



ANNUAL PERFORMANCE REPORT 2017

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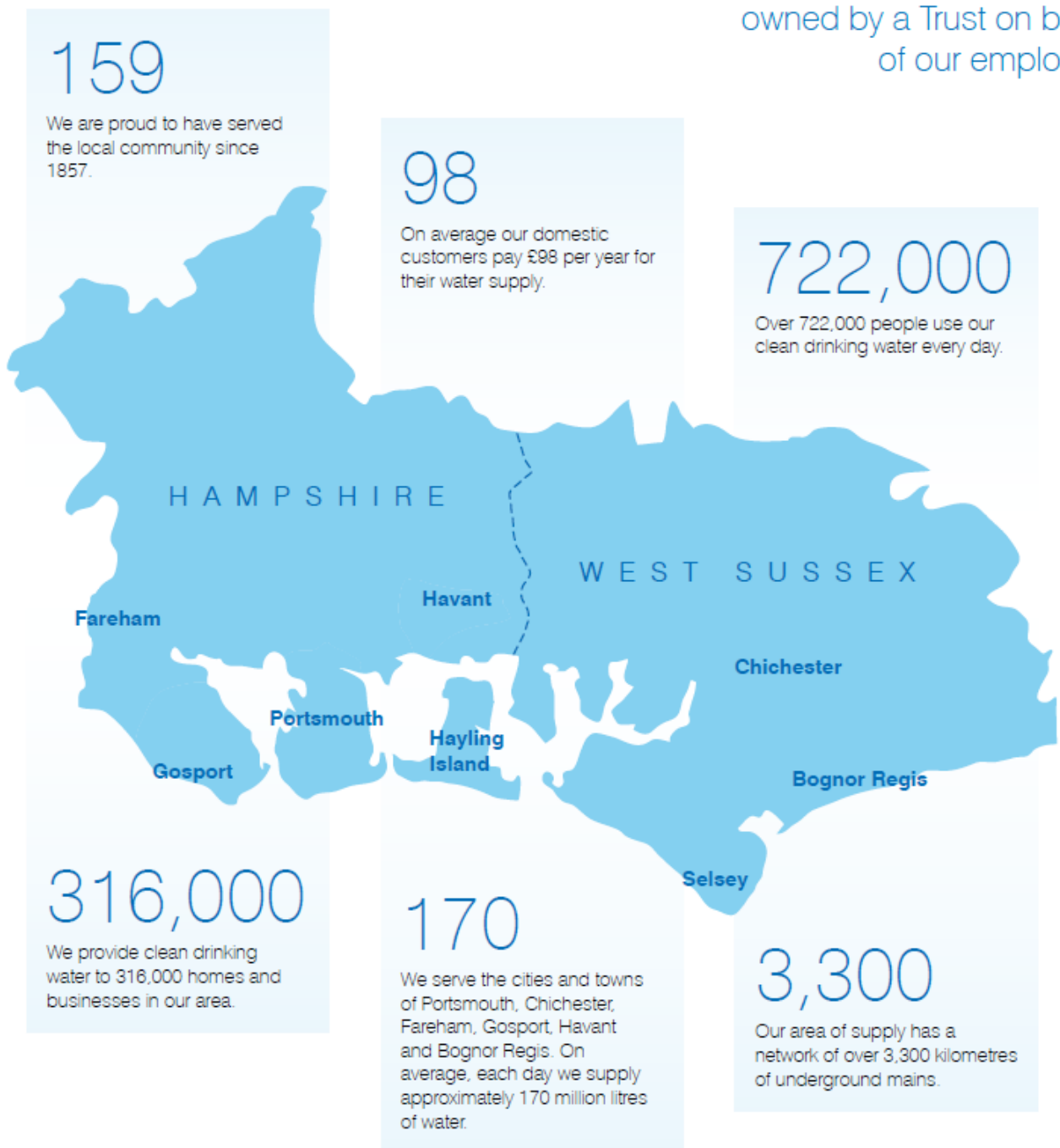
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INTRODUCTION

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.

We are an independent company unique in the industry as we are majority owned by a Trust on behalf of our employees



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 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 principles 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.

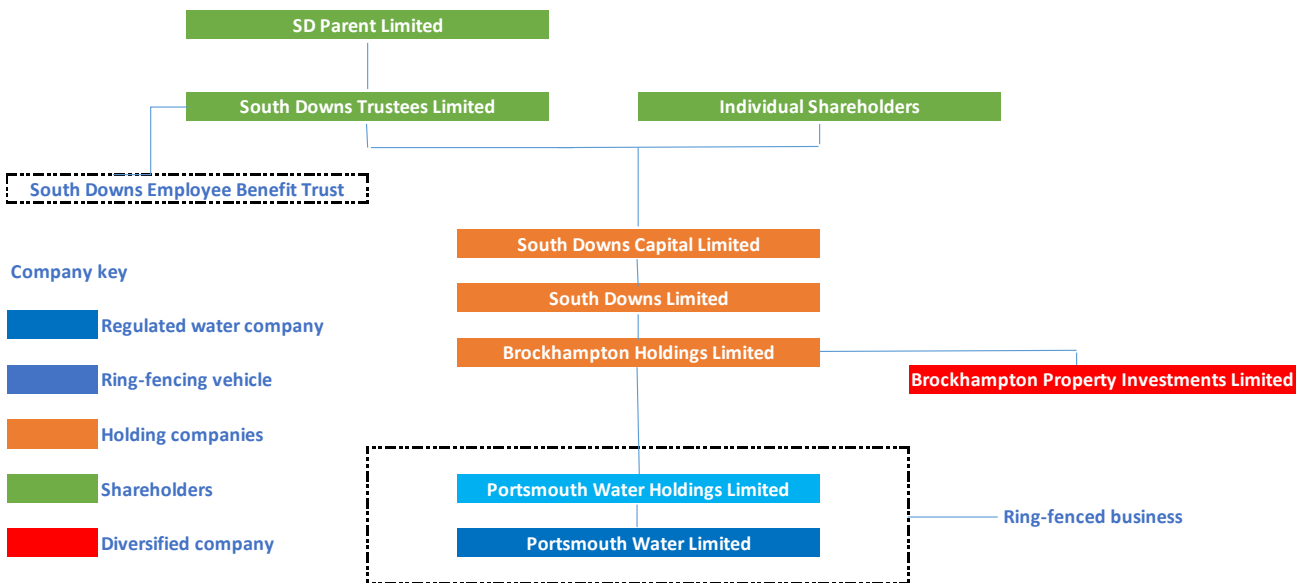
Detailed information in connection with the Company’s Corporate Governance processes and compliance, including operation of the Board, Risk Management and Internal Control is set out on pages 34-49 of the Company’s ARA.

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 Ownership 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 Ownership 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 £5.6m (2016 - £7.6m) returned to a more consistent level following the one off favourable impact in 2015/16 of lower infrastructure renewals (2015/16 impact £1.9m reduction). In addition increased turnover in the year of £0.5m was offset by other operating costs discussed further below;

Revenue

The increase in turnover reflects the allowed regulatory price increase together with 2,100 new properties and higher measured consumptions, offset by lower chargeable work of £0.4m.

Operating costs

Total operating costs increased by £3m which resulted from a number of movements.

As noted above during 2015/16 infrastructure renewals were atypically low following change-over of our main contractor during the year. In 2016/17 infrastructure renewals activity returned to normal levels resulting in an increase of £2.4m on 2015/16.

Depreciation during the year has fallen by £0.9m this is primarily as a result of the £0.7m accelerated depreciation included within 2015/16. Offsetting this is an increase of amortisation of intangible fixed assets of £0.3m following commissioning of our ERP system.

Staff costs, charged to the income statement, have increased by £0.7m. This reflects increased headcount from 251 to 255 driven by operational requirements, particularly the impact of preparation for non-household retail competition and the staff involved in the implementation of the new ERP system (which went live in October 2016). Together with the annual salary increase of 2%, continued increases in pension costs of £0.3m and lower capitalised costs of £0.1m this caused the incremental cost.

In addition there were incremental costs of £0.5m (2016 £nil) under the operating agreement to outsource non-household retail activities to Castle Water for the year. This was a one off cost and will not recur in 2017/18.

Interest & other finance income

Interest payable shows an overall increase of £0.9m which is primarily due to £0.8m higher indexation on the £66.5m index linked loan driven by RPI levels. Other finance income reflects movements in the net pension scheme position and is set out further in note 25.

Taxation

The tax credit in the period of £0.4m includes a current tax credit of £0.6m and deferred tax charge of £0.2m. The reduction in current tax charge was driven by a £0.8m prior year credit in connection with the treatment of previous infrastructure contributions on FRS 102 conversion. In addition losses elsewhere in the group were used to relieve trading profits in the year. Deferred tax charges increased as a result of a number of net movements including the reduction in corporation tax rate and prior year adjustments (as noted above).

Dividends

The dividends paid during the year totalled £1.2m (2016 - £1.2m). 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 £0.8m (2016 - £0.7m) 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 £0.5m.

Capital investments

Gross capital investment in the year was £10.2m (2016 - £9.3m).

Mains activity

	2016/17 £m	2015/16 £m
Renewals charged in the income statement	4.2	1.8
New Mains capitalised	1.4	1.7
Total mains investment	5.6	3.5

During the year the Company renewed 21.4km of mains (2016 - 11.6km) at a cost of £4.2m charged to the income statement. The increase represents a return to typical run rates of activity in 2016/17. A further 13.9km (2016 - 7.6km) of new mains were capitalised at a cost of £1.4m.

FINANCIAL PERFORMANCE

Major capital schemes

The Company continued the programme of capital schemes that were agreed in the Business Plan. The two new UV treatment plants commenced in 2015/16 were largely completed in the year with additional capital spend of £1.7m. In addition, we are close to completing a further UV treatment plant at our Farlington works with spend of £3.4m during the year.

Capital contributions

The Company receives capital contributions, primarily in connection with new mains for housing developments, which amounted to £1.2m (2016 - £1.2m). These contributions are deferred and amortised to the Income Statement.

Cash and Cash Flow

Cash generated from operations of £10.6m fell by £3.1m on the prior year. This was driven by the return to normal levels of infrastructure renewals with a cash flow impact of £2m together with other smaller movements in operating expenses. In addition there were a number of working capital movements, the most significant of which related to a £0.9m increase in non-household trade debtors following the outsourcing of this activity during 2016/17. The overall £2.4m increase in cash at the year-end was driven by a draw down on our revolving credit facility of £4.0m, together with a £2.9m payment received in advance in connection with our disposal of the non-household retail operation (this includes the fair value of future meter reading services for five years - note 23). These were offset by higher expenditure on fixed and intangible assets totalling £3.3m.

Pensions

The Company operates both a defined contribution and a defined benefit pension scheme, the latter of which has been closed to new members since 2011. The Company is the principal employer of the Brockhampton Pension Scheme, a defined benefit scheme. The latest actuarial valuation as at 31 March 2017 was carried out in accordance with FRS 102 and shows a net pension asset (after deferred tax) of £11.4m (2016 - £14.6m). The overall decrease in the surplus on actuarial valuation has largely been driven by the fall in AA corporate bond rates.

Post Balance Sheet Events

As previously disclosed the Company made a decision to dispose of its non-household retail operations with effect from 1 April 2017 (the date of Retail Market Opening) to Castle Water Limited. During the year the Company received a payment in advance of £2.9m (including the fair value of future meter reading activities for five years) in consideration for this transaction. This is discussed further in note 23.

Financial Viability

The Company's financial position is set out in the ARA on pages 53 to 71, including cash flows, liquidity position, borrowing facilities and loan maturities. The ARA, on pages 6 to 31, also covers aspects such as the overall financial performance and financial risks. Finally 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 5 years.

The Company's current bankers are Lloyds who provide a £4m overdraft facility and a £10m revolving credit facility.

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. 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 ARA and APR 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.

TAXATION STRATEGY

Corporate Structure

Portsmouth Water Limited is a wholly owned subsidiary undertaking of South Downs Capital Limited. The Group, which operates entirely in the UK, is majority owned by an Employee Ownership Trust. Debt finance is provided by way of third party loans, the majority of which is by way of a fixed rate, RPI linked bond maturing in 2032.

Portsmouth Water is committed to full compliance with all statutory obligations. As a Company we understand that collecting and paying tax is an important part of contributing to the economic environment that we operate in and in addition to paying corporation tax we also contribute as a result of indirect taxes, employee related taxes and environmental taxes. The Company's tax affairs are managed in a way which takes into account the wider corporate reputation and that of an independent company unique in the industry owned by a Trust on behalf of our employees. At all times the tax affairs are managed in line with the Company values of Integrity, Excellence and Respect.

Governance in relation to UK taxation

- The ultimate responsibility for the tax strategy of Portsmouth Water Limited sits with the Board.
- The Finance and Regulation Director is the Board member with executive responsibility for tax matters.
- The day-to-day management of the tax affairs is delegated to the Financial Controller who reports to the Finance and Regulation Director.
- Members of the Finance team are trained to a level that ensures tax compliance and a continuous cycle of training occurs to ensure all skills are relevant and up to date.
- For tax filing, specialist advice and support Portsmouth Water engage the services of specialist Finance and Accountancy professionals.

Risk Management

Attitude towards tax planning and level of risk

Portsmouth Water Limited manages risks to ensure compliance with legal requirements in a manner which ensures payment of the correct amount of tax.

Portsmouth Water's attitude towards tax planning is one of prudence; seeking to comply fully with relevant tax legislation and to achieve a high degree of certainty in the company's tax affairs. The wider group of Companies applies the same approach to tax planning as a whole.

At all-times Portsmouth Water seeks to comply fully with its regulatory and other obligations and to act in a way which upholds its reputation as a good corporate citizen and a business operating in a regulated environment.

In relation to any specific issue or transaction the Board is ultimately responsible for identifying the risks, including tax risks, which need to be addressed and for determining what actions should be taken to manage those risks. In doing so the Board has regard to the materiality of the amounts and obligations in question. Where specific risks occur the Company will seek specialist professional advice.

In line with the Company's ethos to strive for continuous improvement through innovation we are able to utilise government tax initiatives such as the R&D Tax Credits scheme to reduce our corporation tax charge and therefore.

Working with HMRC

Portsmouth Water seek to have a transparent, respectful and proactive relationship with HMRC at all times, be that directly or through intermediaries acting on our behalf.

Any inadvertent errors that may occur in any submission made to HMRC are fully disclosed as soon as reasonably practicable after they are identified and independent specialist advisors are commissioned to validate the value of any error. Following this, an internal review will then identify any required process changes of internal controls, to ensure full and ongoing compliance.

Future tax changes are considered through Water UK's Tax Forum, of which Portsmouth Water is a member. This group allows us the opportunity to discuss how future tax legislation should be interpreted and applied to the Water Industry.

A review of any special tax events, such as FRS102 transition or significant commercial transaction, is conducted with the help of tax specialists.

REPORT ON REMUNERATION

Remuneration Committee

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 2016/17 annual incentive bonus plan

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.

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) 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. 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) 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. The costs associated with benefits provision are closely monitored and controlled.</p>	None
<p>Pension (Fixed Pay) 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) 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: 5% customer service measures 5% personal objective 10% key performance objectives</p>
<p>Long-term incentive bonus (Variable Pay) 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 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 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

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 discretionary payments under the qualifying Employee Ownership Trust arrangements (EOT).

Annual Report on Remuneration

Directors Remuneration as a Single Figure (Audited Information)

Remuneration is analysed by Director below:

	Salary/Fees £000	Benefits £000	Bonus Scheme £000	Discretionary Payment £000	Pension £000	Total 2017 £000	Total 2016 £000
Executive:							
H. M. G. Orton	105	11	7	9	11	143	68
R. C. Porteous	107	9	15	15	32	178	208
N. Smith	148	13	-	-	36	197	162
Non-Executive:							
H. V. Benjamin	25	-	-	-	-	25	24
M. Johnson	25	-	-	-	-	25	24
M. P. Kirk	38	-	-	-	-	38	37
	448	33	22	24	79	606	523

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 2017 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.

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

	2017 £000	2016 £000
Car and Fuel benefit	25	30
Medical insurance	8	9
Total	33	39

REPORT ON REMUNERATION

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	15%	15
H.M.G. Orton	15.5%	7

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.

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

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

	Customer Service <i>Measure 1</i>		Personal Objectives <i>Measure 2</i>		Financial/Business Objectives <i>Measure 3</i>		Maximum Variable Pay Achievable	
	Target %	Value £	Target %	Value £	Target %	Value £	2017	2016
R. C. Porteous	5	5,000	5	5,000	10	11,000	21,000	20,400

H M G Orton	5	5,000	5	5,000	10	11,000			21,000	8,400
N. Smith	N/A	-	N/A	-	N/A	-	N/A	-	-	-

REPORT ON REMUNERATION

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		2017	2016
	Achieved	Value £	Achieved	Value £	Achieved	Value £	Achieved			
R. C. Porteous	3.5%	4,000	4.5%	5,000	4%	4,000	-	-	13,000	15,000
H M G Orton	3.5%	4,000	4.5%	5,000	4%	4,000	-	-	13,000	7,000
N. Smith	N/A	-	N/A	-	N/A	-	N/A	-	-	-

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
	%	%
R. C. Porteous	10	50
H. M. G. Orton	10	50
N. Smith	10	50

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

	Target %	Long-Term Objectives Value £	Maximum Variable Pay Achievable 2017	Maximum Variable Pay Achievable 2016
R. C. Porteous	10	10,730	10,730	10,200
H. M. G. Orton	10	10,515	10,515	4,700
N. Smith	0	N/A	14,800	14,300

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

	Achieved %	Long-Term Objectives Value £	Maximum Variable Pay Achievable 2017	Maximum Variable Pay Achievable 2016
R. C. Porteous	7	7,243	7,243	7,000
H. M. G. Orton	7	7,098	7,098	3,300
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.

Mr R.C. Porteous and Mrs H.M.G. Orton also received discretionary payments from the Employee Ownership Trust on the same basis as other employees. Mr N. Smith, as a shareholder of the Parent Company, is not entitled to payments.

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 £11,205 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:

REPORT ON REMUNERATION

	Value of increase in scheme benefit 2016/17 £000	Directors contributions 2016/17 £000	Total included in single figure table 2016/17 £000	Value of increase in scheme benefit 2015/16 £000	Directors Contributions 2015/16 £000	Total included in single figure table 2015/16 £000	Accrued Pension 31/03/17 £000pa	Accrued Pension 31/03/16 £000pa
R. C. Porteous ¹	37	5	32	67	5	62	56	54
N. Smith ²	44	8	36	-	8	-	93	90

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.

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 £17,772 (2015/16 - £18,325) of non-pensionable salary.

²The pensionable salary used to calculate Mr. N. Smith's accrued pension excludes nil (2015/16 - £1,420) of non-pensionable salary.

No additional benefits will become available to directors who retire early. For further details regarding each of the pension schemes, please refer to note 25 in the Annual Report & Accounts 2017.

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	2012	2013	2014	2015	2016	2017
Total remuneration excluding pension (£000)	137	153	157	160	162	161

Fuel benefit removed from 1 April 2016.

The above figures for Managing Directors remuneration are all in respect of Mr. N. Smith.

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 Ownership 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

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 Ownership Trust.

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.

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 £11.6m and undrawn loan facilities of £10m as at 31 March 2017;
- 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, 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



SECTION 1 REGULATORY FINANCIAL REPORTING

1A INCOME STATEMENT

For the 12 months ended 31 March 2017

	Note	Adjustments			Total appointed activities £'000	
		Statutory £'000	Differences between statutory and RAG definitions £'000	Non-appointed £'000		Total adjustments £'000
Revenue	2	40,342	(582)	45	(627)	39,715
Operating costs	3	(34,592)	1,067	(25)	1,092	(33,500)
Other operating income	4	(143)	0	0	0	(143)
Operating profit		5,607	485	20	465	6,072
Other income	5	0	721	139	582	582
Interest income	6	1,578	0	0	0	1,578
Interest expense	7	(5,696)	0	0	0	(5,696)
Other interest expense		0	0	0	0	0
Profit before tax and fair value movements		1,489	1,206	159	1,047	2,536
Fair value gains/(losses) on financial instruments		0	0	0	0	0
Profit before tax		1,489	1,206	159	1,047	2,536
UK Corporation tax	8	598	0	(32)	32	630
Deferred tax	8	(230)	0	0	0	(230)
Profit for the year		1,857	1,206	127	1,079	2,936
Dividends	9	1,205	1,210	126	1,084	2,289

1B STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 March 2017

	Note	Current year				Total appointed activities
		Statutory	Adjustments			
			Differences between statutory and RAG definitions	Non-appointed	Total adjustments	
£'000	£'000	£'000	£'000	£'000		
Profit for the year		1,857	1,206	127	1,079	2,936
Actuarial losses on post employment plans	22	(4,147)	0	0	0	(4,147)
Other comprehensive income	20	768	0	0	0	768
Total Comprehensive income for the year		(1,522)	1,206	127	1,079	(443)

1C STATEMENT OF FINANCIAL POSITION

As at 31 March 2017

	Note	Current year				Total appointed activities £'000
		Statutory £'000	Adjustments		Total adjustments £'000	
			Differences between statutory and RAG definitions £'000	Non-appointed £'000		
Non-current assets						
Fixed assets	10	125,255	0	0	0	125,255
Intangible assets	11	2,237	0	0	0	2,237
Investments - loans to group companies	12	55,484	0	0	0	55,484
Investment Properties		440	0	0	0	440
Retirement benefit assets	22	11,446	0	0	0	11,446
Total non-current assets		194,862	0	0	0	194,862
Current assets						
Inventories		474	0	0	0	474
Trade & other receivables	13	10,903	0	0	0	10,903
Investments - other	14	2	0	0	0	2
Cash & cash equivalents	15	11,644	0	0	0	11,644
Total current assets		23,023	0	0	0	23,023
Current liabilities						
Trade & other payables	17	(15,926)	0	0	0	(15,926)
Capex creditor	17	(962)	0	0	0	(962)
Borrowings	16	(4,284)	0	0	0	(4,284)
Current tax liabilities	17	(280)	0	0	0	(280)
Provisions	17	(1,412)	0	0	0	(1,412)
Total current liabilities		(22,864)	0	0	0	(22,864)
Net Current assets/(liabilities)		159	0	0	0	159
Non-current liabilities						
Borrowings	18	(99,613)	0	0	0	(99,613)
Deferred income - G&C's	19	(25,012)	0	0	0	(25,012)
Deferred tax	20	(6,703)	0	0	0	(6,703)
Total non-current liabilities		(131,328)	0	0	0	(131,328)
Net assets		63,693	0	0	0	63,693
Equity						
Called up share capital	21	1,078	0	0	0	1,078
Retained earnings & other reserves	21	62,615	0	0	0	62,615
Total Equity		63,693	0	0	0	63,693

1D STATEMENT OF CASHFLOWS

As at 31 March 2017

	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		5,607	485	20	465	6,072
Other income		0	721	139	582	582
Depreciation & Amortisation		5,594	0	0	0	5,594
Amortisation - G&C's		(582)	0	0	0	(582)
Changes in working capital		(636)	0	0	0	(636)
Notional Pension Costs		463	0	0	0	463
Movement in provisions		0	0	0	0	0
Loss on sale of fixed assets		143	0	0	0	143
Cash generated from operations		10,589	1,206	159	1,047	11,636
Net interest paid		(2,859)	0	0	0	(2,859)
Tax paid		(722)	0	(33)	33	(689)
Net cash generated from operating activities		7,008	1,206	126	1,080	8,088
Investing activities						
Capital expenditure		(11,967)	0	0	0	(11,967)
Grants & Contributions		1,165	0	0	0	1,165
Disposal of fixed assets		37	0	0	0	37
Other		0	0	0	0	0
Net cash used in investing activities		(10,765)	0	0	0	(10,765)
Net cash generated before financing activities		(3,757)	1,206	126	1,080	(2,677)
Cashflows from financing activities						
¹ Equity dividends paid		(1,205)	(1,206)	(126)	(1,080)	(2,285)
Net loans received		4,500	0	0	0	4,500
Proceeds from sale of non-household		2,900	0	0	0	2,900
Net cash generated from financing activities		6,195	(1,206)	(126)	(1,080)	5,115
Increase (decrease) in net cash		2,438	0	0	0	2,438

¹ The Regulatory Accounts includes the Employee Ownership Trust bonus payment in Dividends, for consistency with the Final Determination.

1E NET DEBT ANALYSIS

As at 31 March 2017

	Interest rate risk profile			
	*Fixed rate	Floating rate	Index linked	Total
	£'000	£'000	£'000	£'000
Borrowings (excluding preference shares)	284	4,000	100,494	104,778
Preference share capital				0
Total borrowings	284	4,000	100,494	104,778
Cash				(11,644)
Short term deposits				0
Net Debt	284	4,000	100,494	93,134
Gearing				68.6%
Adjusted Gearing				N/A
Full year equivalent nominal interest cost	0.01	0.10	5.6	5.7
Full year equivalent cash interest payment	0.01	0.10	3.8	3.9
Indicative interest rates				
Indicative weighted average nominal interest rate	3.5%	2.5%	5.6%	5.4%
Indicative weighted average cash interest rate	3.5%	2.5%	3.6%	3.6%
Weighted average years to maturity	25	< 1	15	14

* Perpetual Debt

RECONCILIATION BETWEEN STATUTORY ACCOUNTS AND REGULATORY ACCOUNTS

For the year ended 31 March 2017

	Statutory £m	Regulatory £m	Commentaries
PROFIT AND LOSS ACCOUNT			
Revenue	40,342	39,715	See a) below
Operating profit	<u>5,607</u>	<u>6,072</u>	See b) below
BALANCE SHEET			
Tangible fixed assets (net book value)	<u>125,255</u>	<u>125,255</u>	See c) below

- a) The only difference relates to the way these figures have been presented in both sets of accounts. In the ARA, this figure includes Amortisation of Developer Contributions. In addition, there is non-appointed revenue of £0.045m, which relates to Sale of Stores and Water Efficiency, and is excluded from the Regulatory revenue.

	£m
Statutory revenue	40,342
Amortisation of Developer Contributions	(582)
Non-appointed revenue	<u>(45)</u>
Regulatory revenue	<u>39,715</u>

- b) The difference relates to the way these figures have been presented in both sets of accounts. In the ARA, this figure includes other income of £0.721m, but this is reported after operating profit in the APR. The breakdown of this income is shown below.

The cash payment in connection with the Employee Ownership Trust is not shown in operating costs in the Regulatory Accounts. It is shown as Dividends, below the Profit after Taxation line. The amount for 2017 is £1.206m. This is consistent with the treatment in the Business Plan for PR14 and the Final Determination.

There is non-appointed operating profit of £0.020m, which relates to Sale of Stores and Water Efficiency. This is excluded from Regulatory operating profit.

	£m
Statutory operating profit	5,607
Amortisation of Developer Contributions	(582)
Rental Income	(138)
Home Assistance	(1)
Employee Ownership Trust	1,206
Non-appointed operating profit	<u>(20)</u>
Regulatory operating profit	<u>6,072</u>

- c) 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. 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 of 1 July 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 any out of pocket court costs are 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

Empty Property 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 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
Computer and network hardware	5 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 (acquired before 31st March 2016) 5 years

Software (acquired after 31st March 2016) 3 years

Consultancy and internal staff costs (acquired before 31st March 2016) 5 years

Consultancy and internal staff costs (acquired after 31st March 2016) 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. The purchase date may therefore place them in one category but the commencement of their economic life places them in another. Where this occurs the post March 2016 policy shall apply.

(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.

NOTES TO THE ACCOUNTS

(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.

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.

NOTES TO THE ACCOUNTS

(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.

(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

2016/17

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	No of vehicles and NBV of assets
Stores	Direct material costs

GENERAL ADMIN

Directly identifiable items	Direct
Other General Admin	Direct/Floor space/FTE's
Other Business Activities	Direct/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.

Major Changes in Cost Allocation Methodology

Employer pension and national insurance costs are now allocated directly by person, to the relevant cost centre.

NOTES TO THE ACCOUNTS

	Appointed	Non	Total	Appointed	Non	Total
	2017	Appointed	2017	2016	Appointed	2016
	£000	2017	£000	£000	2016	£000
2. REVENUE						
Unmeasured supplies	21,612	-	21,612	21,446	-	21,446
Measured supplies	14,893	-	14,893	14,098	-	14,098
Measured large users	2,175	-	2,175	2,028	-	2,028
Third party services	1,010	45	1,055	1,470	72	1,542
Other sources	25	-	25	99	-	99
	<u>39,715</u>	<u>45</u>	<u>39,760</u>	<u>39,141</u>	<u>72</u>	<u>39,213</u>

Measured Income Accrual

For the year 2015/16 the measured income accrual was £3,119,269, and the corresponding actual billed revenue was £3,286,027. This is a difference of £166,758.

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
	2017	Appointed	2017	2016	Appointed	2016
	£000	2017	£000	£000	2016	£000
Manpower costs	9,926	6	9,932	8,992	14	9,006
Other costs of employment	346	-	346	356	-	356
Power	2,203	-	2,203	2,063	-	2,063
Rates	2,163	-	2,163	2,118	-	2,118
Hired and contracted services	4,243	1	4,244	4,765	4	4,769
Materials and consumables	1,960	18	1,978	1,544	40	1,584
Service charges	1,322	-	1,322	1,323	-	1,323
Renewals expensed	4,212	-	4,212	1,752	-	1,752
Provision for bad and doubtful debts	785	-	785	810	-	810
Other operating costs	746	-	746	736	-	736
Depreciation and Amortisation	5,594	-	5,594	6,109	-	6,109
	<u>33,500</u>	<u>25</u>	<u>33,525</u>	<u>30,568</u>	<u>58</u>	<u>30,626</u>

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

	2017	2016
	£000	£000
Manpower as reported	9,926	8,992
Notional Pension Cost	(463)	(168)
	<u>9,463</u>	<u>8,824</u>
Manpower Cost for Efficiency and Price Determination purposes		

	Appointed	Non	Total	Appointed	Non	Total
	2017	Appointed	2017	2016	Appointed	2016
	£000	2017	£000	£000	2016	£000
4. OTHER OPERATING INCOME						
Loss arising on disposal of fixed assets	(143)	-	(143)	(562)	-	(562)

NOTES TO THE ACCOUNTS

	Appointed 2017 £000	Non Appointed 2017 £000	Total 2017 £000	Appointed 2016 £000	Non Appointed 2016 £000	Total 2016 £000
5. OTHER INCOME						
Rents	-	138	138	-	91	91
Home Assistance Service	-	1	1	-	1	1
Amortisation of Developer Contributions	582	-	582	582	-	582
	<u>582</u>	<u>139</u>	<u>721</u>	<u>582</u>	<u>92</u>	<u>674</u>
				2017		2016
6. INTEREST INCOME				£000		£000
Loan to Group Company				914		967
Interest on short term deposits				39		26
Other interest receivable				-		3
Other Finance Income (see note 22)				625		382
				<u>1,578</u>		<u>1,378</u>
				2017		2016
7. INTEREST EXPENSE				£000		£000
£66.5m loan						
- interest				3,621		3,564
- indexation				1,831		994
- amortisation of fees				57		57
- administration expenses				79		110
				<u>5,588</u>		<u>4,725</u>
Other bank loans and overdraft				97		41
Debenture stocks				10		10
Other interest payable				1		2
				<u>5,696</u>		<u>4,778</u>
				2017		2016
8. TAXATION (APPOINTED BUSINESS ONLY)				£000		£000
Current tax						
United Kingdom corporation tax at 20% (2016 - 20%)				254		1,300
Group relief surrendered				(95)		(149)
Adjustment in respect of prior periods				(789)		64
				<u>(630)</u>		<u>1,215</u>
Deferred tax						
Origination and reversal of timing differences				141		132
Effect of change to corporation tax rate				(501)		(695)
Difference between pension cost charge and pension cost relief				28		39
Adjustment in respect of prior periods				562		-
				<u>230</u>		<u>(524)</u>
Tax on profit on ordinary activities				<u>(400)</u>		<u>691</u>

NOTES TO THE ACCOUNTS

8. TAXATION (APPOINTED BUSINESS ONLY) (continued)

	2017 £000	2016 £000
The tax charge for the year is lower (2016 - lower) than the standard rate of Corporation tax in the UK of 20% (2016 - 20%), explained as follows:		
Profit on ordinary activities before tax	2,536	5,193
*Less EBT payment (RAG differences) (deductible)	<u>(1,206)</u>	<u>(1,059)</u>
Profit before tax (taxable)	1,330	4,134
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 20% (2016 - 20%)	266	827
Effect of:		
Depreciation on assets not qualifying for capital allowances	25	243
Other tax adjustments (including FRS102 transition)	(6)	196
Difference between pension cost charged and relieved	(32)	34
Prior year adjustment	(788)	64
Payments for group relief	<u>(95)</u>	<u>(149)</u>
Current tax charge for the year	<u>(630)</u>	<u>1,215</u>

*As set out in note 9, payments to employees as beneficiaries under the EOT are charged to operating profit, and tax deductible, in the statutory accounts. This is a RAG difference.

RECONCILIATION BETWEEN CURRENT TAX CHARGE AND CURRENT TAX IN PRICE LIMITS

		Statutory Accounts	GAAP Difference	Non- Appointed	Appointed	Final Determination	Tax Difference @20%
	Note	£'000	£'000	£'000	£'000	£'000	£'000
Profit before tax	1	1,489	1,206	(159)	2,536	3,669	227
Ofwat adjustments gearing	1	0			0	(1,337)	(267)
PBT adjusted for gearing	1	0			2,536	2,332	(41)
Add depreciation	2	5,594			5,594	3,453	(428)
Less Capital allowances		(5,467)			(5,467)	(5,070)	79
Pensions difference		(162)			(162)	94	51
Other adjustments	2	(27)			(27)	300	65
Treatment of EOT payment	4				(1,206)	0	241
Losses relieved	5	(475)			(475)	0	95
Adjusted profit chargeable to CT @20% tax rate		952		(159)	793	1,109	63
Current Tax		190		(32)	159	222	63
Prior Year adjustment	6	(789)			(789)	0	789
		<u>(599)</u>	0	(32)	<u>(630)</u>	222	852

We have analysed the differences between the current tax credit of (£0.630m) for the Appointed business against the tax charge calculated in the Final Determination of £0.222m. The significant movements (referenced above) are as follows:

1. PBT of £2.5m is lower than the FD. However, this should be further adjusted for by a charge of £1.3m which relates to the Ofwat net tax adjustment for gearing. This reflects the higher actual finance cost when compared to the notional finance cost included in the FD. After adjustment, the PBT is broadly comparable.
2. Actual depreciation outturn is higher than estimated in the Business Plan submission.
3. The FD assumed significant disallowable expenses which did not occur.
4. The EOT payment, treated as a dividend for regulatory purposes, is tax deductible and therefore generates a tax difference between the FD and actual results. The FD tax calculation does not model this as a tax deductible.
5. Group tax losses are utilised.
6. A significant PYA was generated on FRS102 conversion due to the tax treatment of previous infrastructure contributions on conversion.

NOTES TO THE ACCOUNTS

9. DIVIDENDS	2017 £000	2016 £000
Equity: Ordinary/'A' Ordinary		
- First interim paid	602	585
- Final paid	603	580
	1,205	1,165

The Directors are proposing the payment of a final dividend of £0.546m for the year ended 31 March 2017. 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.

In addition to the above, payments to employees, as beneficiaries under the Employee Ownership Trust, amounting to £1.210m 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 FD14, in that they are funded through the return on capital element of the Price Control building blocks.

	2017 £000	2016 £000
Dividend ultimately for group shareholders	408	397
Servicing of intercompany debt net of tax	797	768
Employee Ownership Trust	1,206	1,209
Deferred costs	4	-
Total Dividends	2,415	2,374

NOTES TO THE ACCOUNTS

10. TANGIBLE FIXED ASSETS

	Freehold land, buildings & reservoirs £'000	Mains £'000	Pumping Plant £'000	Vehicles, mobile plant & office equipment £'000	Total £'000
COST					
At 1st April 2016	53,114	55,171	46,684	19,768	174,737
Additions	1,856	1,442	4,418	1,647	9,363
Disposals	(84)	(74)	(306)	(429)	(893)
Reclass to intangible fixed assets				(1,895)	(1,895)
At 31st March 2017	54,886	56,539	50,796	19,091	181,312
DEPRECIATION					
At 1st April 2016	12,259	2,717	24,177	12,581	51,734
Charge for year	516	1,082	2,083	1,546	5,227
Disposals during year	(33)	(27)	(257)	(399)	(716)
Reclass to intangible fixed assets	-	-	-	(188)	(188)
At 31st March 2017	12,742	3,772	26,003	13,540	56,057
NET BOOK VALUE					
At 31st March 2017	42,144	52,767	24,793	5,551	125,255
At 1st April 2016	40,855	52,454	22,507	7,187	123,003

ASSETS IN THE COURSE OF CONSTRUCTION

Included in the above table are assets in the course of construction as follows:

	Freehold land, buildings & reservoirs £'000	Mains £'000	Pumping Plant £'000	Vehicles, mobile plant & office equipment £'000	Total £'000
COST					
At 1st April 2016	239	-	3,707	2,122	6,068
Additions	727	196	886	37	1,846
Transferred to Intangible fixed assets	-	-	-	(1,895)	(1,895)
Completed Tangible fixed assets	(239)	-	(3,707)	(227)	(4,173)
At 31st March 2017	727	196	886	37	1,846
DEPRECIATION					
At 1st April 2016	-	-	-	188	188
Transferred to amortisation within Intangible fixed assets	-	-	-	(188)	(188)
At 31st March 2017	-	-	-	-	-
NET BOOK VALUE					
At 31st March 2017	727	196	886	37	1,846
At 1st April 2016	239	-	3,707	1,984	5,880

No depreciation has so far been provided on the above cost.

NOTES TO THE ACCOUNTS

11. INTANGIBLE FIXED ASSETS

	Software, Consultancy and Internal Costs £'000
COST	
At 1st April 2016	127
Transferred from fixed assets	1,895
Additions	823
Disposals	(5)
At 31st March 2017	<u>2,840</u>
AMORTISATION	
At 1st April 2016	50
Transferred from fixed asset depreciation	188
Disposals	(2)
Charge for year	367
At 31st March 2017	<u>603</u>
NET BOOK VALUE	
At 31st March 2017	<u>2,237</u>
At 1st April 2016	<u>77</u>

Intangible fixed assets primarily comprise software costs and the in house development of bespoke software and related IT solutions. Included in the numbers above are £25,000 intangibles work in progress.

12. FIXED ASSET INVESTMENT

	Loan to Group Undertakings £000
At 1 April 2016	55,984
Repayment	(500)
At 31 March 2017	<u>55,484</u>

NOTES TO THE ACCOUNTS

13. DEBTORS	2017 £000	2016 £000
Trade debtors	4,950	3,631
Amounts owed by Group companies	281	14
Prepayments and accrued income	4,507	3,845
Other debtors	1,165	407
	<hr/>	<hr/>
	10,903	7,897
	<hr/>	<hr/>

All of the above amounts fall due within one year

As at 31 March 2017, trade debtors had a carrying value of £8.833m (2016 - £7.176m) 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 £3.883m as at 31 March 2017 (2016 - £3.545m).

The ageing of these debtors was as follows:

	2017 £000	2016 £000
Up to 12 months	4,414	4,040
Over 12 months	4,419	3,136
	<hr/>	<hr/>
	8,833	7,176
	<hr/>	<hr/>

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:

	2017 £000	2016 £000
As at 1 April 2016	3,545	3,355
Provision for bad debt required in the year	784	809
Debt written off in the year as uncollectable	(446)	(619)
	<hr/>	<hr/>
As at 31 March 2017	3,883	3,545
	<hr/>	<hr/>

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.

	2017 £000	2016 £000
Total Revenue Outstanding > 30 days		
- Household	5,136	4,883
- Non-household	789	197
	<hr/>	<hr/>
	5,925	5,080
	<hr/>	<hr/>

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

*In 2016/17 we calculated the non-household customer provision differently, under the Service Agreement with Castle Water Limited.

14. INVESTMENTS	2017 £000	2016 £000
Unlisted investments	2	2
15. CASH AT BANK AND IN HAND		
Of the total amount shown of £11.644m, £1.847m (2016 - £1.801m) is held specifically for the payment of the next half yearly loan interest charges.		
16. BORROWINGS: DUE WITHIN ONE YEAR	2017 £000	2016 £000
3% Perpetual debenture stock	60	60
3½% Perpetual debenture stock	185	185
4% Perpetual debenture stock	39	39
Bank loan	4,000	-
	4,284	284

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.

NOTES TO THE ACCOUNTS

	Appointed	Non	Total	Appointed	Non	Total
	2017	Appointed	2017	2016	Appointed	2016
	£000	2017	£000	£000	2016	£000
17. OTHER CURRENT LIABILITIES						
Payments received on account	2,351	-	2,351	2,414	-	2,414
Trade creditors	1,797	-	1,797	758	-	758
Amounts owed to Group companies	1,571	-	1,571	1,640	-	1,640
Other creditors	2,273	-	2,273	699	-	699
Accruals	1,510	-	1,510	1,010	-	1,010
Water rates in advance	6,424	-	6,424	6,934	-	6,934
	<u>15,926</u>	<u>-</u>	<u>15,926</u>	<u>13,455</u>	<u>-</u>	<u>13,455</u>
Trade and other payables						
Capex creditor	962	-	962	1,042	-	1,042
Current tax liabilities	280	-	280	624	-	624
Special Dividend (Brockhampton)	1,412	-	1,412	1,412	-	1,412
	<u>18,580</u>	<u>-</u>	<u>18,580</u>	<u>16,533</u>	<u>-</u>	<u>16,533</u>

18. NON-CURRENT LIABILITIES	2017	2016
	£000	£000
In five years or more:		
Bank loan	100,494	98,662
Less: deferred arrangement costs	(881)	(938)
	<u>99,613</u>	<u>97,724</u>

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.

19. DEFERRED INCOME: CAPITAL CONTRIBUTIONS	2017	2016
	£000	£000
Capital Contributions	25,594	25,011
Release of Capital Contribution to Turnover	(582)	(582)
	<u>25,012</u>	<u>24,429</u>

20. PROVISIONS FOR LIABILITIES	2017	2016
	£000	£000
DEFERRED TAXATION:		
At 1 April 2016	6,386	6,949
Charged during the year in profit and loss account	317	(563)
	<u>6,703</u>	<u>6,386</u>
At 31 March 2017		

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

NOTES TO THE ACCOUNTS

	2017	2016
	£000	£000
Deferred tax excluding that relating to pension asset:		
Accelerated capital allowances	8,068	9,905
Other timing differences	(1,365)	(3,519)
Pension asset (note 22)	2,344	3,200
	<hr/>	<hr/>
Total provision for deferred tax	9,047	9,586
	<hr/>	<hr/>
At 1 April 2016	9,586	9,206
Deferred tax charge in profit and loss account (note 8)	230	(524)
Deferred tax charged to the statement of total recognised gains and losses	(768)	904
	<hr/>	<hr/>
At 31 March 2017	9,047	9,586
	<hr/>	<hr/>

21. RESERVES

	Called up Share Capital £'000	Share Premium £'000	Capital Redemption £'000	Profit and Loss £'000	Total £'000
Balance at 1st April 2016	1,078	1,539	3,250	60,553	66,420
Profit for Financial Year	-	-	-	1,857	1,857
Remeasurement of net defined benefit asset	-	-	-	(4,147)	(4,147)
Movement on deferred tax relating to pension scheme	-	-	-	705	705
Effect of change to corporation tax rate on pension asset	-	-	-	63	63
Total comprehensive income for the year	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
	-	-	-	(1,522)	(1,522)
Dividends	-	-	-	(1,205)	(1,205)
Balance at 31st March 2017	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
	1,078	1,539	3,250	57,826	63,693

22. PENSIONS

Portsmouth Water Limited, a subsidiary undertaking, 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 2016 was updated to the 31 March 2017 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 by Portsmouth Water Ltd for the year commencing 1 April 2017 is £1.3m (2016 actual: £1.4m). Of this amount, £1.0m 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:

	2017	2016	2015
	% per annum	% per annum	% per annum
RPI inflation	3.3	3.0	3.1
CPI inflation	2.4	2.1	2.2
Discount rate	2.4	3.4	3.2
Pension increases	2.4	2.1	2.2
Salary growth	4.4	5.25	5.35

NOTES TO THE ACCOUNTS

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:

		2017 Fair Value £000		2016 Fair Value £000		2015 Fair Value £000
Equities	35	56,931	34	47,932	44	63,285
Absolute Return Fund	24	38,439	23	33,134	6	8,912
Bonds	-	-	-	-	40	58,372
LDI	22	36,552	21	29,557	-	-
Property	9	14,653	10	14,032	3	4,102
Cash and other	10	16,733	12	17,125	7	9,544
		<hr/>		<hr/>		<hr/>
	100	163,308	100	141,780	100	144,215
		<hr/>		<hr/>		<hr/>

	2017 £000	2016 £000
Total fair value of scheme assets	163,308	141,780
FRS 17 value of scheme liabilities	(149,518)	(124,005)
	<hr/>	<hr/>
Gross pension asset	13,790	17,775
Related deferred tax liability	(2,344)	(3,200)
	<hr/>	<hr/>
Net pension asset	11,446	14,575
	<hr/>	<hr/>

Under FRS 102, the scheme is represented on the statement of financial position at 31 March 2017 by an asset of £13.790m (2016 - £17.775m), which amounts to £11.446m net of deferred tax (2016 - £14.575m).

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 £184,794 (2016 - £136,433).

Movement in the net balance sheet position

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

	2017 £000	2016 £000
Opening asset	17,775	11,287
Expense charged to profit and loss	(1,113)	(1,113)
Gain recognised outside of profit and loss	(4,147)	6,274
Employer contributions	1,275	1,327
	<hr/>	<hr/>
Closing asset	13,790	17,775
	<hr/>	<hr/>

Movement in present value of defined benefit obligation

The FRS 102 value of scheme defined benefit obligation moved over the period as follows:

Opening scheme liabilities	124,005	132,928
Employer's part of current service cost	1,738	1,495
Interest on scheme liabilities	4,145	4,191
Benefits paid	(4,245)	(3,971)
Actuarial (gain)/loss	23,875	(10,638)
	<hr/>	<hr/>
Closing scheme defined benefit obligation	149,518	124,005
	<hr/>	<hr/>

NOTES TO THE ACCOUNTS

Movement in fair value of scheme assets

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

Opening fair value of scheme assets	141,780	144,215
Interest on scheme assets	4,770	4,573
Contributions by the Company, including employee contributions under the SMART arrangement	1,275	1,327
Benefits paid	(4,245)	(3,971)
Actuarial (loss)/gain	19,728	(4,364)
	<hr/>	<hr/>
Closing fair value of scheme assets	163,308	141,780
	<hr/>	<hr/>

Expense recognised in Income Statement

The following amounts have been included within operating profit:

Current service cost (employer's part only)	(1,738)	(1,495)
	<hr/>	<hr/>
Total operating charge	(1,738)	(1,495)
	<hr/>	<hr/>

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

Interest on pension scheme assets	4,770	4,573
Interest on pension scheme defined benefit obligation	(4,145)	(4,191)
	<hr/>	<hr/>
Net return	625	382
	<hr/>	<hr/>
Total return recognised in the Income Statement	(1,113)	(1,113)
	<hr/>	<hr/>

Amounts recognised outside Income Statement

The following amounts have been recognised within the Statement of Changes in Equity:

	2017	2016
	£000	£000
Actual return less interest	(19,728)	4,364
Experience gains arising on scheme defined benefit obligation	(2,567)	(4,398)
Loss/(gain) due to changes in assumptions	26,442	(6,240)
	<hr/>	<hr/>
Remeasurement loss/(gain) of net defined benefit asset	4,147	(6,274)
	<hr/>	<hr/>

The actual return on plan assets was £24.498m in the year to 31 March 2017 (2016 - £0.209m).

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.

23. POST BALANCE SHEET EVENT

On 1 April 2017, as previously disclosed, the Company disposed of its non-household retail activities to Castle Water Limited upon the opening of the new non-household retail market. The Directors do not consider that this represents a separate major line of business as the Company will retain retail activity for household customers together with the wholesale activity for both household and non-household customers. In addition retail non-household represents an immaterial portion of annual turnover of under £0.6m (1% of turnover). As such it has not been treated as a discontinued operation. Total proceeds of £2.9m were paid in advance and include the fair value of meter reading services for a period of 5 years.

SECTION 2 PRICE REVIEW AND OTHER SEGMENTAL REPORTING

2A SEGMENTAL INCOME STATEMENT FOR THE APPOINTED BUSINESS

For the 12 months ended 31 March 2017

Current year

	Retail		Wholesale			Total
	Household	Non-Household	Water Resources	Water Network+	Water Total	
	£'000	£'000	£'000	£'000	£'000	£'000
Revenue - price control	4,616	548		33,516	33,516	38,680
Revenue - non-price control	0	0		1,035	1,035	1,035
Operating expenditure	(4,026)	(1,249)	(3,095)	(19,536)	(22,631)	(27,906)
Depreciation - tangible fixed assets	(113)	(6)	(228)	(4,880)	(5,108)	(5,227)
Amortisation - intangible fixed assets	0	0	0	(367)	(367)	(367)
Other operating income	0	0	0	(143)	(143)	(143)
Operating profit before recharges	477	(707)			6,302	6,072
Recharges from other segments	(182)	(10)	(31)	0	(31)	(223)
Recharges to other segments	0	0	0	223	223	223
Operating profit	295	(717)			6,494	6,072

2B TOTEX ANALYSIS FOR THE APPOINTED BUSINESS – WHOLESALE WATER

For the 12 months ended 31 March 2017

£'000	Water Resources	Water Network+	Water Total
Operating expenditure			
Power	396	1,732	2,128
Service charges/ discharge consents	1,322	0	1,322
Bulk supply/ Bulk discharge	0	0	0
Other operating expenditure	1,128	15,560	16,688
Local authority and Cumulo rates	249	1,680	1,929
Total operating expenditure excluding third party services	3,095	18,972	22,067
Third party services	0	564	564
Total operating expenditure	3,095	19,536	22,631
Capital expenditure			
Maintaining the long term capability of the assets - infra	0	55	55
Maintaining the long term capability of the assets - non-infra	17	5,627	5,644
Other capital expenditure - infra	0	1,354	1,354
Other capital expenditure - non-infra	257	2,876	3,133
Total gross capital expenditure (excluding third party)	274	9,912	10,186
Third party services	0	0	0
Total gross capital expenditure	274	9,912	10,186
Grants and contributions	0	1,166	1,166
Totex	3,369	28,282	31,651

2C OPERATING COST ANALYSIS – RETAIL

For the 12 months ended 31 March 2017

£'000	Household	Non- Household	Total
Operating expenditure			
Customer services	1,618	148	1,766
Debt management	282	44	326
Doubtful debts	428	357	785
Meter reading	104	21	125
Services to developers	0	80	80
Other operating expenditure	1,594	599	2,193
Total operating expenditure excluding third party services	4,026	1,249	5,275
Third party services operating expenditure	0	0	0
Total operating expenditure	4,026	1,249	5,275
Depreciation - tangible fixed assets	113	6	119
Total operating costs	4,139	1,255	5,394
Debt written off	405	41	446

2D HISTORIC COST ANALYSIS OF TANGIBLE FIXED ASSETS - WHOLESALE & RETAIL

£'000	Wholesale		Retail		Total
	Water Resources	Water Network+	Household	Non-Household	
Cost					
At 1 April 2016	13,518	159,964	1,190	65	174,737
Reclassification	0	(27)	27	0	0
Disposals	0	(806)	(83)	(4)	(893)
Additions	54	9,309	0	0	9,363
Reclass to intangible fixed assets	0	(1,895)	0	0	(1,895)
At 31 March 2017	13,572	166,545	1,134	61	181,312
Depreciation					
At 1 April 2016	3,132	47,925	642	35	51,734
Reclassification	0	(79)	76	3	0
Disposals	0	(629)	(83)	(4)	(716)
Charge for year	228	4,880	113	6	5,227
Reclass to intangible fixed assets	0	(188)	0	0	(188)
At 31 March 2017	3,360	51,909	748	40	56,057
Net book amount at 31 March 2017	10,212	114,636	386	21	125,255
Net book amount at 1 April 2016	10,386	112,039	548	30	123,003
Depreciation charge for year					
Principal Services	228	4,880	113	6	5,227
Third Party Services	0	0	0	0	0
Total	228	4,880	113	6	5,227

The net book value includes £1.8m in respect of assets in the course of construction. This is all in the Water Network+ business unit.

2E ANALYSIS OF CAPITAL CONTRIBUTIONS AND LAND SALES - WHOLESALE

For the 12 months ended 31 March 2017

£'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	601	0	0	601
Infrastructure charge receipts (s146)	0	787	0	787
Requisitioned mains (s43, s55 & s56)	0	379	0	379
Diversions (s185)	0	0	0	0
Other Contributions	0	0	0	0
Total	601	1,166	0	1,767

	Current year	
	Water	Total
Balance sheet		
Brought forward	24,429	24,429
Capitalised in year	1,166	1,166
Amortisation (in income statement)	(582)	(582)
Carried forward	25,013	25,013

	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.

2F & 2G REVENUES BY CUSTOMER TYPE

For the 12 months ended 31 March 2017

2F 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	18.305	3.000	21.305	207.197	14
Measured water only customer	6.788	1.616	8.404	84.212	19
Total	25.093	4.616	29.709	291.409	16

2G NON-HOUSEHOLD

	Wholesale charges revenue	Retail revenue	Total revenue	Number of connections	Average non-household retail revenue per connection
	£m	£m	£m	000s	£
Default tariffs					
Unmeasured Water Customer	0.273	0.035	0.308	1,688	21
Measured Water Customer < 10Ml	4.205	0.400	4.605	13,783	29
Measured Water Customer >10Ml and < 50Ml	1.825	0.058	1.883	139	417
Measured Water Customer > 50Ml	2.120	0.055	2.175	31	1,774
Total default tariffs	8.423	0.548	8.971	15,641	35
Non-Default tariffs					
Total non-default tariffs	0.000	0.000	0.000	0	N/A
Total	8.423	0.548	8.971	15,641	35
Revenue per customer				Number of customers	Average non-household retail revenue per customer
				000s	£
Total				15,641	35

2I REVENUE ANALYSIS AND WHOLESALE CONTROL RECONCILIATION

For the 12 months ended 31 March 2017

£'000	Current year		Total
	Household	Non-Household	
Wholesale charge - water			
Unmeasured	18,305	273	18,578
Measured	6,788	8,150	14,938
Third party revenue	0	0	0
Water Total	25,093	8,423	33,516
Wholesale Total	25,093	8,423	33,516
Retail revenue			
Unmeasured	3,000	35	3,035
Measured	1,616	513	2,129
Other third party revenue	0	0	0
Retail Total	4,616	548	5,164
Third party revenue - non-price control			
Bulk supplies	0	60	60
Other third party revenue	0	950	950
Principal Services - non-price control			
Other appointed revenue	0	25	25
Total appointee revenue	29,709	10,006	39,715

	Current year	
	Water	Total
Wholesale revenue governed by price control	33,516	33,516
Grants and Contributions ¹	1,166	1,166
Total revenue governed by wholesale price control	34,682	34,682
Amount assumed in wholesale determination	33,912	33,912
Adjustment for WRFIM		
Total assumed revenue	33,912	33,912
Difference²	770	770

¹ Relevant capital contributions as defined in FD

² Narrative explanation on page 45

NOTES ON THE PRICE REVIEW AND OTHER SEGMENTAL REPORTING

RETAIL PRICE CONTROL ANALYSIS

Household Retail

Operating expenditure within the household retail business was lower than the business plan assumptions with 2016/17 showing a profit, following a loss in 2015/16.

The principal variations were as follows:-

- **Doubtful Debts.** We revised our provisioning methodology in the year, with the provision being made against bills outstanding over 8 weeks, rather than against all unpaid bills. This reduced the provision by £0.375m compared to the previous financial year.
- **IT Costs.** We have revisited and refined our allocation of IT costs across the business. This reduced the IT charge to the Household Retail business by £0.095m compared to 2015/16.

Non-Household Retail

Operating expenditure in the non-household retail business was considerably higher than in the Business Plan. In late 2015 we took a strategic decision to exit the retail market and chose to outsource the billing and customer contact activity from April 2016 to Castle Water, with them acquiring non-household retail activity with effect from market opening on 1 April 2017.

The principal variations were as follows:-

- **Castle Outsource Agreement.** During the year, prior to market opening, we implemented an outsourcing agreement with Castle Water in order to de-risk the transition process for customers prior to exit. This additional operating cost of £0.522m was only marginally offset by a reduction in costs within Portsmouth Water, as we prepared for Open Water and managed the customer transition to Castle Water, ensuring levels of service were maintained during this period.
- **Doubtful Debts.** A provision has been raised in respect of revenue billed by Castle Water within the Outsource Agreement that has yet to be collected. This provision is £0.350m greater than the previous financial year, reflecting ageing in the debtor book.

WHOLESALE CONTROL RECONCILIATION

REVENUE £'000	Actual	FD	Difference
Wholesale Charge:			
Household – Unmeasured	18,305	17,752	553
Household - Measured	6,788	6,256	532
Non-Household - Unmeasured	273	244	29
Non-Household - Measured	8,150	8,674	(524)
Total revenue from charges	33,516	32,926	590
Grants and Contributions	1,166	986	180
TOTAL REVENUE	34,681	33,912	770

We have compared actual revenue with that implicit in tariff setting for 2016/17, and this complied with the Final Determination.

The Wholesale revenue variance is £0.770m reflecting additional revenue from standard charges of £0.590m and greater capital contributions from developers for mains of £0.180m.

The non-household measured wholesale revenue reflects lower property consumption than assumed. This reduction is further exacerbated by the fact that we have reclassified some non-household properties in preparation for the Non-Household Retail Market.

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.

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 position going forward.

The variance of wholesale charges relative to the Final Determination is 1.8%.

The total variance of wholesale revenue relative to the Final Determination is 2.3%.

SECTION 3 PERFORMANCE SUMMARY

OUTCOME PERFORMANCE TABLE 3A

Row	Unique ID	Performance commitment	Unit	Unit description	Decimal places	2015-16 performance level - actual	2016-17 performance level - actual	2016-17 CPL met?	2016-17 reward or penalty (in-period ODI(s))	2016-17 notional reward or penalty accrued	2016-17 notional reward or penalty accrued £m (4 DPs)	Total AMP6 reward or penalty 31 March 2020 forecast	Total AMP6 reward or penalty 31 March 2020 forecast £m (4 DPs)
1	PR14PRTWSW_A1	A1: Bursts	nr	No. of burst mains per year	0	219	298	Yes	-	-	-	-	-
2	PR14PRTWSW_A2	A2: Water quality standards	%	Mean zonal compliance (%)	2	99.94	99.99	Yes	-	-	-	Penalty	-0.3190
3	PR14PRTWSW_A3	A3: Water quality contacts	nr	No. contacts per 1,000 population served	3	0.57	0.670	No	-	-	-	-	-
4	PR14PRTWSW_A4	A4: Temporary usage bans	nr	No. of temporary usage bans per year	0	0	0	Yes	-	-	-	-	-
5	PR14PRTWSW_B1	B1: Leakage	nr	Megalitres per day (M/d)	2	28.06	30.37	No	-	-	-	-	-
6	PR14PRTWSW_C1	C1: Interruptions to supply	time	Mins.secs per property per year	mins.secs	3 min 30 secs	4 min 9 secs	Yes	-	-	-	-	-
7	PR14PRTWSW_D1	D1: Biodiversity	%	% (completion of agreed actions)	0	20	40	Yes	-	-	-	-	-
8	PR14PRTWSW_D2	D2: Water Framework Directive (WFD)	text	Programme completion	na	Progress as planned	Progress as planned	Yes	-	-	-	-	-
9	PR14PRTWSW_D3	D3: Carbon	%	Energy sourced from renewables (% increase)	0	> 95%	> 95%	Yes	-	-	-	-	-
10	PR14PRTWSW_E1	E1: RoSPA Health and Safety accreditation	text	RoSPA Gold award	na	Awarded	Awarded	Yes	-	-	-	-	-
11	PR14PRTTHR_A1	A1: Service incentive mechanism (SIM)	text	Service incentive mechanism (SIM) score ranking	na	89.5	87.7	-	-	-	-	-	-
12	PR14PRTTHR_B1	B1: Reducing per capita consumption (PCC)	nr	Litres per head per day (l/h/d)	2	143.29	145.10	Yes	-	-	-	-	-
13	PR14PRTTHR_C1	C1: Survey of developers	%	Satisfaction rate (%)	0	89	85	Yes	-	-	-	-	-

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 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 27 June 2017.

The actual Leakage performance commitment (Row 5 of the table) for 2015/16 should be adjusted to 28.23 MI/day, following assurance work by Atkins this year.

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 two.

2016/17 performance

Table 3A shows the impact of performance in 2015/16 and 2016/17, 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%, in 2015/16. This sum of money was 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 both 2015/16 and 2016/17, we believe there is scope to improve and mitigate the impact of this performance as this is a five year target. Finally, the Company failed its 2016/17 leakage targets. However, given this is a five year target, there is no reward or penalty recognised at this stage of the five year period.

All other ODIs have exceeded expectation in 2016/17 and if this performance is maintained for the period rewards will apply. Specifically for 5 of our ODIs which are measured on an on-going basis namely bursts, temporary usage bans, 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 placed 3rd 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 2017.

3C AIM TABLE

For the 12 months ended 31 March 2017

Abstraction Site	2016/17 AIM Performance MI	2016/17 Normalised AIM Performance	Cumulative AIM Performance 2016/17 MI	Cumulative Normalised AIM performance 2016/17	Contextual Information relating to AIM Performance
Northbrook	0	0	0	0	-

The AIM encourages water companies to reduce the environmental impacts of abstracting water at sensitive sites, where water is scarce. Portsmouth Water had 2 sites which were mentioned in the 2014 Business Plan.

The Walderton abstraction site influences the River Ems flow gauge. This is an 'augmented' river with Portsmouth Water providing compensation water when flows fall below a trigger called Q_{95} . During 2016/17 the Company agreed a licence variation which included an increased augmentation flow and a more sustainable discharge point. These National Environment Programmes (NEP) outcomes have been signed off by the Environmental Agency and Walderton is no longer part of the AIM reporting requirements.

The second site is Northbrook, which is also covered by an NEP scheme, and this influences the River Hamble. Performance is monitored at the Frog Mill flow gauge, which is maintained by the Environment Agency. The NEP scheme has been partially completed with drainage and access improvement designed to improve water quality. Unfortunately, the final part of the scheme has been delayed due to the problems with land ownership/access.

AIM performance is based on Q_{95} flows and recent actual abstraction. At Northbrook the flow trigger ($Q_{95} = 0.104\text{m}^3/\text{s}$) was not reached in 2016/17. This means that the AIM performance is zero and Table 3C has zero entries. It is anticipated that the NEP scheme will be completed in 2017/18 and that the Northbrook site will also be removed from AIM reporting.

3D SIM SCORE TABLE

For the 12 months ended 31 March 2017

	Units	Score
Qualitative Performance		
1st Survey Score	score	4.47
2nd Survey Score	score	4.58
3rd Survey Score	score	4.30
4th Survey Score	score	4.56
Qualitative SIM Score (out of 75)		65.25

	Units	Score
Quantitative Performance		
Quantitative Composite Score	score	50.56
Quantitative SIM Score (out of 25)		22.47

SIM Score		
Total Annual SIM score (out of 100)		88

SECTION 4 ADDITIONAL REGULATORY INFORMATION

4A NON-FINANCIAL INFORMATION

For the 12 months ended 31 March 2017

Retail - Household	Current year	
	Unmeasured	Measured
Number of void households ('000s)	5.341	1.380
Per capita consumption (excluding supply pipe leakage) l/h/d	150	128

Wholesale	Current year
	Water
Wholesale Volume (MI/d)	
Bulk supply export	1.16
Bulk supply import	0.00
Distribution input	170.0

4B WHOLESALE TOTEX ANALYSIS

£m	Current year	Cumulative 2015-2020
	Water	Water
Actual Totex	31.651	59.193
Less: Items excluded from the menu		
Pension deficit recovery costs	0.000	0.000
Third party costs	0.116	0.427
*Other 'Rule Book' adjustments	0.344	0.469
Total costs excluded from the menu	0.460	0.896
Adjusted Actual totex	31.191	58.297
Adjusted Actual totex - base year prices	28.802	54.372
Allowed totex based on final menu choice - base year prices	28.693	55.119
Variance - base year prices	(0.109)	0.747

* Wholesale share of FRS17 pension cost

The cumulative amounts excluded from the menu include a prior year adjustment of £0.436m, for items not excluded, in error.

TOTEX VARIANCE ANALYSIS

The allowed totex in the Final Determination is £29.428m, in 2012/13 prices. However, the totex menu choice that the Company made was at the original Business Plan submission level of £28.693m. Using the menu choice adopted, this gives a variance to actual totex of (£0.109m), in base year prices. In 2016/17 prices, the following table shows this variance for each element of totex.

2016/17 Prices	Business Plan 2016/17	Actual 2016/17	Variance 2016/17
Operating Expenditure	16,827	17,959	(1,132)
Renewals	5,505	4,212	1,293
Capital Expenditure	9,717	10,186	(469)
Grants and Contributions	(976)	(1,166)	190
WHOLESALE TOTEX	31,073	31,191	(118)

WHOLESALE TOTEX ANALYSIS

Operating Expenditure

The increase in operating expenditure of £0.918m, for the Wholesale business only, is due to the following:

- Wages and salaries, including pension costs increased by c£0.7m driven by higher headcount supporting increased business activity (driven by open water and the implementation of a major IT system) together with further increases in pension costs.
- Additional Open water costs of £0.2m driven by MOSL fees and professional fees for market assurance which were not fully recognised in the business plan.
- Rates increased beyond those allowed of £0.150m.
- Investment department activity not capitalised £0.377m. This was all assumed to be capital in the Business Plan.

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

Renewals

The renewals expenditure for the year was less than the Business Plan by £1.293m. This was due to the following:

- Slight reduction in activity in the year, with only 21.6km of pipe being renewed, compared to 22km in the Business Plan. This was due to the new contractor being unable to recruit in time. For the rest of the AMP, 24km will be renewed each year, to make up for the reduction in the first 2 years of the AMP.
- Lower prices from the new contractor and new installation technology. We have achieved 65% no-dig installations, as compared to 23% in AMP5.

Capital Expenditure

Capital expenditure is higher than the Business Plan by £0.469m. The primary movements are as follows:

- Several capital schemes were brought forward to 2016/17 (from 2017/18), to comply with the DWI undertakings. These related to the new Eastergate and Westergate crypto treatment plants. Expenditure on these in the year was £1.7m, which is only £0.1m higher than in the Business Plan for that year, but the schemes are complete one year earlier than planned.
- An amount of £2.5m for 2016/17 was included in the Business Plan for the Farlington Wash Water Recovery Plant. However, £3.5m was spent in the year on this scheme and it will be completed a year earlier than planned.
- New mains was higher than the Business Plan by £0.7m, but this is offset by higher Grants and Contributions of £0.2m.
- Optional Metering was lower than the Business Plan by £0.3m.
- 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.
- Water quality contact time expenditure of £0.9m was delayed to 2017/18.
- Other schemes delayed until later in the AMP are SEMD, Boosters and the Meter Yearly Replacement Programme.

4C IMPACT OF AMP PERFORMANCE TO DATE ON RCV

£m	Year to Date
RCV determined at FD at 31 March	135.697
RCV element of cumulative Totex over/underspend so far in the price control period	(0.575)
Adjustment for ODI rewards or penalties	0
Projected 'shadow' RCV	135.122

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

4D WHOLESALE TOTEX ANALYSIS - WATER

For the 12 months ended 31 March 2017

£'000	Water resources		Network +				Total
	Abstraction licences	Raw water abstraction	Raw water transport	¹ Raw water storage	Water treatment	Treated water distribution	
Operating expenditure							
Power	0	396	275	2	253	1,202	2,128
Income treated as negative expenditure	0	0	0	0	0	0	0
Abstraction charges/ discharge consents	1,322	0	0	0	0	0	1,322
Bulk supply/ Bulk discharge	0	0	0	0	0	0	0
Other operating expenditure	0	1,128	211	9	2,832	12,508	16,688
Local authority rates	0	249	177	0	1,016	487	1,929
Total operating expenditure excluding third party services	1,322	1,773	663	11	4,101	14,197	22,067
Third party services	0	0	0	0	0	564	564
Total operating expenditure	1,322	1,773	663	11	4,101	14,761	22,631
Capital expenditure							
Maintaining the long term capability of the assets - infra	0	0	0	0	0	55	55
Maintaining the long term capability of the assets - non-infra	0	17	0	14	3,681	1,932	5,644
Other capital expenditure - infra	0	0	0	0	0	1,354	1,354
Other capital expenditure - non-infra	0	257	0	0	1,704	1,172	3,133
Total gross capital expenditure (excluding third party)	0	274	0	14	5,385	4,513	10,186
Third party services	0	0	0	0	0	0	0
Total gross capital expenditure	0	274	0	14	5,385	4,513	10,186
Grants and contributions						(1,166)	(1,166)
Totex	1,322	2,047	663	25	9,486	18,108	31,651
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	1,322	2,047	663	25	9,486	18,108	31,651
Unit cost information (operating expenditure)							
	Licensed volume available	Volume abstracted	Volume transported	¹ Average volume stored	Distribution input volume	Distribution input volume	
Volume (MI)	115,705	64,415	62,065	135	62,065	62,065	
Unit cost (£/MI)	11.43	27.52	10.68	81.48	66.08	237.83	
Population	721,640	721,640	721,640	721,640	721,640	721,640	
Unit cost (£/pop)	1.83	2.46	0.92	0.02	5.68	20.45	

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.

4F OPERATING COST ANALYSIS – HOUSEHOLD RETAIL

For the 12 months ended 31 March 2017

£'000	Household Unmeasured	Household Measured	Total
	Water only	Water only	
Operating expenditure			
Customer services	1,124	494	1,618
Debt management	244	38	282
Doubtful debts	399	29	428
Meter reading	0	104	104
Other operating expenditure	1,134	460	1,594
Total operating expenditure excluding third party services	2,901	1,125	4,026
Depreciation	80	33	113
Total operating costs excluding third party services	2,981	1,158	4,139

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

**4G WHOLESALE CURRENT COST FINANCIAL PERFORMANCE
INCOME STATEMENT**

For the 12 months ended 31 March 2017

£'000	Note	Water	Total
Revenue		34,551	34,551
Operating expenditure		(22,631)	(22,631)
Capital maintenance charges	1	(11,615)	(11,615)
Other operating income		(143)	(143)
Current cost operating profit		162	162
Other income		582	582
Interest income		1,578	1,578
Interest expense		(5,696)	(5,696)
Other Interest expense		0	0
Current Cost Profit before tax and fair value movements		(3,374)	(3,374)
Fair value gains/(losses) on financial instruments		0	0
Current Cost Profit before tax		(3,374)	(3,374)

NOTES ON THE WHOLESALE CURRENT COST FINANCIAL PERFORMANCE

1. CAPITAL MAINTENANCE CHARGES

The Capital Maintenance charges (£11,481) include the Wholesale amount of the Current Cost Depreciation £6.111m and the Infrastructure Renewals Charge £5.504m.

Current Cost Depreciation

	Operational Assets	Infrastructure Assets	Other Tangible Assets	Total
GROSS REPLACEMENT COSTS				
At 1st April 2016	238,444	1,023,392	22,733	1,284,569
Reclass to Intangibles Adjustment			(1,930) (22)	(1,930) (22)
RPI Adjustment	7,487	32,140	639	40,266
Disposals		-	(434)	(434)
Additions	6,507	1,246	1,610	9,363
At 31st March 2017	252,438	1,056,778	22,596	1,331,812

DEPRECIATION

At 1st April 2016	112,008	-	14,404	126,412
Reclassification Adjustment	18		(192) (15)	(192) 3
RPI Adjustment	3,518		440	3,958
Disposals during year			(392)	(392)
Charge for year	4,684		1,523	6,207
At 31st March 2017	120,228	-	15,768	135,996

NET BOOK VALUE

At 31st March 2017	132,200	1,056,778	6,828	1,195,816
At 1st April 2016	126,436	1,023,392	8,329	1,158,157

DEPRECIATION

WHOLESALE	4,684	-	1,427	6,111
RETAIL	-	-	96	96
	4,684	-	1,523	6,207

Infrastructure Renewals Charge

Estimation of Infrastructure Renewals Charge at 2016/17 prices

	£'000	
Actual expenditure 16/17	4,212	
Budget 2017/18	4,854	(£5,000k at 17/18 prices)
Business Plan 2018/19 - 2031/32	5,653	
Average Cost over 15 years	5,504	

4H FINANCIAL METRICS

For the 12 months ended 31 March 2017

	Units	Metric
Net debt	£m	93.134
Regulated equity	£m	42.563
Regulated gearing	%	68.63
Post tax return on regulated equity	%	7.84
*RORE (return on regulated equity)	%	3.99
Dividend yield	%	3.52
Retail profit margin - Household	%	1.61
Retail profit margin - Non-Household	%	-7.88
Credit rating	n/a	BBB
Return on RCV	%	5.53
Dividend cover	dec	1.96
Funds from operations (FFO)	£m	8.724
Interest cover (cash)	dec	3.29
Adjusted interest cover (cash)	dec	1.92
FFO/Debt	dec	0.09
Effective tax rate	%	-24.84
Free cash flow (RCF)	£m	6.439
RCF/capex	dec	0.54

Revenue (actual)	£m	38.680
EBITDA (actual)	£m	10.774

Proportion of borrowings which are fixed rate	%	0.27
Proportion of borrowings which are floating rate	%	3.82
Proportion of borrowings which are index linked	%	95.91
Proportion of borrowings due within 1 year or less	%	3.82
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	%	0
Proportion of borrowings due in more than 5 years but no more than 20 years	%	95.91
Proportion of borrowings due in more than 20 years	%	0.27

* Cumulative average ratio over 2015/16 and 2016/17.

COMMENTARY ON THE RORE FINANCIAL METRIC

RORE MOVEMENTS COMPARED TO BASE RORE SET AT PR14

RORE metrics were set at the last price review, for each of the 5 years of the AMP.

2015/16 FD RORE 5.88%
2016/17 FD RORE 5.87%

Adjustments have been made to these metrics, to reflect the actual results in 2015/16 and 2016/17. The adjustments are explained below, and all numbers are in 2012/13 prices:

2015/16 Adjusted RORE 4.01%
2016/17 Adjusted RORE 3.97%

The average RORE for the first 2 years of the AMP is 3.99%.

2012/13 PRICES	2015/16	2016/17	
NET INCOME – Final Determination	2.644	2.680	Used to calculate FD RORE %'s
PAYG adjustment	(0.492)	(0.512)	Includes Totex, Retail and ODI variances
TOTEX depreciation adjustment	0.005	0.005	Based on run-off rate of 3.8%
Interest adjustment	(0.569)	(0.578)	Based on real cost of debt of 3.6%
Tax on adjustments	0.211	0.217	Tax rate of 20%
NET INCOME - Adjusted	1.799	1.812	Used to calculate adjusted RORE %'s
REGULATED EQUITY	44.930	45.623	
Adjusted RORE	4.01%	3.97%	

Totex Adjustments

These reflect favourable Wholesale variances of £1.093m in 2015/16 and £0.492m in 2016/17, of which 75.7% is PAYG opex and 24.3% is added to the RCV, and depreciated at a run-off rate of 3.8%. There is also a cost-sharing arrangement for the Totex over-performance of 50.7%. The favourable variances relate mainly to savings in the renewals programme as a result of the appointment of a new contractor and improved technology.

Retail Operating Cost Adjustments

These reflect the adverse Retail operating cost variances of £0.613m in 2015/16 and £0.701m in 2016/17. See commentary on page 45 for an explanation of these variances.

ODI Adjustments

A penalty was incurred in 2015/16 of £0.298m, relating to water quality failures.

Interest Cost Adjustments

These reflect the higher actual cost of debt as compared to the Final Determination of 2.84%. The actual cost of debt is 3.6% and this is applied to the notional level of net debt. The difference between this and the interest allowed in the FD is used to adjust the RORE metric. These adjustments are £0.569m in 2015/16 and £0.577m in 2016/17.

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 £55.484m. A repayment of £0.500m 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 £913,559 in respect of the inter-company loan made to South Downs Limited in 2002 (as covered above) was 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 29 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 £167k (2016 cash paid £107k).

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	315*	Market Tested	92
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 £315k of which £181k relates to total rental income and £134k relates to total income from solar power.

Directors Remuneration

There is a recharge of Directors salaries amounting to £51,691 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 2016/17.

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:

- have been properly prepared in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA (RAG1.07, RAG2.06, RAG3.09, RAG4.06 and RAG5.06) and the accounting policies (including the company's published accounting methodology statement as defined in RAG 3.09, appendix 3), set out on page 25.

Emphasis of matter - basis of preparation

Without modifying our opinion on the Regulatory Accounting Statements within the Annual Performance Report, we draw attention to the fact that the Annual Performance Report has been prepared in accordance with Condition F, the Regulatory Accounting Guidelines, the accounting policies (including the company's published accounting methodology statement, as defined in RAG 3.09, appendix 3) set out in the statement of accounting policies and under the historical cost convention. The nature, form and content of the Regulatory Accounts statements are determined by the WSRA. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the WSRA's purposes. Accordingly we make no such assessment.

The Annual Performance Report is separate from the statutory financial statements of the Company and has not been prepared under the basis of United Kingdom Generally Accepted Accounting Practice ("UK GAAP"). 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 Regulatory Accounting Statements on pages 15 to 20 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 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 comprising the segmental income statement (table 2A), the totex analysis for wholesale water and wastewater (table 2B), the operating cost analysis for retail (table 2C), the historical cost analysis of fixed assets for wholesale and retail (table 2D), the analysis of capital contributions and land sales for wholesale (table 2E), the household water revenues by customer type (table 2F), the non-household water revenues by customer type (table 2G), the non-household wastewater revenues by customer type (table 2H) 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 impact of AMP performance to date on RCV (table 4C), the wholesale totex analysis - water (table 4D), the operating cost analysis – household retail (table 4F) and the wholesale current cost financial performance income statement (4G).

The financial reporting framework that has been applied in their preparation comprises Condition F, the Regulatory Accounting Guidelines issued by the WSRA and the accounting policies (including the Company's published accounting methodology statement, as defined in RAG 3.09, appendix 3) 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 (tables 3A to 3D).

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 13, the directors are responsible for the preparation of the Annual Performance Report in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA and the Company's accounting policies (including the Company's published accounting methodology statement, as defined in RAG 3.09, appendix 3).

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 ICAEW Technical Release Tech 02/16 AAF 'Reporting to Regulators on Regulatory Accounts' 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 and tables within 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 International Standards on Auditing (UK & Ireland).

The Company has presented the allocation of operating costs and assets in accordance with the accounting policy for price control segments set out in note 1k and its accounting methodology statement published on the Company's website on 15th July 2017. 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.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where under International Standards on Auditing (UK and Ireland), we are required to report to you if, in our opinion, information in the Annual Performance Report is:

- materially inconsistent with the information in the audited Regulatory Accounting Statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Company acquired in the course of performing our audit; or
- otherwise misleading.

In particular, we are required to consider whether we have identified any inconsistencies between our knowledge acquired during the audit and the directors' statement that they consider the Annual Performance Report is fair, balanced and understandable and whether the Annual Performance Report appropriately discloses those matters that we communicated to the Audit Committee which we consider should be disclosed.

REPORT OF THE INDEPENDENT AUDITOR

Other matters

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 2017 on which we reported on 1 June 2017, 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
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