statement the Company has monitored its performance against its key performance indicators (KPI's) (see table below) and these are discussed in detail in the report. The Company will publish these KPI's on our website on a half yearly basis but monitor them on a more frequent basis internally.

The Risk and Compliance Statement made by the Directors is shown at the end of this Executive Summary.

The full table of Key Performance Indicators is detailed below:

KPI	Score	Target	Unit
Service Incentive Mechanism	19.0 - Quantitative 45.6 - Qualitative Total Score 64.6	> 50 (Total Score is out of 100)	
Water Supply Interruptions	0.08	0.1 (Company - Average achieved previous 5 years)	Hours per total properties served
Serviceability Water Non-Infrastructure	STABLE	STABLE (From FD)	
Serviceability Water Infrastructure	STABLE	STABLE (From FD)	
Leakage	30	30 (From FD)	MI/d
Security of Supply Index	100	100 (From FD)	Index Score
Green House Gas Emissions	12.532	< 10% over 11.501 (From FD)	ktCO2e
Pollution Incidents Water	0	Below Industry Average (Regulatory Compliance Guidance)	Category 1=13 incidents per 1,000 km of main
Discharge Permit Compliance	100	Above Industry Average (Regulatory Compliance Guidance)	%
Post Tax Return on Capital	5.53	5.72 (From FD)	%
Gearing	76.2	< 84	%
Interest Cover	1.89	>1.6	
Mean Zonal Compliance	99.98	99.96	%
Reportable Accidents	1	Nil	

The overall level of service to customers has been maintained at a high level, as measured by the new Service Incentive Mechanism (SIM) methodology introduced by Ofwat. The results of the Qualitative survey for 2011 show that Portsmouth Water was rated second in performance out of 22 companies. However, the score of 19.0 for the Quantitative survey is affected by a low score on the 'number of unwanted telephone contacts'. The number to be reported by Portsmouth for 2011/12 is much higher than reported by all the other companies. This is difficult to understand, given the low level of complaints we receive and the high Qualitative score. It is believed that this may be due to a different interpretation of the guidelines and we intend to take this up with Ofwat. Portsmouth Water treats any call which expresses any dissatisfaction as unwanted, irrespective of the primary reason for the call.

In addition, the Company received only eight written complaints per 10,000 connections which compares to an industry average of 61 recorded for 2010/11 by the Consumer Council for Water.

The Company believes its assets to be in a stable condition, although the number of unplanned jobs for non-infrastructure assets is higher than the output identified in the Final Determination.

Portsmouth Water's customers experienced an average interruption to their supply of 0.08 hours per total properties served.

Leakage for the report year was 30 MI/d and in line with the target of 30 MI/d.

During the year there were no restrictions to supply or drought orders. Although over the winter overall rainfall was well below the average, a wet December in our area provided sufficient recharge to groundwater levels for us to avoid temporary use bans but an appeal was made to customers to show voluntary restraint in their use of water. Due to heavy rainfall in April and a wet May, groundwater levels had reached the long-term average level by the end of May.

Capital Expenditure in the year to March 2012 was £8.1m, (2011 - £9.6m) and included £3.9m, (2011 - £5.0m) on mains renewals. This was lower than usual as a major scheme to reduce the risk of water quality and security issues at the River Itchen Treatment Works was delayed whilst planning permission for the work was obtained. The reduction in the expenditure on mains renewals is the result of the Company increasing the use of 'no dig' techniques which are less expensive than the conventional methods of renewals. The length of mains renewed met the target included in the Final Determination. The scheme at the River Itchen at approximately £5M will largely be completed in 2012/13, and therefore overall Capital Expenditure in this year will be much higher.

Current cost operating profit on a like for like basis was £6.4m compared to £6.0m in 2010/11. The post tax rate of return on capital is lower than the Determination as a result of lower turnover which is caused mainly by the low RPI reflected in customers' bills for 2010/11, relative to the average RPI for that year.

In the reporting period however, the Company out-performed the Final Determination for operating costs achieving efficiency of 4.32% versus 0.25% in the determination.

The number of customers opting to change to a measured supply was 4,046 in the year, (Determination 5,000 per year including selective meters).

A good record on health and safety has been maintained and in 2012, the Company received the prestigious Gold Medal in the RoSPA Health and Safety Awards. However, there was one reportable accident during the year against our target of zero.

In 2012 the Company formed its Customer Challenge Group (CCG) which includes

representatives from the Drinking Water Inspectorate, Consumer Council for Water, Environment Agency, Natural England, several local Councils and representatives for vulnerable customers and local businesses. The CCG will:

- review the Company's engagement process and the evidence emerging from it and ensure customers' views are considered as the Company develops its business plan
- challenge the phasing, scope and scale of work to deliver our agreed outcomes and the company's approach to risk
- advise Ofwat on effectiveness of our customer engagement, and on acceptability to customers or otherwise of our overall business plan and bill impacts
- scrutinise our performance as we deliver our business plan and challenge our response to any performance issues

We believe that this process will improve our understanding of our customers' expectations.

The Board has reviewed this Risk and Compliance Statement and has approved it, and the following statement:

RISK AND COMPLIANCE STATEMENT
PORTSMOUTH WATER

The Board of Portsmouth Water hereby confirms that it:

- considers it has a full understanding of, and is meeting, its obligations and has taken steps to understand and meet customer expectations
- has satisfied itself that it has sufficient processes and internal systems of control to fully meet its obligations
- has appropriate systems and processes in place to allow it to identify, manage and review its risks

In preparing this risk and compliance statement, the Company is aware of its obligations in legislation and our licences that the Company must comply with. These include the following:

- confirming that it has sufficient financial and management resources (licence condition F6A)
- confirming that there are sufficient rights and assets available to enable a special administrator to run the business (licence condition K)
- ensuring that trade with associates is at arm's length (licence condition F6);
- publishing a statement explaining any links between directors' pay and standards of performance (section 35A of the Water Industry Act 1991); and
- maintaining an investment grade credit rating (licence condition F6A).



N SMITH
MANAGING DIRECTOR
JUNE 2012



R J TENNANT
NON-EXECUTIVE DIRECTOR
Chairman of the Audit Committee

Chapter 1 - Company Strategy

For many years Portsmouth Water customers have enjoyed very high standards of drinking water quality, customer service, together with the lowest charges for water supply.

In the performance assessments carried out by Ofwat and CCW, the Company is recognised as one of the best performing companies in the water sector. We achieve:

- The lowest rate of customer complaints
- High levels of service for customers
- The lowest water charges
- The highest level of efficiency
- High standards of drinking water quality

Throughout our long history of independent public water supply in South Hampshire and West Sussex we have remained focussed upon the key principle of maintaining reliable water supplies to customers that are affordable. To maintain this commitment, the Company has a well developed, focussed strategy which will meet the demands of all its stakeholders.

The key objectives are:

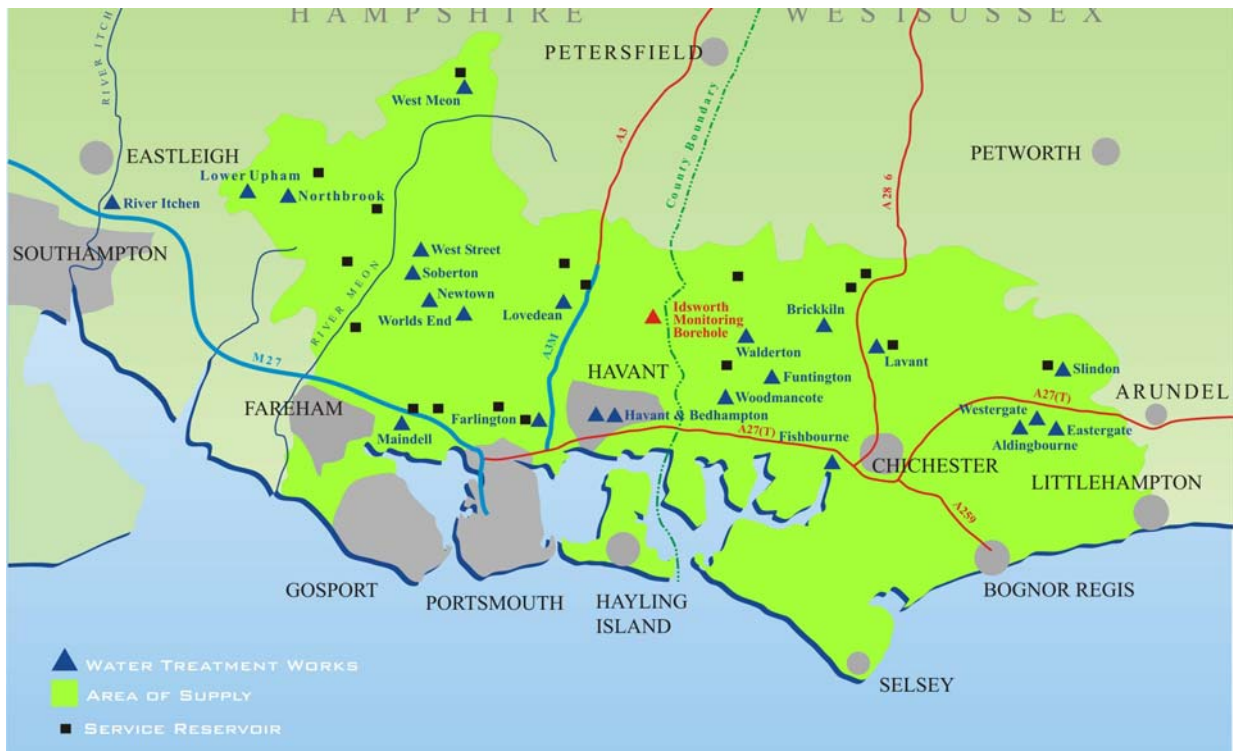
- To ensure customers enjoy reliable and secure supplies meeting all water quality standards.
- To maintain our standards of customer service as one of the highest in the industry.
- To provide value for money by continuing to focus on operational efficiency. A goal of stable prices is seen as a driver for the business.
- To minimise the impact on the environment to ensure we have a sustainable long term future.
- To grow the business where appropriate utilising a good resource position to provide bulk supplies and trade water.
- To achieve returns consistent with retaining investor confidence.

There will be tensions between the various elements of the strategy. The maintenance

of current service levels to customers will be the priority, but this must be done efficiently so that the impact on prices can be minimised.

Despite the challenges of falling income as a result of the Price Determination the Board believes that this Risk and Compliance Statement will demonstrate that the Company is delivering against these objectives.

A Map of the Company's Area



1.1 Changes in Methodology and Approach

There have not been any material changes of approach during the year. The Company does not have a Customer Contact System and as a result the recording and classification of telephone calls as wanted or unwanted is done manually. Therefore we have assigned a low confidence grade to these numbers, but we are implementing a

new billing and customer management system in October 2012 which will improve our recording capability.

Chapter 2 - Key Performance Indicators, Outputs and Service Delivery

The table below details the Regulatory Compliance Key Performance Indicators (KPIs) for the Company. This includes all the KPI's required by Ofwat plus two additional ones:

- i) Mean Zonal Compliance - for water quality performance and,
- ii) Reportable Accidents - for Health and Safety

All the KPI's have been audited by the Company Reporter. These KPI's are commented on below:

KPI	Score	Target	Unit
Service Incentive Mechanism	19.0 - Quantitative 45.6 - Qualitative Total Score 64.6	> 50 (Total Score is out of 100)	
Water Supply Interruptions	0.08	0.1 (Company - Average achieved previous 5 years)	Hours per total properties served
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Post Tax Return on Capital	5.53	5.72 (From FD)	%
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Mean Zonal Compliance	99.98	99.96	%
Reportable Accidents	1	Nil	

2.1 Ofwat Service Incentive Mechanism (SIM) - Results for 2011/12

Ofwat have introduced a new methodology for measuring customer service known as the

Service Incentive Mechanism (SIM). This seeks to measure the quality of service provided rather than just the time taken to provide the service which the original DG indicators measured.

The SIM is divided into two elements:

Quantitative - measured by:

- The number of CCW investigations
- The number of escalated written complaints
- The total number of written complaints
- The number of unwanted telephone contacts
- The total number of abandoned calls over ten seconds
- All lines busy

Qualitative - measures how satisfied customers are with the quality of service they receive based on a survey of customers who have had direct contact with their water company.

Table 2.1 shows the performance against the Company's Key Performance Indicators for 2011/12.

Table 2.1

SIM scores Quantitative Measure	Number	Multiplier	Total	Per 1,000 Properties
All Lines Busy	494	1	494	2
Calls Abandoned	7,665	1	7,665	25
Unwanted Phone Contacts	101,311	1	101,311	332
Written Complaints	216	5	1,080	4
Escalated Written Complaints	32	100	3,200	10
CC Water Investigated	-	1,000	-	-
	109,718		113,750	373
Connected Properties ('000)			305	
Quantitative SIM Score (calculated as per the Ofwat methodology)			19.0	
Qualitative Measure	4.56	10	45.6	
Total SIM Score			64.6	

In the Quantitative assessment the Company has scored poorly on the 'number of unwanted telephone contacts'. The number to be reported by Portsmouth for 2011/12 at 51% of all calls is much higher than reported by all the other companies. This is difficult to understand, given the low level of complaints we receive and the high Qualitative score. It is believed that this may be due to a different interpretation of the guidelines and we intend to take this up with Ofwat. Portsmouth Water treats any call which expresses any dissatisfaction as unwanted, irrespective of the primary reason for the call.

The Company does not currently have a Customer Contact System, which makes a proportion of calls difficult to classify. However a new customer management system will be implemented in October 2012 which will improve our recording capability.

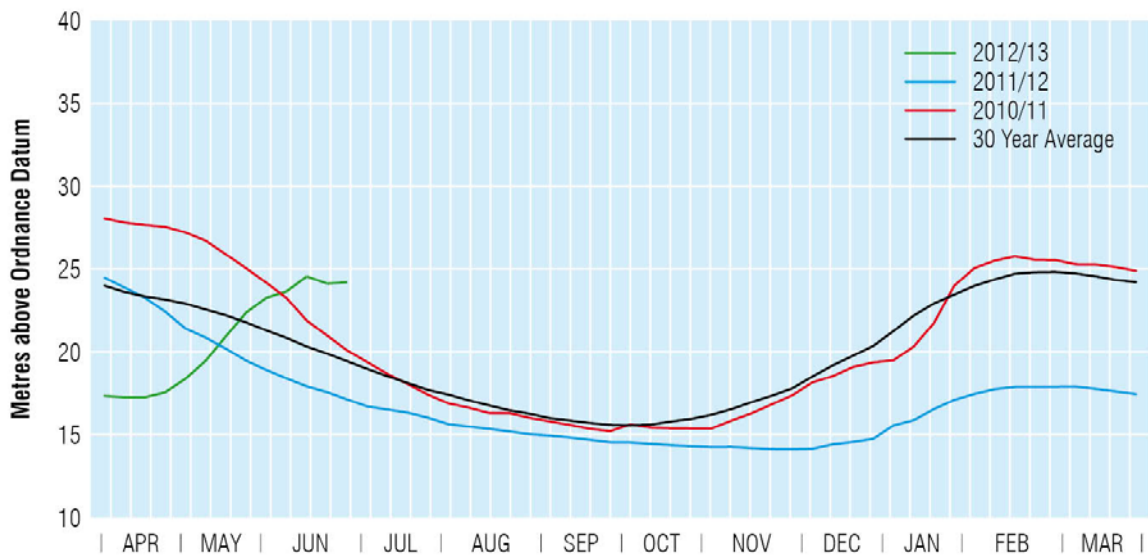
In the Qualitative assessment for the four quarters in 2011 the Company was ranked 2nd of the 21 companies with 4.56 points out of 5.0, top was 4.58, bottom was 3.96.

The Company's overall Qualitative score was 45.6 and the Quantitative score was 19.0. This therefore, gives Portsmouth Water a total score of 64.6.

For 2010/11, Portsmouth Water had 7 complaints per 10,000 customers which was by some distance the lowest in the industry. For 2011/12 this increased slightly to 8 per 10,000 customers (compared to an industry average of 61) and we again expect this to be the lowest.

During the year there were no restrictions to supply or drought orders. This is despite the fact that seven water companies in the South East announced temporary use bans in early April 2012 on non-essential use. Portsmouth Water's area was not as severely affected and we appealed to customers to show voluntary restraint in their use of water. Due to heavy rainfall in April and a wet May, groundwater levels had reached the long term average level by the end of May.

Groundwater Levels



Water Supply Interruptions

Portsmouth Water's customers experienced an average interruption of 0.08 hours per total properties served. In the year, 332 properties experienced an interruption of more than 12 hours. However, 281 of these related to one incident which was a longitudinal fracture of a

12" PVC trunk main, and such a burst is regarded as a very rare occurrence. Our PVC mains are being targeted as part of our mains renewal programme. It should also be noted from the table below that total bursts are currently on a downward trend. The Company has set a target of 0.1 hours per total properties served based on the average of the last five years' performance.

2.2 Water Service Delivery

2.2.1 Serviceability Water Infrastructure

Table 2.2 shows the performance against the serviceability water infrastructure performance indicator target.

Table 2.2 - Infrastructure Performance Levels

Serviceability Indicator	Unit	2010/11	2011/12	AMP5 Reference Level
Total bursts	Nr	327	290	342
	Per 1,000km	100	89	104
Interruptions >12 hours	Nr	NIL	332	50
Iron non-compliance (as 100 - mean zonal compliance)	%	0.77	0.56	NIL
Customer contacts - discolouration	Nr/1,000 population	0.04	0.04	0.06
Distribution Index TIM (as 100 - mean zonal compliance)	%	0.26	0.19	NIL

For most of the KPI's the performance in 2011/12 was an improvement on the previous year. The one exception is interruptions >12 hours, as detailed above.

2.2.2 Water Serviceability non-infrastructure

Table 2.3 shows the performance against the Company's Key Performance Indicator target.

Table 2.3 - Non-infrastructure Performance Levels

Serviceability Indication	Unit	2010/11	2011/12	AMP 5 Reference Level
Water Treatment Works Coliforms Non-compliance	%	NIL	0.05	0.03
Service Reservoirs Coliforms Non-compliance	%	NIL	NIL	NIL
Turbidity	NIL	NIL	NIL	NIL
Enforcement	Nr	NIL	NIL	NIL
Unplanned Maintenance	Nr	914	937	547

The Company recognises non-infrastructure unplanned jobs have risen from 914 jobs in JR11 to 937 in JR12. Since 2007/08 the number of unplanned jobs has progressively increased from 507. The Company raised this with Ofwat in March 2012 as the outcome was outside of the parameters set at the Final Determination.

We have identified that unplanned maintenance issues relevant to the membrane filtration plants were not evident at the time Ofwat set FD09 serviceability levels. Additionally, improved recording of unplanned maintenance events has been implemented and resulted in accurate recording of all unplanned maintenance events. The Company believes the current reference levels are now inappropriate and the increase is not necessarily indicative of asset deterioration.

Table 2.3 above outlines the Company's performance against the AMP5 reference level. The single failure of the serviceability standards is the water treatment works coliform compliance which as described later was due to a faulty sample tap at the Eastergate Water Treatment Works. The Company therefore believes the overall serviceability for non infrastructure remains stable and supported by the results of compliance testing in accordance with the Water Quality Regulations.

Water Quality regulations are in place to ensure water supplied to customers is safe to drink. There are 58 standards selected by the DWI to reflect water quality from source to tap. In 2011 the Company carried out a total of 39,149 determinations in samples taken at treatment works service reservoirs and

customers taps. Of these the overall mean zonal compliance, (MZC) which is the representation of overall drinking water quality and was 99.98% (99.97% in 2010).

Within the MZC, results are grouped by the DWI to reflect the stages of the processes. Process control, Disinfection control and Service Reservoir have been chosen by the DWI to reflect the performance of Non Infrastructure assets.

Process control quality compliance is based upon a selection of parameters which are, in general terms, controlled by the processes in place at water treatment works. The focus is on chemical parameters and in 2011 100% of the samples taken were compliant.

Disinfection control quality compliance is based upon a selection of parameters which demonstrate the effectiveness of disinfection and pathogen removal. Microbiological standards are of particular importance and based upon the presence of coliforms, a highly ubiquitous group of bacteria which are not normally pathogenic and which make excellent indicator organisms. In 2011 99.97% of the samples taken were compliant. There was a single microbiological failure at our Eastergate treatment works this year which gave rise to the 0.05% performance level shown above. However, the cause was found to be the sample tap.

Reservoir integrity quality compliance is based upon a selection of parameters to reflect the hygienic status of service reservoirs and includes microbiological analysis. In 2011 100% of the samples taken were compliant.

The Company believes that serviceability for non-infrastructure has been maintained as stable and is currently in discussion with Ofwat regarding the reasons that have given rise to an upward trend in unplanned non-infrastructure maintenance activities since JR07. Ofwat have recently requested additional information which is being prepared and further dialogue is anticipated.

2.2.3 Key Supporting Activities

Table 2.4

Activity	2010/11	2011/12	Total Activity During 2010-
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			2015
Mains Renewal Km	18	23	116
Mains Relined Km	0	0	0
Number of household Meters renewed nr	183	171	15,000

An improved risk based targeting of mains renewals was introduced in 2010/11. The full impact has been seen in 2011/12 as discussed below.

In 2010/11 the kilometres of mains renewed was 18km. This was lower than anticipated due to the need to contain costs and not exceed the Final Determination. Since then, the Company has reviewed its engineering techniques and materials used as well as making greater use of 'no dig' techniques. This has created cost savings and allowed the number of kilometres renewed to increase to 23 in 2011/12.

2.3 Capital Maintenance - Exceptional Outputs

In the Final Determination, the Company had two exceptional items, both to maintain serviceability and to reduce algal growth in the clarifiers and in a storage reservoir at the River Itchen. The two projects, which are required in response to an undertaking to the DWI are:

- To construct a roof over the clarifiers - Final Determination Completion date 2011
- To construct a roof to cover the bankside storage reservoir - Final Determination Completion Date 2013

The roof over the clarifiers has been delayed in order to combine these two projects plus elements of the security requirement under one tender in an attempt to achieve the efficiency targets set by Ofwat. This delay has been accepted by the DWI. A planning submission was made in December 2011 and granted on 9 March 2012.

2.4 Delivery against Supply/Demand Outputs**Table 2.5 - Security of Supply Performance against target**

	Performance 2011/12	FD Target
SOSI dry year average	100	100
SOSI critical / peak	100	100
Leakage MI/d	30	30
Water Efficiency Base Target MI/d	0.36	0.29
New Properties connected (000's)	1.5	2.5
Metering - Optional Meters (000's)	4.0	5.0

2.4.1 Leakage

Leakage for the year was recorded at an average of 30 MI/d, in line with the Company's target.

2.4.2 Base Service Water Efficiency

In 2010 Ofwat set the Company an annual target of achieving water savings, through water efficiency, of 0.29 mega litres per day (MI/d). This equated to an overall five year target of 1.45 MI/d. Last year saw the Company achieve 0.25 MI/d a shortfall of 0.04 MI/d against the target.

Pleasingly this year the Company has exceeded the target by achieving overall savings of 0.36 MI/d. This includes clawing back the shortfall from last year and gives us going forward a surplus of 0.03 MI/d.

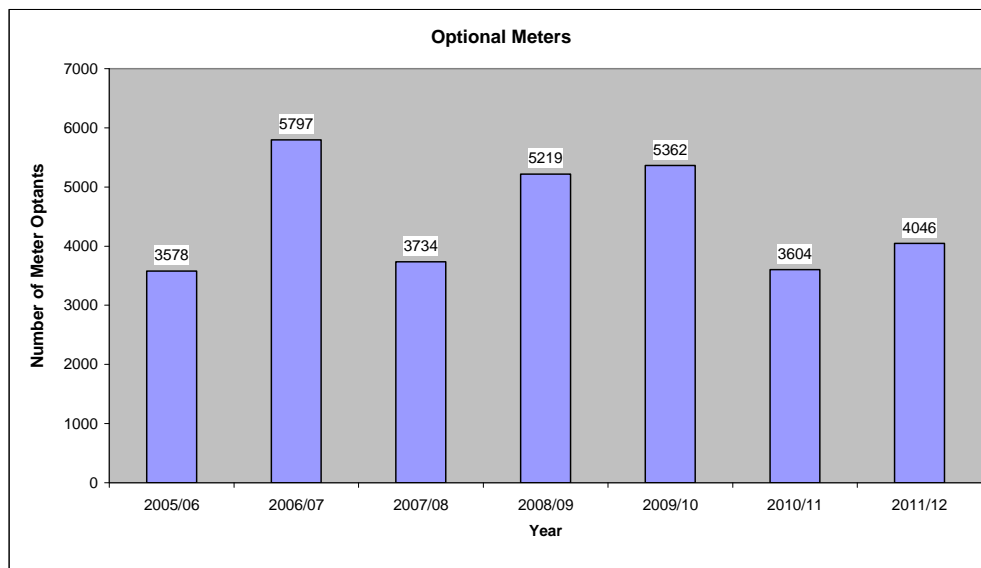
This excellent result was achieved by initiatives such as supplying free water saving packs and subsidised water efficient devices such as shower heads to customers. This was in conjunction with a number of proactive water saving campaigns in the local media such as the "Water Saving Challenge" which is designed to encourage customers to change their behaviour when it comes to water use.

2.4.3 New Properties Connected

The recession in housebuilding is still having an effect in the Company's area of supply and is lasting longer than anticipated at the time of the Final Determination. In 2011/12 1,641 properties were built compared to the Final Determination of 2,500.

2.4.4 Optional Meters

The actual number of meter optants at 4,046 was well below target of 5,000, but higher than 2010/11 (3,604). The chart below shows the history of meter optants.



Falling water and sewerage bills for 2011/12 could be a reason for the shortfall, and the publicity surrounding the universal metering programme of our neighbour and the sewerage provider to our customers, Southern Water may have led customers to believe they will be metered anyway. In 2012/13 we are stepping up our publicity highlighting the savings that some customers are able to make through switching to a measured supply, focussing on the customers with high RV properties. This is in addition to the usual advertising that we carried out in 2011/12 to promote meter optants; on our website, in our annual newsletter and on our charges leaflet (which is included with all unmeasured bills).

2.5 Drinking Water Quality Enhancements

2.5.1 Security and Emergency Measures (SEMD)

The output is not expected to be complete until 2015. The security improvements consist of 5 distinct projects. Two have been completed, contracts are in progress for two and associated works will be complete by March 2013, and one scheme, with the agreement of CPNi, has been deferred for approximately three to four years.

2.5.2 Environmental Obligations

The Company was required to undertake two environmental studies, the Post Implementation Monitoring of the impact of abstraction on certain Habitats Directive sites and the impact of abstraction on the water quality of certain catchments under the Water Framework Directive. The scoping of both studies has been completed and agreed with the Environment Agency. The schemes have commenced and are ongoing. We are engaged in continued dialogue with the stakeholder groups and are on program to deliver the schemes in March 2013.

2.5.3 Catchment Management

In the Final Determination, the Company was allowed £50,000 per year in operating costs to undertake a programme of catchment management to reduce the amount of Nitrates entering the water system. This is being undertaken through the Downs and Harbours Clean Water Partnership comprising Portsmouth Water, the Environment Agency and Natural England. The Partnership was set up in 2009 as part of a joint approach to tackle diffuse water pollution issues affecting ground water, surface waters and coastal waters. The principal drivers of the programme are the Drinking Water Directive and the Water Framework Directive.

Originally, the project was intended to act as catchment advisory service that would be run by Portsmouth Water alone but, following a series of meetings with the Environment Agency and Natural England, it was determined that pooling resources would avoid replication of work and allow the aims of the programme to be more effectively realised.

The project is aimed at protecting and improving water quality by safeguarding groundwater sources used for public water supply, reducing algal growth in the

Portsmouth, Chichester, Langstone Harbours and the River Hamble and to reduce pressures on the ecology of local Rivers including the Meon, Wallington, Ems and Lavant. The main focus of the project is to reduce the amount of nitrate entering the water system; a significant proportion is derived from agriculture, although other rural and urban sources also contribute.

The project works particularly closely with agriculture to promote a voluntary initiative to encourage landowners to reduce the impact of their activities on the water environment. This is achieved by promoting uptake of best practice, benefitting drinking water resources, farming and the environment. The Partnership also actively seeks and engages with other agencies, bodies and individuals that have a vested interest in the aims of the project.

The strategy for delivery was put into action in the second year of the programme, based on the proximity of farms to groundwater abstraction points, rivers and their tributaries. To date, 12% of the total farmed land, equivalent to over 21% of land in the highest priority areas, has been engaged.

Over 60 services have been provided to farmers. Examples to date have included providing 10 farms with fertiliser spreader testing, 11 farms with Soil Mineral Testing, 5 farms with infrastructure audits, 3 farms with biobed visits and a further 7 farms with Nutrient Management Plans and 10 farms with soil testing. Promotion of the programme was made at four workshops and further presentation / promotion made a number of events across the country.

Further promotion has included newsletters and articles in a variety of publications such as South East Farmer, the Environment Agency State of the Environment Report and the DWI Chief Inspectors Report, 2009.

2.6 Resilience

In the Final Determination three small schemes were included to reduce the risk of supply interruptions for 34,000 properties from 1 in 100 years to effectively zero. These schemes were completed in 2011/12.

2.7 Health and Safety

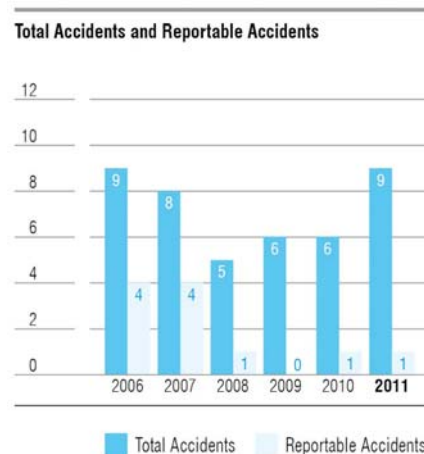
Health and safety of employees is considered fundamental to the success of the

business and the Company is committed to achieving high standards across the organisation. The Company has put health and safety at the top of the agenda and from the Board down has made it a high priority.

Considerable time and resources have continued to be directed into raising the awareness of Health and Safety and the statistical results for the year 2011 show very positive results from these efforts, with only one reportable accident (accident causing more than three days absence) being recorded.

It is pleasing to report that our efforts have again been recognised externally through the RoSPA Health and Safety Awards, by the Company being awarded the Gold Medal. This is in recognition of our Health and Safety record over the last seven years where we have received seven Gold awards and an Industry sector award. This award is again recognition of the efforts of all employees who should feel proud of their achievements in making the Company a safer place.

Total Accidents and Reportable Accidents



Our activities on health and safety are all key elements of the Water UK's "Water Ahead" occupational health initiative.

2.8 Carbon Accounting

Portsmouth Water's total carbon emissions for reporting year were 12,532 tCO₂e based on the Defra definition, a decrease in emissions of 840tCO₂e on the previous year. The amount of carbon emitted per megalitre of drinking water produced has also fallen from 192 to 185 kgCO₂e/MI.

Portsmouth Water have based the carbon target on the projection included in their final Business Plan for the 2009 price review. This target has been adjusted to take account of schemes that were not included in the Final Determination.

Compared to the rebased target there has been a 9% increase in emissions, it should be noted that Portsmouth Water have increased the scope of their carbon reporting since 2008 which accounts for a proportion of the increase. Portsmouth have reported green status for this KPI as the increase is within the 10% stated in the KPI guidance.

2.9 Key Supporting Information

Table 2.6

	2007/08	2008/09	2009/10	2010/11	2011/12
Distribution Input MI/d	178.3	177.99	180.35	179.42	175.81
Water Delivered MI/d	156.8	155.6	159.7	157.81	153.78
Percentage of households metered %	10.1	12.4	14.9	17.0	19.0
Average connected properties	294	294	295	299	299

Pollution Incidents Water

There were no pollution incidents in the year.

Discharge Permit Compliance

Compliance was recorded at 1,061 for the year 2011/12.

Mean Zonal Compliance

The Company carries out an exhaustive programme of testing to ensure that water of the highest quality is supplied to customers. The percentage number of samples which passed the strict standards set out in the Water Supply (Water Quality) Regulations was 99.98%, ahead of our target of 99.96%.

Chapter 3 - Expenditure and Financial Performance Measures

Full details of the Company's financial performance can be found in our published Regulatory Accounts. A few highlights are presented below.

3.1 Total Expenditure

Table 3.1 - Trend of Expenditure as stated in the Risk and Compliance tables

	2007/08 £m	2008/09 £m	2009/10 £m	2010/11 £m	2011/12 £m
Total Operating Expenditure Reported	19.8	20.8	21.2	21.2	21.6
Total Operating Expenditure excluding the notional pension charge	17.5	19.1	19.7	19.5	20.2
Gross Capital Expenditure					
Infrastructure renewals	4.8	5.1	7.0	5.0	3.9
Non-infrastructure	1.3	1.9	2.4	2.2	1.9
Quality Enhancements	4.3	2.7	2.8	0.6	0.6
Enhanced Service Levels	-	-	-	-	-
Supply/Demand Expenditure	1.6	2.1	1.9	1.8	1.7
Total Gross Capital Expenditure	12.0	11.8	14.1	9.6	8.1
Infrastructure Charges and Contributions	0.4	0.9	0.5	0.9	0.9

3.1.1 Accounting Policy Change

A comparison between 2010/11 and 2011/12 and previous years is distorted by an accounting policy change made by the Company in which the Capital Works department, who are responsible for the design and supervision of our capital programme, now charge their time direct to capital schemes rather than to operating cost as in the past. The effect of this change is to increase Capital Expenditure and reduce Operating Expenditure by approximately £0.5m. The change was made because in completing the accounting separation tables, this department did not easily fit into the business units and would be more easily linked to the Capital schemes the individuals are working on. Therefore on a restated basis the figures for Operating Cost in 2009/10 would be £20.7m for the reported basis and £19.2m excluding the notional pension charge. The figures for 2011/12 are stated on the

same basis.

Notional Pension Charge

In accordance with FRS17, the Company is required to charge the full current service cost of the retirement benefit scheme as an operating cost in the Profit and Loss account. This charge is recorded in Operating Cost on all the tables in the Risk and Compliance Statement. Until 2010/11, this charge was notional as the Company did not make any contribution to the scheme. In 2011/12, the Company made a contribution of £0.9m and the notional element was the full cost £2.3m less the actual contribution. In arriving at Price Limits, the notional cost was excluded from Operating Cost and this was also the treatment in calculating efficiency. In previous years, the allocation of the notional pension cost was included in the commentary to table 21.

3.2 Operating Expenditure

Table 3.2 shows the Operating Expenditure compared to the previous year and the FD09 with the comparators adjusted for the impact of the accounting policy change. The notional pension cost is excluded.

Table 3.2 - Operating Costs

	2010/11	2011/12	FD09
	£m	£m	Allowance £m
Reported figures adjusted for Notional Pension	19.5	20.2	21.5
Accounting Policy Adjusted	-	-	(0.5)
	19.5	20.2	21.0

Operating costs increased by 3.6% in the year despite RPI at an average of around 5% and the introduction of the Carbon Reduction Commitment Levy (CRC) of £0.2m which is effectively a tax on our energy usage. There was a reduction of £0.3m to abstraction charges following a review of charges by the Environment Agency for augmentation at the River Itchen. These charges have been paid for many years and it has now been agreed that the Company will receive no benefit for its augmentation.

3.3 Capital Expenditure

Table 3.1 above shows that Capital Expenditure in 2011/12 amounted to £8.1m. This included £3.9m on infrastructure renewals. This was lower than usual as a major scheme to reduce the risk of quality and security issues at the River Itchen Treatment Works was delayed until planning permission for the work was obtained.

The overall capital programme of AMP5 is less than AMP4 and table 3.3 shows the first year's expenditure compared to FD09.

Table 3.3 - Capital Expenditure Compared to FD09

	Actual 2011/12	FD09 (AMP5 Programme)
	£m	£m
Base Service Infrastructure Renewals	3.9	4.7
Base Service Capital Maintenance	1.9	1.3
Growth	1.7	1.3
Quality	0.3	0.3
Security	0.3	0.6
	<hr/>	<hr/>
Gross Expenditure	8.1	8.2
Capital Contribution and Infrastructure Charges	(0.9)	(1.1)
	<hr/>	<hr/>
Net Capital Expenditure	7.2	7.1
	<hr/>	<hr/>

3.3.1 Infrastructure Renewals

Expenditure on infrastructure renewals during 2011/12 was £3.9m compared to £5.0m in 2010/11. This was less than the Determination. The length of mains renewed under the annual mains renewals contract was 23.2km. The Company has significantly increased the length of mains installed by 'no dig' techniques to 24.3% of the year total. However this is an unusually high level and such a level cannot be continued in future years.

3.3.2 Non-Infrastructure Capital Maintenance

Expenditure in the non-infrastructure category includes for the provision of a roof over the clarifiers at the River Itchen Water Treatment Works and the Highwood Raw Water Reservoir, required as part of an Undertaking with the Drinking Water Inspectorate (DWI) to control the level of THMs in the distributed water. Following the determination the Company sought capital efficiencies by combining a number of similar schemes and proposed to let a single contract to derive efficiencies. This approach has necessitated the reprogramming of works and in particular resulted in deferral of expenditure for the clarifiers at the River Itchen Water Treatment Works from 2010/11 into 2011/12 and 2012/13. The reprogramming of works associated with the DWI Undertaking was agreed with the DWI. A contract for the design and construction of the proposed solution was awarded in November 2011 to Clancy Docwra and planning permission was granted on 9 March 2012 with construction commencing in late April 2012. The River Itchen THM Scheme is on programme for completion by March 2013.

The total expenditure for 2011/12 was £1.9m.

The Company is in the process of implementing a new billing and customer contact management system and the cost was £0.2m in the report year, with a total expected out-turn of £0.8m. The project will be completed in October 2012.

3.3.3 Quality Enhancement

Activity in the year included the completion of a number of AMP4 schemes. Table 3.4 shows a breakdown of the Quality Enhancement Expenditure in the report year.

Table 3.4 - Quality Enhancement Expenditure

	£000
AMP4 scheme completion	174
AMP5 security schemes	115
Water Framework Directive Studies	88
Post Implementation Monitoring	72
Flood resilliance - water treatment	21
Protective and Hazardous Chemicals	18

	488

The Determination allowed for an expenditure of approximately £636,000 in 2011/12 for AMP5 security improvement schemes. Expenditure on security has been £289,000, approximately £115,000 has been upon AMP5 schemes, the balance has been upon AMP4 schemes which have now been completed in the report year.

Expenditure in the Determination was for open water security improvements in 2010/11 and 2011/12 and combined and deferred as part of the River Itchen THM solution as reported in JR11. A contract for the design and construction of the open water security enhancements at the Farlington Water Treatment Works was awarded in November 2011 to Clancy Docwra and planning permission granted in January 2012. The Scheme is programmed for completion in March 2013.

Expenditure on improving the flood resilience of four water treatment works occurred in the report year, the scheme is now complete.

Supply/Demand Balance Expenditure**Table 3.5 - Supply/Demand Balance Expenditure**

	2011/12	FD09
	£m	(AMP5)
	£m	£m
New Development Mains	0.9	0.5
Meter Optants	0.8	0.7
	<hr/>	<hr/>
	1.7	1.2
	<hr/>	<hr/>

Capital expenditure on new development relates to mains requisitioned by developers to serve properties and is significantly higher than 2010/11 due to three large development sites commencing this financial year. The sites are located at Flansham and Bersted in Bognor Regis.

The expenditure on meter options was at the Determination level despite the number of optants being 19% below the level assumed in the Determination (4,046 vs 5,000). This is due to the increases in contractor rates which do not match the efficiencies assumed by Ofwat in the Final Determination or the fall in COPI which is reflected in the FD09 cost. As noted earlier, the Company will strive to promote the take up of meters and achieve its target for the full five years.

3.4 Comparison of Operating Profit with the Final Determination**Table 3.6**

	Actual 2011/12 Results before Notional Pension Charge	Determination
	£m	£m
Turnover	36.6	38.5
Opex	(20.2)	(21.0)
Infrastructure Renewals Charge	(5.0)	(5.0)
CCD	(5.3)	(4.8)
Working Capital Adjustment	0.2	0.2
	<hr/>	<hr/>
Current Cost Operating Profit	6.3	8.0
	<hr/>	<hr/>
Rate of Return	5.5%	6.1%

The Determination Opex has been adjusted downwards by £0.5m to reflect the accounting policy change in order to make the comparisons valid.

Turnover

The actual turnover for 2011/12 increased by 3.2% to £36.7m. This reflected the increase in tariffs and an increase in income from mains diversion work of £0.8m. There was however, a 5% reduction in demand from commercial customers during the year. The turnover was however below the Determination. The Determination figures have been inflated using the average RPI for each year. The inflation figure driving the actual turnover for 2010/11, was very low, 0.3% compared to an average of 5% for the year. This impact may be recovered in 2012/13 where the RPI driving prices (November 2011) is projected to be higher than average RPI over the year.

Operating Cost (see Section 3.2)