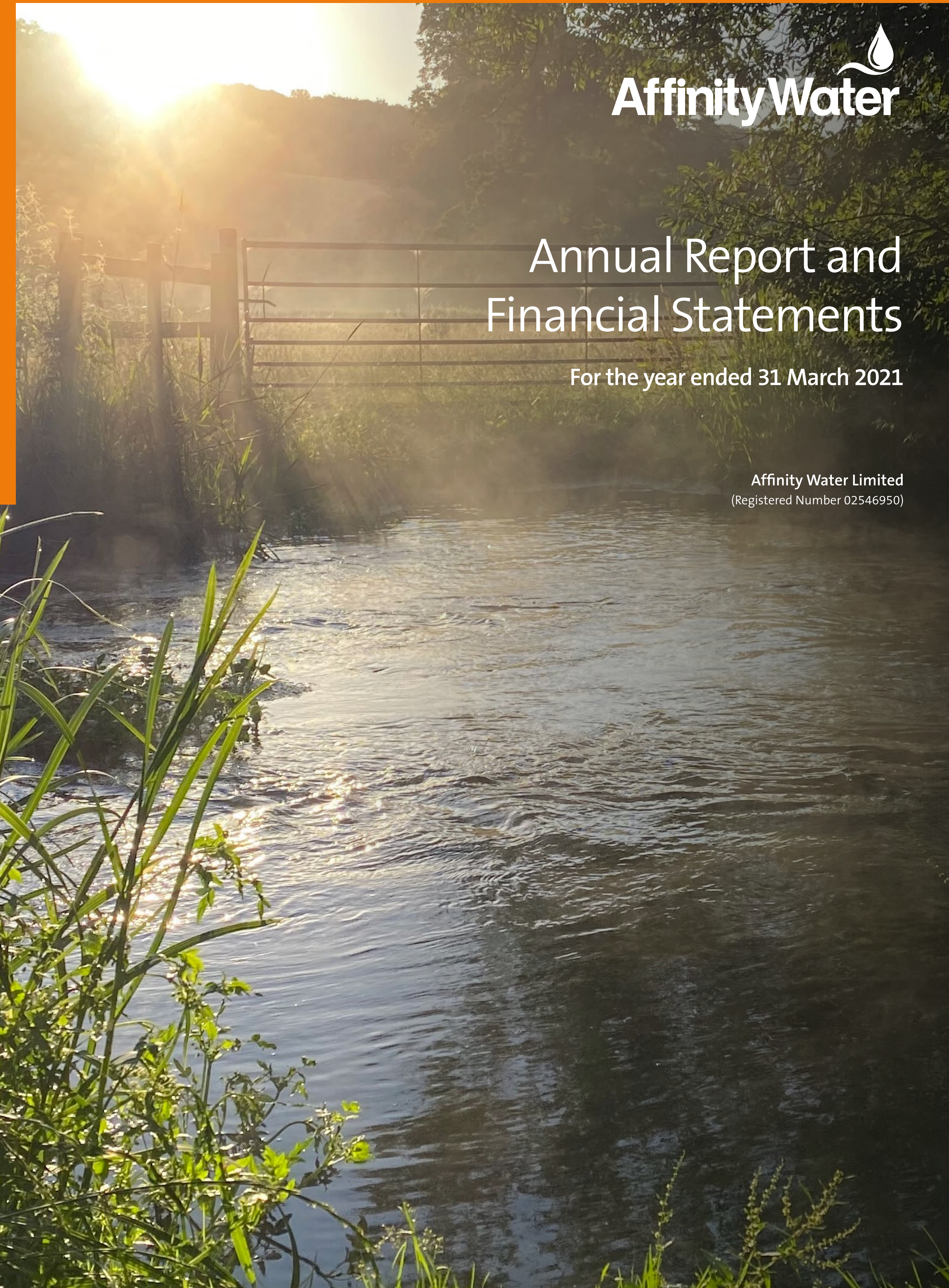


Annual Report and Financial Statements

For the year ended 31 March 2021

Affinity Water Limited
(Registered Number 02546950)

Glossary of key acronyms and definitions used within this report and the water industry

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

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

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

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

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

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

MOSL – Market Operator Services Limited
The market operator of England's non-household water market.

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

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

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

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

R-Mex – Retailer Measure of Experience
A measure of retailer service levels being used by Ofwat in AMP7.

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

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

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

WINEP – Water Industry National Environment Programme
A set of actions that water companies must complete in order to meet their environmental obligations.

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

Our regulators

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

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

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

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

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

Important information

Terms used in this report
The "company" or "Affinity Water" means Affinity Water Limited; the "regulated business" or "regulated activities" means the licensed water activities undertaken by Affinity Water Limited in the South East of England.

Cautionary statement
The annual report and financial statements contain certain statements that are forward-looking. Although the company believes that the expectations reflected in these forward-looking statements are reasonable, it can give no assurance that these expectations will prove to be correct. Because these statements involve risks and uncertainties, actual results may differ materially from those expressed or implied by these forward-looking statements. The company undertakes no obligation to update any forward-looking statements whether as a result of new information, future events or otherwise.

Integrated report
We aim to continually develop our reporting in order to improve our communication with customers and stakeholders. This annual report and financial statements have been prepared using the principles of the International Integrated Reporting Framework.

Our Registered Office
Tamblin Way
Hatfield
Hertfordshire
AL10 9EZ

Contents

AFFINITY WATER AT A GLANCE	**2**
Where we operate	2
Our purpose and vision	3
Performance summary	4
Chair's welcome	6
STRATEGIC REPORT	**8**
Chief Executive Officer's introduction	10
Chief Financial Officer's review	14
Sustainable Development Goals	18
Our business model	20
Our people	32
Our industry	34
Operational performance	35
Principal risks and uncertainties	38
Viability statement	50
Section 172(1) statement	54
Non-financial information statement	63
GOVERNANCE	**64**
Introduction from the Chair	66
Our directors	68
Corporate Governance Statement	74
Nomination Committee report	87
SHEDWQ Committee report	93
Audit, Risk and Assurance Committee report	95
Ownership and financing	105
Remuneration report	111
Directors' report	126
STATUTORY FINANCIAL STATEMENTS	**134**
Independent auditors' report	136
Income statement	146
Statement of comprehensive income	147
Statement of financial position	148
Statement of changes in equity	149
Statement of cash flows	150
Accounting policies	151
Notes to the financial statements	155
REGULATORY ANNUAL PERFORMANCE REPORT	**202**

In April 2021, we won two entries in

Ofwat's Innovation in Water Challenge.

Our winning initiatives – Seagrass Seeds of Recovery and Smarter Tanks – were produced in collaboration with other water companies, UK universities and government agencies with the aim to improve the efficiency and resilience of our water supplies.

The Seagrass project uses nature itself to enhance coastal communities' ecosystems. Planting and restoring seagrass meadows enhance the stability of the coastal zone, locking carbon into the seabed at a rapid rate, improving water quality and creating habitat for hundreds of thousands of small animals.

This innovative project will provide a blueprint for upscaling the restoration of seagrass to enhance the resilience of the estuarine and coastal waters of the Affinity Water and Anglian Water supply regions in Essex and Suffolk.

The Smarter Tanks project will develop a 'business model canvas' to harness real-time monitoring and control solutions for existing water tanks and towers to improve efficiency when water is needed most such as during droughts.

The project aims to make the most use of existing water storage assets in a new way in order to build network resilience and pave the way for the industry to explore new solutions further.

Affinity Water at a glance

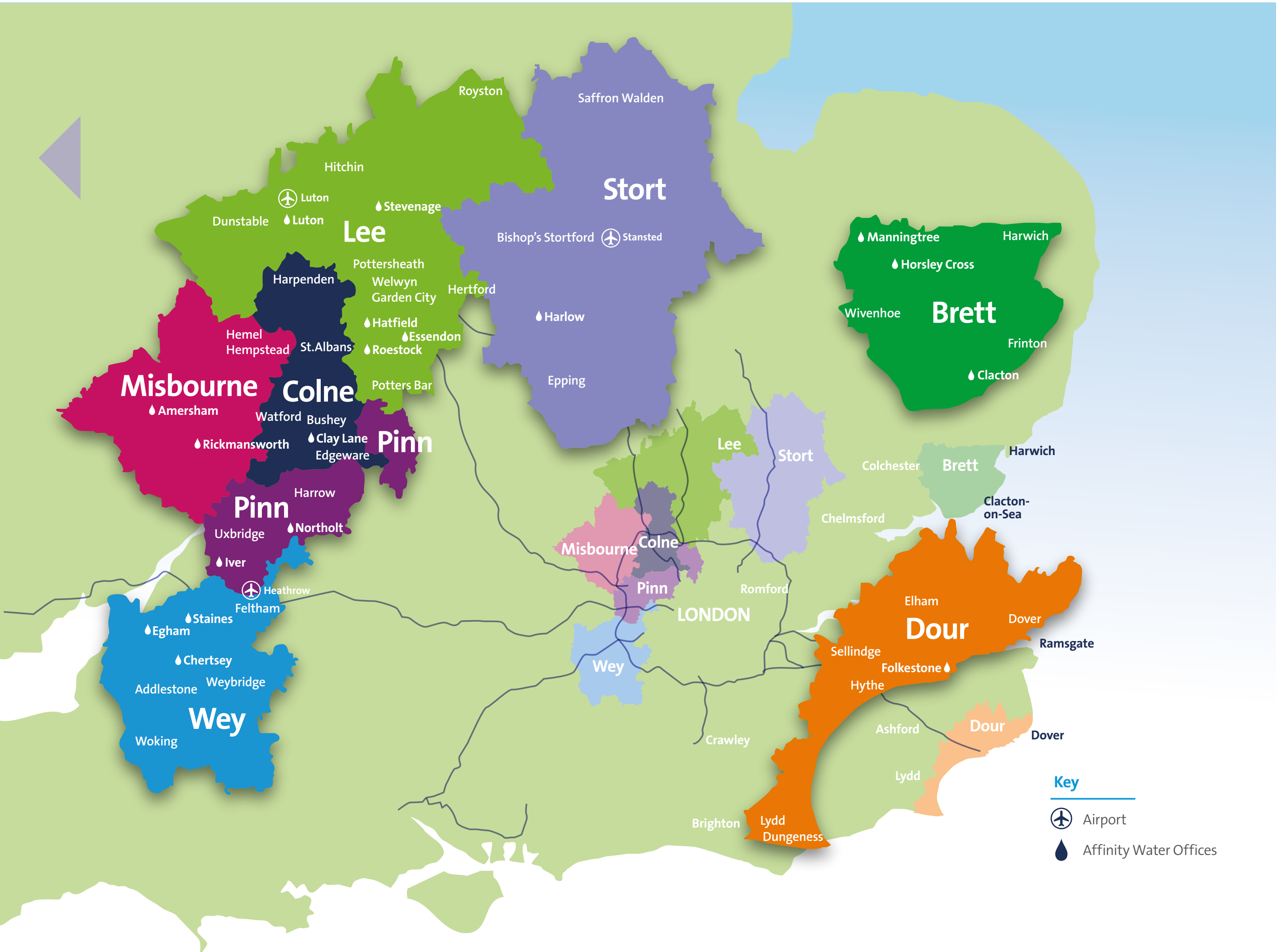
Where we operate

We are the largest water only supply company in the United Kingdom, owning and managing the water assets and network in an area of approximately 4,500km² across three supply regions in the South East of England.

We sub-divide our supply regions into eight different communities, based on our existing water resource zones and each named after a local river, allowing us to tailor a high quality service to customers at a local level.

Facts and figures as at 31 March 2021:

Daily amount of drinking water supplied	**950 Ml**
Population served	**3.83m**
Household properties connected	**1.47m**
Length of mains network	**16,800 km**
Number of water treatment works	**93**
Planned AMP7 investment	**£1.44bn**
Number of employees (excluding directors)	**1,407**
Our average RCV in the year	**£1.258bn**



Our purpose and vision

Our purpose is:

To provide high quality drinking water for our customers and take care of the environment, for our communities now and in the future

Our Strategic Direction Statement ambitions are:

Environment

Aim: Leave the environment in a sustainable and measurably improved state.

We will work with our customers and communities to restore the environment into a sustainable regenerative state so that it can continue to provide its assets and services for the enjoyment of current and future generations.

Customers

Aim: Deliver what our customers need, ensuring affordability for all.

We will develop a constructive, collaborative relationship with our customers that enables us to help them achieve their aspirations for the future.

Resilience

Aim: Be prepared for change, and resilient to shocks and stresses.

We will invest with our stakeholders to create a more resilient community able to cope with and respond to an increasingly uncertain future.

Communities

Aim: Work with our communities to create value for the local economy and society.

Create a collaborative relationship with all our communities allowing us to act together with common purpose to deliver a society and environment that are mutually sustainable.

Our vision is:

To be the UK's leading community-focused water company

Our people serve our customers and their communities every day of the year. In doing so we understand the needs of our communities at a grass roots level and provide them with the best possible service.

Affinity Water at a glance continued

Performance summary

Supplying high quality drinking water

We recorded a CRI score of

1.31

for the 2020 calendar year, within the deadband of 2.00 and improving upon our 2019 performance of 1.73, where a lower score is a better position.

Leaving more water in the environment

We recorded leakage of

171.4 Ml/d

a reduction of 9.7 Ml/d compared to the prior year[1], although not achieving our target of less than 157.8 Ml/d for 2020/21.

Leaving more water in the environment

We recorded PCC of

169.3 l/p/d[2]

an increase of 14.3 l/p/d compared to the prior year and above our target of less than 147.4 l/p/d for 2020/21.

We saw a marked improvement in the number of lost time injuries per 100,000 hours worked throughout AMP6 as we revised our strategy and improvement plan to focus on a number of safety and health initiatives.

This trend has continued in 2020/21, as we recorded

0.12

injuries per

100,000 hours

worked, compared to a target of 0.20 injuries and 0.20 injuries in 2019/20.

Providing a value for money service

Our C-MeX score for 2020/21 was 77.88 compared to an industry mean average of 81.62. This score is not comparable to the prior year score due to a change in Ofwat's methodology for this metric.

We ranked 15th out of 17 companies, compared to our target of 14th and prior year ranking of 15th.

Our D-MeX score for 2020/21 was 84.39 compared to an industry mean average of 82.44. We placed 10th out of 17 companies in the industry league table, against a target of 13th and up from 16th in the shadow year 2019/20.

Minimising disruption to our customers

The number of repairs due to bursts per 1,000km of mains during 2020/21 was

155.8

compared to our target of less than 150.7 and prior year performance of 125.4.

Minimising disruption to our customers

The number of minutes per property where interruptions to supply exceeded 3 hours during 2020/21 was

5 minutes and 49 seconds

compared to our target of 6 minutes and 30 seconds and prior year performance of 13 minutes and 36 seconds.

Net cash inflow before tax and financing[1]:

£15.1m

2019/20: £35.9m

Our net cash inflow was lower than the prior year, primarily due to £8.4m lower cash generated from operations as a result of lower revenues and higher production costs due to COVID-19 and £11.4m higher spend on assets due to the increased investment committed to in AMP7.

Operating profit:

£13.6m

2019/20: £45.6m

Our operating profit for 2020/21 was lower than the prior year mainly due to lower non-household revenue as a result of businesses temporarily closing or reducing activity as a result of COVID-19, and higher operational costs associated with increased demand as more people stay at home.

Post-tax return on regulated capital value:

0.6%

2019/20: 3.0%

Our post tax return on RCV was lower than the prior year primarily due to the decrease in operating profit.

Dividends paid:

£1.0m

2019/20: £nil

Our shareholders are re-investing dividends from the appointed business to enable the substantial investments required to improve resilience and protect the environment.

A £1.0m dividend has been paid from the non-appointed business for the purpose of servicing group debt.

Credit ratings:

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

All of our ratings were confirmed in April 2021 and remain investment grade, with no changes from prior year.

Gearing:

76.0%

31 March 2020: 78.9%

Our gearing at 31 March 2021 was slightly lower than the prior year, even with lower inflation, and remained below our internal threshold of 80.0% of RCV both at 31 March 2021 and throughout the financial year. This allows sufficient headroom within our gearing covenants. See the Viability Statement on page 50 for the impact of gearing on our interest cover.

[1] The methodology for AMP7 is different to that used for AMP6. As such the equivalent figure for 2019/20 would have been 181.1Ml/d, instead of the 162.1 Ml/d reported in our 2019/20 annual report and financial statements.

[2] The methodology for AMP7 is different to that used for AMP6. As such the equivalent figure for 2019/20 would have been 155.0 l/p/d, instead of the 153.0 l/p/d reported in our 2019/20 annual report and financial statements. Our PCC performance has been negatively impacted by COVID-19 in 2020/21, as more people are staying at home, with many now not travelling out of our supply area for work or holidays.

[1] This "non-GAAP" measure is calculated as the total of the following line items per the statement of cash flows (refer to page 150): cash generated from operations; capital contributions; purchases of property, plant and equipment; proceeds from sale of property, plant and equipment; purchase of intangible assets; and principal elements of lease payments.

Affinity Water at a glance continued

Chair's welcome

I was delighted to be appointed to the Board of Affinity Water on 11 January 2021, taking over the Chair from Tony Cocker on 29 January 2021.

I would like to thank Tony for his extensive contribution to Affinity Water. He was Chair of the Board for three years overseeing the start of a transformation of the company which I will continue to pursue as we deliver the remaining four years of AMP7.

I very much look forward to working with the Affinity Water Board, its investors and the executive team to continue to deliver resilient and affordable water supplies for the 3.8 million people across the South East of England.

AMP7

Going into AMP7, we agreed challenging commitments with our regulator, Ofwat. We recognise these commitments, and we owe it to our customers to achieve these targets.

These commitments are a response to the significant environmental, social and governance ('ESG') challenges we face of a rising population and increased demand for water, as well as a reduction in the availability of water in years ahead.

We want our customers and stakeholders to be able to measure our success and hold us to account. Our AMP7 commitments and customer outcomes included in our Business Plan are summarised on page 22. We have aligned our operational key performance indicators ('KPIs') to our key performance commitments in response to customer expectations. Please refer to the Chief Executive Officer's introduction on page 10 and the table on page 35 for more detail on our operational performance during 2020/21.

ESG PRINCIPLES

We recognise the importance of ESG principles in operating an effective and ethical company. Our strategic report includes information on the environment and society integrated throughout.

We recognise that causing damage to the environment we operate in is a key risk for our company (see our principal risks on page 38). In August 2020, we published our internal digital Environmental Handbook which provides an easy-to-use reference guide to help us check and understand our environmental requirements within our daily operations, helping us carry out every job with the environment in mind.

Our governance report from page 66 onwards details our compliance with the 2018 Code, Ofwat's 2019 principles and includes the Board's consideration of ESG principles including health and safety, employee engagement and culture, diversity and our environment. Details of relevant policies are included on page 63. More details on our ESG principles are included on our website at: **affinitywater.co.uk/responsibility**.

SUSTAINABLE DEVELOPMENT GOALS

Last year we outlined the United Nations' Sustainable Development Goals ('SDG's'), detailed in full on page 18.

The SDG's are a blueprint to achieve a better and more sustainable future for all. The 17 related goals address the global challenges we face including those related to poverty, inequality, climate, environmental degradation, prosperity, peace and justice.

As a water company supplying a vital resource to our communities, we have identified which goals are particularly applicable to us and our long-term ambitions and have set these out on page 18 and throughout our strategic report to highlight where we feel we are making a contribution towards these goals.

COVID-19

The COVID-19 pandemic has changed the way we live and the way we work. Throughout 2020/21, our teams have been exceptional in ensuring our customers receive the high-quality drinking water they rely on. More details on the operational and financial impacts of COVID-19 are given in the CEO's introduction and CFO's review on pages 10 and 14 respectively.

BREXIT

The UK withdrew from the European Union ('EU') on 31 January 2020 and we have been in contact with critical suppliers on the impact of Brexit on our supply chain. We require a number of supplies and spares from the EU, and the disruption of these components would present an operational risk to the company. We have contingency plans in place that mean we are able to continue to supply water to our customers should these critical suppliers become unavailable. For example, we have our pumps and chemical supplies multi-sourced within the UK and outside the EU.

GOVERNANCE

The Board of Affinity Water has a strong ethos with two female non-executive directors ('NEDs') and four male NEDs joining me. In addition, we have representatives from each of our three shareholders and two executive directors: Pauline Walsh, our Chief Executive Officer ('CEO') and Stuart Ledger, our Chief Financial Officer ('CFO'). In total we have seven men and five women on the Board. Diversity is an area we will be focusing on in 2021/22 across the whole company to better reflect the communities we serve. See page 91 for more details.

The Board met 11 times during 2020/21, albeit virtually due to the COVID-19 pandemic. Justin Read was appointed to the Board in July 2020 as an Independent Non-Executive Director. Justin brings immense financial and managerial experience working across a number of different industries. Justin replaces Patrick O'Donnell Bourke as the Chair of the Audit, Risk and Assurance Committee. Patrick left the Board in September 2020.

In the executive management team, Sunita Kaushal was appointed as General Counsel and Company Secretary on 1 April 2020. Sunita is an accomplished solicitor with experience in global businesses. She has worked for Bakkavor Plc, De Vere Group and Cushman and Wakefield.

EXECUTIVE REMUNERATION

Our policy for Executive Director pay continues to be aligned to the company's strategy of delivering value through high quality customer service and operational performance whilst ensuring the cost of water remains affordable.

We have continued to keep the reward packages for our Executive Directors and other senior managers under review to ensure they remain market competitive, incentivise company and individual performance, and focus on the achievement of short-term targets that will enable the company to fulfil its long-term vision and purpose.

Our Executive Directors have committed to not receiving an increase in their salary for either 2020/21 or 2021/22. Our Board-approved executive remuneration policy is available on our website: **affinitywater.co.uk/governance-assurance**.

DIVIDENDS

We are restricting dividends to our shareholders throughout AMP7 to enable the substantial investments to improve resilience and protect the environment. Equity dividends of £1.0m were paid from our non-appointed business (the parts of our business not regulated by Ofwat) during the year (2020: £nil), in order to service group debt, reflecting the shareholders' commitment to re-invest all planned returns from the company's appointed business for the benefit of our customers.

Our dividend policy is available on our website: **affinitywater.co.uk/governance-assurance.**

LOOKING FORWARD

I have been warmly welcomed to the business since joining in January 2021 and look forward to leading the company to excel in the KPIs it has agreed with its regulator, Ofwat.

2020/21 has not been an easy year operationally, due to the COVID-19 pandemic and the restrictions and new ways of working put in place as a result, but the management team and our people have made firm commitments to build on what we have learnt and deliver for all stakeholders as we progress through AMP7 and beyond.

Ian Tyler
Company Chair

Strategic report

Contents

Chief Executive Officer's introduction	10
Chief Financial Officer's review	14
Sustainable Development Goals	18
Our business model	20
Our people	32
Our industry	34
Operational performance	35
Principal risks and uncertainties	38
Viability statement	50
Section 172(1) statement	54
Non-financial information statement	63

On World Rivers Day 2020, we announced that we will voluntarily turn off a major groundwater abstraction site at the head of the Chess Valley in the Chilterns

Strategic report continued

Chief Executive Officer's introduction

We care passionately about delivering for our customers and the environment. We accepted Ofwat's Final Determination of our Business Plan in February 2020.

Since then, we have faced unprecedented times with COVID-19 impacting every single person and requiring every one of us to modify our behaviours in ways none of us expected or thought possible. Despite not meeting some of our performance targets for 2020/21, we have outperformed in others, and we remain committed to delivering our plans. We have made step changes in all areas in this first year of AMP7 through driving transformation, and are on a glidepath to achieving our targets over the course of the AMP.

COVID-19

I would like to begin with a big thank you to all our employees, customers and stakeholders. I host a weekly podcast with Affinity Water's employees and there is a real sense of purpose and commitment from everyone as we have pulled together through both the COVID-19 pandemic and the variable weather patterns of 2020/21.

During the pandemic, we have remained consistent with Government advice. Our depots and offices are COVID-19 secure and compliant, and more than 1,000 of our people have worked from home, including our customer contact centre which has been maintained throughout. Our IT teams and systems have ensured that we have been able to operate seamlessly, with none of our direct employees being furloughed.

We loaned out 50 spare laptops to help children of our employees to learn from home while their schools were shut during the COVID-19 pandemic.

All our employees are key workers with more than 750 people in the field. We have had new high-vis outerwear designed with a "Keep your distance" message in order to keep our people safe.

Operationally we have continued to ensure that we provide high quality water to all our communities as well as support them during the current pandemic.

We experienced unprecedented high demand during the hot summer period, whilst more people stayed at home and within our supply area under COVID-19 travel restrictions. Our engineers and technicians worked around the clock to treat and pump more water into the network.

During this time, demand for our water saving devices also surged by 40%.

For our customers, we have publicised our Priority Services Register and promoted our collaboration with the National Debtline charity in order to better aid our customers with any debt-related issues. We also proactively contacted customers who we thought could be more impacted by the pandemic, for example cash payers and have facilitated direct debit payments instead.

More than 7,000 people were given payment breaks during 2020/21 and we continue to support 85,000 households in our region with Social Tariffs – a reduced fixed rate which can be spread over 12 months, rather than requiring payment either once or twice a year. We also teamed up with seven other utility networks to provide a boost to local community foundations, contributing £15,000.

As a result of the impact of COVID-19, revenue for 2020/21 was £8.0m lower than the prior year, while additional costs of £5.3m were incurred. The decrease in revenue was primarily due to lower non-household wholesale revenue as a result of businesses temporarily closing, although partially offset by increased household consumption. The increase in costs was largely due to increased production costs as a result of the higher demand. More details are included in the Chief Financial Officer's review starting on page 14.

COVID-19 has also impacted us operationally, especially our PCC performance and properties at risk of low pressure, and we have undertaken research and launched programmes to improve delivery. Please refer to our operational performance section on page 35 for more details.

OUR COMPANY AND OUR ENVIRONMENT

As a monopoly supplier and steward of a precious resource, water and the environment, for future generations, we are acutely aware that we must continually invest in building trust with our customers and hold our performance accountable to our communities and wider stakeholders. This is central to achieving our vision of being a community focused, sustainable and responsible business.

ESG principles are the predominant drivers of everything we do. Affinity Water is at the forefront of climate change – our operations must be sensitive to the environment in which we operate – in the provision of water for society, in its abstraction from the environment and in the protection of water and the environment for future generations.

Alongside the water industry, we have committed to an industry wide target of achieving net zero carbon emissions by 2030 whilst continuing to provide high quality water. We will be phasing out our diesel generators and replacing pumps with more energy efficient ones as well as looking at our natural capital and how we can measure this to help us better deliver our objectives on leaving the environment in a measurably better state than it is today.

AMP7

We continue to align our operational KPIs and targets to the key performance commitments made in our Business Plan (as detailed on page 22) in response to our customer outcomes: supplying high quality water you can trust; making sure you have enough water, whilst leaving more water in the environment; providing a great service that you value; and minimising disruption to you and your community.

We maintain necessary stretching targets that respond to the significant social and environmental challenges we face – a rising population and increased demand for water, as well as a reduction in the availability of water in the years ahead.

SUPPLYING HIGH QUALITY WATER YOU CAN TRUST

We recorded a CRI score of 1.31 for the 2020 calendar year, within the deadband of 2.00, and a leading result in the industry. Water quality is paramount to everything we do and this year our production teams have been focusing on improving our site standards and areas of work in order to promote water quality. We use the latest treatment technology and sophisticated monitoring systems at our treatment works.

We use a large amount of energy to lift water from rivers and aquifers, for treatment processes required for wholesome water supply, to move water around the network and to pressurise the water for customers' use.

We report on our operational emissions annually and have already made significant progress to reduce our carbon and greenhouse gas emissions. We are also developing a carbon reduction strategy with our stakeholders which we will publish in July 2021. Please refer to pages 128 to 130 for energy efficient actions we have taken in 2020/21.

MAKING SURE YOU HAVE ENOUGH WATER, WHILST LEAVING MORE WATER IN THE ENVIRONMENT

We endeavour to address the environmental challenges of protecting our precious local rivers and habitats through reducing abstraction while encouraging behavioural change. We launched the Save our Streams campaign in April 2021 which aims to promote sustainability through various social media channels, with 45,000 customers already having signed up to our website and the company receiving accolades from key stakeholders.

In our AMP7 Business Plan, we have also committed to reducing the amount of water we take from the environment by 27.3 million litres per day by 2024/25.

We are investing £59m in providing customers with metered data relating to water use in their locality. This is a part of our various campaigns to influence our customers to reduce consumption (please refer to the case study on page 29 for more details).

Our WhyNotWater campaign continued with its call to action to demand key changes to legislation and policy to help ensure long-term water sustainability. Some of the "asks" we set out are being incorporated into legislation, with mandatory water efficiency labelling on all goods and the target of restricting water use to 110 l/p/d in water stressed areas now on the Government's "to do" list.

Furthermore, we will work with neighbouring water companies to provide a foundation for water trading in the South East of England by transferring water from water-rich areas to drier regions.

During 2020/21 we have been focused on restoring globally rare chalk streams in our supply area to help bring them and the habitats that surround them back to health. Chalk streams are a precious part of our local and national heritage and a priceless natural resource. There are only 200 chalk streams known globally, 85% of which are found in southern and eastern England and 10% in our supply area.

On World Rivers Day 2020, we announced that we would stop taking water from boreholes at the top of the Chess Valley which affects the River Chess in the Chilterns an Area of Outstanding Natural Beauty. This follows years of investigation, trials and collaborative efforts with local groups in the Chilterns and was a highly significant announcement for the industry, please refer to the case study on page 23 for more details.

The River Beane in Hertfordshire, the River Misbourne in Buckinghamshire and the River Lea in Bedfordshire, are the latest chalk streams to undergo improvements under our Revitalising Chalk Rivers programme during 2020/21. These involve important collaborations with partners including local councils, river groups and the EA. Please refer to the case study on page 31 for detail on how we are innovating to improve these chalk streams.

14.3km of river improved across our catchments during 2020/21, bringing rivers back to a more natural state to improve habitat for wildlife

As part of our environmental responsibilities, we have been working with Cambridge Water to pioneer a successful EnTrade online reverse auction to cut nitrate in soils. In 2020/21 we worked with 18 farms using an exciting cover crop scheme, aiming to capture 37.4 tonnes of nitrate which could otherwise leach into the chalk aquifers that are used to supply drinking water. Please refer to the case study on page 25 for more details.

Strategic report continued

Chief Executive Officer's introduction

PROVIDING A GREAT SERVICE THAT YOU VALUE

I would like to welcome Caroline Warner, the new chair of our CCG, who will work with us to ensure we are engaging effectively with our customers and communities and providing excellent customer service.

We have again received the British Standards Institution certification for help to vulnerable customers. This recognises that we are providing a fair, flexible service to all regardless of our customers health, age or personal circumstances. We have been proactively reaching out to our customers in different ways and working in partnership with charities, other utilities and organisations to really improve the awareness of the support we are offering, particularly to our most vulnerable customers.

However, we need to and can do much better in other areas. Our C-MeX score for the year ended 31 March 2021 was 77.88 against an industry mean average of 81.62, ranking us 15th out of 17 companies. The C-MeX score consists of two surveys: customer service and customer experience. Customer service was successfully achieved through the actions we took to support our customers during the COVID-19 pandemic and the hot, dry summer experienced. In contrast, customer experience, which is based on customer perception and awareness, has lowered our performance this year. Both elements are of utmost importance to us, thus we recognise there are areas we need to improve in order to rise up the league table.

Our key focus going forward is to improve our customer experiences by ensuring we are proactive in keeping our customers informed and up to date as well as striving to complete interactions correctly the first time. We will be rolling out improvements to customer journeys within various areas including metering and complaints.

During 2020/21 we have been working with Experian to connect our data sources and develop a better understanding of our customer base. We have identified seven core customer groups with shared traits and attributes and have mapped these across the regions we serve. This fresh understanding has shaped how we approach our customer engagement strategy.

MINIMISING DISRUPTION TO YOU AND YOUR COMMUNITY

Disappointingly, we have not met our leakage target for 2020/21, though we are still committed to reducing leakage from water pipes by 20% over AMP7, following a 15% reduction achieved in AMP6, the industry's largest percentage reduction target for AMP6.

We plan to spend approximately £100m to tackle leaks in AMP7. Our plan is to:

- fix 50% of visible leaks in 24 hours, 70% within 48 hours and 90% within five days;
- use quantum technologies to detect and fix leaks;
- use new techniques to monitor flows and fast logging and pressure reduction schemes to locate leaks so we can target them more effectively and maximise the amount of water we save; and
- offer more free repairs to customers where there are leaks on the pipe supplying their home.

We want to innovate more. Our new leakage technician apprenticeship scheme is industry leading, as is our use of Artificial Intelligence data sharing to allow water companies to better monitor the impact of the weather and COVID-19 on water demand. This is a model we are sharing with others in the sector.

Our deployment of the Step Testing technique – a series of short steps isolating sections of pipe – will allow our engineers to systematically work through district areas, opening and closing valves to isolate parts of the network to narrow down areas suffering from loss of water due to leakage. Please refer to page 27 for more details on our commitment to reducing leakage.

We have also made improvements during 2020/21 to reduce the impact of supply interruptions to customers by changing the way we work to ensure 'water is always on' through providing alternative supplies rather than prioritising fixing the burst as we have done in the past.

Despite the COVID-19 restrictions on working we have met this year's mains renewals target, as per page 30. This investment will be key to maintaining resilience and ensuring our customers have enough water.

OUR PEOPLE

We aspire to embed continuous innovation and improvement in everything we do. We are continuing to shift our working practices to be more agile and more responsive as well as transforming customer experience. We have created a strong culture of learning and development through significant investment in training and are building a culture of coaching and mentoring to release the potential of our people. We have implemented a Business Excellence programme which is delivering tangible benefits to our customers and our employees and helping us drive efficiencies in our everyday ways of working.

We have been closely monitoring the UK Government's COVID-19 advice and have adapted our operations to protect our people, as well as allowing much of our support services staff to work effectively from home. Please refer to page 32 for more detail on how we have supported our people throughout the pandemic.

We are committed to promoting equal opportunity in all areas of employment including recruitment, promotion, training, pay and benefits. We have a Culture Ambassador forum to improve our culture across the organisation and make Affinity Water a great place to work. We have 38 Cultural Ambassadors who represent all departments and directorates throughout the company. Please refer to page 33 for more details on employee engagement.

We take the safety, health and wellbeing of our people and suppliers very seriously and we are committed to operate our business without harm. We encourage our people to spot unsafe behaviour and take ownership to prevent it. During 2020/21 we recorded three lost time injuries and achieved our lowest ever Lost Time Injury Frequency Rate of 0.12 injuries per 100,000 hours worked. A period of 422 days without a work-related lost time injury between 1 August 2019 and 26 September 2020 was a significant feature in this achievement.

I am proud of the work our employees have accomplished over the last year, which has been very challenging against the backdrop of AMP7 and COVID-19.

I would like to thank every one of them. Their efforts have contributed to a year-end performance which has resulted in a partial payment of the company-wide bonus, linked to the achievement of key operational targets.

Pauline Walsh
Chief Executive Officer

Strategic report continued

Chief Financial Officer's review

We have been financially impacted by COVID-19 throughout 2020/21, and we expect this to continue into 2021/22.

Our non-household ('NHH') revenue decreased significantly due to businesses temporarily closing as a result of the pandemic. Household revenue only increased slightly despite consumption significantly increasing as households follow the UK Government's advice to stay at home, due to a bill reduction and a significant number of customers being on unmetered tariffs.

Our operational costs, particularly bulk water imports and electricity costs, have increased as a result of higher demand and supply caused by COVID-19. Within our capital programme, we have invested £3.0m to manage issues with customers experiencing low pressure as a result of the high demand. Our underlying base costs have however shown some stability as we aim to deliver the efficiencies to meet the challenging allowances set for AMP7, and we have exceeded our underlying cost efficiency target for the year.

We transacted £225.0m of CPI linked inflation swaps and £75.0m of RPI linked inflation swaps during 2020/21 in order to mitigate our interest cover ratio covenant. These transactions lead to a net interest receivable cashflow over the life of the swap, offset by an accretion payment on maturity (2026 for the RPI swap and either 2030 or 2036 for the CPI swap). There is no liquidity risk created by these transactions prior to these dates as there is no requirement to pay collateral prior to maturity.

We donated £105,000 to Community Foundations and the Chilterns Conservation Board during 2020/21

In March 2021, we issued shares totalling £4.0m, increasing our ordinary share capital to £30.5m, demonstrating the long-term investment of our shareholders.

In April 2021, all three of our credit rating agencies; Moody's, Standard & Poor's and Fitch, affirmed our ratings.

AMP7 BUSINESS PLAN

We planned to invest £1.44bn totex during AMP7 and have spent £286.6m in 2020/21. This will be key to maintaining resilience and making sure our customers have enough water, whilst leaving more water in the environment by delivering sustainable abstraction reductions in line with our WRMP for the 60-year period from 2020 to 2080.

Our Plan for AMP7 keeps customers' bills as low as possible. We have always worked hard to keep our bills low whilst maintaining a high quality and trusted service, with our water bills being consistently lower than the industry average. Our average household bill for 2020/21 was £173.31, the equivalent of just 47p per day. Our AMP7 price control set an initial drop in revenue, followed by real terms increases, so household bills in 2021/22 are expected to be about 2% higher than in 2020/21.

This small increase will help fund the investments we are making to improve our services and to ensure these essential plans are protected from the financial impacts of COVID-19. We have increased our support for vulnerable customers during the year and our owners have committed to taking no dividends from the regulated business over AMP7 allowing us to reinvest in the business.

INNOVATION FUND

During 2020/21 we paid £1.1m into Ofwat's Innovation in Water Challenge, an industry-wide initiative to drive transformational change and better meet the evolving needs of customers, society and the environment.

In April 2021, Ofwat announced 11 winning projects, two of which we had led on – Seagrass Seeds of Recovery and Smarter Tanks, both of which will improve the efficiency and resilience of our water supplies.

2020/21 FINANCIAL PERFORMANCE

Our financial results are prepared in accordance with Financial Reporting Standard 101: "Reduced disclosure framework" ('FRS 101') and are summarised in the table below. For more information refer to the basis of preparation of our statutory financial statements on page 151.

	2021 £m	2020 £m
Revenue	**286.8**	307.2
Operating costs	**(290.9)**	(280.1)
Other income	**17.7**	18.5
Operating profit	**13.6**	45.6
Net finance costs	**(77.1)**	(45.5)
(Loss)/profit before tax	**(63.5)**	0.1
Taxation	**12.2**	(21.8)
Loss for the year	**(51.3)**	(21.7)

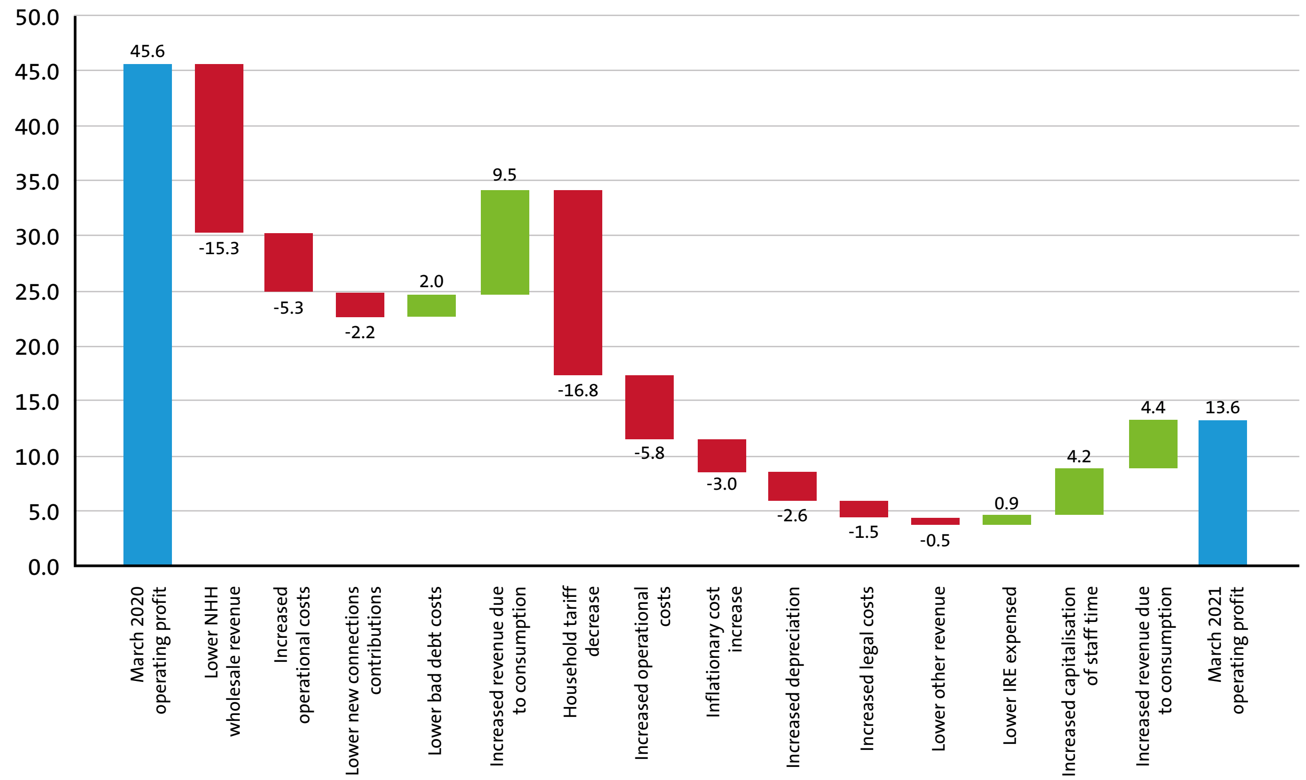
Revenue for 2020/21 was £286.8m, being a £20.4m (6.7%) decrease on the prior year (2020: £307.2m). The decrease is primarily due to lower NHH wholesale revenue as a result of businesses temporarily closing due to COVID-19, and a decrease in household tariffs, although this was partially offset by increased consumption as a result of COVID-19 and the hot summer weather. New connections activity was also reduced during the year, resulting in lower contributions received.

Operating costs for the year increased by £10.8m (3.9%) to £290.9m (2020: £280.1m). Of this, it has been estimated that £5.3m can be attributed to COVID-19 due to the increased demand and supply of water, particularly increasing our bulk water import and electricity costs as more people stay at home and within our supply area. There was a further £1.5m increase relating to the hot, dry summer weather, with the remainder relating to increased spend on materials and maintenance.

Inflation and depreciation continue to be higher year on year. Inflation increased by 1.47% between March 2020 and March 2021, increasing our cost base by £3.0m, whereas depreciation was £2.6m higher than the prior year as a result of increased investment in our assets. The £1.1m payment into Ofwat's innovation fund was also an added expense this year.

These increases were partially offset by a lower bad debt charge for the year, and reduced staff costs, as more time was charged to capital projects in 2020/21.

As a result, operating profit fell by £32.0m (70.2%) to £13.6m (2020: £45.6m) as shown below:



The net finance expense of £77.1m was £31.6m (69.5%) higher than last year (2020: £45.5m), primarily as a result of the significantly increased fair value loss on our swaps due to the additional swap transactions during the year, and the mark to market movement thereon, although this was partially offset by increased interest income received on those swaps. For more detail refer to note 4 of the statutory financial statements.

Loss before tax for 2020/21 was £63.5m, being a £63.6m decrease on prior year (2020: profit of £0.1m).

Strategic report continued

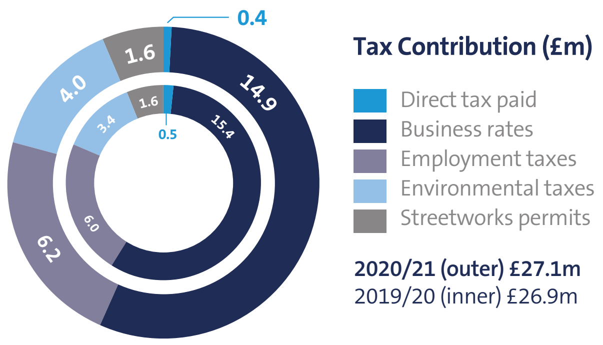
Chief Financial Officer's review (continued)

TAXATION

The income tax credit on loss before tax was £12.2m (2020: £21.8m charge). The effective current tax rate (19.2%; 2020: 23,929%) was slightly higher than (2020: higher than) the UK corporation tax rate of 19% (2020: 19%). Further information and a full reconciliation of the current tax charge are set out in note 5.4 of our statutory financial statements. All our profits are taxed in the UK, and we do not use artificial tax avoidance schemes or tax havens to reduce our tax liabilities.

In February 2021, we were reaccredited with the Fair Tax Mark for the third year running. Details of the tax strategy for our regulated business can be found within our regulatory Annual Performance Report. Our group tax strategy of Daiwater Investment Limited, our ultimate holding and controlling company in the UK, is published on our website: **affinitywater.co.uk/library.**

Our total tax contribution is set out below:



DIVIDENDS

Equity dividends of £1.0m were paid from our non-appointed business during the year (2020: £nil), in order to service group debt, reflecting the shareholders' commitment to re-invest all planned returns from the company's appointed business for the benefit of our customers.

CAPITAL EXPENDITURE

Capital expenditure in the year was £139.4m (2020: £129.9m), and was incurred principally in our mains renewals, trunk main replacement, water treatment (including pesticide treatment) and integrated water savings programmes. This excluded £16.5m (2020: £17.2m) of infrastructure renewal expenditure, which is treated as an operating cost under FRS 101. Our capital expenditure programme has been impacted by COVID-19, with some expenditure scheduled for 2020/21 having been delayed until later in AMP7.

Our plan to phase out diesel generators and replace pumps with more energy efficient ones, as part of our carbon reduction strategy, will not have a material impact on our financial statements going forward.

TOTAL EXPENDITURE

Our overall totex for 2020/21 showed an underspend of £30.7m (10.8%) in outturn prices compared to our allowed expenditure, although the amount we expect customers to fund through the sharing mechanism is only £2.9m (in 2020/21 prices). This was primarily due to the reprofiling of capex works later in the AMP as a result of the COVID-19 pandemic.

CASH FLOW

Net cash inflow before tax and financing[1] for the year was £15.1m being a 57.9% decrease on last year (2020: £35.9m). The decrease is primarily due to £8.4m lower cash generated from operations as a result of lower NHH wholesale revenue and increased production costs, both as a result of COVID-19 as well as £11.4m higher spend on assets due to the increased investment committed to in AMP7.

NET DEBT AND GEARING

As we are a business with a long-term outlook and expenditure commitments, we need to match this with long-term sources of debt finance. We consider the most cost effective way to raise long-term debt to be through the debt capital markets. Our financing subsidiaries have outstanding external bonds totalling £1,014.2m, raised in the debt capital markets and on-lent to the company on the same terms.

We expect to undertake our next major refinancing exercise in July 2026 when our £250.0m fixed rate bond matures. The maturity profile of all our borrowings is set out in note A4 to our statutory financial statements. See pages 109 to 110 for further details of our financing arrangements.

Our net debt[2] as at 31 March 2021 was £994.1m, an increase of £21.2m since last year (2020: £972.9m) due to accretion on the index-linked bonds coupled with lower cash balances. Our gearing as measured by net debt to RCV at 31 March 2021 was 76.0% (2020: 78.9%), so has decreased during 2020/21 despite lower inflation, and remains below our internal maximum gearing level of 80.0% of RCV.

While we have higher gearing than some of our peers in the water industry, there is sufficient headroom within our financial covenants, which are only triggered at a level of more than 90.0%. It is our intention to continue to reduce our gearing over AMP7.

[1] This Alternative Performance Measure is calculated as the total of the following line items per the statement of cash flows (refer to **page 150**): cash generated from operations; capital contributions; purchases of property, plant and equipment; proceeds from disposal of property, plant and equipment; purchase of intangible assets; and principal elements of lease payments.

[2] This Alternative Performance Measure is calculated as borrowings and accrued interest less loan from immediate parent company and all company cash and short-term deposits. It is reconciled to our regulatory net debt in table 1E of our annual performance report (refer to **page 226**).

LIQUIDITY AND ACCESS TO MARKETS

Our objective is to ensure we have banking arrangements and adequate, though not excessive, cash resources, borrowing arrangements and standby facilities to enable us at all times to have the level of funds available which are necessary for the achievement of our business and service objectives.

At 31 March 2021, we had cash balances of £84.8m (2020: £85.6m) and short-term deposits held as investments of £15.1m (2020: £25.2m).

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

At the year-end, 61.3% of our gross borrowings were at fixed rates (2020: 61.7%), 33.0% (2020: 32.6%) at rates indexed to RPI and 5.7% (2020: 5.7%) at rates indexed to CPI. Taking into account our index-linked inflation swaps, the proportion of borrowings at fixed rates decreased to 19.2% (2020: 47.0%), the proportion indexed to RPI increased to 52.5% (2020: 45.0%) and the proportion indexed to CPI increased to 28.3% (2020: 8.0%).

To the extent that additional funding is required, as well as our cash balances, we have access to two revolving credit facilities totalling £100.0m (2020: £100.0m), which were undrawn at 31 March 2021 (2020: undrawn), to finance capital expenditure and working capital requirements. These facilities, which have sustainability performance measures included, were renewed on 28 June 2020.

In addition, we have access to a further £55.0m of liquidity facilities (2020: £61.0m), consisting of a 364 day revolving £32.0m facility to fund any debt service payments in the event of a liquidity shortfall that would otherwise prevent such payments being made and a 364 day revolving facility of £23.0m to fund operating and capital maintenance expenditure in the event of a liquidity shortfall.

For more details on our borrowings and liquidity, please refer to note A4 of our financial statements.

Stuart Ledger
Chief Financial Officer

Strategic report continued

Sustainable Development Goals

The United Nations' SDG's are a blueprint to achieve a better and more sustainable future for all. The 17 related goals address the global challenges we face including those related to poverty, inequality, climate, environmental degradation, prosperity, peace and justice.

As a water company supplying a vital resource to our communities, we have identified which goals are particularly applicable to us and our long-term ambitions. Further detail is given throughout our strategic report where we feel we are making a contribution towards these goals.

SDG	Core activities	The way we operate	Stakeholders	Further detail
4 QUALITY EDUCATION	Providing training and employment for our people	We have created a strong culture of learning and development through significant investment in training, in order to ensure our employees feel they are valued and continuously learning. This will ultimately help us become more efficient as a business and improve customer satisfaction.	Employees Customers Shareholders	Training and development Page 32
5 GENDER EQUALITY	Promoting a culture of diversity and inclusivity throughout the workplace	Our Equality, Diversity and Inclusion Committee are tasked with understanding the challenges our industry faces, including gender equality. We have set long term goals to ensure our employee diversity is representative of the communities we serve. Our gender pay report is published on our website: **affinitywater.co.uk/responsibility**	Employees	Diversity and equality Page 33
6 CLEAN WATER AND SANITATION	Supplying quality water, working alongside sewerage companies regarding sanitation	We use the latest treatment technology and monitoring systems to ensure a consistent supply of high quality water to our customers, benefitting the wider communities and positively impacting our environment.	Employees Customers Communities Regulators	Maintain high quality water Page 24
7 AFFORDABLE AND CLEAN ENERGY	Net Zero and carbon neutral solutions	We are developing a carbon reduction strategy with our stakeholders which we will publish in July 2021. Our plans include moving to a greener vehicle fleet, planting trees and developing a solar farm. As a utility company, it is vital that we contribute to the ongoing environmental challenges we all face.	Environment Communities Regulators Shareholders	Greenhouse gas emissions statement Page 128
8 DECENT WORK AND ECONOMIC GROWTH	Ensuring employees are engaged, making Affinity Water a great place to work	Our culture and ways of working are based on five key principles which are embedded in everything we do. We want to ensure we are a responsible employer and are contributing to both our shareholder returns and providing wealth and income to the communities we serve and where our employees live.	Employees Communities Suppliers Shareholders	Employee engagement Page 33
9 INDUSTRY, INNOVATION AND INFRASTRUCTURE	Securing sustainable quality water and supplying to domestic and commercial customers	We continuously invest in our physical assets, both above and below ground to ensure we have stable long term assets available to continue to provide water to future generations.	Environment Customers Communities Shareholders	Invest in our assets Page 30
10 REDUCED INEQUALITIES	Supporting vulnerable customers that need help paying their bill or accessing their water	We treat all members of our communities fairly and inclusively, providing a flexible service that can be used by all consumers equally, regardless of their health, age or personal circumstances.	Customers Communities	Supporting vulnerable customers Page 28
12 RESPONSIBLE CONSUMPTION AND PRODUCTION	Securing the long term provision of sustainable water for all	Our Water Resources Management Plan identifies, over a 60-year period, how we will balance available supplies with required demand, to ensure a reliable water supply for future generations. Our WRMP is available on our website: **affinitywater.co.uk/water-resources-plan**	Environment Customers Communities Regulators Shareholders	PCC reduction Page 26
13 CLIMATE ACTION	Supplying quality water for all and protecting the environment	We are continuously adapting to the challenges that climate change poses on our industry as well as considering our own impact on climate change, by looking at ways we manage our natural capital.	Environment Communities	Making sure you have enough water Page 26
14 LIFE BELOW WATER	Ensuring sustainable water sourcing and protecting the environment	We are working with stakeholders to address the environmental challenges of protecting our precious local rivers and habitats while encouraging behavioural change. We are reducing groundwater abstraction in order to leave more water in the environment to ensure we can meet future demand.	Environment Communities Regulators	Abstraction reduction Page 26
15 LIFE ON LAND	Increasing biodiversity and sustaining the environment	Our catchment management programme aims to make a positive impact on the environment by improving soil and water quality, capturing carbon, and managing flood risk.	Environment Communities	Catchment management Page 24

Strategic report continued

Our business model

Forces acting upon us

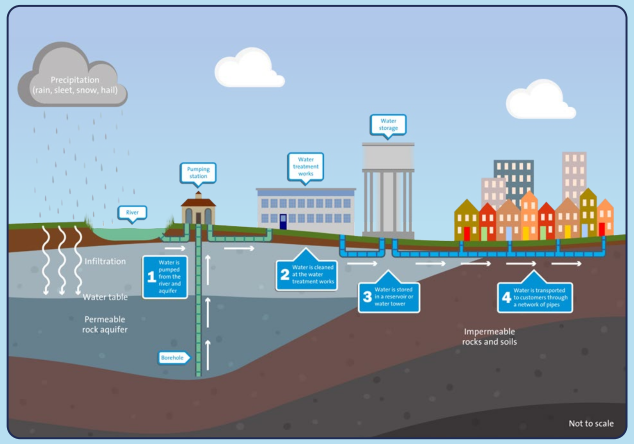
Protecting the natural environment
- Climate change
- Population growth

Regulatory and political environment
- Laws and government
- UN Sustainable Development Goals

Economic environment
- Financing our business
- Customer expectations

External pressures

The water cycle



Our capitals

Financial, Manufactured, Human, Intellectual, Natural, Social

These are the resources and relationships that we have available to us. They are the inputs to our business and are transformed through our decision making process and operating activities into our strategic outcomes.

What we stand for

Our purpose

To provide high quality drinking water for our customers and take care of the environment for our communities now and in the future.

Our vision

To be the UK's leading community-focused water company.

Our principles

Doing the right things for the customer and delivering against our commitments and promises.

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

Our strategy

Our strategic direction statement ambitions

Environment
Leave the environment in a sustainable and measurably improved state

Key strategic focus
- End unsustainable abstraction from chalk groundwater sources
- Achieve Net Zero Carbon by 2030
- Deliver a Natural Capital net gain

Customers
Deliver what our customers need, ensuring affordability for all

Key strategic focus
- Exceed customers' expectations for drinking water
- Personalise our services to support different needs and wants
- Take care of our vulnerable customers and ensure affordability for all

Communities
Work with our communities to create value for the local economy and society

Key strategic focus
- Building trust and transparency
- Enhancing environmental and societal health to provide value to our communities
- Reducing our footprint in the water environment

Resilience
Be prepared for change, and resilient to shocks and stresses

Key strategic focus
- Ensure resilient water supply for the environment and our customers
- Ensure our physical assets are resilient for the future
- Ensure our people, processes suppliers and finances remain resilient

Our plans and priorities

Our AMP7 strategic plans and priorities

- Maintain high water quality
- Catchment management
- Water treatment

- Abstraction reduction
- PCC reduction
- Leakage reduction

- Keep bills low
- Support vulnerable customers
- Improve customer experience

- Reduce supply interruptions
- Reduce risk of low pressure
- Invest in our assets

Our customer outcomes

- Supplying high quality water you can trust
- Making sure you have enough water, whilst leaving more water in the environment
- Providing a great service that you value
- Minimising disruption to you and your community

Our business priorities

- Achieving and outperforming our financial commitments
- Meeting our health, safety, regulatory and compliance obligations
- Developing a supportive culture, which enables everyone to perform to their best
- Striving to make a positive impact on the environment in all that we do

Strategic report continued

Our business model (continued)

Our Business Plan for AMP7 includes a total of 28 stretching performance commitments that will ensure we deliver our four customer outcomes. Please refer to page 35 for details on our performance against key commitments in the year.

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

Our purpose in action

Taking action to restore priceless English chalk streams

On World Rivers Day we signaled a step change in our commitment to the chalk streams, a habitat ten times rarer than coral reefs, by committing to end unsustainable abstraction from our chalk groundwater sources. To show that this was more than words we voluntarily and permanently stopped abstraction from two boreholes in the Chess catchment, within the Chiltern Hills, an Area of Outstanding Natural Beauty. Our action will help improve the ecology of the River Chess and maintain the amenity value for local communities. To promote these special habitats this was featured on Radio 4's flagship PM show and featured in the Times and Observer newspapers, where we have been acknowledged as helping to lead this important area.

We also sponsored the Chess Valley Challenge, a 10 mile walk along the River Chess bringing the local community together and raising awareness of the value of local rivers to us all. Teams from across the business adopted innovative new ways of working with our communities to make this happen.

KEY STAKEHOLDERS
- Chilterns Conversation Board
- Environment Agency
- River Chess Association
- Chilterns Chalk Streams Project
- Herts and Middlesex Wildlife Trust

CAPITALS UTILISED
- Natural
- Human
- Social

ACTIONS AND OUTPUTS

- The water abstraction reduction, follows years of investigation, trials, and collaborative efforts with local groups in the Chilterns and confirms our commitment to contribute to the restoration of globally rare chalk streams, and to protect the River Chess, a globally rare habitat.
- The voluntary abstraction reduction is an important part of company's response to protecting environment and managing the increasing challenges that impact our water resources such as climate change, growing population and higher than average water consumption in the region.
- Sponsorship of the Chess Valley Challenge, an annual event that raises money for local charity Herts and Middlesex Wildlife Trust and engages Trust members and local community that share the appreciation of local rivers and the value they provide for wellbeing, nature and water supply.
- This innovation approach for the Chess uses natural capital assessment and can support our work in other catchments to deliver improvements in natural capital and an environmental net gain.

Strategic report continued

Our business model (continued)

Supplying high quality water you can trust

MAINTAIN HIGH QUALITY WATER

We continued to supply high quality drinking water throughout the COVID-19 pandemic. Against a backdrop of a significantly altered supply pattern, we continued to see year on year improvement in our water quality through a focus on site standards and culture.

We maintained a high quality supply through targeted catchment management programmes, using the latest treatment technology and sophisticated monitoring systems at our treatment works, regularly inspecting the integrity of our storage reservoirs and operating our distribution systems in a manner that ensures water arrives at our customers' properties in the same condition as it leaves our water treatment works.

CATCHMENT MANAGEMENT

Our catchment management schemes have significantly reduced the amount of pesticides lost to water and provided enhanced resilience to drinking water quality.

We ran a programme of successful pesticide reduction schemes across our supply area with over

80 participating farms

covering eligible arable land over 122km²

For the second year running, we ran an innovative scheme in our Lee community incentivising farmers to grow cover crops over the 2020/21 winter period. We used a reverse-auction platform for farmers to bid competitively for the lowest funding to deliver the eco-system services we required.

Our aim was to work in partnership with landowners and other experts to improve water quality by reducing the amount of bare soil during the winter months, which can have a range of benefits including nitrate and carbon capture, flood risk management, soil health improvement and increased biodiversity. For more information, please refer to the case study on page 25.

WATER TREATMENT, DISTRIBUTION AND SUPPLY

During 2020/21 we reduced our energy consumption per litre of water produced at our water treatment works, delivered a larger storage maintenance program than the company has previously seen and completed the preliminary work ahead of our first solar farm.

We produced

16,400 tonnes

of sludge cake at two of our water treatment works sites which is then take and used for agricultural purposes

During 2020/21 we saw an unprecedented increase in production due to COVID-19 with more people staying at home and within our supply area. Our three supply regions, positioned to the North and West, East, and South East of London respectively, each consist of a large number of commuter towns, but with more people working from home their water usage was contained within our own supply area, rather than neighbouring regions.

Despite the increased demand, we were able to adapt our strategic supply operations to enable the early cessation of abstraction to support the River Chess and continue to look for new operational practices that would accelerate our environmental ambitions.

We have strengthened our organisational structure to improve pace and efficiency of capital maintenance activities and have created a future ready planning and maintenance focus within our operational teams. We continue to our catchment to customer journey by the strengthening of our leadership structure and operating KPI's within control operations.

Our purpose in action

Using cover crops to capture nitrates and improve raw water quality

Affinity Water and Cambridge Water are working in collaboration with farmers to expand its scheme to enhance the ecosystem services that are provided from the farmed land around its water sources. Building on the success of the 2019 cover crop scheme we have extended the pilot into the 2020/21 growing season.

Cover crops provide a range of benefits to the farmer and the wider environment, including reducing nitrate leaching and soil erosion. However, the cost of seed and establishment of the crop can put some farmers off, so this scheme allows the water companies to share the financial cost and obtain the benefits that cover crops provide.

KEY STAKEHOLDERS
- The Farming and Wildlife Advisory Group East
- Cambridge Water

CAPITALS UTILISED
- Natural
- Human
- Social

ACTIONS AND OUTPUTS

- The aim of this project is to incentivise farmers in our Lee community to grow a crop over winter not for food production, but to reduce losses of nitrate which could otherwise leach into the chalk aquifers that are used to supply drinking water.
- We partnered with Cambridge Water, the Farming and Wildlife Advisory Group East and EnTrade for the second consecutive year to run a "reverse auction" in which farmers could bid for funding for cover crops on their land.
- We have worked with 18 farms across 800 hectares. The aim of this project is to capture 37.4 tonnes of nitrate which could otherwise leach into the chalk aquifers that are used to supply drinking water.

Strategic report continued

Our business model (continued)

Making sure you have enough water, while leaving more water in the environment

We have a high dependency on groundwater sources, which account for around 60% of the water we supply and need to be replenished each year by winter rainfall.

Other than aquifers, we do not have significant storage for untreated water. We monitor our groundwater levels closely in accordance with our Drought Management Plan, and work with environmental non-governmental organisations, regulators and catchment groups recognising and communicating instances of environmental drought to our customers.

13 CLIMATE ACTION

Climate change is believed to be making periods of prolonged dry weather more intense. We saw this during 2020/21 where we had periods of very dry weather through the summer months. It is important that we can adapt to the challenges that climate change will bring and continue to use water more wisely. All three of our supply regions have been designated as areas of "serious water stress" by the Secretary of State for the Environment, Food and Rural Affairs. Protecting the rare and sensitive chalk streams within our operating area is a priority.

Climate change along with a population increase in our supply area, means that demand for water will outstrip supply by 256Ml/d by 2080. We recognise the importance of resilience and long-term planning in adapting to increased water stress, and have been looking at ways to manage our natural capital to ensure we can achieve our company purpose and address the challenges detailed above, including considering an options appraisal to deliver wider environmental benefits in line with our WRMP and understand the wider benefits of our investment.

ABSTRACTION REDUCTION

14 LIFE BELOW WATER

We are working with stakeholders to address the environmental challenges of protecting our precious local rivers and habitats while encouraging behavioural change. Most of the world's chalk streams are in the South East of England with many flowing through our supply area. They can be particularly at risk of drying up if the water table in the chalk bedrock is lowered by drought progression or locally by abstraction. We will be reducing groundwater abstraction in the Ver, Mimram, Upper Lea and Misbourne catchments by 2024 to leave more water in the environment.

LEAKAGE REDUCTION

It is essential that we continue to work hard to reduce leakage on our network; our customers expect us to lead the way and we are committed to doing so. Our CEO, Pauline Walsh, chairs the Leakage Public Interest Commitment Group, the aim of which is to work collaboratively across the water industry to understand how we improve leakage performance sharing best practice and insight. We continue to work closely with our supply chain as we trial new innovation and equipment to ensure we are doing all we can to reduce leakage.

During 2020/21, we employed ten new Leakage Control Technicians across our field teams responsible for the physical detection of leaks. We also introduced our first leakage apprenticeship scheme. Our aim is for ten apprentices to join Affinity Water each year and provide us with sustainable recruitment and succession planning. Our leakage performance is detailed on page 35.

PCC REDUCTION

Our Universal Metering Programme plans to install 200,000 meters over AMP7, as we work towards our long-term goal of 90% meter penetration by 2045. We are aiming to achieve a reduction in PCC by 12.5% over AMP7. However, we have seen consumption rise during 2020/21 as businesses close and households stay at home, following the UK Government's COVID-19 advice.

We provided

125,000+

free water saving devices in the year to help our customers to reduce consumption

12 RESPONSIBLE CONSUMPTION AND PRODUCTION

Our WRMP sets out our plan to secure the long-term provision of resilient and sustainable water supplies for customers, whilst emphasising that our customers will have enough water while leaving more water in the environment. We plan to install more water meters, increase engagement with customers on their consumption, and improve our resilience to droughts. Our WRMP is available on our website: **affinitywater.co.uk/water-resources-plan**

Our purpose in action

Our commitment to reducing leakage

With climate change, a growing population and our commitment to take less water from the environment, we know that leakage is still a serious issue and are determined to do more, hence we are now targeting a further 20% leakage reduction by 2025, having met our 15% leakage reduction target for 2015-20, which was the water industry's largest percentage leakage reduction target for AMP6.

We recorded our lowest ever levels of leakage in the prior year through a major transformation programme, better use of data, investing in the latest technologies, innovating to improve our productivity and working closely with other companies to share ideas and best practice. We aim to carry this forward into AMP7, and exceed our achievements from AMP6 to reduce our impact on the environment.

KEY STAKEHOLDERS
- IT department
- Leakage team

CAPITALS UTILISED
- Natural
- Human
- Manufactured
- Financial

ACTIONS AND OUTPUTS

- We introduced step-testing, allowing engineers to systematically work through districts and streets, using monitoring and isolation techniques to more effectively target areas suffering from water leaks, that enabled a reduction in leakage in the Kingswood area of Watford by 60%.
- We transformed our systems using a Situational Awareness solution, which is currently being used by the 24/7 network control team and by engineers in the field.
- Our in-house IT team has developed a new alerting model called SNEDS (Smart Network Event Detection System), which allows teams to respond more quickly to water supply interruptions and leaks, have instant visibility of incidents and access all the information they need to plan the best response.
- Leak noise mapping has been tracking unusual water use during night-time when water use is typically low.
- We introduced state-of-the-art high frequency correlators by Engima and Gutermann, which allows engineers to pinpoint leaks quicker and with greater accuracy and efficiency, especially on plastic pipes. They have also reduced the amount of 'dry holes' that are dug to find leaks on pipes, which has helped to reduce impact on local traffic as leaks are now located more precisely.
- By leading by example and reducing our leakage, we hope to encourage our customers to be mindful of their own water usage and have a positive impact on the environment. In future years, we hope to be able to measure the financial benefit of reducing our leakage on the environment and wider communities as part of natural capital appraisal analysis.

Strategic report continued

Our business model (continued)

Providing a great service that you value

We are privileged to serve our communities. Being the monopoly supplier and steward of a precious resource for future generations, we are acutely aware that we must continually invest in building trust and legitimacy with our customers and make ourselves accountable to our communities for our performance.

Our vision to be the UK's leading community-focused water company reflects the importance we place on the way our people work within the communities we serve. By continually increasing our focus on customers we strive to deliver improvements in the service we provide.

KEEPING BILLS LOW

Our challenge is to achieve value for money for customers whilst also creating value for investors. Value for money for customers is achieved by delivering the standards of service customers expect along with the performance commitments included in our Business Plan at a reasonable price (refer to the table on page 22). We create investor value by outperforming in selected areas, thereby receiving regulatory rewards for doing so and through effective risk management to reduce cash flow volatility.

Our AMP7 price control set an initial drop in revenue, followed by real terms increases, so household bills in 2021/22 are expected to be about 2% higher than in 2020/21.

10 REDUCED INEQUALITIES

We have been addressing affordability issues through social tariffs, improving customer awareness of help available to pay their bills and our commitments to value for money and living wage. Affordability of our water bills is an acute issue in some of the communities we serve. It can be exacerbated by changes in sewerage charges, set by wastewater companies but which are billed to the majority of our household customers and which we collect on behalf of other companies.

We have redesigned our bills to make them clearer, more compelling and to encourage our customers to start saving water. The new look bill gives our customers more context about the water they use and provides a comparison with average similar-sized households in their area.

SUPPORTING VULNERABLE CUSTOMERS

10 REDUCED INEQUALITIES

We treat all members of our communities fairly and inclusively. For the third year running, we have been recognised and verified by the British Standards Institution for our inclusive services, demonstrating that we are providing a fair, flexible service that can be used by all consumers equally, regardless of their health, age or personal circumstances.

We recognise that many households are facing difficulties at this time, so we have been proactively contacting customers who we believe might be more impacted as a result of the COVID-19 pandemic. We have designed a dedicated 'Money Worries' web page to allow customers to see the different ways that we have assisted other customers who have had problems paying. Our financial help packages include a range of different payment options and budgeting schemes, variable tariffs, and our priority services register.

85,000 households are now supported by our social tariffs

and **66,000** households are listed on our Priority Services Register

IMPROVING CUSTOMER EXPERIENCE

Providing excellent customer experience for customers and developers is fundamental for maintaining trust and confidence in the water sector. Written complaints have fallen 19.2%, and escalations have fallen 55.2%, compared with 2019/20, however, our C-MeX score during the year ended 31 March 2021 was 77.88 compared to a mean industry average of 81.62, ranking us 15th out of 17 companies. Our D-MeX score during the year ended 31 March 2021 equated to 84.39 against an industry mean average of 82.44, ranking us 10th out of 17 companies.

Customer service is of utmost importance to us, and we recognise there are many areas we need to improve on in order to climb up the league table and reach our ultimate goal of a top 4 ranking by the end of AMP7.

We are launching a brand campaign in 2021/22 aimed at improving customer awareness, perception of value for money, and trust, in addition to changing behaviours around water usage. For more information on our C-MeX and D-MeX scores, please refer to our operational performance on page 35.

Our purpose in action

'Save 10 a Day' campaign to reduce per capita consumption

Our 'Save 10 a Day' campaign was run in the St Albans district area between October and December 2020.

It encouraged customers to value their water, to the extent where they were prepared to change their behaviour and use less water in the short- and long-term.

By using less water, residents were not only saving money, but they were also helping to protect their local globally rare chalk stream, the River Ver.

We partnered with GetWaterFit, a national water efficiency platform, and asked St Albans residents to each save 10 litres of water per day by signing up to water saving challenges and ordering water saving devices. Participants were also able to donate virtual 'coins' to local charities which resulted in Affinity Water donating £10,000 between five local causes.

The campaign drove collaboration with local stakeholders, businesses and community groups in St Albans, and celebrated the local environment, whilst contributing to our PCC household consumption targets.

KEY STAKEHOLDERS
- St Albans community groups
- Local schools and businesses
- Media and social media

CAPITALS UTILISED
- Natural
- Human
- Social

ACTIONS AND OUTPUTS

- This campaign is one of the most successful that we have run, with over 100,000 campaign emails opened, messages seen over 2.16 million times and customers engaging with our content more than 275,000 times.
- We used multi-channel engagement with the St Albans community during the campaign, including via radio, newspapers, local influencers, social media, charities, MPs and schools which helped build a hyperlocal community focus. We also commissioned a local artist, Zoe Andrews, from 'Herts Chalk Walk' to create two large scale chalk drawings of the River Ver.
- As a result of the campaign, we saw between 0.5 and 0.7 Ml/d reduction in water use in St Albans, with 61% of customers saying that they had consciously started using less water, which helps to leave more water in the environment and available for future generations.

Strategic report continued

Our business model (continued)

Minimising disruption to you and your community

Maintaining the health of our assets is essential to ensure we can operate 24 hours a day, 365 days a year, and to make sure we promptly respond to emergency failures. This has remained a key focus throughout the COVID-19 pandemic, with our employees classified as key workers to enable us to continue meeting our objectives.

REDUCE SUPPLY INTERRUPTIONS

We have made considerable improvements during 2020/21 to reduce the impact of supply interruptions to customers. We have changed our mentality to concentrate on 'water always on' through providing alternative supplies rather than prioritising fixing the burst as we have done in the past.

This change of focus has resulted in a significant improvement in our interruptions to supply greater than three hours target, based on average time per property. However we did miss our target of having no more than 320 properties having an interruption to their supply greater than 12 hours, largely due to one single incident where there was no alternative method of supply to these customers.

REDUCE RISK OF LOW PRESSURE

We have a performance commitment to reduce the number of properties at risk of receiving low pressure, however the COVID-19 pandemic has changed the way our customers are using water. Lockdowns, school closures and more people working at home has changed the balance of water consumed by customers and businesses, as well as the volume, and time of day.

Typically, our water networks are designed to cope with two peaks in demand during the day. The first, in the morning before our customers go to work and school, and the second, in the early evening when they return home. During 2020/21 more water has been used by our household customers than our commercial and industrial customers due to the actions taken to control the pandemic.

We have invested £3.0m during 2020/21 in order to meet our pressure obligations at approximately 100 locations in our supply area, and continue to monitor pressures on our network and respond to any low pressure risks in a manner that maximises the benefit to our customers.

INVEST IN OUR ASSETS

We continuously invest in our physical assets, both above and below ground, as well as meeting our environmental obligations such as biodiversity. We balance costs, risks, and performance to ensure we prioritise our investments. This year, we have spent £128.2m to meet our commitments to our customers and the environment. This investment will be key to maintaining resilience in our network.

To minimise disruption in our communities, we have a proactive approach to replacing our underground assets based on age, condition, and burst history. We met our mains renewals target of 13.6km by 31 March 2021, of which 0.8km were trunk mains, despite our AMP7 investment programme being delayed slightly as all non-essential work ceased during the UK Government's first national lockdown period.

During 2020/21, we assessed 10% of the monitoring equipment on our larger diameter pipes, upgrading where our risk assessment found it necessary. We also explored innovation in leakage detection and network monitoring to be able to find and respond to bursts, and to resolve any water supply issues as quickly as possible.

Since its inception in 1992, our Asset Performance Lab has processed more than
6,600 pipe samples
allowing us to determine deterioration rates and inform future investment

Above ground, we investigated more efficient ways to abstract, treat and pump water, balancing age and increasing maintenance costs with capital investment for more efficient assets.

We accelerated our pump efficiency programme to maximise efficiency savings in AMP7. In 2020/21, we improved the efficiency of 27 pumps, which included 11 refurbishments. We also completed 11 reactive replacements or refurbishments. By building a 'digital twin' of our supply system, we can stress-test our assets to optimise their operation and identify requirements for future investment.

Our purpose in action

Environmental innovation to revitalise chalk streams

Our Revitalising Chalk Rivers programme creates resilient river systems by restoring rivers and enhancing habitats. Many chalk streams have been mismanaged for decades, often reducing biodiversity and the number of available habitats.

These historic moderations have made it difficult for rivers to cope with natural variations in flow. Recognising the importance of the landscape in which the river lies, we have begun the painstaking work of restoring the South East's rivers.

We have developed a new innovative way to deliver holistic catchment improvements to benefit local communities, environment and drinking water resilience, all in support of the revitalisation of chalk streams in our supply area.

KEY STAKEHOLDERS
- Thames Water
- Arup
- Cambridge University
- Environment Agency
- River Restoration Centre
- Chalk Stream First
- Chilterns Chalk Streams Project
- River Beane Restoration Association.

CAPITALS UTILISED
- Natural
- Intellectual

ACTIONS AND OUTPUTS

- We developed a new framework and resilience metrics to establish baseline health of chalk streams in the Chilterns Area of Outstanding Natural Beauty beyond regulatory framework.
- We consolidated a range of existing evidence and data and established a clear vision and strategy for improving chalk streams across England.
- An Independent Panel has been created to scrutinise the work that brought together various stakeholders representing national and local interest groups, regulators, water companies, politicians, academics and experts in river restoration, to improve the unique habitat of our precious chalk streams.
- A new approach to defining catchment plans has been established, with new framework, assessment methodology and chalk stream 'health metrics' to ensure that the progress can be closely monitored with real change made visible.

Strategic report continued

Our people

Our people play a critical role in creating long-term value. Attracting and retaining highly motivated people who are proud to work for us is central to our ability to deliver an outstanding service for customers.

COVID-19 has changed the way we live and the way we work. During 2020/21, our teams have been exceptional in ensuring our customers receive the high-quality drinking water they rely on. We have had a large number of employees working from home, including our customer contact centre which has remained fully operational. We have not furloughed any of our direct employees throughout the pandemic.

TRAINING AND DEVELOPMENT

4 QUALITY EDUCATION

We have created a strong culture of learning and development, through significant investment in training. We introduced specific remote management training for all managers to assist with how they can continue to motivate and inspire their teams during the COVID-19 pandemic and beyond. Where required and in line with our commitment to safety and health, we continued to provide mandatory classroom based training to ensure all our employees were provided with the right skills to perform their roles, with all sessions conducted in line with Government guidance to provide a COVID-secure environment.

During 2020/21, we invested in programmes that focus on business transformation, responsive working practices and management development, all which will help to improve customer satisfaction. With a focus on the wellbeing of our employees, we introduced several interactive Mental Health seminars and provided material on our intranet, consisting of webinars, tools and guidance. We have launched a new Apprenticeship programme for Leakage and Customer Service Technicians.

Delivering our commitments is underpinned by our Business Excellence programme. We have trained 39 green and 69 yellow belts in Lean Six Sigma, a method relying on team collaboration to improve performance, to identify how they can add value for colleagues, customers and stakeholders by streamlining processes and thereby increasing efficiencies across the business.

SAFETY, HEALTH AND WELLBEING

242 line managers

have been trained in Mental Health Awareness to raise their understanding of mental health

The safety, health and wellbeing of our people and suppliers are priorities we take very seriously, and we are committed to operate our business without harm. To drive continuous improvement across these areas, our 2020/21 Improvement Plan was developed and includes activities which will build on our leadership, behaviours and wellbeing.

The year has been particularly challenging with the pandemic and we have had the need to adapt our workplaces ensuring they are COVID-19 secure and that our teams working in the field are given the appropriate levels of protection to keep them safe. Many of our people are working from home and we have worked to ensure their safety and wellbeing is also given the highest priority.

A number of immediate short- and long-term measures have been put in place to provide employee support. A Wellbeing Committee has been launched with representation from across the business. We also established a wellbeing platform and increased our regular communications with all our employees through podcasts recorded by our CEO twice each week and live manager briefings held virtually every fortnight.

86% of respondents

to our wellbeing survey conducted in May 2020, agreed that the company was supporting their health and wellbeing during the COVID-19 pandemic

Our people are encouraged to discuss safety at every opportunity, spot unsafe behaviour and take ownership to stop it, and to report and resolve unsafe conditions.

There has been a strong focus on wellbeing and mental health, with a number of webinars organised for people to attend as they wished. Resultantly, our lost time injury frequency rate reduced to 0.12 lost time injuries per 100,000 hours worked for the year ended 31 March 2021 (31 March 2020: 0.20).

OUR SUPPLIERS

Our suppliers and contractors provide us with essential services which we rely on to deliver our short and long-term plans. Unfortunately, our average time to pay invoices increased between April 2020 and April 2021 (from 35 to 46 days) as did the number of invoices paid late (from 38% to 44%). We recognise there is room for improvement and will continue to monitor our performance and maintain ongoing communication with all stakeholders to facilitate more efficient invoice processing and payments.

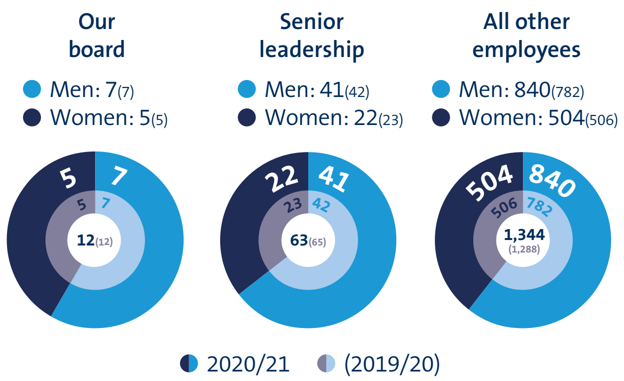
DIVERSITY AND EQUALITY

The Equality, Diversity and Inclusion ('EDI') Committee have continued their great work. We have joined with EU Skills and committed to report our diversity data to help understand the challenges our industry faces, including gender, BAME and age of employees. Other key highlights include celebrating World Religion Day through blogs and webinars.

5 GENDER EQUALITY

We published our Gender Pay report of April 2020 data on our website: **affinitywater.co.uk/responsibility** which showed a 1.6% widening in our mean gender pay gap from 19.0% in April 2019 to 20.6% in April 2020, primarily due to the proportion of women in administrative roles increasing, whilst the proportion in senior leadership decreased. For details on the work we are doing to reduce the gap, see page 88.

The gender breakdown of our directors and employees as at 31 March is shown below:



Senior Leaderships include the Executive Management Team and their direct reports

EMPLOYEE ENGAGEMENT

8 DECENT WORK AND ECONOMIC GROWTH

Our culture and ways of working are based on five key principles which are embedded in everything we do. We have introduced a monthly peer recognition scheme to recognise these achievements from colleagues across the business. To support our culture and principles we also have a dedicated team of Culture Ambassadors who represent the interests and views of their colleagues. The Culture Ambassadors provide cross functional feedback and support the introduction of new activities to drive change and transformation.

38 people appointed as Culture Ambassadors and

13 people appointed as Diversity and Inclusion Ambassadors

Trevor Didcock, one of our Independent Non-Executive Directors, is the Designated Director for Employee Engagement. His role ensures that the voice of the workforce is heard and considered at Board level. Trevor is also a member of our Diversity and Inclusion Committee responsible for bringing to life our commitment to build a more inclusive culture and attend the Culture Ambassador Forums to drive cultural change across the company. For information on the Board's involvement in establishing our purpose, values and culture, and in monitoring values and culture to satisfy itself that behaviour throughout the business is aligned with the company's purpose, refer to page 77.

Our people are actively involved and engaged in driving our business outcomes and we have several initiatives in place to ensure that we listen and act upon their ideas to continuously improve life at Affinity Water.

In response to COVID-19 we held regular briefing calls with our leaders and across the company to relay key messages and to ensure that we clearly understood the issues our teams were facing. These were a highly effective way to gauge sentiment, understand the issues and put in place initiatives and plans to support our teams. We have seen a real increase in engagement levels from across the business during this difficult period.

Strategic report continued

Our industry

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

Ofwat | Environment Agency | dwi | Department for Environment Food & Rural Affairs | NATURAL ENGLAND | CCW

POLITICAL AND REGULATORY ENVIRONMENT

During 2020/21, we have operated in extraordinary circumstances, against the political backdrop of the COVID-19 pandemic and the Government's restrictions intended to safeguard public health. We have implemented all the changes necessary to our operations to comply with the Government's instructions and to prioritise service continuity, adapting our ways of working as the pandemic evolved throughout the year. We have continued to cooperate with the Government, our regulators and other authorities to maintain the vital public water supply service.

Our new price controls for the period 2020-25 took effect this year. We have operated our business to deliver against the substantial challenges embodied in our five-year settlement although circumstances this year have been extremely difficult.

The Competition and Markets Authority ('CMA') published its final determination of 2020-25 controls for the four companies who appealed against their Final Determination, bringing PR19 to a close. Ofwat has already began work on the next price control review, PR24.

ECONOMIC REGULATION

Our business is a regional monopoly and is subject to incentive-based economic regulation by Ofwat. In the period 2020-25 we are subject to strict revenue controls, designed to incentivise efficiency in operations and investment decisions.

Our wholesale revenue control is disaggregated into a 'water resources' control (abstraction) and a 'network plus' control (raw water transport, storage, treatment and treated water distribution). The wholesale revenue controls are based on incentives related to total expenditure. Our retail household price control continues to operate on a maximum allowed revenue per customer basis in order to drive efficiency.

Ofwat assess our operational performance against agreed performance commitments. Each performance commitment contains an ODI, which can carry a financial reward, penalty or both, which from 2021 onwards, for PCC, will not be realised 'in-period' due to COVID-19 and will be part of PR24. There are also reputational consequences for failures against performance commitments.

We operate eight ODIs with performance measures and financial incentives that are common across all companies and nine ODIs with financial incentives that are bespoke to us. A further 11 bespoke ODIs do not carry financial penalties, but if we fail to meet the standards required, we are likely to worsen our reputation with stakeholders. More information on our PR19 price control determination is available on our website: **affinitywater.co.uk/business-plan**

NON-HOUSEHOLD RETAIL MARKET

We operate as a wholesaler in the non-household retail market and achieved 4th place out of 15 companies in the R-Mex survey league table for 2020/21. We are also consistently within the top three performers for the industry's operational performance measures and finished 2020/21 year in 9th position out of 15 for market performance.

During 2020/21 we consulted with industry stakeholders regarding a range of options for simplifying our wholesale tariffs and we intend to continue this dialogue whilst supporting the work the industry-led Retailer Wholesaler Group is doing on this topic.

We also launched an alternative eligible credit product designed to both support the needs of retailer's already operating in our supply region and to encourage new entrants, with 11 retailers now benefiting from this arrangement. We have also grown the meter reading services we offer in our supply region, now providing reads to 14 out of the 24 retailers active in our area, representing approximately 90% of metered supply points.

Operational performance

We have aligned our operational KPIs to our key performance commitments in response to customer expectations.

We want customers and stakeholders to be able to assess our track record and hold us to account.

We are required to report our performance against targets set by Ofwat, the DWI and Defra. These targets include the performance commitments made in our AMP7 Business Plan.

Our performance in relation to these targets for 2020/21 is analysed in the tables below.

For more information on our performance for 2020/21 in relation to all 28 of the performance commitments we made in our AMP7 Business Plan refer to section 3 of our regulatory Annual Performance Report, beginning on page 250.

KPI: Water quality CRI (Score)	
Actual: **1.31** Target: **2.0**	In the calendar year 2020 there were 30 exceedances of the relevant water quality standards from just under 180,000 compliance tests (0.017%) taken from our sites and consumer properties (2019: 50 exceedances from 190,000 compliance tests, 0.026%). Due to COVID-19 related restrictions, we were unable to take samples from randomly chosen properties, as required by the Water Supply (Water Quality) Regulations 2016 (as amended), from March 2020 onwards. Where possible we used fixed sample points and managed to collect over 85% of our expected consumer property sampling programme. This reduction in sample and associated tests as well as the non-random nature of the sampling does account for some of the reduction in exceedances seen in 2020. A new measure, CRI, has been introduced to measure water quality performance in AMP7 which measures the compliance risk of every exceedance. We have estimated our CRI score for 2020 to be 1.31 (final score to be published in July 2021 by the DWI) which met our performance commitment of having a CRI score within the deadband of 2.0 or less. Another measure of our performance is the number of serious and significant water quality events. During 2020 three events notified to the DWI were classified as serious or significant (2019: one event).

KPI: Leakage Average annual water leakage from our network (Ml/d)	
Actual: **171.4** Target: **157.8 or less**	We have committed to reducing leakage by 20% across the whole of AMP7, on top of the 15% delivered in AMP6, but we did not meet our target for the year despite investing both in additional resources and new technology to improve our leakage performance. We recorded leakage of 171.4 Ml/d, a reduction of 9.7 Ml/d compared to the prior year, although not achieving our target of less than 157.8 Ml/d for 2020/21. We invested in the latest acoustic leak detection equipment at the same time as using artificial intelligence to enhance our existing equipment and infrastructure. We also introduced a new customer side leakage policy and process that enables us to carry out free repairs on high volume leaks. We continue to closely monitor lower volume leaks, working collaboratively with our customers to get them fixed. Leakage is really important to us and we are very disappointed to have missed our target. We understand that it is a critical customer priority and one that raises significant emotion. We need to change our approach if we are to succeed in meeting our stretching leakage targets and are making significant changes to how we manage leakage. This includes bringing in new methods and technologies and targeting our approach to maximise the benefit delivered both in amount of water saved and in managing visible leaks. We have set up an internal taskforce to manage this critically important work.

KPI: PCC Average water use (l/p/d)	
Actual: **169.3** Target: **147.4 or less**	During 2020/21 we recorded PCC of 169.3 l/p/d, which is an increase of 14.3 l/p/d (9.2%) on the prior year (2020: 155.0 l/p/d). We experienced an unprecedented year for demand due to more people staying at home and within our supply area as a result of COVID-19, coupled with the hot weather period from May 2020 to August 2020, and had to adapt our delivery plan as a result, including offering virtual Home Water Efficiency Checks and retraining technicians. We also launched our 'Save 10 a Day' marketing campaign as outlined in our case study on page 29, and followed this up in April 2021 with the launch of our 'Save Our Streams' campaign We also met our target of installing 25,000 new meters during 2020/21 as part of our Universal Metering Programme which aims to install 200,000 meters across AMP7, as part of a plan to reduce water wastage by 130 Ml/d by 2025. We met our 2020/21 target despite putting the programme on hold during the first half of the year, and then working to new COVID-19 guidelines when it was safe for us to resume this activity.

Strategic report continued

Operational performance (continued)

KPI: C-Mex
(Score)

Actual: **15th**
Target: **14th**

In 2020/21, C-MeX, the new mechanism introduced by Ofwat for measuring customer experience, went live. This followed its successful testing during the 2019/20 shadow year. There are two elements of C-MeX, the Customer Service Survey and the Customer Experience Survey. Our overall C-MeX score during the year ended 31 March 2021 equated to 77.88, compared to an industry average of 81.62. Whilst our score represented a small improvement upon the shadow year, our ranking of 15th of the 17 water companies remained static.

This year, we have worked to bring together Community Operations and Customer Experience into one directorate focused on delivering improved experience right across the customer journey. We have introduced new operating models in operational teams, multi-skilled all contact centres to create a single team, enhanced our customer insights and defined new customer journeys including targeted communications with a single tone of voice, based on newly created personas.

We recognise that it is the Customer Experience element of C-MeX, based on customer perception and awareness, that has pulled down our score this year. In 2021/22 we will be launching an unprecedented brand campaign aimed at improving customer awareness, perception of value for money, and trust, in addition to changing behaviours around water usage. Together, this will ensure we are in a stronger position to climb up the C-MeX league table.

KPI: D-Mex
(Score)

Actual: **10th**
Target: **13th**

D-MeX is the measure of developer service levels being used by Ofwat in AMP7, following a shadow year in 2019/20. The score is made up of both a qualitative and a quantitative element.

Our D-MeX score during the year ended 31 March 2021 equated to 84.39 compared to an industry mean average of 82.44. We were placed 10th out of 17 companies in the industry league table, up from 16th in the shadow year 2019/20, with consistent improvement in position quarter-on-quarter during 2020/21.

We halted Developer Services works during the first national lockdown as a result of COVID-19, which impacted negatively on our compliance levels of service metric. However, this was recovered following successful remobilisation of our teams at the end of May 2020, as effective planning helped to clear the backlog of jobs, with our quantitative performance average for the year recovering to 98%.

KPI: Mains repairs (due to bursts)
(Number per 1,000km mains)

Actual: **155.8**
Target: **150.7 or less**

We have failed to meet our target of 150.7 burst repairs per 1,000km of mains in the year. This has been a challenging target and performance was on track until the severe weather hit in February 2021, as the number of bursts rose significantly during the freeze and subsequent thaw, with the impact being similar to the previous such incident, the 'Beast from the East' in 2018.

Moving into the new year we will continue to focus on reducing night pressures, reducing volatility of our network and continuing analysis of where and when bursts occur to inform our mains renewals programme.

KPI: Water Supply Interruptions > 3 hours
(Average minutes per property, water supply interruption)

Actual: **5 minutes and 49 seconds**
Target: **6 minutes and 30 seconds**

We have achieved our target of 6 minutes and 30 seconds as the average number of minutes our customer base has been affected by a supply interruption in the year.

This is the first year this has been a performance commitment for the company, although the metric has been tracked in preceding years. Considerable improvements have been made over the year reducing our impact to customers, reducing our prior year performance by nearly eight minutes from 13 minutes and 36 seconds in 2019/20.

Changing the company mentality to concentrate on 'water always on' rather than fixing the burst has been instrumental in improving our performance. We are continuing to look at reductions in response times, availability of resources and innovative methods of ensuring water is always on.

KPI: Properties at risk of low pressure
(Number per 10,000 properties)

Actual: **196.850**
Target: **1.645**

We have failed to meet our target of 1.645 properties at risk of low pressure per 10,000 properties, as the COVID-19 pandemic has significantly changed the way our customers are using water.

Typically, our water networks are designed to cope with two peaks in demand during the day. The first in the morning before our customers go to work and school, and the second, in the early evening when they return home. This has not been the case during 2020/21 due to the actions taken to control the pandemic, with lockdowns, school closures and more people working at home changing the balance of water consumed by customers and businesses, as well as the volume, and time of day, which has ultimately increased the risk of properties receiving low pressure.

Going forward we will continue to monitor pressure on the network to understand what the "new normal" is, and how we can best respond to the pressure needs of our customers. We may need to adjust our current normal management of the network, with more of our customers working at home for at least part of the week.

KPI: Unplanned interruptions to supply over 12 hours
(Number of properties)

Actual: **538**
Target: **320 or less**

We have failed to meet our target for unplanned interruptions greater than 12 hours and have incurred the full ODI penalty. This is a very disappointing result as we have been working hard to focus our resources to a 'water always on' mindset. 468 of the properties affected were the result of a single incident where there was no alternative method of supply to these customers.

Focus for the coming year remains on improving response times, increasing local resources and alternative methods of continuing to ensure the water supply to customers properties is not interrupted.

KPI: Accident frequency rate
(Number of lost time injuries per 100,000 hours worked)

Actual: **0.12**
Target: **0.20 or less**

As part of our drive for continuous improvement and to ensure we strengthen our Safety, Health and Environmental ('SHE') practices, we developed a 2020/21 SHE Improvement Plan. This has five key areas of focus which include Embrace Leadership Behaviours and Enhance Capabilities, Occupational and Functional Safety, and Wellbeing and Health. Teams across the business are helping to deliver the plan.

During 2020/21, we recorded three work related lost time injuries, having a frequency rate of 0.12 lost time injuries per 100,000 hours worked. This is the lowest score we have ever recorded, and compares to five lost time injuries in 2019/20 with a frequency rate of 0.20.

We have continued to see improvements in our safety performance, but we know we cannot become complacent. See page 32 for more details on our approach to safety and health.

Strategic report continued

Principal risks and uncertainties

RISK MANAGEMENT

We have an established framework for identifying, evaluating and managing the key risks we face. A key aim is to foster a culture in which teams throughout the business manage risks as part of their management of day-to-day operations. Our Executive Management Team ('EMT') also carries out regular assessments of emerging risks, including horizon scanning and monitoring of early warning indicators.

Operational risks are recorded and assessed, including existing management and control processes, and action plans are prepared, if necessary, to implement further mitigation. Activities against these plans are monitored on an on-going basis. Operational risks are also ranked by our teams during the year. Based on these rankings the most significant risks are discussed by our senior management and included in the strategic risk register, which is reviewed by the Board and the Audit, Risk and Assurance Committee. The latter reviews senior management's work on risk management and reports to the Board on the effectiveness of risk management processes.

For more information on the responsibilities of the Board and the Audit, Risk and Assurance Committee in relation to risk management and internal control refer to page 99 onwards.

EMERGING RISKS

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

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

The EMT holds regular sessions to identify and review current and emerging risks. Along with the strategic risks, these are reviewed at least quarterly by the EMT and at least twice-yearly by the Board.

Our current emerging risks are as follows:

A. Failure to respond to shifts in societal and political expectations and perceptions and rising levels of activism.

B. Skills gaps or unavailability due to an increasingly nomadic workforce, and ongoing pandemic impacts including economic uncertainty.

C. Changes to our supply chain (in particular, materials and resources) and to the water sector arising from Brexit, the COVID-19 pandemic and general economic uncertainty.

D. Changes to the power industry, including regional differences in pricing, reliability of service, etc.

E. Failure to sufficiently quickly react to changes in society; and customer demand and expectations (including environmental considerations) post-pandemic and post-Brexit.

We will continue to keep these and other emerging risks under regular and close review.

COVID-19

A national health pandemic, including COVID-19, has been included as a principal operating risk. We have assessed this risk, and the other principal risks, on the assumption that the impact of COVID-19 will significantly reduce over the course of 2021/22. The potential longer term impacts of COVID-19 are assessed in the viability statement on page 50.

CLIMATE CHANGE

Climate change is one of the greatest challenges for the industry as a whole and this challenge appears likely to increase in the coming years. Sustainability and resilience in the light of this challenge is important in maintaining the trust of our customers and regulators.

Climate change can have short and long-term impacts on our assets, our operations and, therefore, the services we provide. The most recent significant example was the extreme weather much of the UK experienced in March 2018. Whilst we dealt with that situation very effectively and efficiently, we took the opportunity to review and revise our business continuity and emergency response arrangements. Those arrangements continued to serve us well throughout 2020/21 in coping with the COVID-19 pandemic.

We have identified climate change as an underlying cause of many of the principal risks listed below, in particular numbers 2, 5 and 7. We have also, therefore, documented in our risk registers, where appropriate, controls in place to mitigate as far as possible the potential effects of climate change in elevating those risks. We will continue to monitor climate change and its impacts on our operations as well as the effectiveness and efficiency of our mitigating controls, with the objective of ensuring our ongoing sustainability and resilience.

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

PRINCIPAL RISKS

The following have been identified from our risk management analysis as potentially having material adverse effects on our business, financial condition, results of operations and reputation.

They are managed as described but are not always wholly within our control and may still result in material adverse impacts. Factors other than those listed could also have a material adverse effect on our business activities.

TABLE KEY

(a) Risks included in the sensitivity stress testing for the viability statement (refer to page 50). The directors consider that none of these risks would in isolation compromise the company's financial viability during the lookout period. Instead, these risks could be considered as part of a number of different severe, plausible and reasonable sensitivities to the company's base case forecast.

(b) Risk included in the scenario stress testing for the viability statement (refer to page 50). The directors considered that these risks, if they were to occur, might in isolation threaten financial viability potentially leading to significant unforeseen additional cash requirements during the lookout period in the event of the significant events detailed on page 52 of the viability statement.

We have identified 14 principal risks to our business in three categories:

OPERATIONAL RISKS

1.	Some of our work activities could cause serious harm to our employees, contractors or members of the public	a
2.	We may become unable to meet our obligations to provide a sufficient supply of high-quality drinking water	b
3.	We may fail to attract, develop and retain employees with the competencies, values and behaviours required to engage with and promote our corporate culture, and deliver our strategic ambition and business outcomes	a
4.	Availability, confidentiality or integrity of information or data could become compromised	b
5.	We may fail to deliver our business plan, commitments and service to customers	a
6.	Our supply chain may fail to deliver the goods and services we need to operate our business	a
7.	i) We could cause damage to the environment in the course of our business activities; or ii) climate change and other environmental factors could negatively impact our business operations	a
8.	We may fail to implement the cultural and operational transformation of our business necessary to deliver our business plan obligations	a
9.	A national health pandemic or similar event could cause severe disruption to our normal business activities	a
10.	The health of our assets may deteriorate such that water supply or quality is compromised	b

Strategic report continued

Principal risks and uncertainties (continued)

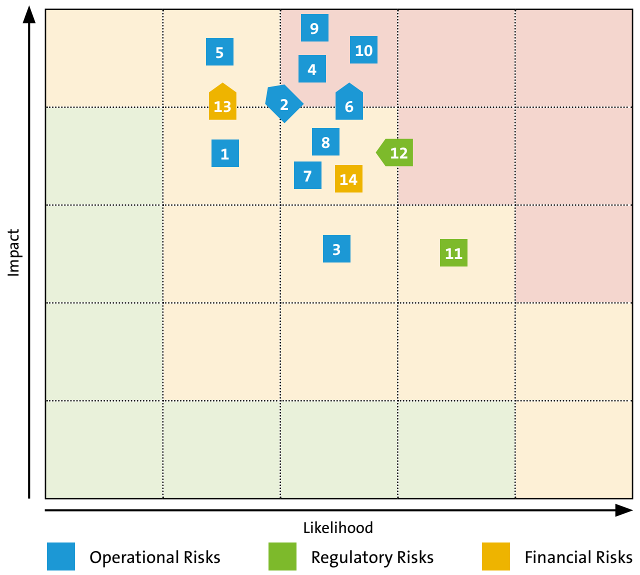
REGULATORY RISKS

11.	Changes could occur in the legal and regulatory framework, or social or political climate, which have significant effects on our operational or financial performance	a
12.	We may inadvertently fail to comply with laws and obligations under our instrument of appointment	a

FINANCIAL RISKS

13.	We could fail to maintain or renew appropriate financing for our business activities	a
14.	Macro-economic factors (interest rate, inflation and tax risks) could have a material adverse effect on our financial performance	a

The heat map below shows a summary view of our current assessments of our principal risks. In this heatmap we have highlighted those risks where, during the financial year, we have revised the impact and/or likelihood assessments for individual risks due to changing circumstances.



Our Risk Management Framework defines our methodology for assessing likelihood and impact scores for our strategic and operational risks. To determine impact scores we take account of the estimated extent of various types of consequences, including health and safety; people; financial; and reputational. Our likelihood scores are assessed on the basis of estimated frequency of occurrence and probability of occurrence within a 5-year period.

The following pages describe these risks in more detail, including descriptions of the main mitigating controls which we have operated throughout the financial year.

MAIN CHANGES SINCE 2019/20

We have carried out an exercise to rearticulate our principal risks in order to ensure that they clearly describe the events which, if they were to occur, could result in significant detrimental impacts on our operational or financial performance.

This year we have added the following risk to our report:

10. The health of our assets may deteriorate such that water supply or quality is compromised.

This risk had already been captured in our operational risk registers and as an underlying cause for other principal risks. However, during the year we came to recognise that this needed to be identified and monitored as a principal risk in its own right, particularly due to the increased importance of corporate resilience in ensuring that we can effectively deal with the challenges posed by changing patterns of demand caused by the COVID-19 pandemic.

As mentioned elsewhere in this report, throughout the financial year we have been dealing with the various operational and financial impacts on our business caused by the COVID-19 pandemic. Our business continuity arrangements have continued to allow us to continue to provide the vast majority of our services to customers whilst ensuring the health and wellbeing of our employees.

Currently, there is continued uncertainty with regards to how long the pandemic will last; although the ongoing rollout of various vaccines provides some confidence that numbers of infections and fatalities will continue to significantly decrease.

However, we do not under-estimate the challenges that will arise in the near future as and when new "normal" societal behaviours emerge.

OPERATIONAL RISKS

1. Some of our work activities could cause serious harm to our employees, contractors or members of the public (a)

Risk: Failing to manage this risk may result in personal injury or occupational ill-health, disruption to operations, reputational damage, criminal fines, civil damages and regulatory penalties.

Mitigation: We seek to operate our business using our Health & Safety management system, which is externally verified and certified to ISO 45001. This encompasses policies, procedures, guidance and risk assessment protocols.

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

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

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

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

2. We may become unable to meet our obligations to provide a sufficient supply of high-quality drinking water (b)

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

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

Interruptions to supply (or supply restrictions) caused by drought, water resource restrictions, changes in quality of water supplies, extreme weather events (extremely cold or prolonged hot weather), flooding events, terrorist attacks, cyber events, civil unrest, disease or misinformation in the media with regards to the quality of our water could impact on the health, safety and security of our people or communities, or on our financial position and our reputation.

Mitigation: We manage this risk through:
- competent staff and processes which are reviewed continuously as part of our Quality management System and through Lean improvement processes;
- our WRMP which identifies, over a 60-year period, how we will balance available supplies and required demand with sufficient headroom for unplanned outage;
- our Water Saving Programme, including new customer meters, water efficiency and leakage reduction, which allows us to maintain headroom as demand grows through new building developments and our supply base is eroded by committed sustainable abstraction reductions;
- investment in our trunk main assets to keep their condition stable through targeted renewal;
- our implementation of improvements to increase resilience through measures such as moving and protecting pipework, protecting electrical and control infrastructure, removing single points of failure, implementing treatment upgrades and increasing connectivity to provide greater flexibility of operation;
- our Drought Management Plan which is approved by the Secretary of State; and
- our emergency and business continuity plans.

Strategic report continued

Principal risks and uncertainties (continued)

OPERATIONAL RISKS (CONTINUED)

2. We may become unable to meet our obligations to provide a sufficient supply of high-quality drinking water (continued) b

Risk (continued): The risk with respect to availability of water remains relatively high for us, as we operate in an area of serious water stress. This, coupled with high demand (PCC) from our consumers, housing and other development in the South East, the construction of the HS2 railway, and other potential large capital infrastructure projects have the potential to further increase this risk. Furthermore, climate change and long-term weather trends, such as global warming, appear to be contributing to a more unpredictable climate in the UK. A lack of resilience to these extremes could result in disruptions to customer service and impinge on delivery of our business plan.	**Mitigation (continued):** We have good working relationships with our neighbouring water companies from whom we import and to whom we export water. We continue to demonstrate collaborative methods of working to ensure that we collectively meet our customers' needs. In particular, during AMP7, we are working in collaboration with other water companies to develop strategic regional water resources solutions to secure long-term resilience on behalf of customers while protecting the environment and benefiting wider society. Over the course of our reviews of this risk during the year, we determined that as this is one of our most significant risks, the impact score should be increased; but at the same time, the various developments as referred to above mean that the likelihood has reduced somewhat.

3. We may fail to attract, develop and retain employees with the competencies, values and behaviours required to engage with and promote our corporate culture, and deliver our strategic ambition and business outcomes a

Risk: It is vital that we introduce talented individuals into the organisation at all levels, in line with resource planning needs. If we are unable to fill vacant positions at the right time with the right level of skills, it will severely impact the ability of the company to achieve its business objectives.	**Mitigation:** We have a dedicated recruitment team which uses direct resourcing methods and works with identified recruitment suppliers to ensure good quality candidates are sourced. The use of the company's website is crucial in providing a strong Employee Value Proposition that will attract talent. A project is underway to provide consistency on role definition, create job families and provide salary banding for roles. During the year we have delivered a transformation programme to deliver greater employee engagement and improvements in a number of areas including performance levels; employee incentivisation and reward; employee development; and career opportunities for individual growth. We have appointed Culture Ambassadors to represent their business areas and provide feedback and support on the culture change journey. We have also embedded a revised Personal Best process, for appraisal/performance management, to attain high performance levels and achieve our business objectives. Throughout the year, we also delivered a programme of communications, webinars and management development training courses in order to ensure that our leaders and employees were provided with as much support as possible to enable them to cope with the unique challenges posed on their working lives by the COVID-19 pandemic.

4. Availability, confidentiality or integrity of information or data could become compromised b

Risk: Customer information and our data are at risk from unauthorised disclosure and improper use. In addition, our operational resilience is always subject to threats in respect of our operational technology. The General Data Protection Regulation ('GDPR') places a legal obligation on organisations to handle personal data securely, in order to avoid that data being put at risk from unauthorised or unlawful processing, accidental loss, destruction or damage. Failure to protect such information may lead to increased costs of operation, reputational damage, criminal fines and civil damages, and a reduction in the confidence that stakeholders place on the information that we publish. Non-compliance with GDPR could result in a fine of up to 4% of worldwide turnover compared to a previous maximum £500,000 fine under the Data Protection Act. As the use of online communications, cloud-based technology and the sophistication of hackers continue to increase, so too do the risks of cyber-attack and other external threats.	**Mitigation:** We continue to strengthen our capabilities to ensure that technical and organisational controls to prevent the unauthorised disclosure, loss or improper use of data are kept under review and improved where appropriate. Alignment with ISO 27001, the global information security standard, demonstrates our commitment to security best practices and ensures that we meet relevant regulatory requirements. We continue to monitor and enhance our information security management system, designed to protect us against current and future threats. Privacy impact assessments are carried out for all projects and initiatives to analyse the potential effects on the privacy of individuals. Our enterprise-level security controls, aligned with ISO 27001, are designed to secure all our information assets and therefore contribute to the protection of all the personal data which we process. As part of our AMP7 Business Plan submission, we published our Data Strategy for AMP7. Following Ofwat's initial assessment of our AMP7 Business Plan and its 2018 Company Monitoring Framework assessment, we initiated a significant programme of work to implement this strategy and achieve a number of objectives, including improvements to increase stakeholders' trust and confidence in the data and information that we publish. This work has been ongoing throughout 2020/21 and has continued into 2021/22.

Strategic report continued

Principal risks and uncertainties (continued)

OPERATIONAL RISKS (CONTINUED)

5. We may fail to deliver our business plan, commitments and service to customers a

Risk: We have made a number of performance commitments in our Business Plan which, if not met, may result in us incurring financial penalties and suffering reputational damage in the eyes of our regulators and other stakeholders.

In addition, we must implement the investment programme set out in our Business Plan. Failure to do so may lead to the imposition of sanctions, including financial penalties or other enforcement action.

It is also crucial that we provide consistently high levels of service to all customers and that they are demonstrably satisfied that we are doing so.

Failure to maintain and continually improve our levels of service in the eyes of our customers will severely impact customer satisfaction levels, volumes of complaints, and our reputation.

From the start of AMP7, two new measures of customer service have been introduced: C-MeX is a mechanism to incentivise water companies to provide an excellent customer experience for residential customers, across both the retail and wholesale parts of the value chain; D-MeX is a mechanism to incentivise water companies to provide an excellent customer experience for developer services (new connections) customers.

Mitigation: We have an established programme management function with responsibility for delivering the investment programme. The Board and senior management team monitor performance and ensure that corrective action is taken when required.

We continually monitor our performance on a wide range of Business Plan metrics and commitments and take prompt corrective action to address any indicators of under-performance.

We continue to actively manage engagement with all our regulators and other stakeholders. In particular, we work closely with our CCG, an independent body with an independent Chair, which advises, challenges and supports us in the development of our plans, to ensure that they reflect customers' priorities.

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

We have implemented a company-wide Business Excellence programme to drive a culture of continuous improvement of all business processes. This is delivering tangible benefits to our customers and our employees and helping us drive efficiencies in our everyday ways of working. We have trained over 100 people on Yellow and Green Belt in Lean/Six Sigma and they are using their newly acquired skills to help identify and solve issues, making improvements every day.

We are investing in new technologies and ways of working which will help standardise the way we work and ensure our customers receive a seamless experience regardless of where they interact with us; online, over the telephone or in their home and local community.

We actively engage with our customers on a day-to-day basis. As part of our PR19 business planning, we conducted an extensive, multi-phase customer engagement programme in order to fully understand customers' needs and expectations.

We employ a third-party customer feedback partner to measure our customer service performance. In 2020/21, our partner surveyed 116,724 customers with whom we had experienced some interaction. Of those surveyed, 90% expressed themselves as "satisfied" or "very satisfied". We analyse all complaints and have increased our focus on root cause analysis which feeds into the continuous improvement cycle.

Since March 2020, we have encountered various challenges associated with the COVID-19 pandemic. We have seen increases in household customer water consumption and this has impacted achievement of our PCC performance commitment for 2020/21. However, we believe we have sufficient mitigation in place to cope with the pandemic and that we will successfully deliver against many of our commitments over AMP7.

During 2020/21 we have seen a 19% reduction in customer complaints year on year. In addition, we have outperformed our expectations on our supply interruptions greater than three hours (property minutes) performance at a time when our customers have relied on our essential services more than ever.

6. Our supply chain may fail to deliver the goods and services we need to operate our business a

Risk: Much of our capital delivery programme and field activity in our Central region is outsourced to third parties. Existing contractors could have limited capacity to take on additional work due to the volume of large-scale infrastructure projects in some of our operational areas.

We are also facing particular challenges with regards to supply of certain chemicals which are essential for our water treatment processes. In some cases these are concentrated in single suppliers. There is a shift of chemical production abroad which could present further supply chain risks.

Mitigation: We seek to ensure that our relationship with critical suppliers is secured under long-term agreements, where appropriate. For key activities, we may retain more than one supplier to mitigate the risk of supplier failure. We also undertake significant due diligence in the selection and on-going management of suppliers through audit, inspection and verification of performance.

During the year we secured a new 5-year framework with three partners for our above-ground capital delivery projects, which provides certainty of supply and quality of delivery for the remainder of AMP7. We secured new contracts for field fix and repair, metering installation and developer services. We also changed our contracting model for below ground capital works which provides further resilience in the delivery of this.

We continue to work with other companies in the industry to address the short-term and long-term challenges associated with supply of water treatment chemicals in the UK as a whole.

7. (i) We could cause damage to the environment in the course of our business activities; or (ii) climate change and other environmental factors could negatively impact our business operations a

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

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

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

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

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

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

We have committed to a significant programme expenditure (forecast £72.6m) on environmental enhancements during AMP7. Other mitigations in place include: our National Environment Programme; landholdings management plans; corporate social responsibility schemes; catchment management programme; carbon reduction strategy; and education programmes.

We undertake a range of activities to strengthen environmental compliance and promote best practice including the maintenance of a company environmental handbook, monthly environmental communications and company environmental awareness events.

The EA has announced that it is to extend the scope of its Environmental Performance Assessment ('EPA') to include water-only companies. Reporting commenced in 2021 with the intention to make public a benchmark comparison in Summer 2022. We have been in discussions with the EA while this is rolled out.

Strategic report continued

Principal risks and uncertainties (continued)

OPERATIONAL RISKS (CONTINUED)

8. We may fail to implement the cultural and operational transformation of our business necessary to deliver our business plan obligations a

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

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

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

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

9. A national health pandemic or similar event could cause severe disruption to our normal business activities a

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

Throughout the financial year, we have continued to face the challenges posed by the COVID-19 crisis affecting the whole country and many other countries around the world. As the provider of an essential service, we are expected to continue to maintain the supply of high quality drinking water to all of our customers.

Mitigation: We have emergency response plans and business continuity plans in place, designed to ensure that we continue to perform our business-critical processes in the event of an actual or potential disruption. These plans have been invoked in order to respond to the COVID-19 crisis and have been found to be robust, allowing us to continue to perform the vast majority of the services which we provide to customers.

In particular, supply of high quality drinking water has been maintained in all of our customer communities. We temporarily ceased only a few non-essential processes such as customer appointments which require home visits, unless in the case of an emergency. All these activities have restarted.

Where possible, our employees have been instructed to work from home. In order to protect our employees and subcontractors, we have changed the way in which we perform some of our operational processes and in all cases, we continue to follow the Government's COVID-secure guidelines for businesses.

At the time of writing, we are developing our plans for returning to "business as usual" as and when the time is right to do so in line with the Government's roadmap.

10. The health of our assets may deteriorate such that water supply or quality is compromised b

Risk: The health of our assets is critical in facilitating the ongoing supply of sufficient quantities of high-quality water to our customers and ensuring the operational resilience of the business.

The health of our assets is also important in ensuring that they can be operated safely by our employees.

Mitigation: Due our funding constraints, we make asset investment decisions based on a "risk and value" system and extract as much value from our assets as much as we reasonably can, but not to the detriment of water supply or quality. We are working on enhancing the accuracy and completeness of the data we maintain and the resulting suite of asset health metrics, in order to further improve our decision-making in this area.

We are subject to a number of legislative obligations relating to particular categories of operational assets and we are diligent in complying with them. For these obligations we operate a comprehensive suite of 1st and 2nd line internal controls, including regular maintenance and inspections.

REGULATORY RISKS

11. Changes could occur in the legal and regulatory framework, or social or political climate, which have significant effects on our operational or financial performance a

Risk: Changes to the regulatory framework by Ofwat or the Government may have an adverse effect on our operational or financial performance. We are also exposed to risks arising from the general social and political climate, for example, debate around the merits of the current water ownership model, political pressure to restrict price increases and other issues, such as the adequacy of our WRMP and some objections to compulsory water metering. These pressures may lead to a reduction in revenue or have a reputational impact.

Nationalisation itself has fallen down the political agenda but there is now great focus on COVID-19, and Brexit, such that political risk remains high due to continued scrutiny of the industry.

Mitigation: We continue to contribute fully to consultations with our regulators and seek to ensure our voice is heard on emerging changes through strong relationships with all our stakeholders.

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

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

We conduct periodic horizon scanning exercises to identify new or changing legislation early so that we are prepared and can adapt business processes accordingly.

Strategic report continued

Principal risks and uncertainties (continued)

REGULATORY RISKS (CONTINUED)

12. We may inadvertently fail to comply with laws and obligations under our instrument of appointment a

Risk: We need to ensure that our activities and outputs comply with licence conditions or statutory requirements arising from our appointment, and applicable laws and standards.

Failure to do so may result in an enforcement order, a fine up to 10% of appointed turnover or termination of our appointment and special administration.

Mitigation: All legal requirements are captured in the Compliance Obligations Register ('CORe') which is regularly reviewed by senior management to ensure we are aware of all relevant obligations. The CORe provides a reference point for the biannual Compliance Returns process whereby EMT members are required to provide a declaration that they and their teams are fully compliant with relevant procedures and controls, or otherwise record any risk of non-compliance for areas of the business for which they are accountable. An action plan is required to address any heightened risk of non-compliance in appropriate timeframes.

We continue to operate our abstraction, treatment and supply activities to environmental standard ISO 14001 and have adopted the principles of other relevant management systems and standards.

Our compliance programme is designed to ensure that:
- all employees are adequately educated on the legislation and regulations particularly relevant to their specific job roles; and
- appropriate assurance activities are in operation to provide positive evidence of compliance.

FINANCIAL RISKS

13. We could fail to maintain or renew appropriate financing for our business activities a

Risk: Our business has an on-going liquidity requirement, driven by the operational costs of the business and our substantial capital investment programme. This results in liquidity risk in the event that we are unable to meet our cash flow requirements as and when they fall due.

We are subject to a number of covenants in relation to our borrowings. If a covenant is breached, this could lead to an event of default with any outstanding borrowings, becoming immediately repayable. This could also impact our ability to raise funds on sufficiently favourable terms in the future.

Mitigation: We have undrawn revolving loan facilities, cash balances and standby loan facilities to meet our forecast cash flow needs. Our treasury policy requires us to maintain a minimum level of liquidity capable of covering at least 12 months' forecast cash flow requirements.

Longer term financing needs are sourced from the private and public bond markets. We have £14.2m of debt maturing in AMP7 and a spread of maturity beyond this. We expect to raise further financing for AMP7 of £100.0m. Our next major refinancing exercise is scheduled for July 2026 when our £250.0m fixed rate bond matures. Our credit ratings remain investment grade and our policy is to maintain a diverse portfolio of counterparties through which we can access liquidity at all times. This ensures we are not reliant on any single treasury counterparty.

We have a regular monitoring and certification process of the financial covenants within our Whole Business Securitisation ('WBS') documentation. This covers information, financial and general covenants. Our treasury policy requires that financial covenants, which include gearing and interest cover ratios, are monitored and reported on a regular basis to the Board.

We continue to maintain investment grade credit ratings with credit rating agencies.

14. Macro-economic factors (interest rate, inflation and tax risks) could have a material adverse effect on our financial performance a

Risk: Movements in interest rates can result in an increase in the cost of our debt.

We have a financial covenant within our WBS documentation stipulating that at least 85% of our outstanding debt is hedged against movements in interest rates.

Our wholesale revenues in a given financial year are explicitly linked to the CPIH published the previous November. An inability to control our cost inflation on the same basis would lead to a reduction in the company's profitability. Our RCV is also linked to inflation and nominal returns are therefore likely to be further reduced in a low inflation environment.

We operate a pension plan providing defined benefits based on final pensionable salary.

The assets and liabilities within the plan depend on a number of external factors outside our control, including performance of equity markets, interest rates and future inflation, which may increase the cost of our cash contributions.

Customer debt and affordability remain key areas of focus for our business. A downturn in the economy may lead to an increase in unpaid water customer bills. We are not permitted to disconnect water supplies to household and certain other types of premises in the event of non-payment, resulting in loss of revenue and increased cost of collection.

Mitigation: Interest rate risk is primarily managed by using a mixture of fixed rate and inflation-linked borrowings, and approved hedging instruments (refer to note A4 to the financial statements for further information).

Each year we undertake a robust and challenging budgeting process to ensure costs are clearly understood and then subsequently controlled during the financial year. We also use inflation-linked debt to ensure a proportion of our interest costs is linked to inflation and therefore offsets an element of the reduction in revenue and RCV that results from lower inflation. During the financial year we entered into CPI linked inflation swaps with a notional value of £225m and RPI linked inflation swaps with a notional value of £75m in order to increase the proportion of our debt that is linked to inflation. In total, we now have inflation linked swaps with a notional value of £250m (CPI) and £210m (RPI). The proportion of debt linked to inflation is now 80.8% (2020: 53.0%).

The defined benefit pension plan has been closed to new members since September 2004 and the assets of the plan are held separately from those of the company. The plan is in surplus on a technical provisions basis (refer to notes 10 and A5 to the financial statements) and the latest actuarial valuation of the defined benefit section of the Affinity Water Pension Plan ('AWPP') as at 31 December 2017, determined by an independent qualified actuary, concluded that the pension plan was fully funded on a self-sufficiency basis. The company signed a new schedule of contributions effective from October 2018 and no further deficit payments were required. An updated actuarial valuation as at 31 December 2020 is currently being undertaken. 92.5% of the interest rate and inflation risk associated with the plan's liabilities are hedged by the plan's assets through Liability and Cashflow Driven Investment.

We have processes and teams dedicated to the efficient collection of customer debt, and outsource the recovery of debt where initial recovery action has been unsuccessful to a number of debt collection agencies. For those customers who struggle to pay their bill, we have payment arrangements that are as flexible as possible and we encourage customers who find themselves in difficulty to contact us as early as possible. We also have a social tariff (LIFT) to help support customers who are least able to pay their bills.

Strategic report continued

Viability statement

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

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

The directors have assessed the company's financial viability over a shorter ten-year period to 31 March 2031 (the "lookout period"). The forecasts used in the assessment of financial viability, therefore, project beyond the current price control period taking into account both our AMP7 Final Determination and our WRMP. The level of reliability of the assumptions used reduces in the second half of the lookout period; however, the directors continue to consider the ten-year period to be appropriate given the long-term nature of the business.

The directors also reviewed the principal risks and uncertainties facing the company set out in the previous section, and determined that it was reasonable to expect that none of the individual principal risks identified on page 39 with the icon (a), if these were to occur, would in isolation compromise the company's financial viability during the lookout period. Instead, these risks could be considered as part of a number of different severe, plausible and reasonable sensitivities to the company's base case forecast.

Stress-testing was performed on a Board approved base case cash flow forecast (the "base case cash flow forecast") reflecting a capital structure consistent with the de-gearing scenario agreed with the company's shareholders detailed in our AMP7 Business Plan with projected gearing reducing to 74.5% by the end of AMP7, projected revenues for the period to 31 March 2025 as allowed by Ofwat's final determination of price controls and taking into account revenue adjustments in light of COVID-19 and anticipated expenditure for AMP7, and an extrapolation of the AMP7 Final Determination for AMP8. AMP8 expenditure also includes anticipated expenditure to further develop strategic regional water resource solutions, as detailed in our WRMP. The base case has taken into consideration the impact of COVID-19 on the company, reflecting that the pandemic has impacted non-household and household revenues, with only the latter adjusted for as part of the revenue adjustment mechanism, in two years' time, increased our adverse bad debt projections, customer collections impacting cash collection in 2021/22 and reprofiled capital expenditure from projects delayed during the first year of AMP7 into later years of AMP7. The base case has also taken into consideration our forecast gearing against notional gearing, using a gearing sharing mechanism consistent with methodology prescribed by Ofwat in our final determination with a one AMP delay.

The base case forecast includes capital expenditure over AMP7 on a net basis, offsetting capital spend on HS2 projects with contributions received. Gross capital expenditure in the year ended 31 March 2021, including HS2 spend, was £139.4m (2020: £129.9m). HS2 contributions of £52.4m (2020: £48.6m) were received against this spend.

The projections for the ten-year lookout period apply the AMP7 mechanism for sharing financial outperformance with customers. They also include the impact of the company's net ODI penalties relating to AMP6 performance in AMP7 and potential net ODI penalties resulting from AMP7 performance in AMP7 and AMP8. The base case has assumed any rewards or penalties relating to the PCC performance commitment will still be adjusted for as part of the revenue adjustment mechanism to ensure a prudent approach.

The base case cash flow forecast also assumes a further £399.0m of debt is raised via the capital markets throughout the ten-year forecast period. In the ten-year period, we are only forecasting that £1.0m of funds raised utilising the RCF facility priced at LIBOR+1.3% margin will be outstanding and refinanced.

A further refinancing exercise is forecast to take place in July 2026 when our £250.0m fixed rate bond matures (refer to page 109 for details of our bond maturities). An all-in interest rate of 5% has been projected for this refinancing, which is consistent with the assumptions used in assessing the financeability of our AMP7 Business Plan.

Tests were applied to the base case cash flow forecast to assess for resilience against financial shocks, compliance with financial covenants and availability of cash reserves. Financial ratio targets (including targets for cash interest cover, adjusted interest cover, funds from operations to debt, return on capital employed and return on regulatory equity) to evaluate the results of the stress testing were set to align with the levels required to meet our Baa1 credit rating under Moody's current methodology and to maintain an investment grade credit rating. A key assumption of this viability statement is that the company maintains an investment grade credit rating, in line with its Instrument of Appointment.

The targets maintain headroom against the trigger and default levels set out in the company's WBS documentation. Trigger levels, if reached, would require increased reporting to the WBS lenders and would lock up dividend payments. If default levels were reached, the company would be in breach of its WBS arrangements and subject to the provisions of the STID, in particular the standstill period mechanisms, each lender may declare all amounts outstanding to be immediately due and payable and recoveries would be applied by the Security Trustee in accordance with the payment priorities.

The directors regularly review the base case cash flow forecast and formally review the output of the stress-testing on an annual basis.

The following sensitivities, approved by the Audit, Risk and Assurance Committee, were applied to stress-test the base case cash flow forecast.

S1: 10% increase in totex;
S2: 1% decrease in all three inflation metrics (RPI, CPI and CPIH);
S3: 1% decrease in inflation, impacting revenue only;
S4: replacing the base inflation forecast with a negative 1% forecast, while maintaining a 1% increase in expenditure;
S5: one off exceptional event;
S6: 5% increase in unpaid water customer bills represented by a 5% reduction in revenue;
S7: 1% decrease in inflation impacting revenue only, 5% increase in totex and 5% increase in unpaid water customer bills;
S8: 100% decrease in cash generated by the company's non-appointed business; and
S9: 2% increase in cost of debt.

The sensitivities applied in relation to totex, revenue and unpaid water customer bills were in line with those used in testing performed during the PR19 process to assess the robustness and financeability of our AMP7 Business Plan.

The directors consider that the sensitivity applied in relation to totex (S1) is of a sufficient magnitude to capture the financial impact of exceptional items, such as regulatory fines and legal costs (refer to principal risks 1, 4 and 11); costs associated with extreme weather events (refer to principal risk 2); costs associated with a water quality event (refer to principal risk 2); and costs not taken into account by Ofwat in setting our price controls (i.e. unfunded costs).

The inflation sensitivities (S2 and S3) reflect severe, plausible and reasonable scenarios in the context of the company's inflation-linked debt and inflation-linked costs (for example staff costs), which act as natural hedges to lower revenue.

The scenario of negative inflation combined with an increase in expenditure (S4) is intended to reflect conditions during an economic recession (refer to principal risk 14), such as those experienced in 2008/09 and projected as a result of the ongoing COVID-19 pandemic. This scenario captures a realistic expectation, when considering the structure of the company's cost base, that in general costs will not fall during a period of negative inflation.

The scenario of a one off exceptional event (S5) reflects the prospect of an exceptional event with an initial capex requirement of £60.0m and an opex requirement of £20.0m in year 1 to deal with the immediate needs following the event with some legacy impact to opex of £10.0m in year 2 and £5.0m in year 3.

The sensitivity applied in relation to unpaid water customer bills (S6) reflects a severe, plausible and reasonable scenario considering that the risk is spread across our whole customer base. The stress test has been applied across all years, on top of the increased bad debt projections in year 2 as a result of COVID-19 included in the base case. The directors consider that this sensitivity is of a sufficient magnitude to capture also the financial impact in severe, plausible and reasonable scenarios of ODI penalties incurred through worse than planned operational performance (refer to principal risk 5).

Strategic report continued

Viability statement (continued)

The scenario of a decrease in inflation impacting revenue only, together with a 5% increase in totex and 5% increase in unpaid water customer bills (S7) is intended to reflect severe, plausible and reasonable conditions during a downturn in the economy.

The sensitivity of a 100% decrease in cash generated by the company's non-appointed business (S8) reflects a severe, plausible and reasonable scenario that companies may decide to no longer procure non-appointed services from us.

A sensitivity has been applied in relation to cost of debt (S9), as £264.2m of the company's existing bonds are due to mature in the ten-year outlook period, in addition to forecast accretion payable on the swaps, and the company has not yet secured financing for all AMP7 expenditure commitments and expected expenditure commitments beyond AMP7.

The directors consider that this sensitivity reflects a severe, plausible and reasonable scenario of an increase to cost of debt in the context of how the ten-year gilt has performed over the last 20 years. To achieve an all-in coupon, a credit spread has been included that is consistent with the current and historic performance of the £250.0m fixed rate bond, forecast to be refinanced in the lookout period.

The directors consider that the sensitivity applied in relation to cost of debt is of a sufficient magnitude to capture the financial impact in a severe, plausible and reasonable scenario of a credit rating downgrade. As stated in previous paragraphs, a key assumption is that, even if downgraded, the company's credit rating remains investment grade.

For the principal risks identified in the principal risk table on page 39 with the icon (b), the directors considered that these risks, if they were to occur, might in isolation threaten financial viability potentially leading to significant unforeseen additional cash requirements during the lookout period in the event of:

- a major asset failure resulting in large scale interruptions to operations (refer to principal risk 2 and page 30 for further details of this risk and our mitigating activities);
- a major water quality issue (refer to principal risk 2 and page 24 for further details of this risk and our mitigating activities);
- a severe drought incident within our supply region as considered in our Drought Management Plan (refer to principal risk 2 and page 26 for further details of this risk and our mitigating activities); or
- a significant cyber-attack leading to a major loss of customer data or interruption to operations (refer to principal risk 4 for further details of this risk and our mitigating activities).

The directors consider that the sensitivity applied in relation to scenario 5 is of a sufficient magnitude to capture the financial impact of these exceptional items.

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

The directors consider that the impact on the company's cost of debt in the lookout period as a result of a lower investment grade rating of Baa2/Baa3 under a severe, plausible and reasonable scenario is captured by the 2% increase in cost of debt stress test.

Scenario	Rating agency measures		Key covenants			Rating agency measures		Key covenants	
	Adjusted interest cover	Funds from operations to debt ratio	Interest cover ratio (conformed Class A adjusted)	Gearing (senior net indebtedness to RCV)		Adjusted interest cover	Funds from operations to debt ratio	Interest cover ratio (conformed Class A adjusted)	Gearing (senior net indebtedness to RCV)
	Without mitigation				Mitigation	With mitigation			
Base	Met	Met	Met	Met	N/A	Met	Met	Met	Met
1	Met	Met	Trigger	Met	Required	Met	Met	Met	Met
2	Met	Met	Met	Met	N/A	Met	Met	Met	Met
3	Met	Met	Met	Met	N/A	Met	Met	Met	Met
4	Met	Met	Met	Trigger	Required	Met	Met	Met	Met
5	Met	Met	Met	Met	N/A	Met	Met	Met	Met
6	Met	Met	Met	Met	N/A	Met	Met	Met	Met
7	Met	Met	Trigger	Met	Required	Met	Met	Met	Met
8	Met	Met	Met	Met	N/A	Met	Met	Met	Met
9	Met	Met	Met	Met	N/A	Met	Met	Met	Met

As set out in the table above, without mitigation trigger levels would be reached for the interest cover ratio under the sensitivities S1 and S7, and under S4 for the gearing ratio, in one or more years over the viability period. There are no scenarios resulting in default. The triggers experienced in years 2 and 3 of the period are due to the higher level of forecast expenditure in these years compared to other years in the viability period due to the phasing of our AMP7 commitments.

S1 – without mitigation, a 10% increase in totex would result in a trigger level being reached for the interest cover ratio in year 2 of the viability period but the covenant would be met in all other years.

S4 – without mitigation, replacing the base inflation forecast with a negative 1% forecast, while maintaining a 1% increase in expenditure, would result in a trigger level being reached for the gearing ratio in year 10 of the viability period.

S7 – without mitigation, a 1% decrease in inflation impacting revenue only, 5% increase in totex and 5% increase in unpaid water customer bills would result in a trigger level being reached on the interest cover ratio in years 2 and 3.

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

- issue a further short term RPI linked swap to reduce the interest charge. This would yield a higher impact to the interest charge than a longer term swap;
- reduce further operating costs;
- buy back a portion of the 5.875% class A fixed rate bond, the company's most expensive debt, reducing the overall interest charge; and
- restrict dividend payments in AMP8.

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

Together with the results of the stress-testing (summarised in the table on the previous page), the directors also considered the following:

- the company's available liquidity;
- the company's ability to renew its existing short-term borrowing facilities under most market conditions;
- the likely effectiveness of current and planned mitigating actions, as detailed in the principal risk section;
- the company is financially and operationally "ring-fenced" from the rest of the Affinity Water group by way of the WBS (refer to pages 105 to 110 for further details); and
- under the regulatory model, a primary legal duty of Ofwat is to ensure that water companies can finance their functions.

To conclude, based on the above assumptions and analysis, the directors confirm that they have a reasonable expectation that, with the mitigating actions implemented if required, the company will continue to operate and meet its liabilities, as they fall due, over the lookout period.

Strategic report continued

Section 172(1) statement

OUR STAKEHOLDERS

Our responsible business approach is the way we do business. It is centered on issues which are of importance to our customers and stakeholders and to the responsible delivery of our business plans. We have had discussions with stakeholders across all areas of our business to better understand what matters most to them and how we can further involve them in our decision-making. We focused on the following four areas: the environment, supply and demand, water efficiency and vulnerability with the aim of gathering information to inform our current and future strategy.

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

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

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

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

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

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

Step 1: "Engagement strategy"
Set vision and level of ambition for future engagement, and review past engagement

Step 2: "Stakeholder mapping"
Define criteria for identifying and prioritising stakeholders, and select engagement mechanisms

Step 3: "Preparation"
Focus on long-term goals to drive the approach, determine logistics for the engagement, and set the rules

Step 4: "Engagement"
Conduct the engagement itself, ensuring equitable stakeholder treatment while remaining focused on priorities

Step 5: "Action plan"
Identify opportunities from feedback and determine actions, revisit goals, and plan next steps for follow-up and future engagement

The Board's role in stakeholder engagement is to:

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

In 2020/21, the Board's Schedule of Reserved Matters and each Board Committee's terms of reference were reviewed by the Board and updated to ensure that consideration of section 172 factors and Ofwat's 2019 Board leadership, transparency and governance principles were appropriately addressed. Directors are reminded of the section 172 requirements at the start of every Board meeting and undertook a training session delivered by external advisors on their responsibilities during the year.

SECTION 172(1) IN ACTION

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

Customers Current and future customers, including household and non-household customers, and market participants such as retailers and self-lay providers, developers and NAVs.	**Communities** Communities, non-governmental organisations and civil society, especially environmental organisations and campaigners.
Why engagement is important Customers rely on water as an essential service and are at the heart of our business model. We aim to be a positive contributor to, and able to earn fair returns from, a reliable service that is trusted by and represents value for money for customers. Transparent conversations and engagement with the CCG will support delivery of our purpose and environmental ambitions.	**Why engagement is important** These groups bring distinctive perspectives and influence on key environmental and social issues on behalf of customers and the public. Engagement will result in us being a progressive, well-regarded company that delivers its purpose and with which communities and civil society want to work in pursuit of common goals.
How the company engages • Daily contact with customers • Customer research programme • Public meetings • Our website, including our specific COVID-19 page • Media/social media • Through our CCG	**How the company engages** • Stakeholder Assembly • Joint Forums • Public meetings • Catchment partnerships • Water resources monthly email updates • Volunteering days
How the Board engages **Information reported to the Board:** • The Board receives monthly performance summaries of our AMP7 performance commitments including leakage, PCC, C-MeX and D-MeX and supply interruptions, and other key metrics including customer satisfaction and written complaints. **Direct engagement mechanisms:** • There is a clear reporting line to the CEO and accountability for arrangements regarding handling customer complaints • Chair of the CCG attended the Board Strategy meeting • Quarterly meeting with the CCG to discuss key performance metrics • The regional Chair of CCW attended the November 2020 Board meeting discussing performance, response to COVID-19 and social tariffs available **Customer protection:** The Board considers the company's policies around the protection of customer data through its review of the strategic risk register (refer to page 38 for further information) and revised our GDPR policy during the year to make this more engaging and user friendly	**How the Board engages** **Information reported to the Board:** • The Board receives monthly updates on community projects • The Board received updates on the proposed company rebranding, based on customer feedback received, and how this will impact customers and communities. **Direct engagement mechanisms:** • Our Board-approved Community Engagement Strategy and activities are focused around three core areas: - Protecting rivers and habitats - Investing in science, technology, engineering and mathematics ('STEM') and future skills - Developing community partnerships Throughout 2020/21, we continued to build on our social purpose and defining the programme of work that will help us meet the growing expectations of our stakeholders and add value to our communities • Board members attended key community events in 2020/21, including World Rivers Day in the Chess Valley (see page 23)

Strategic report continued

Section 172(1) statement (continued)

SECTION 172(1) IN ACTION (CONTINUED)

Employees
The workforce, including both employees and the wider workforce

Why engagement is important
Our success depends on the shared talents, skills and values of the people who work for our company, and our ability to attract and retain a talented and diverse future workforce.

Successful engagement will mean we are an inclusive employer that retains and attracts people with the talent and skills to achieve our business objectives and whose make-up is aligned with the diversity of the communities we serve.

How the company engages
- Senior leadership forums
- Engagement surveys, focusing in 2020/21 on the changing working environment as a result of COVID-19
- Monthly one-to-one meetings and personal best check-ins three times a year
- Wellbeing fortnight focussing on mental health and wellbeing of employees
- Weekly podcasts from the CEO
- Culture Ambassador forums to gain feedback and progress culture development initiatives
- Diversity and Inclusion Steering Group to drive a stronger agenda of inclusiveness
- Designated Director for Employee Engagement reporting issues and progress to the Board
- Internal communications and monthly team leader briefings communicated to all line managers
- Management Enhancement Program introduced, with a Manager Corporate Induction
- COVID-19 updates and an internal COVID-19 website for employees
- Customer Hero Awards launched in October 2020 to reward behaviours that support our principles

How the Board engages
Information reported to the Board:
- Following an inaugural Culture Survey in 2019/20, we have continued to drive cultural change across the business in 2020/21. Culture Ambassadors represent their departments in the rollout of cultural improvement and progress made. We have 38 Cultural Ambassadors who meet every two months to continue to drive change and support in the creation and execution of changes relevant to their departments. Cultural Ambassadors were key in delivering COVID-19 messages to departments during the pandemic. The Board received updates from engagement surveys conducted in the year
- Information on productivity, attrition levels, learning participation, training and development plans, wellbeing and output from exit interviews is reported monthly to the Board
- Whistleblowing incidents are reported to the Board. All incidents are taken extremely seriously and are thoroughly investigated, working with external reviewers if required
- Details on the company's return to work plans as a result of COVID-19 and the impact the pandemic is having on employees.

Direct engagement mechanisms:
- Trevor Didcock, Director of Employee Engagement is responsible for employee liaison in accordance with the Code. The overriding purpose of the role is to ensure that the voice of the workforce is heard and considered at Board level. A key secondary purpose is to improve the transparency of Board activities, discussion and decision-making and in so doing improve alignment between the Board and the workforce. Trevor attends the Culture Forums with Cultural Ambassadors from within the business, providing training to ambassadors, reporting and holding discussions of the corrective actions taken. Trevor is also a member of our Diversity and Inclusion Committee, established in 2019/20 to bring to life our commitment to build a more inclusive culture, allowing all members of our workforce to bring their true selves to work.
- All of our workforce are entitled to be trade union members. Our CFO is a member of the Joint Negotiation and Consultative Committee ('JNCC') which, together with employee trade union representatives and other company nominated representatives, meets quarterly to consult on workforce practices and policies and negotiate workforce pay.
- The CEO met employees across the business to thank them for their work during the pandemic and understand the issues on the ground and the new ways of working.

Workforce policies and practices:
- Refer to page 80 for further detail on workforce policies and practice and workforce concerns, and the governance report for details of what the Board is doing about gender equality and reducing our gender pay gap.

Shareholders Owners of shares in the company.	**Regulators** Regulators, including Ofwat, MOSL, EA, DWI, Defra, HSE, Natural England and CCW. Government – central and local government and MPs, highways authorities, Highways England and TfL.
Why engagement is important Our shareholders have an important role to play and a direct interest in the strong and effective governance and stewardship of our business. We aim to provide a reasonable long-term return on their investment.	**Why engagement is important** To ensure we maintain our licence to operate and that our actions are in accordance with the framework determined by the Government and regulators. Engagement will ensure that we are a responsible company which delivers on its purpose.
How the company engages • Board meetings attended by shareholders/nominated directors • Monthly financial and operational updates, including the impact of COVID-19 on our financial results • Regular meetings and calls • Annual report and financial statements, which gives details of the performance, strategy, viability and company business model, approved by the Board	**How the company engages** • Industry working groups including committees, panels and forums • Responding to consultations and requests for information • Ongoing dialogue on strategic planning and land disposals • Regular meetings and calls, including meetings with key MPs in our supply area • Discussions on our key worker status and priorities in response to COVID-19
How the Board engages • We explain how the Board engages with our shareholders and involves them in decision-making in our revised publication: "Consulting with our shareholders", approved by the Board in June 2020 to include the Ofwat 2019 principles, available on the governance pages of our website • In 2020/21 the Board engaged directly with shareholders in setting and approving budgets for 2021/22 • The Board engaged with shareholders on the £4.0m equity injection into the company in March 2021, including objectives from the funding and the source of the finance • The Board conducted an effectiveness review, including responses from shareholder appointed non-executive directors, in the year. See more details on page 85.	**How the Board engages** **Information reported to the Board:** • The Board receives monthly updates on regulatory and relevant political developments, and regulatory consultations and requests for additional information • Risk assessments reviewed to ensure sites are all COVID-19 compliant, in line with Government guidance **Direct engagement mechanisms:** • Board approved updated terms of reference (see the Governance report on page 66 onwards for more details), to include Ofwat's 2019 Board leadership, transparency and governance principles • The Board received updates on proposals to submit to Ofwat for Innovation Competition funding • Throughout 2020/21 the CEO had meetings with Ofwat representatives and Water UK on the impact of COVID-19 on the industry and performance commitments • The CEO had meetings with the EA, Ofwat and the DWI on the hot weather event over the summer and the impact on ODIs and abstraction licences • Delivery Steering Group set up in 2020/21 to drive the achievement of performance commitments in AMP7. • Non-executive directors attended regular events with Ofwat, including prior to their appointment • The Chair of the CCW attended one of our Board meetings in 2020/21.

Strategic report continued

Section 172(1) statement (continued)

SECTION 172(1) IN ACTION (CONTINUED)

Environmental bodies	Providers of finance and credit rating agencies
Why engagement is important We need to manage the impact of taking water from sensitive habitats and to maintain flows in local rivers whilst also ensuring a continuous supply of high quality water for customers in line with our purpose. Successful engagement will mean we protect water sources and the quality of water supplied and minimise our impact on the environment.	**Why engagement is important** It is imperative that we maintain effective relationships and ongoing dialogues with our banks and credit rating agencies to ensure access to financial services as well as capital markets. Successful engagement means we will be a responsible company that delivers reliable returns and is transparent in our reporting.
How the company engages • WRMP • Catchment management • River restoration • Launch of company environmental policy during the year to ensure we meet our purpose to provide high quality drinking water for our customers whilst taking care of the environment	**How the company engages** • Annual review meetings with credit rating agencies • Regular meetings and calls with banks • Financial reports • Engaged with banking groups and credit rating agencies on the impact of COVID-19 and the issue of new swaps
How the Board engages **Governance arrangements:** • The Board is composed of individuals who have appropriate knowledge, skills, experience and background to take decisions informed by an awareness and understanding of environment related threats and opportunities (refer to the biographies of our directors on pages 69 to 73). In particular, the Board benefits from the presence of Susan Hooper on the Board who is a director of Chapter Zero, an organisation dedicated to providing education, insight and support on climate change to non-executive Board directors. Our shareholder directors are focused on environmental issues, as part of our shareholders' wider environmental, social and governance ('ESG') programmes and alignment to the UN's Sustainable Development Goals ('SDGs') • The Safety, Health, Environment and Drinking Water Quality ('SHEDWQ') Committee reviews and monitors, on behalf of the Board, environmental matters arising from our activities and operations, including monitoring performance against targets (refer to page 93 for further information on the work of the SHEDWQ Committee) • Environmental considerations are embedded into our principal risks and the management of these risks, in particular the principal risk "We may become unable to meet our obligations to provide a sufficient supply of high-quality drinking water", which are monitored by the Board. A full review of risks was undertaken in January 2021. • The Board receives monthly information on our performance in relation to key environmental metrics, including water quality, leakage, sustainable abstraction reductions, average water use and water available for use, to enable it to monitor the success of strategies implemented **Local environment:** • The Board reviewed customer feedback when approving our company purpose and considered customers' views on the environment, and in 2020/21 the Board approved stopping extraction from boreholes at the top of the Chess Valley, highlighting the company's commitment to restoring chalk streams. See page 23 for more details. • The Board undertook a deep dive exercise on leakage plans, targets and current performance **Climate change:** • The Board considers climate change in two principal ways: 1) the potential impacts of climate change are addressed through long-term planning as part of the statutory WRMP (available on our website: **affinitywater.co.uk/water-resources-plan**, addressed in Technical Reports 1.2 and 1.3). A Board sub-committee on the WRMP oversaw this work and was advised by external technical experts; and 2) in 2020/21, we worked alongside other water companies and Water UK to develop a route map to reduce carbon emissions to net zero by 2030, an industry wide target.	**How the Board engages** **Information reported to the Board:** • A treasury report is provided to the Board on a quarterly basis, which includes details of the company's covenants and gearing headroom, financial results and the impact of COVID-19 on the financials **Direct engagement mechanisms:** • The CFO, on behalf of the Board, and the treasurer met with lenders and credit rating agencies during the year and renewed the credit facility, using SONIA as the reference rate and which has sustainability performance measures included • The Board approved the strategy to enter into a power hedging arrangement when market conditions were favourable (this was not entered into during the year to 31 March 2021) Refer to note A4 of the statutory financial statements for further information on our risk management processes and the Board's role in these.

Supply chain
Why engagement is important We rely on our supply chain for delivery of operations and capital projects, and partners provide investment and support delivery as well as acting as a source of innovation and new ways of working. We are in contact with critical suppliers on the impact of Brexit on our supply chain. Successful engagement will mean we are a good company to work with, to partner and do business with, ensuring that we and our partners maximise the greatest mutual value and we can continue to operate in a post Brexit working environment.
How the company engages • Integration of contractors into our teams • Sharing of reporting and management systems for collaborative and shared learning • Quarterly forums with all our Maintenance and Repair and Traffic Management suppliers, to discuss "lean" processes and improvements • Regular meetings and calls, including monthly performance meetings with our largest suppliers • Discussions with suppliers on how we perform key essential work in response to COVID-19
How the Board engages **Board's involvement in the agreement of supplier terms:** • We have a standard set of purchase order terms and conditions and a Supply of Goods and Services Agreement published on our website: **affinitywater.co.uk/policies**, which is reviewed and amended (where necessary) by our Procurement and Legal teams who report to our executive members of the Board • We have a Contracts Committee, attended by executive members of the Board, which approves the award of material contracts • In 2019/20 a subset of the wider Board was involved in formulating a strategy for contracting our key Maintenance and Repair suppliers for AMP7, including determining key principles, contract scopes and tender evaluation criteria. In 2020/21, the Board agreed changes to key suppliers. • The Board considers the company's policies around compliance with the Modern Slavery Act and GDPR as they relate to suppliers through the approval of the company's Modern Slavery Statement and review of the appropriateness of mitigation detailed in the strategic risk register in relation to the principal risk: "Availability, confidentiality or integrity of information or data could become compromised") The Board receives information on a monthly basis on operational ODI performance. Annual payment practice information is also reported to the Board to enable it to consider our performance and how it compares to industry peers • The SHEDWQ Committee also reviews and monitors, on behalf of the Board, safety and health matters arising from our activities and operations, including in relation to our supply chain (refer to page 93 for further information on the work of the SHEDWQ Committee) • The Board considers the risk of supply chain failure through its consideration of the strategic risk register **Direct engagement mechanisms:** • Executive directors attend meetings with key members of the supply chain based on a supplier strategy

Following a review of direct engagement mechanisms in 2020/21, the Board identified the following priorities for 2021/22 and the remainder of AMP7.

- Achieving and outperforming our financial commitments
- Meeting our health, safety, regulatory and compliance obligations
- Developing a supportive culture, which enables everyone to perform to their best
- Striving to make a positive impact on the environment in all that we do.

Strategic report continued

Section 172(1) statement (continued)

KEY DECISIONS MADE IN 2020/21

We set out below key decisions made in 2020/21 and the Board's consideration of section 172 factors in making these. Refer to page 97 for further information on matters considered by the Board in 2020/21.

Approved the company's ongoing response to COVID-19	The Board received regular updates on the company's response to COVID-19, having weekly calls at the start of the pandemic to assess the implications and agree the company strategy in response to the change in working environment. The Board reviewed the emergency plan and agreed it was crucial to continue to meet the demands of the public whilst ensuring the utmost safety of employees. The Board considered updates from Public Health England, the NHS, World Health Organisation and the Foreign and Commonwealth Office. The Board reviewed updates on financial implications, regulations and risk assessments and reviewed plans for a phased return to work. The Board engaged with the following stakeholders in assessing its response to COVID-19: **Customers** • The CEO met with vulnerable customers to understand the impact of the financial hardship they are facing as a result of the COVID-19 pandemic, to allow us to provide relevant financial support. **Employees** • The CEO met employees across the business to thank them for their work during the pandemic and understand the issues on the ground and the new ways of working • The Board reviewed results from engagement surveys, completed by all employees, to understand the impact of COVID-19 on the workforce and draft 'return to work' plans. **Shareholders** • The Board shared with shareholders the impact that COVID-19 has had on the company financials, and consulted with them on best course of mitigating actions to put in place. **Regulators** • The Board had discussions with regulators regarding key worker status, not using the furlough schemes, and discussed our operational priorities and the impact the pandemic has had on our ODI performance. **Providers of finance** • The CFO, on behalf of the Board, engaged with banking groups and credit rating agencies on the impact of COVID-19 and the issue of new swaps to mitigate against our interest cover ratio covenant. **Supply chain** • The Executive Team, on behalf of the Board, had discussions with suppliers on how we perform key essential work in response to COVID-19, to ensure we are aligned and continue to meet our customer outcomes during the pandemic.
Formulated and approved the long term Strategic Direction Statement	The Board was fully engaged with and received regular updates on the Strategic Direction Statement, which will be published on our website shortly. This sets out the company's long-term strategy and plans in place to achieve this. Our Strategic Direction Statement provides our vision for the next 25 years, the challenges that we will face and how we need to manage these to ensure that we can meet the needs of our customers today and in the future. The Board engaged with the following stakeholders in formulating our long term strategy: **Communities and Customers** • We led extensive feedback sessions with customers and communities to understand all viewpoints when formulating our strategy. Communities want us to collaborate and bring everyone together to address the challenges and share knowledge and resources to create a more resilient and sustainable future • Our customers understand water is crucial and it is our responsibility to shape a more sustainable future by changing the way in which they use water and increase understanding of why this is key. One of the things they told us is that affordability continues be a key concern for our customers, especially in the wake of the pandemic and we understand we must support customers through the journey of adaptation. **Regulators** • We engaged with Ofwat and the DWI when formulating our Strategy, taking on board feedback received on the direction of the wider water industry. **The environment and environmental regulators** • Demand pressures and environmental protection in the South East, including the climate change emergency we are facing formed the basis of our Strategic Direction Statement. We have considered abstraction targets, population growth, our natural geography and our asset health and consulted with the Environmental Agency, Defra and other environmental agencies in formulating our Statement. **Providers of finance** • It is fundamental that we continue to maintain resilience in our finances in order to continue to deliver and invest in services. We engaged with Investors and other financial agencies to understand the need to balance between investing in our services, offering investors a fair return and maintaining affordable water bills.
Approved the appointment of the company Chair and Chair of the Audit, Risk and Assurance Committee	The Nomination Committee approved the appointment of the company Chair, Ian Tyler, and Chair of the Audit, Risk and Assurance Committee, Justin Read, during the year. The Committee engaged with the following stakeholders in approving the appointments: **Shareholders** • The Committee as a whole was involved in shortlisting candidates and once preferred candidates had been identified the other Directors were included in the interview process. Shareholder appointed directors sit on the Nomination Committee. **Communities** • The Committee engaged the services of independent search consultants Korn Ferry to evaluate, screen and identify suitable candidates. Extensive references were sought in respect of the preferred candidates, from peers and companies for which they had previously worked **Regulators** • Ian Tyler and Justin Read attended a pre-appointment meeting with Ofwat to allow them to get an understanding of Ofwat's expectations for the role of non-executive directors of a regulated company.

Strategic report continued

Section 172(1) statement (continued)

KEY DECISIONS MADE IN 2020/21 (CONTINUED)

Approved the AMP7 investment plan and transformation program	We believe our Final Determination will be challenging to deliver, but we accept the need to improve performance for our customers and for the environment. Over the year, we have been determined to continue to transform our business to achieve this. The Board reviewed and approved the AMP7 transformation program in June 2020, consisting of capital expenditure plans, delivery of operational efficiencies, delivery of enabling projects and meeting our performance commitments, all ensuring we are "getting fit for the future". The Committee engaged with the following stakeholders in approving the plan: **Customers** • Investment plans and proposed initiatives have customers at the forefront of all decisions to deliver what matters most to them **Employees** • Delivery Steering Group set up, consisting of members of the Board, Executive Management Team and Senior Leaders to ensure delivery of the plan and that objectives of Shareholders, Regulators, Customers and Employees are met • Employees can access a dedicated Business Excellence page on our internal website which includes details of the plans and transformation projects and encourages all employees to deliver more efficient outcomes **Shareholders** • Shareholders were made aware of all investment plans and proposed initiatives and consulted with when approving the final investment plan and transformation program **Regulators** • Stretch targets set by Ofwat as part of the PR19 process and the business is working to find ways to ensure we achieve these commitments
Approved our sustainability plans to protect the chalk streams within our supply area	The Board reviewed customer feedback when approving our company purpose and considered customers' views on the environment, and in 2020/21 the Board approved stopping extraction from boreholes at the top of the Chess Valley, highlighting the company's commitment to restoring chalk streams. The company will develop a strategy in 2021/22 for achieving our pledge to end unsustainable abstraction, assess the impact and will benchmark with the local community to revise the Upper River Chess and cut groundwater abstraction in our supply region. Across our supply area, we will be significantly reducing groundwater abstraction in the Ver, Mimram, Upper Lea and Misbourne catchments by 2024 to leave more water in the environment. The Committee engaged with the following stakeholders in approving the plans: **Customers** • Feedback from customers was obtained when approving the company purpose and environmental plans. **Communities** • Discussions were had with the River Chess Association on the use of the river within our communities, especially during the recent COVID-19 pandemic. Communities are being brought together to help in the task of protecting our chalk streams. **Regulators** • Investigation, trials, and collaborative efforts with local groups in the Chilterns, the Chilterns Conservation Board (CCB) and the Environment Agency were held and we will continue to work with these partners to understand the longer term beneficial impacts. **The environment** • The chalk streams that flow through the Chilterns are widely regarded as the most threatened of all chalk streams in the world and have suffered increasingly from chronic low flows and dry periods. Reducing abstraction will go a long way towards reversing the decline in flow of these streams.

Non-financial information statement

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

Reporting requirement	Information necessary to understand our business and its impact	Policies, guidance and standards which govern our approach[1]
Social matters	• Providing a great service that you value (page 28) • Our suppliers (page 32) • Our industry (page 34)	• Customer Experience Principles (page 20) • Supporting children's education (page 10) • Donation to Community Foundations (page 16) • Our CCG (**affinitywater.co.uk/ccg**) • Purchase Order Terms and Conditions and Supply of Goods and Services Agreement (page 59)
Environmental matters	• Supplying high quality water you can trust (page 24) • Making sure you have enough water, while leaving more water in the environment (page 26) • Greenhouse gas emissions statement (page 128)	• Environmental Policy (**affinitywater.co.uk/environment**) • WRMP (page 26)
Employees	• Our people (page 32)	• Health and Safety Policy (page 80) • Gender pay gap report (page 32) • Company Principles (page 20) • Diversity and Inclusion Policy (page 32)
Respect for human rights	• Diversity and equality (page 32)	• Modern Slavery and Human Trafficking Statement and Modern Slavery and Human Trafficking Policy (page 80) • Privacy Policy and Guidelines (page 80)
Anti-corruption and anti-bribery	• Workforce policies and practice and workforce concerns (page 80)	• Anti-bribery and Corruption Policy (page 76) • Whistleblowing Policy (page 80) • Systems of risk management, planning and internal controls (page 99)
Description of principal risks	• Principal risks and uncertainties (page 38) • Viability statement (page 50)	• Systems of risk management, planning and internal controls (page 99) • "Three lines of defence" assurance processes (page 99) • Compliance Obligations Register (page 100)
Description of business model	• Our business model (page 20)	• Board statement on direction and performance (page 204)
Non-financial key performance indicators	• Operational performance (page 35) • Outcome performance table (page 250)	• Non-financial performance measured against performance commitments agreed with Ofwat (page 34)

Approval of the strategic report
By order of the Board

Ian Tyler
Chair
28 June 2021

[1] Some policies and standards are only published internally

Governance

CONTENTS

Introduction from the Chair	66
Our Board of directors	68
Corporate Governance Statement	74
Nomination Committee Report	87
SHEDWQ Committee Report	93
Audit, Risk and Assurance Committee report	95
Ownership and financing	105
Remuneration Report	111
Directors' report	126

During 2020/21 we improved 14.3km of rivers, bringing them back to a more natural state to improve habitat for wildlife

Governance

Introduction from the Chair

2019 OFWAT BOARD LEADERSHIP, TRANSPARENCY AND GOVERNANCE PRINCIPLES

The objectives of the Ofwat Board Leadership, Transparency and Governance Principles 2019 ('BLTG Principles') are incorporated into the Affinity Water Corporate Governance Code ('AW Code') and our compliance with them is as follows:

Purpose, values and culture: the regulated company board establishes the company's purpose, strategy and values, and is satisfied that these and its culture reflect the needs of all those it serves. See Corporate Governance Statement on pages 75 to 87 and strategic report on pages 8 to 64.

Stand-alone regulated company: the regulated company has an effective board with full responsibility for all aspects of the regulated company's business for the long-term. See Corporate Governance Statement on pages 75 to 87.

Board leadership and transparency: the board's leadership and approach to transparency and governance engender trust in the regulated company and ensure accountability for its actions. See Remuneration report on pages 112 to 126, Dividend Policy Statement in Directors' Report on page 125 onwards and Ownership and Financing on page 106 onwards.

Board structure and effectiveness: boards and their committees are competent, well run, and have sufficient independent membership, ensuring they can make high quality decisions that address diverse customer and stakeholder needs. See Corporate Governance Statement on pages 75 to 87.

QUICK LINKS:

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

I was delighted to join the Board and be appointed as Chair earlier this year and am pleased to be introducing our Corporate Governance Report for 2020/21. This report sets out how we satisfy the high standards of governance expected by our stakeholders and those specific to a regulated water company.

BOARD CHANGES

Our Board saw some changes during the year. Justin Read was welcomed to the Board as non-executive director and Chair of the Audit, Risk and Assurance Committee during the year. He succeeded Patrick O'D Bourke, who resigned after serving seven years on our Board. Having been appointed as the new Chair following the resignation of Tony Cocker, I am looking forward to leading the business through AMP7 and the next phase of its growth. I take this opportunity to thank both Patrick O'D Bourke and Tony Cocker for their leadership and contribution to our Board and company during their tenure.

AREAS OF BOARD FOCUS

The Board had a busy and varied agenda in 2020/21, the key activities of which are detailed in this Corporate Governance Report. Whilst managing our COVID-19 response, the Board stayed focused on the long-term success of the company. We developed our AMP7 investment plan, refreshed our corporate governance framework and continued to embed our purpose, principles and culture into the business ensuring they aligned with our strategy.

COVID-19

COVID-19, and responses to it, affected the personal and professional lives of all our stakeholders. We immediately recognised the need to adapt our ways of working to make sure the safety of our people, customers and suppliers remained our highest priority. Our robust business continuity plans were put into action so that we could ensure the continued supply of water to all of our customers in the South East. I am proud of the way our people responded to the disruption to our usual way of working and want to thank them for their hard work and dedication during these extraordinary times.

CORPORATE GOVERNANCE

The Ofwat Board Leadership, Transparency and Governance Principles 2019 ('BLTG Principles') and the UK Corporate Governance Code 2018 served to change our corporate governance landscape. Our Board used this as a positive opportunity to refresh our approach to corporate governance, by adopting a new Affinity Water Corporate Governance Code ('AW Code'), which sets out how we seek to govern the company. It incorporates the BLTG Principles, relevant provisions of the UK Corporate Governance 2018 and is available on our website: **affinitywater.co.uk/governance-assurance**.

With the exception of aligning executive directors pension contributions with those of the workforce (see details in the Remuneration Committee report on page 111), the company was compliant with all areas of the 2018 Code.

Both I, and your previous Chair, lead an independent Board as befits a regulated water company. Whilst independent non-executive directors are in a majority, our board also includes three shareholder nominated directors, who, whilst nominated by our shareholders, nevertheless exercise independent judgement in all Board matters and bring considerable knowledge and expertise that the Board values. In the interests of transparency, we outline the matters on which we engage with our shareholders in our publication: "Consulting with our Shareholders" which can be found on our website: **affinitywater.co.uk/governance-assurance**.

LOOKING FORWARD

During the coming year, the Board will continue to focus on the company's recovery from the COVID-19 crisis and the strategic opportunities that will present.

Ian Tyler

Chair
28 June 2021

AFFINITY WATER CORPORATE GOVERNANCE CODE COMPLIANCE

Our Board governed the company throughout the reporting period in accordance with the Affinity Water Corporate Governance Code ('AW Code'), which was refreshed in February 2021 and we complied with the principles of our Code during 2020/2021 as follows:

1. **BOARD LEADERSHIP AND TRANSPARENCY (INCLUDING COMPANY PURPOSE, VALUES AND CULTURE AND STAKEHOLDER ENGAGEMENT):**
   See Corporate Governance Statement on pages 75 to 87 and strategic report on pages 8 to 64.
2. **BOARD COMPOSITION AND DIVISION OF RESPONSIBILITIES:**
   See directors' biographies on pages 70 to 74 and Corporate Governance Statement on pages 75 to 87.
3. **SUCCESSION, EVALUATION AND EFFECTIVENESS:**
   See Corporate Governance Statement on pages 75 to 87 and Nomination Committee Report on pages 88 to 93.
4. **AUDIT, RISK AND INTERNAL CONTROL:**
   See Audit, Risk and Assurance Committee Report on pages 96 to 105.
5. **REMUNERATION:**
   See Remuneration report on pages 112 to 126.

QUICK LINKS:

A copy of the Affinity Water Corporate Governance Code can be found on the company's website:
affinitywater.co.uk/governance-assurance

Governance continued

Our Board of directors

Biographies of our Board of directors as at 31 March 2021 are detailed below.

Where a director holds other directorships within the Affinity Water group, the numbers listed alongside his or her name are cross referenced to the relevant company shown on the structure chart on page 105.

Director membership of our Board Committees is also listed by letter, alongside the relevant director's name:

- A Audit, Risk and Assurance Committee
- R Remuneration Committee
- N Nomination Committee
- S Safety, Health, Environment and Drinking Water Quality Committee ('SHEDWQ Committee')

Former directors

Name	Former Role	Period of service
Tony Cocker	Company chair	30 January 2018 to 29 January 2021
Patrick O'D Bourke	Independent non-executive director	24 July 2013 to 29 September 2020

INDEPENDENT NON-EXECUTIVES

IAN TYLER, CHAIR

R N S

Ian has a wealth of experience and knowledge having worked across a number of different industry sectors. Ian qualified as a chartered accountant with Arthur Andersen in 1985, and over his career has gained considerable experience in building and transforming businesses in the UK and United States.

An accomplished leader, Ian held a number of senior finance and operational positions within listed companies including Group Financial Controller at Storehouse plc, Financial Controller at Hanson plc, Finance Director at ARC Limited, Finance Director and Chief Operating Officer at Balfour Beatty plc before being appointed its Chief Executive for the period from 2005 to 2013. During his time as Chief Executive, he took Balfour Beatty from being primarily a UK construction business to a global infrastructure services business, and trebled turnover to £10bn.

Ian currently sits on four other Boards; as non-executive director ('NED') of BAE Systems, Chair of Vistry Group plc (formerly Bovis Homes Group plc), Independent Chair of the AWE Management Limited, (a joint venture between Lockheed Martin, Serco and Jacobs Engineering, which operates the Atomic Weapons Establishment on behalf of the Ministry of Defence) and NED and Chair of Amey plc (a subsidiary of Ferrovial S.A.).

TREVOR DIDCOCK

R S

Trevor has experience in a number of industry sectors as a CIO and Group IT Director and most recently as a NED. Trevor joined the company in November 2015, is an Independent NED, Senior Independent Non-Executive Director ('SID'), and Director for Employee Engagement.

Trevor is a NED at Futurice Oy (a digital innovation and engineering company) and a non-executive member of the Transformation Programme Board at the Civil Aviation Authority. In his executive career, Trevor was Chief Information Officer at EasyJet plc from 2010 to 2015, HomeServe plc from 2008 to 2010, the Automobile Association Limited from 2003 to 2007 and Group IT Director at RAC Motoring Services Limited from 1999 to 2003.

Trevor has a BSc (Hons) in Mechanical Engineering from the University of Nottingham, and an MBA and Marketing Diploma from Cranfield Business School.

Governance continued

Our Board of directors (continued)

INDEPENDENT NON-EXECUTIVES (CONTINUED)

SUSAN HOOPER

R N

Susan has significant experience in customer-facing businesses and as a NED. Susan joined the company in November 2015, is an Independent NED and Chair of the Remuneration Committee.

She is currently a NED of the Rank Group and Uber UK and has previously served on the Boards of Wizz Air, DExEU, and Whitbread. Susan was previously Managing Director of British Gas Services Limited and Chief Executive of the Acromas Group's travel division from 2009 to 2013.

She is a founding Director of Chapter Zero, the Directors Climate Change Forum. Susan has a BA and MA in International Economics from Johns Hopkins University.

MARK HORSLEY

A R

Mark has over 40 years' experience in the energy sector – particularly gas and electricity network businesses. Mark joined the company in December 2019 and is an Independent NED.

He is currently CEO of Northern Gas Networks, the North of England's gas distributer, and has been in that role since 2011. Mark's previous roles include: Equity Partner and Head of Power Distribution at EC Harris, an international built asset consultancy; Strategy and Central Programmes Director at Scottish Power; and President and Chief Operating Officer at CE Electric UK.

He began his career as an apprentice cable jointer at North Eastern Electricity Board. Mark has a passion for innovation and its role in consistently improving ways of working and driving positive change. He is a NED of the Energy Innovation Centre (EIC), and was Chair from 2014 to 2017, and was Chair of the Energy Network Association from 2004 to 2006.

CHRIS NEWSOME

A S

Chris has extensive experience across large, regulated infrastructure businesses and over 40 years' experience within the water industry (at Yorkshire Water, Kelda Water and Anglian Water). Chris joined the company in January 2019, is an Independent NED and Chair of the Safety Health, Environment and Drinking Water Quality Committee.

Chris is a member of the Government's Green Construction Board and Chairman of the Infrastructure Working Group driving down carbon in infrastructure assets. He is Past President and Board Member of the Institute of Asset Management, a director of UK Water Partnership Limited and board adviser for Barhale Limited.

Chris has a BSc in Civil Engineering from Loughborough University, an MBA from the Manchester Business School and a post-graduate diploma in Structural Engineering from the University of Bradford. He has a passion for carbon reduction and innovation and was awarded an OBE for services to Civil Engineering and Carbon Reduction in 2017.

ANN BISHOP

R N

Ann brings a strong background of experience advising regulated industries combined with expertise from her extensive roles as chair, deputy and NED. Ann joined the company in March 2020 and is an Independent NED.

Ann was the founder and Managing Director of Indepen, a management consultancy company, working with clients facing the challenges of regulation, deregulation, competition and restructuring. She has over 30 years' experience in the regulated sectors working with investors, the chair, chief executives, board members and senior executive teams, helping to develop and implement policy and strategy.

Ann is a Governor of Leeds Beckett University and Chair of Senior Staff Remuneration Committee and is Chair of the Customer Engagement Group for UK Power Networks. Ann was a member of the London First Infrastructure Commission and of the Ofwat Expert Panel. Ann was also an Ambassador of Wellbeing of Women and, from 2000 to 2010, was NED and Deputy Chair for Opera North. Ann has a BA and MA in English Literature from Cambridge University.

JUSTIN READ

A N

Justin has a wealth of financial and management experience working as an executive and non-executive across a number of different industry sectors in a wide variety of businesses both within the UK and internationally. Justin joined the company in July 2020, is an Independent NED and Chair of the Audit, Risk and Assurance Committee.

Justin is a NED and Chair of the Remuneration Committee for Grainger plc and a NED and Chair of the Audit Committee at Ibstock plc. In his executive career, Justin was CFO of SEGRO plc from 2011 to 2016, and Speedy Hire plc from 2008 to 2011. Previously he had worked at Hanson plc, Disneyland Paris, and Bankers Trust.

Justin has an MBA from INSEAD in France and a BA and MA in Modern History from Oxford University.

Governance continued

Our Board of directors (continued)

NON-EXECUTIVES

JAROSLAVA KORPANEC

A R N
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8 9 10 11 16

Jaroslava joined the company in May 2017 and is a NED and shareholder representative of Allianz Capital Partners.

She is Managing Director at Allianz Capital Partners and heads up the London office. Since joining Allianz in 2008, she has led the investments made in a number of infrastructure assets, including the Thames Tideway Tunnel, Porterbrook (the train rolling stock leasing business) and the gas distribution business of National Grid. Before joining Allianz Capital Partners in 2008, Jaroslava worked at AIG Financial Products on several debt and equity investments, including the acquisition and management of London City Airport. Jaroslava is also on the Boards of Cadent Gas, the gas distribution company, as well as Gasnet and Net4Gas, the gas transmission company of the Czech Republic. Jaroslava was also responsible for Allianz's acquisition of NET4GAS, in 2013, and Gasnet in 2019.

Jaroslava has a BA and MA in Law from the University of Cambridge and is a member of the New York bar and a solicitor of the Supreme Court of England and Wales.

TONY ROPER

A N S
2 3 4 5 6 7
8 9 10 11 18

Tony joined the company in July 2018 and is a NED and shareholder representative of InfraRed Capital Partners.

Tony was a Managing Partner and a senior member of the infrastructure management team at InfraRed Capital Partners until June 2018. He was one of the founders of InfraRed Capital Partners, having been part of the senior management team which bought HSBC Specialist Investments from HSBC, renaming it InfraRed Capital Partners. Previously he had worked for HSBC and John Laing Group plc in infrastructure investment activities. He started his career as a structural engineer with Ove Arup and Partners.

Tony is the Chairman of two UK investment trusts: Aberdeen Standard European Logistics Income plc and SDCL Energy Efficiency Income Trust plc. Tony has a BA and MA in Engineering from the University of Cambridge and is a qualified ACMA-CGMA accountant.

ANGELA ROSHIER

R S
2 3 4 5 6 7
8 9 10 11 17

Angela joined the company in May 2017, and is a NED and shareholder representative of DIF. Angela is Partner and Head of Asset Management at DIF. She joined DIF in 2010 and oversees the asset management of DIF's investment portfolio of approximately 120 assets. She is also a member of DIF's Executive Committee and Investment Committees. She is responsible for the ESG strategy at DIF and has been instrumental in DIF achieving a United Nations' Principles for Responsible Investment score of A+. DIF is a leading independent fund management company with funds under management in the Public-Private Partnership , regulated asset and renewable energy sector.

Prior to DIF, Angela was a member of 3i plc and Actis's Infrastructure teams. With more than 22 years' experience she has contributed to the origination and asset management of a wide variety of infrastructure assets in the PPP, water, renewable energy and transport sectors, both in Europe and emerging markets. She holds an MBA from London Business School and a MA from the University of Cambridge.

EXECUTIVE DIRECTORS

PAULINE WALSH, CEO

S
2 3

Pauline has broad international experience and a track record in leading transformational changes in large scale operations. Pauline joined the company as CEO in May 2018. She was previously Director of Gas Transmission for National Grid responsible for building and maintaining the assets of the UK's high-pressure national gas transmission system.

Prior to joining National Grid in 2015, Pauline held senior leadership roles at Ford Motor Company, Philips Electronics, Havells-Sylvania, and Fred Olsen. Until November 2019, Pauline was a NED at Buccleuch, a business which is focused on the sustainable economic development of vast land resources and deploying renewable energy technologies. Pauline is a member of the board of Water UK and of the Energy & Utility Skills CEO Council.

Pauline has an MBA from IMD in Switzerland and a BEng (Hons) in mechanical engineering from University College Dublin. She is an honorary fellow of the Institute of Engineers of Ireland.

STUART LEDGER, CFO

2 3 4 13 14 15

Stuart has significant experience in utilities and in finance. Stuart joined the company as CFO in October 2017.

He has held a number of senior finance roles, most recently CFO for Retail at Thames Water. Before joining Thames Water in 2008 as the Group Financial Controller, he was the Financial Controller at Wolseley and started his career at EDF Energy. Stuart is a director of Landlord Tap Limited, which provides a website for landlords and managing agents of residential properties to provide water companies with details of those responsible for the payment of water and/or sewerage charges for their tenanted properties. He is also a trustee of the charity, Rett UK.

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

Governance continued

Corporate Governance Statement

AFFINITY WATER GOVERNANCE CODE

The company is committed to high standards of corporate governance and transparency, believing these to be essential in delivering the long-term sustainable success of its business. The Board governs the company in accordance with the Affinity Water Corporate Governance Code ('AW Code'), which incorporates the Ofwat Board Leadership, Transparency and Governance Principles 2019 ('BLTG Principles') in their entirety and those parts of the UK Corporate Governance Code 2018 that are deemed relevant to its business. With the exception of aligning executive directors pension contributions with those of the workforce (see details in the Remuneration Committee report on page 111), the company was compliant with all areas of the UK Corporate Governance Code 2018.

This Report illustrates how we have applied with the AW Code principles and complied with its provisions during the year ended 31 March 2021. In doing so, we believe that it fulfils the Ofwat Licence requirement to explain in a manner that is effective, accessible and clear how we meet the objectives of the BLTG Principles. The AW Code is available on the company's website: **affinitywater.co.uk/governance-assurance**. Our Board confirms that the principles of good corporate governance contained in the AW Code have been consistently applied throughout the financial year.

BOARD LEADERSHIP AND COMPANY PURPOSE

OUR BOARD OF DIRECTORS

During the year, there were a number of changes to the composition of our Board of directors. Ian Tyler joined our Board as Chair Designate on 11 January 2021 and was appointed Chair on 29 January 2021 following the resignation of Tony Cocker who had held the position for a three-year period. Patrick O'D Bourke resigned as independent non-executive director and Chair of the Audit, Risk and Assurance Committee on 29 September 2020. In his place, Justin Read was appointed to the Board on 28 July 2020 and as Chair of our Audit, Risk and Assurance Committee on 19 November 2020.

Our Board appreciates the contribution that both Tony Cocker and Patrick O'D Bourke have made to the stewardship of Affinity Water during their time with the company. With the appointment of a new Chair and independent non-executive director, our Board is ready to lead the company through the next phase of its business development.

EFFECTIVE BOARD

Our Board is composed of highly skilled professionals who bring a range of skills, perspectives and corporate experience to our boardroom. These are detailed in the directors' biographies on pages 69 to 73 and in the directors' skills matrix on page 84.

The role of our Board is to promote the long-term sustainable success of the company, generate value for shareholders and contribute to wider society. The Board's effectiveness is facilitated by the use of its four principal Committees, namely the Audit, Risk and Assurance Committee, the Nomination Committee, the Remuneration Committee and the SHEDWQ Committee. These Committee's operate under their own terms of reference, which can be found on the Company's website at **affinitywater.co.uk/governance-assurance**, and report to the Board at each meeting.

HOW THE BOARD OPERATES

The Board and its Committees have a scheduled forward programme of meetings which allow sufficient time for both routine and non-routine matters to be considered. The Nomination Committee met an additional 9 times during the year to consider the appointment of our new Chair, Ian Tyler.

The Chair of the Board and the Chairs of the Committees set the agendas for upcoming meetings with the Company Secretary. Board and Committee papers and reports are required to be clear and concise. They are circulated five working days prior to the meeting and are accessed from a secure Board portal.

The authors of Board papers and reports are sometimes invited to join Board discussions, to enable directors to truly drill-down into the information provided and to question management directly. Minutes of Board and Board Committee meetings are prepared and circulated in a timely manner by our Company Secretary after each meeting.

All directors have access to our Company Secretary and the right to request any Board challenge be recorded in the minutes of the meeting. No dissenting votes nor any instances of challenge were recorded in the minutes of board meetings during the year.

BOARD AND COMMITTEE MEETINGS ATTENDANCE

During the year, due to the pandemic, the Board and its Committees have conducted meetings both in person and remotely via video conferencing. Where a director was unable to attend a meeting, they still received all the papers for the meeting and were given the opportunity to raise issues outside of the meeting.

	Board	Audit, Risk and Assurance Committee	Remuneration Committee	Nomination Committee	SHEDWQ Committee	Special Nomination Committee*
Number of Meetings	**11**	**4**	**5****	**3**	**4**	**9**
Company Chair						
Ian Tyler Joined as Chair Designate on 11 January 2021 and appointed as Chair on 29 January 2021	3/3	1/1	1/1	1/1	2/2	-
Tony Cocker Stepped down as Chair on 29 January	9/9	3/3	4/4	3/3	3/3	1/9
Independent Non-Executive Directors						
Patrick O'D Bourke Left the Board on 29 September 2020	6/6	2/2	-	1/1	-	6/6
Trevor Didcock	11/11	-	5/5	2/3***	4/4	9/9***
Mark Horsley	10/11	3/4	4/5	-	-	-
Chris Newsome	11/11	4/4	-	-	4/4	-
Ann Bishop	9/11	-	4/5	2/3	-	6/9
Susan Hooper	11/11	-	5/5	2/3	-	8/9
Justin Read Joined 28 July 2020 and Chair of Audit, Risk and Assurance Committee from 19 November 2020	8/8	3/4	-	2/3	-	9/9
Non-Executive Directors						
Jaroslava Korpanec	10/11	3/4	5/5	2/3	-	9/9
Tony Roper	11/11	4/4	5/5***	3/3	4/4	9/9
Angela Roshier	11/11	-	3/5	2/3***	4/4	1/9***
Executive Directors						
Pauline Walsh	11/11	4/4***	5/5***	3/3***	4/4	4/9***
Stuart Ledger	11/11	4/4***	4/5***	-	-	-

*An additional 9 Special Nomination Committee meetings were held during the year to consider the appointment of the Chair

** Includes one Special Remuneration Committee meeting on 15 June 2020

*** Not a member of the Committee but joined by invitation

Governance continued

Corporate Governance Statement (continued)

KEY ACTIVITIES OF THE BOARD DURING THE YEAR

During the year, the following key activities were undertaken by the Board:

Strategy

- Led and monitored the company's response to COVID-19;
- Reviewed and monitored the company's business strategy;
- Approved the company's AMP7 Plan;
- Updated and monitored our sustainability strategy and associated policies; and
- Reviewed the development and execution of the customer service, communications and media strategies and reaffirmed our customers as central to our purpose.

Finance

- Approved the Annual Report and Financial Statements for the financial year ended 31 March 2020;
- Reviewed and approved the interim and final dividend recommendations for 2021;
- Approved the company's budget for the financial year;
- Provided oversight and approval of related financial policies ensuring compliance with the company's Instrument of Appointment; and
- Additional governance scrutiny provided by the Audit, Risk and Assurance Committee.

People

- Approved implementation of the people and culture strategy;
- Approved the appointment of a new Chair and Independent Non-Executive Director;
- Approved the company's Policy on Modern Slavery and Human Trafficking; and
- Approved our strategy on diversity and inclusion and our approach to health, safety and wellbeing across the organisation.

Governance

- Refreshed the Affinity Water Corporate Governance Code and updated our high-level corporate governance framework in line with current best practice for a regulated water company;
- Approved a 'Consulting with Shareholders Policy' which details matters reserved for shareholder consultation;
- Reviewed the terms of reference of all Board Committees;
- Approved and updated company policies on Fraud, Anti Bribery and Corruption; and Health and Safety;
- Considered the Board and Board Committee evaluation reviews; and
- Introduced a new Non-Executive Directors' Induction Programme.

At each Board meeting there are standing items, which include:

- review and approval of the previous minutes;
- status update on any matters outstanding from previous meetings;
- Board Committee updates to the Board;
- report from the Chief Executive Officer; and
- report from the Chief Financial Officer.

HOW GOVERNANCE SUPPORTS STRATEGY

The Board is responsible for delivering value for shareholders by setting the Group's strategy and overseeing its implementation by the Executive Management Team. Our strategic priorities and our four customer outcomes are set out in the business model on page 20 onwards in the strategic report. The Board held a strategy day in September 2020 at which it conducted a detailed review of our strategy, including our purpose and strategic objectives. The strategy day was facilitated externally and members of the Executive Management Team were invited to present on specific matters. The Board receives regular updates on progress in delivering the strategy throughout the year.

RISK MANAGEMENT

Our governance arrangements also support the development and delivery of strategy and the long-term success of our business by maintaining a sound system of risk oversight, management and an effective suite of internal controls, which are outlined in pages 99 to 100 in the Audit, Risk and Assurance Committee report.

PURPOSE, VALUES AND CULTURE

In last year's Annual Report, the Board introduced the company's purpose: **'to provide high quality drinking water and take care of our environment for our communities now and in the future'.**

Fundamental to our purpose is its alignment with our culture based on our principles of **being proactive, making it easy, showing we understand, showing we care, and doing what we say we will.**

To ensure that everyone at Affinity Water stays focused on delivering our strategy, the Board has reaffirmed the company's purpose, principles and strategy and has satisfied itself that these and its culture are aligned. The Board has adopted an AMP7 Plan, which details our strategy to make our purpose and principles happen.

The Board continues to embed the company's principles in our operational practices through a range of corporate policies including our Code of Conduct, Health and Safety, Security, Environmental, Data Protection, Procurement, Fraud Anti-bribery and Corruption, Whistleblowing and Modern Slavery and Human Trafficking.

To continue the roll out of the company's culture, 38 Culture Ambassadors were appointed during the year. They are tasked with promoting our culture amongst colleagues through a series of Culture Forums, attended by Trevor Didcock, our SID and nominated Non-Executive Director of Employee Engagement, who represents the views of employees at Board level.

STAKEHOLDER ENGAGEMENT

To deliver on its purpose, the Board considers our stakeholders when making decisions. Wider stakeholders include our customers, suppliers, the communities in which we operate, our shareholders, regulators and environmental bodies. Details of how our Board has engaged with stakeholders in putting our purpose into action during the year can be found in the strategic report, which includes our Section 172(1) statement on page 54.

Throughout the year, the Board has monitored and assessed the company's culture via:

- The holding of culture forums across the company led by our team of Culture Ambassadors;
- Reviewing the outcomes of employee surveys carried out in May and October 2020;
- Assessing culture indicators such as compliance with the Group's policies and procedures;
- Feedback from our wider stakeholders, as explained in our Section 172(1) statement;
- Incidents reported through the Group's whistleblowing system;
- Health and safety data;
- Promptness of payments to suppliers;
- Training data and spend; and
- Independent assurance sought through the internal audit team and various external advisers.

The Board is confident that the company's principals and culture are delivering against its clear purpose and improving the performance of our business.

Governance continued

Corporate Governance Statement (continued)

OFWAT

As a water company, Ofwat is both our regulator and stakeholder, with which we have a regular dialogue led by our Director of Regulation and Strategy and our Director of Corporate Affairs. Our dialogue includes consultations on all aspects of the water industry, our governance, pricing and PR24 preparations.

To ensure that we are better aligned with the 2019 BLTG Principles, we incorporated four BLTG objectives into the AW Code as follows:

Purpose, values and culture

Affinity Water Objective:
The Board must establish the company's purpose, strategy and values, and satisfy itself that these and its culture reflect the needs of all those it serves.

- Embedding our purpose and principles
- Greater stakeholder engagement
- Development of workforce policies
- Implementing our culture change initiative

Stand-alone regulated company

Affinity Water Objective:
The company must be led by an effective and entrepreneurial board which has full responsibility for all aspects of the company's business and whose role is to promote the long-term sustainable success of the company.

- Reviewing the independence of our NEDs
- Reviewing the division of responsibilities between our Chair and Chief Executive Officer
- Introducing a framework for consulting with our shareholders

Board leadership and transparency

Affinity Water Objective:
The Board's leadership and approach to transparency and governance must engender trust in the company and ensures accountability for their actions.

- Monitoring directors' conflicts of interest
- Defining our governance ambitions in a new Affinity Water Corporate Governance Code
- Aligning Board and Executive remuneration with performance against our purpose and long-term success

Board structure and effectiveness

Affinity Water Objective:
The Board and its Committees must be competent, well run, and have sufficient independent membership, ensuring they can make high quality decisions that have regard to diverse customer and stakeholder needs.

- Revising Matters Reserved for the Boards and Committee Terms of Reference
- Reviewing Board composition and balance
- Enhancing directors' induction and training programmes
- Evaluating the Board and reviewing its effectiveness and that of its Committees

SHAREHOLDER ENGAGEMENT

Affinity Water is owned by a consortium of private investors. Our group structure, ownership and financing are outlined on page 105 onwards.

Each of our private investors is represented on our Board. Jaroslava Korpanec is the non-executive director representing Allianz Capital Partners, Tony Roper represents InfraRed Capital Partners and Angela Roshier represents DIF. To ensure that the Board as a whole, remains fully focussed on the activities of the company and the interests of its all its stakeholders, the Board has an established process for consulting with its shareholders and for their views to be represented in Board discussions without compromising the independent judgement, leadership and governance of the Board. Whilst our Board considers the views of our shareholders in its deliberations, it acts independently and in the best interests of the company as a whole. Affinity Water values the particular expertise that can be brought into consideration through the experience and expertise shareholders bring to these decisions which are in a large part similar to the matters Affinity Water's senior financiers have control rights over.

A limited number of matters require shareholder consultation before decisions can be made. These are in a large part similar to the matters Affinity Water's senior financiers have control rights over and are set out in a governance framework document "Consulting with our Shareholders" at **affinitywater.co.uk/governance-assurance**, available on the governance pages of our website.

During 2020/2021, the Board consulted with its shareholders on the following issues, which are all detailed in this report:

- Appointment of Ian Tyler as our new Chair;
- Appointment of Justin Read as an Independent Non-Executive Director and Chair of our Audit, Risk and Assurance Committee;
- The refresh of the Affinity Water Corporate Governance Code; and
- Devising our policy on 'Consulting with Shareholders'.

Following shareholder consultation, the Board's deliberations, decisions and actions on these matters were considered and taken collectively as a Board independently of its shareholders.

EMPLOYEE ENGAGEMENT

We have an experienced, diverse and dedicated workforce which is recognised as a key asset of our business. Our employees operate across a number of sites. In order to reach all our employees (including individuals engaged under contracts of service, agency workers and remote workers), the Board uses a combination of formal and informal engagement methods, which are detailed in the Section 172(1) statement on page 54 of this Annual Report.

Our employee engagement programme was principally led and overseen by Trevor Didcock, our Non-Executive Director of Employee Engagement during the year.

Effective two-way communication with our workforce is a key part of our corporate culture and has proved particularly important throughout the COVID-19 pandemic in encouraging our employees to stay engaged and connected with the company.

Employee concerns about job security, working from home successfully and the safeguarding of their health and safety on their return to the office have been reported to and responded to by the senior management team and the Board via our culture forums, the Joint Negotiation and Consultative Committee and director roadshows.

During the lockdown, our intranet was used to provide employees with Government guidelines and the company's response to the pandemic.

The two employee surveys carried out during the year were used in part by the Board to gauge whether employees felt they had been supported by the company during the pandemic and to receive feedback on home working and our wellbeing initiatives. As a result of these surveys, the Board and Executive Management Team introduced a 'Wellbeing Fortnight', held several externally facilitated interactive wellbeing sessions and appointed 11 mental health first aiders to support the health and wellbeing of our workforce across the business.

Governance continued

Corporate Governance Statement (continued)

WORKFORCE POLICIES AND PROCEDURES

The Board and Executive Management Team review and approve all key workforce policies and practices. Our policies are published on the company's intranet and are easily accessible to our employees.

Our company induction process covers training on key policies for new employees and we communicate any subsequent changes that take place.

To ensure policies are embedded in our business practices, our workforce undertake mandatory e-learning on a regular basis to keep informed of current company policies.

The Board respects the right of its employees to be members of trade unions. Our Chief Financial Officer meets with employee trade unions at quarterly meetings of the Joint Negotiation and Consultative Committee to consult on workforce policies and practices.

It is important for our workforce to be able to raise any concerns with management and the Board confidentially and anonymously, if desired. As part of our Whistleblowing Policy, an independent and confidential helpline is available to anyone wanting to speak up about potential ethical and business conduct issues. During the reporting year, a number of incidents were reported, indicating a healthy 'speak up' culture in which our stakeholders can raise their concerns with confidence.

All incidents were thoroughly investigated by appropriate members of the executive and senior management team, working with external advisors when required, with matters being brought to the attention of the Board as appropriate. Whilst some reported incidents presented an opportunity for enhancing the company's internal controls, the Board remains confident that its Whistleblowing Policy is effective and continues to promote its awareness amongst stakeholders.

As a highly regulated business with operations limited to the South East of England, the Board is cognisant of human rights issues and upholds a zero-tolerance approach to modern slavery and human trafficking across our business and supply chain. The Board approves the both the Policy and annual statement on Modern Slavery and Human Trafficking.

These documents are adhered to by our employees and suppliers who provide support for major capital programme delivery, operational support as well as services and supplies. Both documents can be found on our website: **affinitywater.co.uk/responsibility**.

Our procurement team monitor compliance with the Policy in our supply chain and report any breaches to our Chief Financial Officer, who would then bring these to the attention of the Board as a whole.

We are pleased to report no incidents of modern slavery and human trafficking were reported during the financial year.

OUR GOVERNANCE FRAMEWORK AND DIVISION OF RESPONSIBILITIES

GOVERNANCE FRAMEWORK

We pride ourselves on conducting our business in an open and transparent manner.

The Board has a clear corporate governance framework comprising matters reserved for the Board and various Board Committees with clear terms of reference.

Our Board is primarily responsible for setting the company's strategy for delivering long-term value to our shareholders and other stakeholders, providing effective challenge to management concerning the execution of the strategy and ensuring the company maintains an effective risk management and internal control system.

The Board

Our Board is primarily responsible for setting the Group's strategy for delivering long-term value to our shareholders and other stakeholders, providing effective challenge to management concerning the execution of the strategy and ensuring the Group maintains an effective risk management and internal control system.

The Schedule of Matters Reserved for the Board are available on the company's website at: **www.affinitywater.co.uk/corporate** and members of the Board appear in the directors biographies on pages 68 to 72

Our strategy Page 20
Our principal risks Page 38
Our Section 172(1) statement Page 54
Key activities of the Board Page 76

Board Committees

Audit, Risk and Assurance Committee
Oversees the Group's financal reporting, maintains an appropriate relationship with the external Auditor and monitors internal controls.

Remuneration Committee
Establishes Affinity Water's Remuneration Policy and ensures a clear link between performance and remuneration.

Nomination Committee
Evaluates and makes recommendations regarding Board and Committee composition, succession, planning and directors' potential conflicts of interest.

SHEDWQ Committee
Reviews and monitors health and safety, environment, drinking water quality and personal security matters arising from our activities and operations

The terms of reference of each Board Committee are available on the Company's website at: **www.affinitywater.co.uk/corporate** and members of the Committee are listed in the various Committee Reports

Audit, Risk and Assurance Committee Report Page 95
Remuneration Report Page 111
Nomination Committee Report Page 87
SHEDWQ Committee Report Page 93

Chief Executive Officer

Executive Management Team

The Executive Management Team meets on a monthly basis and is responsible for the day-to-day running of the business.

Chief Exeutive Officer's Introduction Page 10
Executive Management Team **www.affinitywater.co.uk/corporate**

Shareholders and Stakeholders

Governance continued

Corporate Governance Statement (continued)

ROLES AND RESPONSIBILITIES OF THE BOARD

Board members have separate clearly defined roles and responsibilities, as illustrated in the table below. Their roles and responsibilities are well defined, set out in writing and approved by the Board.

Role	Name	Responsibility
Chair	Ian Tyler	The Chair leads the Board and is responsible for its overall effectiveness in directing the company. He promotes a culture of openness and debate facilitating constructive Board relations and the effective contribution of all non-executive directors, and ensures that the Board receive accurate, timely and clear information
Chief Executive Officer	Pauline Walsh	The CEO is responsible for the day-to-day running of the company's business and the development and implementation of strategy, decisions made by the Board and operational management of the company, supported by the Executive Management Team
Chief Financial Officer	Stuart Ledger	The CFO supports the CEO in developing and implementing strategy, oversees the day-today financial activities of the company and ensures that policies and practices set by the Board are adopted at all levels of the company
Senior Independent Non-Executive Director	Trevor Didcock	The SID is an independent non-executive director, who provides a sounding board for the Chair and serves as an intermediary for the other directors and shareholders where necessary. The SID also leads the annual appraisal and review of the Chair's performance
Non-Executive Director of Employee Engagement	Trevor Didcock	The Non-Executive Director of Employee Engagement is responsible for ensuring that the interests of the company's employees are considered by the Board when making significant decisions through an active employee engagement programme
Non-Executive Director	Ann Bishop Trevor Didcock Susan Hooper Mark Horsley Jaroslava Korpanec Chris Newsome Justin Read Tony Roper Angela Roshier	The Non-Executive Directors are responsible for bringing an external perspective, sound judgement and objectivity to the Board's deliberations and decision making, and to support and constructively challenge the Executive Directors using their broad range of experience and expertise
Company Secretary	Sunita Kaushal	The Company Secretary acts as Secretary to the Board and all Board Committees and is responsible for supporting the Chair of the Board in the delivery of the corporate governance agenda

INDEPENDENCE OF BOARD

Our Board comprises seven independent non-executive directors, including the Chair; three non-executive directors representing our shareholders; and two executive directors, the Chief Executive Officer and Chief Financial Officer.

The balance of independent and non-independent directors ensures that shareholder views are represented on the Board with the Board as whole acting independently in the interests of all stakeholders and the company in accordance with our Instrument of Appointment, with no one individual or group of individuals dominating the Board's decision-making.

As per our Code, independent non-executive directors are also in a majority on all Board Committees.

EXTERNAL DIRECTORSHIPS AND TIME COMMITMENT

The company is mindful of the time commitment required from non-executive directors to effectively fulfil their responsibilities on the Board.

Prior to their appointment, prospective directors are asked to provide details of any other roles or significant obligations that may affect the time available for them to commit to the company.

The Chair and the Board are then kept informed by each director of any proposed external appointments or other significant commitments as they arise.

These are monitored to ensure that each director has sufficient time to fulfil their obligations and Board approval is required prior to a director taking on any additional external appointment.

Each director's biographical details, independence and significant time commitments outside of the company are set out in the directors' biographies on pages 69 to 73.

CONFLICTS OF INTEREST

To further safeguard its independent judgement and to the prevent the undue influence of third parties on the Board's decision making, the Board operates a conflicts of interests policy, which restricts a director from voting on any matter in which they might have a personal interest unless the Board unanimously decides otherwise.

Prior to all major Board decisions, the Chair requires the directors to confirm that they do not have a potential personal conflict with the matter being discussed. If a conflict does arise, the director is excluded from discussions and voting on the matter.

Governance continued

Corporate Governance Statement (continued)

BOARD BALANCE AND EFFECTIVENESS

BOARD BALANCE

An effective Board requires the right mix of skills and experience. Our Board is a diverse and effective team focused on promoting the long-term success of the company for the benefit of all stakeholders. The majority of our Board is comprised of independent non-executive directors and 40% are female.

The composition of the Board as at 31 March 2021 is illustrated in the diagram below:

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

Board composition at 31 March 2021	Directors	Independent (including Chair)	Male	Female
	12	7	7	5

BOARD SKILLS AND ATTRIBUTES

Our directors' biographies on pages 69 to 73 highlight their experience and the chart on the next page provides an overview of their skills and attributes.

		Chair from 29/01/21	Chair until 29/01/21	Executive Directors		Independent Non-Executive Directors						Non-Executive Directors		
		Ian Tyler	Tony Cocker	Pauline Walsh	Stuart Ledger	Trevor Didcock	Susan Hooper	Chris Newsome	Justin Read	Mark Horsley	Ann Bishop	Jaroslava Korpanec	Angela Roshier	Tony Roper
Experience	Utility industry experience or experience of network operations	✓	✓	✓	✓		✓	✓		✓	✓	✓	✓	
	Relationships with Government and Regulators (economic)	✓	✓	✓	✓		✓	✓		✓	✓			
Corporate Governance	Board effectiveness; Ofwat's principles	✓	✓	✓	✓		✓	✓	✓	✓	✓	✓	✓	✓
Strategy	Strategy development and implementation	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Key skills and experience														
Finance	Accountancy, audit	✓			✓				✓			✓	✓	✓
	Audit Committee experience	✓	✓	✓	✓	✓	✓		✓	✓		✓	✓	✓
Remuneration	Remuneration Committee experience	✓					✓		✓		✓	✓		✓
Risk	Risk management	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Customer	Customer insight and engagement	✓	✓	✓	✓	✓	✓	✓		✓	✓			
Technology	Technology/digital systems			✓	✓	✓		✓						✓
Resilience	Capital projects	✓	✓	✓	✓	✓		✓	✓	✓		✓	✓	✓
	Engineering	✓		✓		✓		✓		✓				✓
Environment	Environmental/sustainability		✓	✓			✓	✓		✓	✓	✓	✓	✓
Team	People management	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Health and safety	✓	✓	✓			✓	✓		✓			✓	✓
Transformation	Business and cultural transformation	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓			

APPOINTMENTS TO THE BOARD

Appointments to our Board are made on the recommendation of the Nomination Committee with due consideration given to the benefits of diversity in its widest sense, including gender, social and ethnic backgrounds and personal strengths. The Nomination Committee report on pages 87 to 92 provides further information on:

- Board composition;
- Board appointments, induction and training,
- succession planning; and
- diversity.

ANNUAL BOARD EVALUATION

The Board undertakes a review of its effectiveness annually. An internal evaluation was undertaken during the year led by the Chair and Company Secretary. The evaluation was based on questions that have been scored and benchmarked year-on-year and included the opportunity for free text. The questions assessed both the performance of the Board, and each of its principal Committees, as well as that of the Chair and each of the non-executive directors. Sean O'Hare of Board Dialogue Limited facilitated a discussion of the results of the Board effectiveness review.

Governance continued

Corporate Governance Statement (continued)

ANNUAL BOARD EVALUATION (CONTINUED)

The table highlights key findings from the review and the plans made to address any issues:

2020/21 evaluation findings	Plans to address issues
Board decision-making	Management to further improve the quality and timeliness of information provided to the Board and its Committees, to clarify decision-making authority and to consider post-decision-making lessons learned
Succession planning	Further develop succession plans for senior management
Risk appetite	Expand the Board's focus on non-compliance related risks such as climate change
Board and Executive Management Team relations	Create more opportunities for Board and Executive Management Team interaction through both formal and informal means

UPDATE ON 2019/2020 OUTCOMES

2020/21 evaluation findings	Plans to address issues
Board Induction and Training	A new Directors' Induction Programme was introduced with directors attending training courses and seminars throughout the year. The Board also met with Ofwat to talk about the key issues currently faced by water companies and with the Drinking Water Inspectorate to discuss water quality matters.
Board Meeting Support	Board papers were made more concise and issued at least 5 days prior to Board meetings, with minutes being circulated on a timely basis.
Board composition	The Board and Nomination Committee conducted a review of Board composition and skills as a part of its succession planning.
Communication between Board Meetings	Meetings with senior management and between the Chair and individual Board members were held on a more frequent basis.

By order of the Board

Sunita Kaushal
Company Secretary
28 June 2021

Nomination Committee report

IAN TYLER

Nomination Committee members as at 31 March 2021

- Ian Tyler
- Justin Read
- Susan Hooper
- Jaroslava Korpanec
- Tony Roper
- Ann Bishop

Composition of the Committee

Male: 50%
Female: 50%

Independent directors on Committee: 67%

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

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

Dear shareholder,

This report details the role of the Nomination Committee and the important work it has undertaken during the year. The pages that follow provide additional detail on the activities and discussions of the Committee for the year ended 31 March 2021.

I am delighted to present the Nomination Committee Report for my first year as Chair, to detail the important work of the committee, our approach to director recruitment and training and development of the Board.

The Committee's responsibilities include:

Assessing the performance of the Board:
- reviewing Board performance, paying specific attention to the structure, size and composition of the Board including skills, independence, knowledge, ethnicity, and diversity
- continually assessing the skills, experience, and capabilities required on the Board, taking account of the company's strategic priorities and the future challenges affecting the business
- annually making recommendations to the Board regarding the re-appointment of any non-executive director, having considered the time required for the role and identifying his or her continued contribution to the Board, having particular regard to his or her key skills and expertise

Recommending appointments to the Board:
- making recommendations concerning the membership of Board Committees and the appointment of the SID and the Director for Employee Engagement
- leading the process for appointments, considering, and recommending to the Board persons who are appropriate for appointment as executive and non-executive directors to maintain an appropriate mix of skills and experience within the company and on the Board, taking into account future challenges affecting the company
- In identifying suitable candidates, using open advertising or external advisers, considering candidates from a wide range of backgrounds, and considering candidates on merit and against objective criteria with due regard to the benefits of diversity on the Board, taking care that appointees have sufficient time available to devote to the position

Overseeing Board and company diversity:
- working with the Human Resources and Culture team to take an active role in setting, monitoring, and meeting diversity objectives and strategies for the company as a whole, and overseeing the Diversity and Inclusion policy

Ensuring succession planning:
- ensuring plans are in place for orderly succession to both Board and senior management positions, and overseeing the development of a diverse pipeline for succession
- overseeing the induction, training, and the continuing professional development of Board members

Governance continued

Nomination Committee report (continued)

THE COMMITTEE'S ACTIVITIES IN THE YEAR

Assessing the performance of the Board	• Reviewed the Board's evaluation relating to the composition of the Board, concluding that the Board is balanced and diverse in thought and skill set • Agreed the format of a new Board skills matrix, see page 84, and agreed there was an appropriate level of skills and experiences on the Board • Undertook a self assessment questionnaire on the performance of the Nomination Committee, discussing areas of strength and implementing plans to address lower performing areas • Strengthened the induction process for new members to Board Committees • Reviewed other Board member external appointments to ensure the Board had adequate time available for their roles
Recommending appointments to the Board	• Led the process for appointment of the new company Chair and the appointment of a new Independent Non-Executive Director in the year, see the next page for details
Overseeing Board and company diversity	• Reviewed and approved the Diversity and Inclusion policy, a policy that strives to promote equal opportunity to everyone, creating an open and inclusive workforce where people feel valued. • Discussed and advised on how to advertise roles to appeal to different communities and how to positively influence diversity and gender targets, including how to reduce the gender pay gap within the company. As the gender pay gap has widened by 1.6% in the latest reporting period to April 2020, the Nomination Committee will work with the Diversion and Inclusion Committee to: i) Conduct a root cause analysis of where and why the gender pay gap exists; ii) Take positive action planning on career succession of women into mid and senior management roles; iii) Understand our approach to attract more women into the operational areas of the business; and iv) Understand how to build on our inclusive and supportive culture • Received presentations from members of the Diversion and Inclusion Committee, engaging with the workforce and understanding the work the Diversion and Inclusion Committee had undertaken in the year, including World Religion Week, International Women's Day, Black History Month, International Men's Day, Parent Chat and Neuro Diversity Day
Ensuring succession planning	• Reviewed the operational structure of the business, noting structural changes that have been made across the business and considered further proposed changes • Received presentations on how the business develops its leaders, including the new cross-company calibration of performance evaluation and the new enhance management development programme • Agreed the use of a 9-Box grid approach to assess potential leaders and succession planning for the EMT, including identifying potential candidates for future succession • Agreed next steps to develop a leadership behaviour framework to determine the characteristics of a senior leadership role, and understand how the company can use IT systems to monitor performance

APPOINTMENTS TO THE BOARD

Appointments to the Board are subject to a formal, rigorous and transparent procedure and the Board and Nomination Committee maintain an effective succession plan for Board and senior management roles. Appointments and succession plans are based on merit and objective criteria, which protect against discrimination for those with protected characteristics within the meaning of the Equalities Act 2010.

The Board promotes diversity of gender, social and ethnic backgrounds, and of cognitive and personal strengths across the whole employee population and has an approved Diversity and Inclusion Commitment.

Appointment of the new company Chair

A key focus during the year was the Committee's search for a new Chair. The Special Nomination Committee met to agree a detailed specification for the role of Chair, including the attributes of the candidates to be considered. The Board approved the Chair's role specification.

The process was led by Trevor Didcock, our SID, with support from the whole Board and our Company Secretary, Sunita Kaushal. Trevor Didcock chaired all nine Special Nomination Committee meetings and regular feedback was provided to the Board throughout the recruitment process.

The Committee engaged the services of independent search consultants Korn Ferry to evaluate, screen and identify suitable candidates. The Committee examined a long list of candidates in consultation with Korn Ferry, assessing each candidate against the role specification. The Committee as a whole was involved in shortlisting candidates and once preferred candidates had been identified the other Directors were included in the interview process. Extensive references were sought in respect of the preferred candidates, from peers and companies for which they had previously worked.

Following the interviews, the Committee discussed the shortlisted candidates, and after careful deliberation, the Committee unanimously agreed that Ian Tyler be recommended to the Board for appointment as Chair. It was noted that Ian was independent on appointment and on 11 January 2021 it was announced that Ian would be appointed as Chair Designate.

In addition, the following steps were employed to ensure clear separation of duties between the Chair and Chief Executive:

- The Chair's appointment is for an initial three-year term, subject to annual re-election by shareholders. The term can be renewed by mutual agreement, up to a maximum term of nine years; and
- The responsibilities of the Chair and Chief Executive are separate and clearly defined in our 'Division of Responsibilities between Chair and CEO' which is subject to regular review.

Induction

Non-executive directors (including the Chair) who have been nominated for appointment attend a pre-appointment meeting with Ofwat. This meeting allows nominated directors to get an understanding of Ofwat's expectations for the role of non-executive directors of a regulated company and any other issues which Ofwat considers appropriate. It provides an opportunity to ask Ofwat any questions ahead of their appointment.

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

- the company's business model, key operations, processes and sites;
- its risk profile and approaches to management and assurance;
- its strategy, Business Plans and performance;
- its governance and regulatory framework; and
- their duties as directors, including details of the annual Board (and relevant Board Committees) planner, effectiveness reviews and action plans.

When Government restrictions allow, the induction process will recommence visits to water treatment works, and time spent with frontline employees.

Governance continued

Nomination Committee report (continued)

TRAINING AND CONTINUING PROFESSIONAL DEVELOPMENT

Our Board members are conscious of the need to keep themselves properly informed and to deepen their understanding of the business.

They receive updates on relevant issues, including legislative, regulatory and reporting matters to help improve their understanding and knowledge of the water industry and its regulatory environment.

As part of the individual directors' element of the board evaluation process, directors are asked to identify any skills or knowledge gaps they would like to address. Training and updates for non-executive directors in relation to specific topics or key areas of interest have included attending regulatory working group meetings; attending forums for senior leaders in the business; and tours of water treatment works and other facilities when COVID-19 restrictions allow.

Non-executive directors also participate in industry events, including regular Ofwat events for non-executive directors, and are conscious of the need to keep themselves properly briefed and informed to deepen their understanding of the business. The Nomination Committee are responsible for overseeing the training and continuing professional development of Board members.

BOARD EVALUATION

Details of the full external Board evaluation undertaken in the year are included in the Governance report on page 85. The Nomination Committee reviewed the results from the evaluation and focused on the evaluation of the composition, skills and diversity of the Board, including the development of the Board skills matrix to conclude the skill set was appropriate.

RE-APPOINTMENT OF DIRECTORS

The company's Articles include provisions for the re-election of all directors at AGMs and includes providing justification as to why directors should be re-elected.

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

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

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

COMMITMENT TO DIVERSITY

Diversity is crucial for the long-term success of the business and the company is striving to create diverse teams across the business to better reflect the communities we serve. Achieving real change requires committed leadership at the top and real focus and effort to shift mindsets. The Nomination Committee therefore recognises that continued focus in this area is crucial and will ensure that progress is made regarding ethnicity, gender, disability and age balance within the organisation.

Our diversity vision

We are committed to building a more inclusive culture where every member of our workforce can bring their true selves to work, confident that they will be valued. Our ambition is to enable our employees to thrive and to reach their full potential and in doing so, enhance the culture of our business.

- Diverse - to represent our communities in terms of the demographics of our employees
- Included - for all employees to feel valued, supported and respected at work
- Equal - for there to be a zero pay-gap when we look across our company and the protected characteristics

The Diversity and Inclusion Committee have collected and reviewed data against the protected characteristics in the workforce and have compared this to the statistics for communities we serve. It is clear we have a difference between our employee and community population, and we want to work to reduce this to be more representative of the communities we serve.

The company has set targets to increase and retain employees from BAME groups, reduce the gender pay gap from the 20.6% reported gap at April 2020 and improve our data collection across all protected characteristics to guide an action plan and increase inclusion, with the full support of the Nomination Committee. In the long-term, we want to ensure that we represent our communities, our employees feel valued at work and are able to be their true selves. Over the past year, the Diversity and Inclusion Committee has run events across the company celebrating and raising awareness of different religions, International Women's Day, International Men's Day, Black History Month and World Mental Health Day.

Along with other UK utilities and their contractors, the company has set out its ambition to enhance the diversity of its workforce and be ever more diverse and inclusive, supported by the Energy & Utility Skills Group, an employer-led membership organisation that helps to ensure the gas, power, waste management and water industries have the skills they need now and in the future.

In addition, together with other UK water companies, the company has signed up to be the first sector to achieve 100% commitment to the Social Mobility Pledge, a pledge to become more inclusive and connect with underrepresented groups, including the way we attract, recruit and develop our staff.

This is part of the water sector's wider aim to promote opportunity in local communities and increase talent and diversity within companies.

Governance continued

Nomination Committee report (continued)

COMMITMENT TO DIVERSITY (CONTINUED)

Board diversity

A Board skills matrix was developed during 2020/21 that enabled the Committee to see the range of skills and experience across the Board and conclude the skill set was appropriate, see more details on page 84. Going forwards, the Committee will then assess this skills matrix periodically in the context of discussions on tenure, director and Committee evaluations and long-term succession strategies. The company strives for a genuine diversity of its directors and employees.

Currently, the Nomination Committee is not following a specific male or female quota for Board members, with appointments being awarded on suitability of applicants. Nevertheless, all appointments are based on the diversity of contribution and required competencies, irrespective of gender, ethnicity, age or any other personal characteristics and applications from all backgrounds are welcomed and encouraged.

See page 32 of the strategic report for the split between males and females within the business and how we are improving diversity across the talent pool.

Approval
On behalf of the Nomination Committee

Ian Tyler
Chair of the Nomination Committee
28 June 2021

SHEDWQ Committee report

CHRIS NEWSOME (CHAIR)

SHEDWQ Committee members as at 31 March 2021

- Chris Newsome
- Ian Tyler
- Trevor Didcock
- Angela Roshier
- Tony Roper
- Pauline Walsh

In addition to the above members, the Committee is also attended by the directors of relevant business areas and the Head of Water Quality and the Head of Safety, Health and Environment as required. The Head of Legal Services is invited to attend if required.

Composition of the Committee

Male: 67%
Female: 33%

Independent directors on Committee: 50%

The Committee is required to comprise of at least four members, at least three of whom shall be independent non-executive directors. The Committee was compliant with these terms throughout the year.

The Committee met four times in the year to 31 March 2021.

The Committee's terms of reference can be found on our website at **affinitywater.co.uk/governance-assurance**

As Chair of the SHEDWQ Committee I am pleased to introduce this report, detailing the work of the Committee in the year.

RESPONSIBILITIES OF THE COMMITTEE

The Committee's role includes:

- reviewing and monitoring, on behalf of the Board, safety and health, including employee wellbeing, environment, drinking water quality and security matters arising from the company's activities and operations, including monitoring performance against targets and advising on strategic direction;
- keeping under review the adequacy of the framework of company policies and procedures (including training and competency assessment), and compliance with relevant legislation;
- consideration of whether risks related to the above are being managed effectively; and
- considering where the above may have strategic business and reputational implications for the company and, where necessary, recommend appropriate measures, responses and targets.

The Committee is also responsible for reviewing the scope, schedule of and results of any audits relating to the above areas.

COMMITTEES ACTIVITIES IN THE YEAR

- Reviewed progress against the 2020/21 Safety, Health and Environment and Wellbeing plan and reviewed and fed back on the draft 2021/22 plan, including what metrics are appropriate to measure achievement against the plan;
- Received updates on water quality actions and Monitoring Plans, including linkage to our performance commitments and impact of COVID-19 on water quality and discolouration;
- The Committee received a presentation from the Chief Drinking Water Inspectorate on Water Quality Risk Assessments and challenged the company to look into whether any actions were needed as a result of this;
- Monitored plans to ensure the business is compliant with The Construction (Design and Management) Regulations 2015, including reviewing action plans to achieve this;
- Reviewed key health and safety performance metrics, including the Accident Frequency Rate ('AFR') and near misses and discussed any actions implemented, including the AFR threshold that would result in the company performing a detailed root cause analysis;
- Reviewed findings from the DWI Chief Inspector's Annual Report and annual technical audits, including action plans and ensured the company was implementing;
- Assessed the wellbeing of employees working in a COVID-19 environment, including responses to surveys and discussed the actions needed, including progress made. The Committee play a crucial role in ensuring that the wellbeing of employees is protected, and it supported the company in its plans to put wellbeing first;
- Reviewed the company Distribution Operations Maintenance Strategy and assessed progress made on reservoir inspections;

Governance continued

SHEDWQ Committee report (continued)

COMMITTEES ACTIVITIES IN THE YEAR (CONTINUED)

- Received updates on operational resilience across the company, including power and the ability to respond to a significant water supply incident, including the company's use of mutual support schemes. The Committee challenged the approaches used to ensure adequate business readiness;
- Reflected on the tragic events that have occurred in the wider water industry in July 2015 and December 2020, reviewed lessons learned and assessed the company's own policies and risks to ensure our working environment remains safe. The Committee provided support to ensure the company has appropriate controls in place;
- Discussed environmental compliance and improvement, including the company and water industry commitment to net zero operational carbon emissions by 2030. The Committee challenged management on how we will achieve this and the route map including options for net zero Scope 1 and Scope 2 emissions, offering the Committee's skills and combined expertise to provide direction on options available; and
- Challenged management on the company strategy regarding natural capital, including how we are going to embed this into our company policies, how to use options appraisal to deliver wider environmental benefits and how the company is utilising natural capital within the Water Resources Management Plan. The Committee challenged how management will embed natural capital into its processes and utilise this to meet our performance commitments and deliver on our company purpose.

Approval

Chris Newsome
on behalf of the SHEDWQ Committee
28 June 2021

Audit, Risk and Assurance Committee report

JUSTIN READ

Audit, Risk and Assurance Committee members as at 31 March 2021

- Justin Read
- Mark Horsley
- Jaroslava Korpanec
- Chris Newsome
- Tony Roper

Composition of the Committee

Male: 80%
Female: 20%

Independent directors on Committee: 60%

In addition to the members set out above, the CEO and CFO, Head of Audit, Risk and Compliance, Financial Controller and the external Auditors normally attend, by invitation, all meetings of the Committee. Other members of senior management are also invited to attend, as appropriate.

The biographies of the remaining current Committee members are presented on pages 70 to 74.

In accordance with the Audit, Risk and Assurance Committee terms of reference, key areas of focus are:
- Monitor and review the financial statements, accounting policies and any other formal announcements relating to the company's financial performance;
- Review the adequacy of the risk management and internal controls, including the disclosures within the viability statement;
- Review procedures relating to compliance, whistleblowing and fraud and advising the Board on their responsibilities for these matters;
- Have oversight of internal and external audit functions; and
- Review the adequacy and effectiveness of the regulatory reporting function.

Dear shareholder,

I am pleased to present the report of the Audit, Risk and Assurance Committee following my first year-end as Chair of the Committee. I would like to take this opportunity to thank Patrick O'D Bourke for his work as former Chair of the Committee, his commitment to the company over the years and his generous assistance during our handover period. This report details the role of the Committee and the work it has undertaken during the year.

The Audit, Risk and Assurance Committee understands and acknowledges its key role of protecting the interests of shareholders as regards the integrity of financial information published by the company. Additionally, some of the Committee's responsibilities are targeted at the regulated information in the annual report and financial statements published by the company for the benefit of other stakeholders.

The Audit, Risk and Assurance Committee is responsible for assisting the Board in discharging its oversight responsibilities for the integrity of the company's financial statements, and the assessment of the effectiveness of the system of internal control and risk management, and reports to the Board on how the Committee discharges its responsibilities in accordance with its terms of reference (which were updated in July 2020 and are available on the governance pages of our website: **affinitywater.co.uk/governance-assurance**).

The Committee also has responsibility for overseeing the relationship with our external Auditor (PwC), including assessment of its ongoing objectivity, and overseeing the assurance of regulatory returns to Ofwat. In performing its duties, the Committee has access to the services of the Head of Audit, Risk and Compliance, the Company Secretary and, if required, external professional advisers.

Our work cannot provide absolute assurance that the company's risk management and internal control systems are operating effectively, nevertheless in summary we are satisfied that the control and compliance culture and processes of the company are strong which helps to provide reasonable assurance that the financial statements are free from material error and/or misstatement.

The Committee is further satisfied that the 2020/21 annual report and financial statements, taken as a whole, provide:

i. a fair, balanced and understandable assessment of the company's position; and
ii. the information necessary for shareholders to assess the company's performance, business model and strategy.

Governance continued

Audit, Risk and Assurance Committee report (continued)

The Audit, Risk and Assurance Committee is key to ensuring that the organisation has robust and effective processes relating to financial reporting, internal controls, risk management and ethics. The Committee is also the main oversight body for the internal and external Auditor.

The Committee is central to the company's governance structure and ensures the interests of customers, shareholders and other stakeholders are protected, and that responsible business practices are adhered to.

The Committee's terms of reference (see **affinitywater.co.uk/governance-assurance**) are structured to ensure it achieves compliance with governance best practice and are reviewed annually to ensure the effectiveness of the Committee.

Up until 29 September 2020, the Committee was chaired by Patrick O'D Bourke, an Independent Non-Executive Director who had served on the Board for seven years. Justin Read joined the Board on 14 July 2020 and took on the role as Chair of the Audit, Risk and Assurance Committee from 29 September 2020. Justin Read has relevant and up to date financial and management experience working across a number of different industry sectors, including real estate, support services, building materials and banking, with the Committee as a whole having competency relevant to regulated utilities and infrastructure businesses. The CEO, CFO, Head of Audit, Risk and Compliance, Financial Controller, external Auditor and other parties are invited to attend meetings as appropriate.

RESPONSIBILITIES OF THE COMMITTEE

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

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

COMMITTEE PERFORMANCE REVIEW

As per the requirement in the terms of reference to review the performance of the Committee annually, Committee members have undertaken a self-assessment using an externally drafted questionnaire. The following areas were highlighted as requiring further focus:

- improve understanding of risk appetite and risk management of the internal controls;
- improve the provision of concise, timely information; and
- ensure meetings follow a structured agenda and have clear priorities set;

To address concerns over the understanding of risk appetite and risk management of internal controls, a deep dive exercise on risks was undertaken during the year and a Board strategy day was held which focused on strategic and emerging risks, including risk appetite. Progress on risk management was reported to the Committee at each meeting held.

To address concerns over concise, timely information, there has been a drive for the Committee to receive papers sufficiently in advance of any Committee meeting and the provision of concise, timely information has improved.

To address concerns over the priorities of the Committee, this will be reviewed as it was agreed there is not a formal listing of priorities, although a full listing of key roles and responsibilities can be found in the Committee Terms of Reference.

The composition of the Committee met Ofwat's expectations throughout the year for there to be a majority of independent members on the Committee.

OVERVIEW OF THE ACTIONS TAKEN BY THE AUDIT, RISK AND ASSURANCE COMMITTEE TO DISCHARGE ITS DUTIES

The significant matters considered by the Committee in relation to the 2020/21 financial statements were consistent with those identified by the external Auditor in its report on pages 136 to 145. The Committee has an extensive agenda of business which it deals with in conjunction with senior management, the external Auditor and the Internal Audit function. During the year, the Committee met four times. As part of these meetings, the Committee met with internal and external auditors without management being present.

The table below and continued on the next page presents a summary of business considered during 2020/21:

External Auditor	• Recommended to the Board the re-appointment of PwC as external Auditor. • Reviewed and agreed the scope of the audit work to be undertaken by PwC. • Agreed the fees to be paid to PwC for its review of the September 2020 half-yearly report and its audit of the March 2021 financial statements. • Conducted an assessment of the qualification, expertise, resources and independence of PwC and the effectiveness of the external audit process. This included consideration of a report on PwC's quality control procedures and its annual independence letter. • Agreed that the non-audit services provided to the company did not impact PwC's independence.
Internal audit	• Agreed a programme of work for the Internal Audit function, including a programme of compliance audit work. • Reviewed reports from the Head of Audit, Risk and Compliance on the work undertaken by Internal Audit, as well as management responses to proposals made in audits issued by the function during the year. • Monitored and reviewed the effectiveness of the Internal Audit function.
Financial and other reporting	• Reviewed the September 2020 half-yearly financial results and the March 2021 annual report and financial statements. • Reviewed the March 2021 regulatory Annual Performance Report to ensure that the information met Ofwat's new AMP7 reporting requirements. • Advised the Board on whether the annual report and financial statements, taken as a whole, were fair, balanced and understandable, and provided the information necessary for shareholders to assess the company's position and performance, business model and strategy. • Reviewed the assessment of the company's long-term prospects, viability statement and stress test scenarios, including the impact of COVID-19 on the company's results and forecasts.

Governance continued

Audit, Risk and Assurance Committee report (continued)

OVERVIEW OF THE ACTIONS TAKEN BY THE AUDIT, RISK AND ASSURANCE COMMITTEE TO DISCHARGE ITS DUTIES (CONTINUED)

General	• Reviewed its terms of reference.
	• Reviewed and provided advice to the Board on the effectiveness of the company's risk management and internal control systems and associated disclosures made in the annual report and financial statements.
	• Reviewed compliance certificates and investor reports required under the company's debt facilities.
	• Received presentations across the year on:
	  • tax matters;
	  • the company's insurance programme and renewal;
	  • 2021/22 tariffs and charging scheme, including governance around this process and charging arrangements for new connections services;
	  • non-financial regulatory reporting management plan and requirements for 2020/21;
	  • the renewal of the company's contract with its Reporter, an external assurance provider who provide assurance on engineering and technical data;
	  • a review of the company's operational and regulatory compliance obligations by a third-party consultant;
	  • a review of the Whole Business Securitisation Compliance Certificates;
	  • an update on the progress of the Resilience Action Plan;
	  • gifts and hospitality activity;
	  • governance arrangements for compliance work carried out by the Markets Oversight Committee[1], an internal working group overseeing compliance with competition law;
	  • new corporate, governance, statutory and regulatory reporting requirements for 2020/21;
	  • the company's whistleblowing arrangements;
	  • the status of the company's information security against ISO27001 controls;
	  • compliance with Security and Emergency Measures Direction 1998.
	• Self-evaluated the effectiveness of the Committee by means of a questionnaire covering the range of its responsibilities and procedures as well as the understanding of its members.
	• Approved the company's non-audit fee policy.

[1] The Markets Oversight Committee is a key part of our governance framework, it is not a formerly established committee of the Board. It is attended by senior representatives across the company.

RISK MANAGEMENT AND INTERNAL CONTROL

The Audit, Risk and Assurance Committee advises the Board on the company's internal control systems. The Board is responsible for reviewing the effectiveness of these control systems, taking the advice of the Committee in areas including financial, operational and compliance controls and risk management.

The company's systems of internal control are designed to manage the risk of failure to achieve business objectives (although such risk cannot be completely eliminated), and provide reasonable, not absolute, assurance against material misstatement or loss.

The main features of the company's internal control and risk management systems in relation to the financial reporting process include:

- a structured review process for year-end financial reporting, including review by the Audit, Risk and Assurance Committee early in the drafting process;
- recruitment, training and development of appropriately qualified and experienced financial reporting personnel;
- formalised monthly close control procedures, including journal approval and validation, balance sheet reconciliations and ledger checks; and
- preparation of monthly management accounts on the same basis of accounting as year-end financial reporting.

Particular features of the systems of risk management, planning and internal controls include:

- a comprehensive suite of internal control procedures across both operational and financial matters, supported by segregation of duty matrices and detailed delegated levels of authority;
- an Internal Audit function, the head of which (the Head of Audit, Risk and Compliance) reports to the Audit, Risk and Assurance Committee, together with other internal control and assurance resources which monitor compliance with laws, regulations, policies and procedures;
- the setting and monitoring of annual budgets at a detailed level supported by a five-year forecast;
- specialist planning teams retained within the organisation to work on major projects, such as business planning activities, supported by external specialists where appropriate; and
- the use of appropriate external assurance review, both fiscal and operational.

We have an established framework for identifying, evaluating and managing the principal and emerging risks the company faces, including those that would threaten its business model, future performance, solvency or liquidity. This framework has been in place for the year under review and up to the date of approval of this annual report and financial statements. Refer to page 38 of the strategic report for further information.

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

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

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

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

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

Governance continued

Audit, Risk and Assurance Committee report (continued)

RISK MANAGEMENT AND INTERNAL CONTROL (CONTINUED)

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

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

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

SIGNIFICANT ISSUES CONSIDERED BY THE AUDIT, RISK AND ASSURANCE COMMITTEE IN RELATION TO THE FINANCIAL STATEMENTS

The Committee considered the appropriateness of the company's accounting policies and the implications of COVID-19 on the accounting disclosures.

We discussed the critical accounting judgements and key sources of estimation for the relevant aspects of the financial statements and concluded based on the information available that the estimates, judgements and assumptions used were reasonable and that they had been used appropriately in applying the company's accounting policies. The Committee considered the disclosures made detailing the financial impact of COVID-19 on the company in the year, including additional costs incurred as a result of the pandemic and the impact on our revenue. The company's viability statement, including information on the company's approach to preparing it, can be found on page 50.

In relation to the company's existing accounting policies and the following principal areas of judgements and estimates for all matters described below, the Committee concluded that the treatment adopted in the financial statements was appropriate:

Issue	How the issue was addressed by the Committee
Revenue recognition	The Committee reviewed the methodology for the recognition of revenue, specifically the measured income accrual and recognition of non-household revenues during the COVID-19 pandemic and concluded that the approach and conclusions reached were appropriate.
Policy for the loss allowance of trade receivables	The Committee reviewed the policy for providing for the impairment of trade receivables, including the assumptions with respect to collectability of debt during the COVID-19 pandemic, and concluded that the approach taken was appropriate.
Capitalisation policy	The Committee reviewed the processes and policies to distinguish between maintenance and enhancement costs and it was concluded that these would result in cost capitalisation in line with the company's policy and applicable accounting standards.
Defined benefit pension assumptions	The Committee reviewed the assumptions used in calculating the defined benefit pension surplus.
Adoption of the going concern basis in the financial statements	The Committee reviewed the assumptions underpinning the directors' decision to continue to adopt the going concern basis in the financial statements, including the expectation that loan covenants would continue to be met for a period of not less than 12 months from the date of signing the financial statements. The Committee reviewed actual and budgeted financial results, forward looking forecasts including associated assumptions, the company's ability to generate future positive operative cash flows and the company's access to financing arrangements.
Viability statement	The Committee considered and provided input into the determination of which of the company's principal risks and combinations thereof might have an impact on the company's financial viability and reviewed the results of management's stress testing of the company's base cash flow forecasts.

Governance continued

Audit, Risk and Assurance Committee report (continued)

SIGNIFICANT ISSUES CONSIDERED BY THE AUDIT, RISK AND ASSURANCE COMMITTEE IN RELATION TO THE FINANCIAL STATEMENTS (CONTINUED)

We challenged management on the following areas described below:

Area of challenge	Outcome of this challenge
Implementation of the new Fusion reporting system, including the risks and mitigating actions taken to ensure a smooth transition to the new accounting and data software	All risks of implementation were managed by a project team, with regular updates provided to the Committee. Updates were provided from external assurance providers on the progress
Arrangements for ensuring legal and regulatory compliance across the business	A third party review was undertaken and a new Compliance Obligations Register was developed and embedded during the year. Progress on updating the Register was reported to the Committee, with key dates and deadlines added
Scope of the internal audit plan for 2020/21 and proposed review areas, including an increased focus on environmental areas and the resourcing available to deliver on the plan	New areas were proposed and discussed, with updates provided to the Committee throughout the year. The Committee endorsed the internal audit plan
Key risks were reviewed in detail and challenged as part of deep dive exercise, including the company approach to emerging risks	Progress made in developing the risk appetite statements and consultations were held with relevant stakeholders on their risk appetite
Disclosures in the 2020/21 annual report, including a benchmarking review of competitor reports, format of the governance report and an assessment of the COVID-19 impact	Benchmarking undertaken and disclosures included in the 2020/21 report on the impact COVID-19 has had on the company both operationally and financially. Narrative disclosures in the Annual Report reviewed and developed

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

Area of challenge	Outcome of this challenge
• Accuracy of the measured income accrual • Adequacy of the loss allowance in a COVID-19 environment • Going concern basis, including viability statement • Assessment of cost capitalisation, including Fusion • Assessment of pension assumptions • Legal claims	No issues noted during the interim or year-end audit. See the audit opinion on page 136 onwards for more details.

PwC were not specifically asked by the Audit, Risk and Assurance Committee to look at any areas in particular and undertook their work in line with required auditing standards.

EXTERNAL AUDIT

PwC was appointed as external Auditor in 2013/14 following a competitive tendering exercise. The company intends to put the external audit contract out to tender at least once every ten years, as stipulated in the Audit, Risk and Assurance Committee's terms of reference, to enable the Committee to compare the quality and effectiveness of the services provided by the incumbent external Auditor with those of other audit firms.

Owen Mackney has been the senior statutory audit partner since 1 January 2017. Having completed five years in the role, Owen Mackney will rotate, and the audit for the year ended 31 March 2022 will be led by a new audit partner.

To fulfil the Audit, Risk and Assurance Committee's responsibility regarding the independence and objectivity of PwC, the Committee considered:

- PwC's plan for the current year, noting the role of the senior statutory audit partner signing the audit report, who, in accordance with professional rules, has not held office for more than five years, and any changes in key audit staff;
- the arrangements for day-to-day management of the audit relationship; and
- PwC's annual independence letter.

A key factor that may impair PwC's independence is the volume of non-audit services. The company has a policy for the provision of non-audit services, under which all proposals for such work are subject to pre-approved limits. Any non-audit service that exceeds these thresholds requires approval from the Audit, Risk and Assurance Committee. Auditors remuneration was £421,000 in the year to 31 March 2021 (2020: £555,000) and included services relating to the audit of financial statements and other audit related assurance services. There was £7,000 expenditure on other non-audit services in the current year primarily relating to training and access to technical materials. In the prior year, there was additional non-audit services relating to the submission of our PR19 business plan. Whilst the proportion of non-statutory audit services is high, the Committee has reviewed the scope of the work and is happy that PwC were best placed to provide the services. See note 2.3 on page 159 for a breakdown of fees in the current and prior year.

The Committee reviews the provision of non-audit services by the external Auditor and has primary responsibility for making a recommendation on the appointment, re-appointment and removal of the external Auditor.

It also reviews policies and the overall process for identifying and assessing business risks, liaising closely with the external Auditor. It receives regular assurance reports from Internal Audit, management and others on the operational effectiveness of matters related to risk and control, and monitors the timeliness and effectiveness of corrective action taken by management. It also monitors and reviews the effectiveness of internal audit activities and carries out a robust assessment of the company's principal risks, reviewing the company's position and performance, business model and strategy.

During the year, PwC:

- provided a non-audit service in delivering a technical accounting session for the company's finance team. PwC was engaged to provide this service as it was recognised as having expertise in this area; and
- was engaged to provide agreed upon procedures as part of the company's regulatory compliance and annual reporting to Thames Water Utilities Limited ('Thames Water') and Anglian Water Services Limited ('Anglian Water'). None of the procedures performed were advisory in nature.

Auditor objectivity and independence were safeguarded in these instances through the work being performed on a review and recommend basis with final decisions being taken by management.

On the recommendation of the Audit, Risk and Assurance Committee, the external Auditor role is considered annually by the Board for reappointment.

To assess the effectiveness of PwC, the Audit, Risk and Assurance Committee reviewed:

- its fulfilment of the agreed audit plan and any variations from the plan;
- feedback from the management and finance teams;
- the robustness and perceptiveness of its handling of key accounting and audit judgements; and
- the content of its reporting on internal control.

Based on the above review, we are recommending to the Board that PwC be re-appointed for the year ending 31 March 2022. Note 2 to the financial statements includes disclosure of the Auditor's remuneration for the year, including an analysis of audit services, audit-related services and other non-audit services under those headings prescribed by law.

Governance continued

Audit, Risk and Assurance Committee report (continued)

INTERNAL AUDIT

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

To fulfil our responsibilities relating to monitoring and reviewing the effectiveness of the Internal Audit function, we reviewed:

- Internal Audit's charter, reporting lines and access to the Audit, Risk and Assurance Committee and all members of the Board;
- Internal Audit's plans and its achievement thereof;
- the results of key audits and other significant findings, including the adequacy of management's response and the timeliness of resolution;
- the function's resources, team members' qualifications and experience, and timeliness of reporting;
- the level and nature of non-audit activity performed by Internal Audit; and
- the company's whistleblowing policy which contains arrangements for the Head of Audit, Risk and Compliance to receive in confidence concerns about malpractice or misconduct, including complaints on accounting, risk issues, internal controls, auditing issues and related matters, for reporting to the Audit, Risk and Assurance Committee as appropriate. See the Corporate Governance Statement on pages 74 to 86 for details on whistleblowing incidents in the year.

PLANS AND OBJECTIVES FOR 2021/22

During 2021/22, the Committee plans to achieve the following:

- Undertake training deep dive sessions on the following areas; risk registers and resilience plans;
- Review the action plans and timetable for the 2021/22 statutory and regulatory financial statements, including going concern, viability, narrative disclosures and new AMP7 reporting requirements;
- Review the external audit function and mandatory rotation of the senior statutory audit partner;
- Consider the impact of the Department for Business, Energy and Industrial Strategy proposals on "Restoring trust in audit and corporate governance" on the company;
- Monitor progress made against the 2021/22 internal audit plan;
- Review a number of internal policies including whistleblowing, code of conduct, tax and treasury; and
- Undertake a cyber security review.

OVERVIEW

As a result of the Committee's work during the year, we concluded that we acted in accordance with our terms of reference and ensured the independence and objectivity of PwC. I will be available at the AGM to answer any questions about the activities of the Committee.

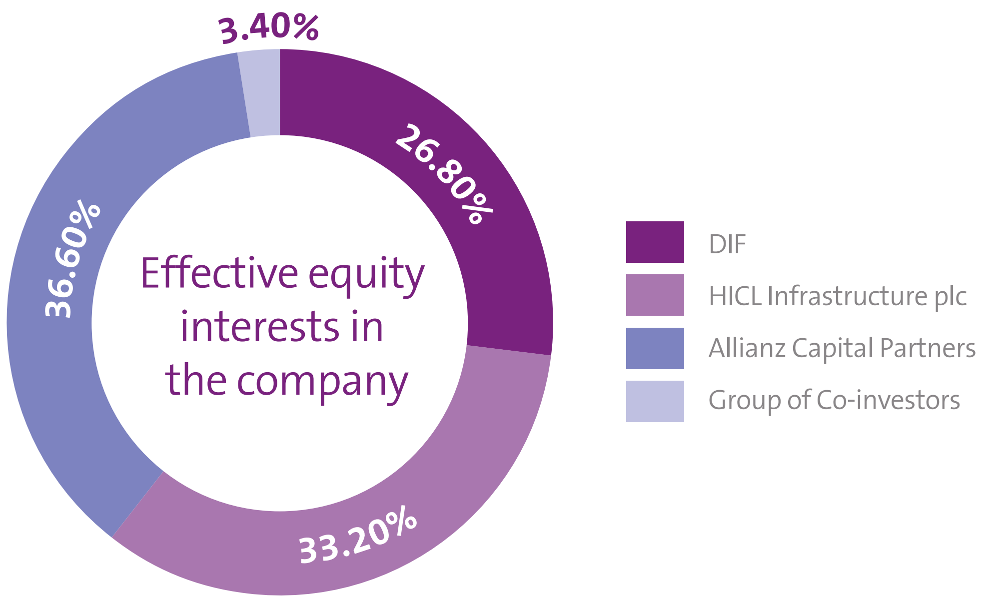
Approval
On behalf of the Audit, Risk and Assurance Committee

Justin Read
Chair of the Audit, Risk and Assurance Committee
28 June 2021

Ownership and financing

OWNERSHIP

On 19 May 2017, Affinity Water Acquisitions (Investments) Limited was acquired by a consortium comprising DIF, HICL Infrastructure Company Limited (advised by InfraRed Capital Partners Limited) and Allianz Capital Partners on behalf of the Allianz Group. As part of the transaction, the consortium also acquired Veolia Water UK Limited's 10% equity interest stake in the company. Subsequent to the initial acquisition, HICL Infrastructure Company Limited (advised by InfraRed Capital Partners Limited) sold down 3.4% of its interest to a small group of co-investors, comprising UK local authority pension funds in June 2017. On 1 April 2019, HICL Infrastructure Company Limited transferred its investment portfolio, assets and liabilities to HICL Infrastructure plc, a new listed UK registered investment trust, and shareholders of HICL Infrastructure Company Limited became shareholders of HICL Infrastructure plc. On 1 July 2020 Sun Life Financial Inc acquired an 80% interest in the InfraRed business from InfraRed Capital Partners (Management) LLP and became an ultimate controller.



The consortium made its investment through Daiwater Investment Limited, which has been our UK holding company since 19 May 2017. We consider the following entities to be our ultimate controllers, as they are in a position to exercise material influence over our policy and affairs:

- Allianz Infrastructure Holding I Pte. Limited
- DIF Management Holding BV
- DIF Management UK Limited
- HICL Infrastructure plc
- InfraRed Capital Partners (Management) LLP
- Sun Life Financial Inc

These entities, together with Daiwater Investment Limited, have provided us with legally enforceable undertakings that they will:

- give us such information as may be necessary to enable us to comply with our obligations under the Water Industry Act 1991 and Instrument of Appointment;
- refrain from any action which would cause us to breach any of our obligations under the Water Industry Act 1991 or the conditions of our Instrument of Appointment; and
- use their best endeavours to ensure that our Board maintains three INEDs, who shall be persons of standing with relevant experience and who shall collectively have connections with and knowledge of the areas for which we are a water undertaker and an understanding of the interests of customers and how these can be respected and protected.

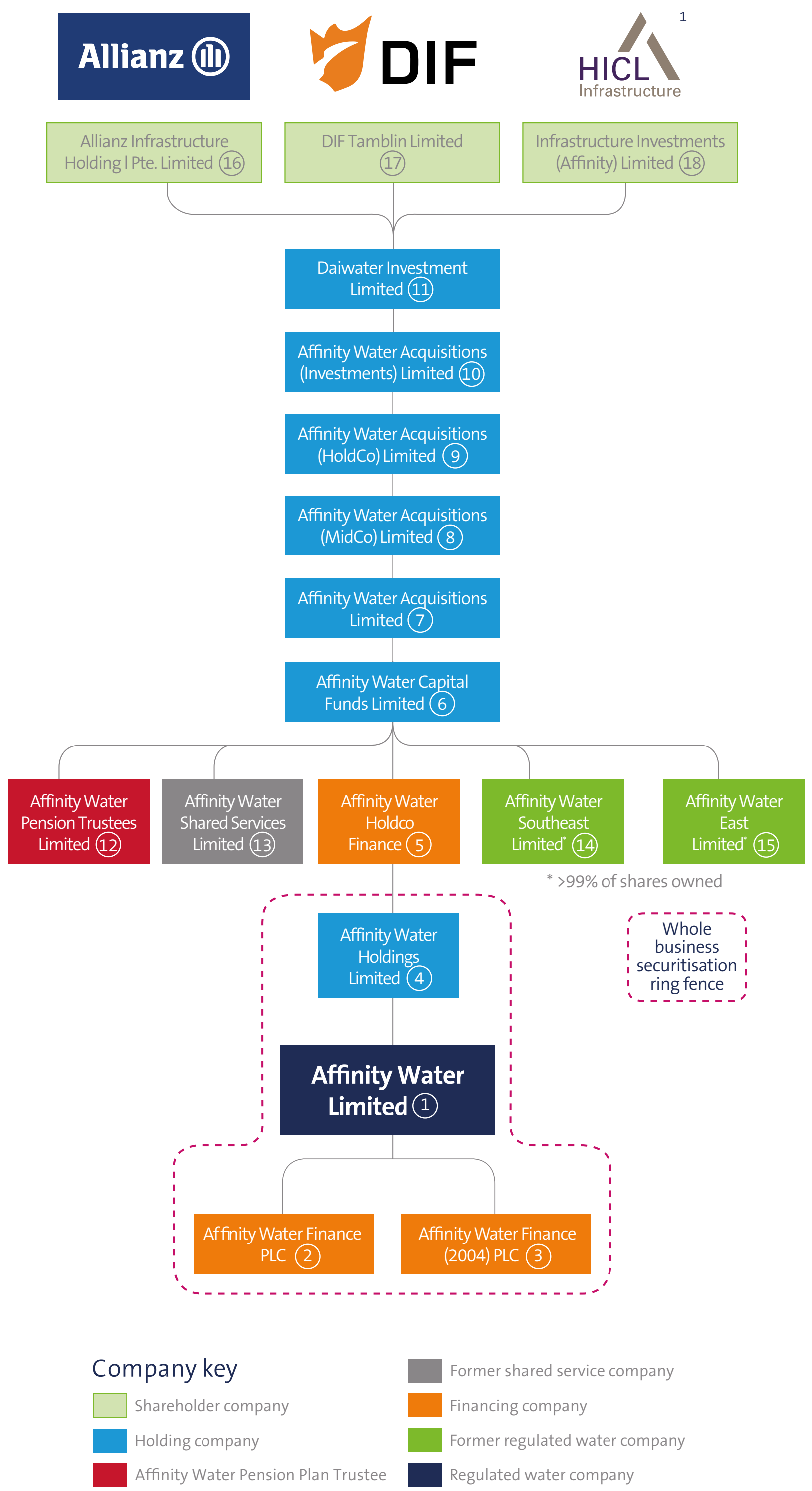
We are satisfied that these undertakings are being properly discharged and that we are able to fully meet our regulatory obligation to operate our appointed business as if it were substantially our sole business and the company were a separate listed company.

Governance continued

Ownership and financing (continued)

OWNERSHIP (CONTINUED)

The chart below shows the equity interests held by each owner and the structure of the group, excluding dormant subsidiaries, as at 31 March 2021. Unless otherwise indicated, all companies are wholly owned by the parent company shown. The numbers listed alongside the companies within the group structure may be cross referenced to the other group directorships of the company's directors, indicated within their biographies on pages 69 to 73.



[1] HICL Infrastructure sold down 3.4% of its interest to a small group of co-investors, comprising UK local authority pension funds in June 2017.

The following table provides further explanation of the group structure.

Structure chart reference	Company	Description	Place of registration
1	Affinity Water Limited	A water undertaker holding an appointment under the Water Industry Act 1991, supplying water to a population of around 3.8 million people in the South East of England. It is the principal trading company of the group.	England and Wales
2	Affinity Water Finance PLC	A financing subsidiary of Affinity Water Limited established in 2018 to issue bonds under a Euro Medium Term Note ('EMTN') programme. It lends monies raised from its bonds to Affinity Water Limited.	England and Wales
3	Affinity Water Finance (2004) PLC	A financing subsidiary of Affinity Water Limited established in 2004 to issue a bond. It lends monies raised from its bond to Affinity Water Limited.	England and Wales
4	Affinity Water Holdings Limited	Affinity Water Limited's immediate holding company. Its equity is provided as security to bondholders in the event of default.	England and Wales
5	Affinity Water Holdco Finance Limited	A financing subsidiary of Affinity Water Capital Funds Limited established in 2017. It lends monies raised to Affinity Water Capital Funds Limited.	England and Wales
6	Affinity Water Capital Funds Limited	The original holding company for Veolia's regulated water businesses, which was acquired by the group in June 2012 through Affinity Water Acquisitions Limited, which provides management services to the company.	England and Wales
7	Affinity Water Acquisitions Limited[1]	The company which bid for and acquired Affinity Water Capital Funds Limited and its subsidiaries from Veolia Water UK Limited in 2012. It issued subordinated debt notes to Affinity Water Acquisitions Midco) Limited as part of the acquisition finance.	England and Wales
8	Affinity Water Acquisitions (Midco) Limited[1]	The holding company of Affinity Water Acquisitions Limited which holds subordinated debt notes issued by Affinity Water Acquisitions Limited. It issued subordinated debt notes and exists to enable the introduction or withdrawal of shareholder subordinated debt without impacting on agreements between the original acquisition consortium in 2012 and Veolia Water UK Limited.	England and Wales
9	Affinity Water Acquisitions (Holdco) Limited[1]	The holding company of Affinity Water Acquisitions (Midco) Limited. The inclusion of a holding company between Affinity Water Acquisitions (Midco) Limited and Daiwater Investment Limited enables the introduction or withdrawal of additional shareholders without impacting on shareholder agreements between the original acquisition consortia.	England and Wales

[1] The financial statements of these companies have not been prepared on the going concern basis of accounting, as the Daiwater Investment Limited group have commenced a project to simplify the group structure. It is the intention of the directors of the respective companies that they will be wound up in the year ending 31 March 2022.

Governance

Governance continued

Ownership and financing (continued)

OWNERSHIP (CONTINUED)

Structure chart reference	Company	Description	Place of registration
10	Affinity Water Acquisitions (Investments) Limited[1]	The holding company of Affinity Water Acquisitions (Holdco) Limited. It was the ultimate holding company of the group in the United Kingdom up until 19 May 2017, when it was acquired by Daiwater Investment Limited.	England and Wales
11	Daiwater Investment Limited	The ultimate holding company of the group in the United Kingdom, paying dividends to the acquisition consortium subsidiaries.	England and Wales
12	Affinity Water Pension Trustees Limited	The trustee company of the Affinity Water Pension Plan.	England and Wales
13	Affinity Water Shared Services Limited[1]	A company which provided administrative and technical services solely to Affinity Water Limited until 31 March 2015. Its employees were transferred over to Affinity Water Limited on that date. Since the transfer, the company has ceased trading and it is the intention of the directors that the company will be wound up in the near future.	England and Wales
14	Affinity Water Southeast Limited	A company which formerly held an Instrument of Appointment as water undertaker for the Dour community of Affinity Water Limited's water supply area. The appointment was transferred to Affinity Water Limited on 27 July 2012. The company is no longer trading but continues to honour income assurances made to minority shareholders on transfer of its water undertaking to Affinity Water Limited.	England and Wales
15	Affinity Water East Limited	A company which formerly held an Instrument of Appointment as water undertaker for the Brett community of Affinity Water Limited's water supply area. The appointment was transferred to Affinity Water Limited on 27 July 2012. The company is no longer trading but continues to honour income assurances made to minority shareholders on transfer of its water undertaking to Affinity Water Limited.	England and Wales
16	Allianz Infrastructure Holding I Pte. Limited	A company which holds indirectly Allianz Capital Partners' investment in the group.	Singapore
17	DIF Tamblin Limited	A company established in 2017 to hold indirectly DIF's investment in the group.	England and Wales
18	Infrastructure Investments (Affinity) Limited	A company established in 2017 to hold indirectly HICL Infrastructure plc's investment in the group, together with the co-investment by certain local authority pension funds.	England and Wales

[1] The financial statements of these companies have not been prepared on the going concern basis of accounting, as the Daiwater Investment Limited group have commenced a project to simplify the group structure. It is the intention of the directors of the respective companies that they will be wound up in the year ending 31 March 2022.

OUR FINANCING

Affinity Water Limited is financially and operationally 'ring-fenced' from the rest of the Affinity Water group by way of a WBS. The securitisation further enhances the ring-fencing provisions already in our licence. The sole business of our immediate holding company, Affinity Water Holdings Limited, is holding the shares of Affinity Water Limited.

We have two financing subsidiaries which have issued bonds which are listed by the UK Listing Authority ('UKLA') and the proceeds of which have been lent on to and are guaranteed by the company:

- Affinity Water Finance (2004) PLC has issued an external bond of £250.0m; and
- Affinity Water Finance PLC has issued external bonds totalling £764.2m.

We believe that the ring-fencing structure provides significant corporate benefits, providing better access to long-term debt markets and an opportunity to reduce the cost of capital employed in the regulated business for the benefit of customers.

Bonds issued by both Affinity Water Finance (2004) PLC and Affinity Water Finance PLC are subject to the Listing Rules and Disclosure and Transparency Rules, being listed by the UKLA.

The bonds issued by the company's subsidiaries at 31 March 2020 can be summarised as follows:

Debt	Bond (£m)	Coupon	Maturity Date
Class A fixed rate bond 2026*	250.0	5.875%	July 2026
Class A fixed rate bond 2036 *	250.0	4.500%	March 2036
Class A RPI linked bond 2045 *	190.0	1.548% (real)	June 2045
Class A fixed rate bond 2042*	85.0	3.278%	August 2042
Class A fixed rate bond 2033*	60.0	2.699%	November 2033
Class A CPI linked bond 2042*	60.0	0.230% (real)	November 2042
Class A fixed rate bond 2022 *	14.2	3.625%	September 2022
Total Class A	**909.2**		
Class B RPI linked bond 2033	95.0	3.249% (real)	June 2033
Class B RPI linked bond 2033*	10.0	1.024% (real)	June 2033
Total Class B	**105.0**		
Total	**1,014.2**		

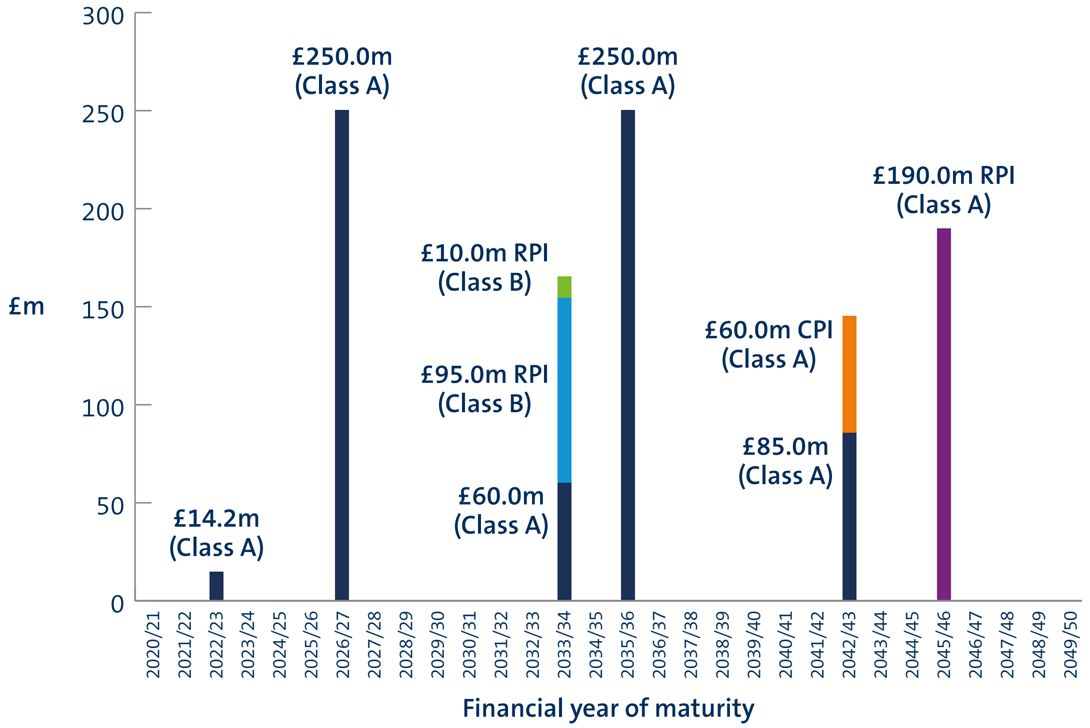
* Listed on the London Stock Exchange

Governance continued

Ownership and financing (continued)

OUR FINANCING (CONTINUED)

The following chart shows the maturity profile of our bonds as at 31 March 2021:



The credit ratings for our subsidiaries' bonds assigned by the rating agencies, Moody's, Standard & Poor's and Fitch, at 31 March 2021 were as follows:

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

All three agencies affirmed credit ratings in April 2021.

Remuneration report

SUSAN HOOPER

Remuneration Committee members at 31 March 2021

- Susan Hooper
- Ann Bishop
- Trevor Didcock
- Mark Horsley
- Jaroslava Korpanec
- Angela Roshier
- Ian Tyler

The changes made to the policy for AMP7 have allowed the company to focus on delivering against the tough challenges embodied in our settlement. Customers, regulators and stakeholders rightly expect that the remuneration of executive directors and senior management is linked to standards of performance experienced by customers.

During 2021/22 we will continue to keep the reward packages for our executive directors and other senior managers under review to ensure they remain market competitive, incentivise company and individual performance, are aligned to our company culture, and focus on the achievement of short-term targets that will enable the company to fulfil its long-term vision.

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

The company has used external advisors in the year to review its executive director pension contributions, with the target to have a plan by December 2022 that details how the company will align contributions with those of the workforce to ensure compliance with the Code.

See page 198 for a signed statement from the Board confirming the transparency of our disclosures.

I am pleased to present the report on directors' remuneration, which sets out the remuneration paid to the directors of the company for the year ended 31 March 2021, and changes to the remuneration policy, as presented in last year's report, for 2020/21.

As we embed the changes to the remuneration policy in the first year of AMP7, we continue to align executive pay to the company's performance and strategy of delivering value through high quality customer and operational performance whilst ensuring the cost of water remains affordable for customers by incentivising financial efficiencies. We offer competitive salaries and link directors' annual bonuses and long-term incentive plan ('LTIP') payments to the standards of performance we provide to customers as well as the value created for shareholders.

The remuneration of executive directors reflects the performance of the business through the annual bonus plan and LTIP scheme. The Remuneration Committee established measures of financial and non-financial performance for the year, continuing to link the remuneration of executive directors to the standards of performance expected by customers by aligning the operational targets to our stretching AMP7 commitments. The Remuneration Committee exercised discretion in determining the level of bonus awarded in relation to personal performance, assessing objectives set at the start of the year, application of the company principles and overall performance. See page 114 for more details on setting stretching targets.

Whilst the company has been adversely impacted both operationally and financially by the ongoing COVID-19 pandemic, the LTIP and annual bonus operational targets have not been adjusted to allow for the impact of COVID-19 on the metric. For the financial metrics, the timing differences in capital spend and revenue earned have been adjusted for in the actual results seen however this has not resulted in achieving the financial metric for the annual bonus scheme, and would only result in timing differences between different years in the LTIP scheme as the metrics across the period are fixed.

The leakage, water quality, interruptions to supply, C-MeX and financial targets continue to be aligned for the executive director, senior manager, selected manager and company-wide schemes, as this ensures there is a common focus across the business, particularly with respect to service to customers and performance measures can be compared across different years. Additionally, in 2020/21, executive directors and senior managers are also targeted to achieve stretching PCC and water pressure targets. For employees, we wanted to keep a focus on a set number of metrics to maintain the focus and keep the scheme simple and impactful. Additionally, for employees the metrics used can be directly attributed to their roles. For senior managers and executive directors, the bonus scheme has additional measures to reflect the main delivery of our business plan.

The purpose of the LTIP is to incentivise executive directors and senior management to meet both financial and strategic targets, including service and performance commitments over a six year period. See page 114 for details of the LTIP scheme.

The company used external advisors Mercer LLC during the year to complete a benchmarking review of executive directors' salaries and to review executive pension contributions, with the target to have a plan by December 2022 that details how the company will align contributions of the executive directors with those of the workforce.

Governance continued

Remuneration report (continued)

INTRODUCTION

We have prepared this report in accordance with the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (the 'Regulations'), which are applicable to companies whose equity shares are listed. The Regulations are not applicable to the company but are reported under to ensure transparency. The report also meets the relevant requirements of the Listing Rules of the FCA and describes how we have applied the principles relating to directors' remuneration in the Code. A resolution to approve the report will be proposed at the AGM of the company.

At our 2020 AGM, the single available vote was cast in favour of the resolution to approve the remuneration policy report, which is subject to a binding vote every year. At the same time, the remuneration implementation report, which is subject to an annual advisory vote, was also approved.

The Regulations require the external Auditor to report to the members of a quoted company on certain parts of the directors' remuneration report and to state whether in their opinion those parts of the report have been properly prepared in accordance with the Accounting Regulations of the Act. We have asked PwC to report on this basis notwithstanding that the Regulations do not apply to our business. The auditable part of the directors' remuneration report has been identified as 'audited'. Other information given is not required to be audited.

REMUNERATION POLICY REPORT

Remuneration Committee

The Remuneration Committee is responsible for determining the remuneration policy and the terms and conditions of employment of the directors and senior executives. The Committee met on five occasions during the year, and is chaired by Susan Hooper, an INED.

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

Director	Independence
Susan Hooper (Chair)	Independent
Ian Tyler (from 11 January 2021)	Independent
Tony Cocker (until 29 January 2021)	Independent
Trevor Didcock	Independent
Mark Horsley	Independent
Ann Bishop	Independent
Jaroslava Korpanec	Shareholder appointed
Angela Roshier	Shareholder appointed

Pauline Walsh, CEO, Stuart Ledger, CFO and the Director of HR & Culture attended the meetings when requested by the Committee. Sunita Kaushal was appointed Company Secretary on 1 April 2020 and was in place throughout the financial year. Members of the Committee and attendees are excluded from discussions regarding their own remuneration and conditions of employment.

The Committee meets to review the performance of the business as well as the performance of executive directors and senior executives against planned targets. The Committee also meets to consider and apply an appropriate remuneration framework to retain high calibre management. Its focus is on ensuring that the company can attract, motivate and reward executives who can lead the business to achieve short and long-term targets and on ensuring those targets are closely linked to standards of performance which are of benefit to customers.

The remuneration framework is structured and appropriately balanced between fixed elements and incentive pay, to ensure that executives deliver a high standard of performance, whilst minimising risk. The Committee ensures that the performance measures are objective, easy to understand and motivational to the participants. The Committee also reviews and approves the senior managers' and selected managers', and company-wide bonus schemes.

Remuneration policy for non-executive directors

Tony Cocker was appointed as Chair of the company on 30 January 2018 for an initial period of three years. Tony Cocker stepped down as Chair of the company on 29 January 2021. Ian Tyler was appointed as his replacement and joined the company on 11 January 2021 and took on the role of Chair from 29 January 2021. Both Tony Cocker and Ian Tyler receive a fixed annual fee for their services, reflecting the time commitment and responsibilities of the role.

The other non-executive directors in office at 31 March 2021 fell into two groups.

Group A	Group B
Ann Bishop	Jaroslava Korpanec
Trevor Didcock	Tony Roper
Susan Hooper	Angela Roshier
Mark Horsley	
Chris Newsome	
Justin Read	

Our Board considers the directors in Group A to be independent. Each has a written agreement relating to his or her services. They receive a fee for their services which is not related to company performance. They are not in receipt of share options or an LTIP. The fees for these directors are set taking into account the market rate for non-executive directors, with particular reference to the water industry in the United Kingdom.

There are no specific termination payments applicable to these appointments. The appointment of the directors may be terminated by either the director or the company giving to the other three months' written notice.

The fee policy for the Group A directors in 2020/21 remained unchanged from that reported in the 2019/20 remuneration policy report and will apply during 2021/22, unless the Committee agrees changes during the year.

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

Remuneration policy for executive directors

The remuneration policy is designed to attract, retain and motivate executive directors of the calibre required to deliver the business strategy. Individual remuneration packages are structured to align rewards with the performance of the company for customers and stakeholders and the interests of shareholders.

The remuneration arrangements incorporate performance measures which link to the standards of performance we provide to customers as well as the value created for shareholders.

The remuneration packages for all new executive directors are set in line with the company's approved policy, published in November 2020, to ensure we meet the objectives set in the Ofwat publication "Putting the sector back in balance" and is consistent with our AMP7 plan. The Committee takes into account, in arriving at a total package, the skills and experience of the candidate, the market rate for a candidate of that level of experience, as well as the importance of securing the best candidate.

Annual bonuses and long-term incentives are awarded in line with the maximum limits outlined in the remuneration policy report. Participation in the plans is normally pro-rated for the year of joining.

The Committee may make additional cash awards if deferred pay is forfeited by an executive director on leaving a previous employer. Such awards would take into account the nature of awards forfeited (i.e. cash or shares), time horizons, attributed expected value and performance conditions. Other payments may be made in relation to relocation expenses and other incidental expenses as appropriate.

Shareholder views on executive directors' remuneration for 2020/21 were considered through the presence of two directors appointed by our shareholders on the Committee. As with other Committee members, shareholder directors must have regard to the views of other stakeholders, the risk appetite of the company and alignment to the company's long-term strategic goals when fulfilling their duties.

Governance continued

Remuneration report (continued)

REMUNERATION POLICY REPORT (CONTINUED)

Remuneration policy for executive directors (continued)

The Committee did not formally consult with employees when drawing up the directors' remuneration policy but considered the average base salary of employees, which may be subject to inflationary increases, in setting base salaries for the executive directors. The Committee reviewed the Workforce Pay Policy to ensure it was being sensitive to pay and employment conditions elsewhere in the company when setting directors' remuneration. This ensured that pay for both directors and employees is at the median of the market it operates in and that pay reflects the competence and experience of the individual at the time of appointment. The Committee reviewed the relevant sections of the Workforce Pay Policy relating to salary at appointment, annual pay reviews, company bonuses and variable pay when drawing up the directors' remuneration policy. All of our workforce are entitled to be trade union members and our CFO is a member of the Joint Negotiation and Consultative Committee ('JNCC') which, together with employee trade union representatives and other company nominated representatives, meets quarterly to consult on workforce practices and policies and negotiate workforce pay.

Annual bonus plan and LTIP scheme

The targets for each metric were reviewed and approved by the Remuneration Committee following acceptance of the AMP7 Final Determination, giving more focus on the objective of better incentivising the delivery of long-term sustainable performance for customers and communities, employees and shareholders.

Structure

The annual bonus plan is a scheme which measures performance against annual targets and makes payments in the first few months of the following financial year. The LTIP scheme is a longer term scheme over a six year period, with performance measured over the first three year period and payments made in each of the years in the second three year period.

The remuneration of executive directors reflects the performance of the business through the annual bonus plan and LTIP schemes. The Remuneration Committee established measures of financial and non-financial performance for the year, listed in the table on the following page. The achievement of performance against these targets provided the basis for determining the value of annual bonus awards and LTIP scheme.

We continued to link the remuneration of executive directors to the standards of performance expected by customers by aligning the operational targets where possible to our stretching AMP7 commitments. C-MeX and D-MeX are not aligned to AMP7 targets as these do not have a target in the final determination however the internal target is to improve performance for customers over AMP7. The safety target is to maintain the stretching performance seen in prior years.

Performance needs to deliver at a minimum of the performance set in the final determination. For interruptions to supply, the target for employees, senior managers and executive directors differs from our performance commitment as we have a performance improvement plan that targets a path of constant improvement to reach the performance set in the final determination by the end of the AMP.

The LTIP and annual bonus metrics in the table on the following pages were used as these are what we consider key to meeting our company objectives for the year. Our company objectives are set to ensure we can meet our four customer outcomes below:

- Supplying high quality water you can trust
- Making sure you have enough water, whilst leaving more water in the environment
- Providing a great service that you value
- Minimising disruption to you and your community

The Remuneration Committee exercised discretion in determining the level of bonus awarded in relation to personal performance, assessing objectives set at the start of the year, application of the company principles and overall performance of executive directors.

No changes have been introduced to the structure of the AMP7 annual bonus scheme versus those approved and reported in the prior year remuneration report. No changes in relation to the LTIP have been introduced for 2020/21 or 2021/22 onwards versus those approved and reported in the prior year remuneration report.

No changes have been made to the remuneration policy for executive directors since the publication of the annual report and financial statements for the year ended 31 March 2020; however the targets and their weighting for the AMP7 annual bonus plan and LTIP for executive directors and senior management have been finalised by reference to the company's final determination for AMP7. The details are presented in the following table, which sets out all elements of executive director remuneration.

Given the tough challenges the company faces in AMP7, the executive directors did not receive a salary increase for the year 2020/21 and will not receive an increase in 2021/22.

Purpose and link to strategy	Policy and approach	Maximum potential value (as % of base pay)	Performance metrics	Changes for 2021/22
LTIP				
To incentivise executives to achieve long-term shareholder value whilst achieving high levels of customer experience performance, although both award and payment are discretionary.	Base awards are granted as a percentage of salary and are paid out in cash at the end of a three-year performance period, with 33% of the amount earned paid at the end of year four, 33% paid at the end of year five and 33% paid at the end of year six subject to the achievement of performance conditions. The scheme is based on three-year targets that are aligned to strategic delivery for AMP7. The targets for each metric are set in each year of the AMP. No award will be made for a metric if performance is below target/plan and additional award will be made if the company meets its stretch targets. Base awards include clawback and malus provisions, as detailed below. The awards do not automatically vest on change of control of the business.	Up to 150% of base salary for the CEO and 125% of base salary for the CFO if stretch targets are achieved.	The award is determined based on the performance of the company over the three years. For the 2020/21 LTIP, 40% of the scheme pay-out is based on financial targets, including cash generated from operations and investment targets; 50% based on customer service and stakeholder commitments, including C-MeX (6.25%) and D-MeX (6.25%) position, water quality (6.25%), helping vulnerable customers (6.25%), leakage (6.25%), consumption (6.25%), mains bursts (6.25%) and environmental innovation (6.25%); and 10% based on employee commitments , including culture surveys (5%) and safety (5%). These arrangements were formally agreed during the February 2020 Remuneration Committee meeting.	No changes have been made to the policy for 2021/22 up to the date of approval of this annual report and financial statements.

Governance

Governance continued

Remuneration report (continued)

REMUNERATION POLICY REPORT (CONTINUED)

Remuneration policy for executive directors (continued)

Purpose and link to strategy	Policy and approach	Maximum potential value (as percentage of base pay)	Performance metrics	Changes for 2021/22
Base salary				
To provide competitive fixed remuneration that will attract and retain key employees and reflect their experience and position in the company.	To target around market median, dependent on experience in the role.	N/A	N/A	No changes have been made to the policy for 2021/22 up to the date of approval of this annual report and financial statements.
Other taxable benefits				
To provide market competitive benefits.	Private health care insurance cover, life assurance and income protection are provided, together with a fully expensed company car (or car allowance).	N/A	N/A	No changes have been made to the policy for 2021/22 up to the date of approval of this annual report and financial statements.
Annual bonus plan				
The annual bonus plan is designed to provide a direct link between executive and company performance and the level of bonus awarded, although award and payment remain discretionary.	Maximum bonus potential is set at a market competitive level. The bonus is based on budgeted non-financial and financial targets that are aligned to the company's AMP7 commitments, plus individual targets.	Up to 100% of base salary for the CEO and up to 75% of base salary for the CFO. Where discretion is applied to executives relating to the performance of measures, the same level of discretion must be applied to all employees and managers.	40% of the total bonus is determined on the achievement of the financial performance target, which is based on net cash outflow before taxation and financing. 40% of the total performance is on customer service and stakeholder commitments including C-MeX (5.7%), leakage (5.7%), consumption (5.7%), water quality (5.7%), water pressure (5.7%), interruptions to supply (5.7%) and safety (5.7%). 20% of the total bonus is determined on the achievement of personal objectives. No payment will be awarded if achievement is below the target/plan for that metric. There is also the introduction of a check that stops pay-out of the bonus if either the customer or the financial elements of the bonus fall below a set level to ensure equal focus across all metrics. Reduction in the discretion of the Committee to award any bonus outside performance delivery targets. This was approved by the Remuneration Committee in April 2020.	No changes have been made to the policy for 2021/22 up to the date of approval of this annual report and financial statements.

Purpose and link to strategy	Policy and approach	Maximum potential value (as percentage of base pay)	Performance metrics	Changes for 2021/22
Pension related benefits				
To provide competitive post-retirement benefits.	Executives joining the company after 2004 are invited to participate in the company's defined contribution pension plan. No current executives joined prior to this date. Under the defined contribution scheme, executives who joined the company before 1 April 2020 contribute at a rate of 7% of salary and the company contributes at 20%. Executives who joined the company after this date are aligned to contributions made by the general employee population, with the company doubling contributions made by the executive up to a maximum company contribution of 12%.	20% of executive salary for executives appointed before 1 April 2020, 12% of executive salary for executives appointed after this date. Where executive directors are not members of the defined contribution scheme, the directors received a taxable allowance of 26% of base pay for the CEO and 20% of base pay for the CFO.	N/A	No changes have been formally approved however options are being looked into to align current executive director contributions to those of the workforce.
Compensation for the forfeit of variable remuneration from previous employer				
To provide compensation for forfeited remuneration from previous employers.	The Committee may make additional cash awards if deferred pay is forfeited by an executive director on leaving a previous employer. Such awards would take into account the nature of awards forfeited (i.e. cash or shares), time horizons, attributed expected value and performance conditions.	N/A	N/A	No changes have been made to the policy for 2021/22 up to the date of approval of this annual report and financial statements.

Governance continued

Remuneration report (continued)

REMUNERATION POLICY REPORT (CONTINUED)

Executive directors' service contracts

The executive directors who served during the year each had service contracts, neither of which are fixed term, with notice periods as follows:

CEO Pauline Walsh	CFO Stuart Ledger
From the executive to the company – 12 months	From the executive to the company – 6 months
From the company to the executive – 12 months	From the company to the executive – 6 months

In the event of loss of office, the executive directors are subject to the terms and conditions as set out in their respective service contracts and employment letters with the company. These service contracts do not set out details of how the circumstances of the director's departure and performance during a period of office might be taken into account when exercising discretion in relation to loss of office payments. They also do not contain provisions implying an obligation on the company in the event of loss of office.

Base awards under the LTIP include provisions that enable the company to recover sums paid or withhold the payment of any sum in a circumstance or circumstances of malus before the vesting of the award or within a clawback period of three years commencing on the payment date of the award.

Circumstances of malus include wilful or gross misconduct, acts of personal dishonesty or fraud, conviction of certain criminal offences, conduct which results in significant losses to the company, material failure of related management or business units, material misstatement in the audited financial statements, and reputational damage. If an executive director ceases to hold office prior to the vesting date, other than in the event of death; ill-health, injury or disability, as established to the satisfaction of the Board; the company ceasing to be part of the group or transferred to another group company; or another reason at the Board's discretion, except where the director is summarily dismissed, their unvested award will lapse.

There are no arrangements in place for the remuneration of directors by any holding company or other company in the group.

Pay-outs under different scenarios

The following charts show the potential remuneration in respect of 2021/22 under the proposed arrangements for the CEO and CFO under different scenarios.

In developing the scenarios the following assumptions have been made:

Fixed	Consists of base salary, taxable benefits and pension related benefits including cash allowances in lieu of being a member of the company's retirement benefit schemes.
Threshold	Based on what an executive director would receive if the threshold level of performance relating to the company bonus was achieved: annual variable pay out at 75% of maximum (assuming the financial, operational, customer and community, safety and health, and personal targets are met), in addition to awards from the 2018/19 LTIP that vested in 2020/21, the second third of the total of which becomes payable in 2021/22, and the first award from the 2019/20 LTIP which will vest in 2021/22 and become payable.
Maximum	Based on what an executive director would receive if the threshold level of performance relating to the company bonus was achieved: annual variable pay out at 100% of maximum (assuming the financial, operational, customer and community, safety and health, and personal targets are met), in addition to awards from the 2018/19 LTIP that vested in 2020/21, the second third of the total of which becomes payable in 2021/22, and the first award from the 2019/20 LTIP which will vest in 2021/22 and become payable.

Governance continued

Remuneration report (continued)

REMUNERATION POLICY REPORT (CONTINUED)

Management

We operate a discretionary performance bonus scheme for other senior managers (the Executive Management Team) and other selected managers who meet the criteria for inclusion in the scheme. At the date of approval of this annual report and financial statements, such managers continued to be entitled to participate in a performance-related discretionary bonus scheme for up to 40% of their salary. This is payable after the end of the financial year. Bonus awards are dependent on the success of the company. For the Executive Management Team they are determined by reference to three components:

- 40% of the total bonus is dependent on the achievement of financial performance targets, which are identical to the executive directors' annual bonus scheme;
- 40% of the total bonus is dependent on the achievement of operational, customer performance and safety targets, which are identical to the executive directors' annual bonus scheme; and
- 20% of the total bonus is dependent on the achievement of personal objectives.

For other selected managers who meet the criteria for inclusion in the scheme, bonus awards are determined by reference to three components, which were rebalanced in the year to 2020/21:

- 40% of the total bonus is dependent on the achievement of financial performance targets;
- 40% of the total bonus is dependent on the achievement of customer service and stakeholder commitments; and
- 20% of the total bonus is dependent on the achievement of personal objectives.

This rebalance has ensured our focus on customer service and stakeholder commitments is heightened, whilst ensuring we continue to work to meet our financial targets. The personal performance element of the bonus has been retained as this encourages and rewards strong performance. It is the responsibility of the company to set the management targets and the bonus split however the Remuneration Committee will ensure that the policy is rigorously applied across the whole company when approving a payment under the scheme.

The scheme is designed to provide a direct link between senior management and company performance and both bonus award and payment remain discretionary.

Company culture

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

The Remuneration Committee agreed during the year to a reward strategy focused on incentivising and rewarding employees based on performance. The company is committed to ensuring consistent salary measures are in place and will be implementing a grading and salary framework in the financial year to 31 March 2022 to provide transparency of job role evaluation. This will assist in diagnosing any disparity on gender pay and will support the company's aim of reducing the gender pay gap and achieving equality for all employees.

Within the company's annual appraisal process, known internally as our 'Personal Best', employees are provided with a performance rating based on both achievement of objectives and behaviours that support the principles of the company. For senior managers, the bonus scheme captures their performance contribution with an element of bonus awarded on personal contribution. As the culture of the company continues to evolve there is a greater focus on recognition of employees demonstrating the right behaviours and we have introduced a monthly peer recognition scheme.

The company has invested in a number of wellbeing activities over the last 12 months and has 38 Culture Ambassadors who provide cross functional feedback and support introducing new activities to drive change and transformation.

The company has put in place mechanisms to engage with employees on the 2020/21 directors' remuneration policy by communicating details of the policy to all employees in this annual report and financial statements and consulting with employees via Unions when any changes to employee terms are made - Unions consider the fairness of the policies in terms of whole company remuneration.

REMUNERATION IMPLEMENTATION REPORT

Company-wide bonus scheme

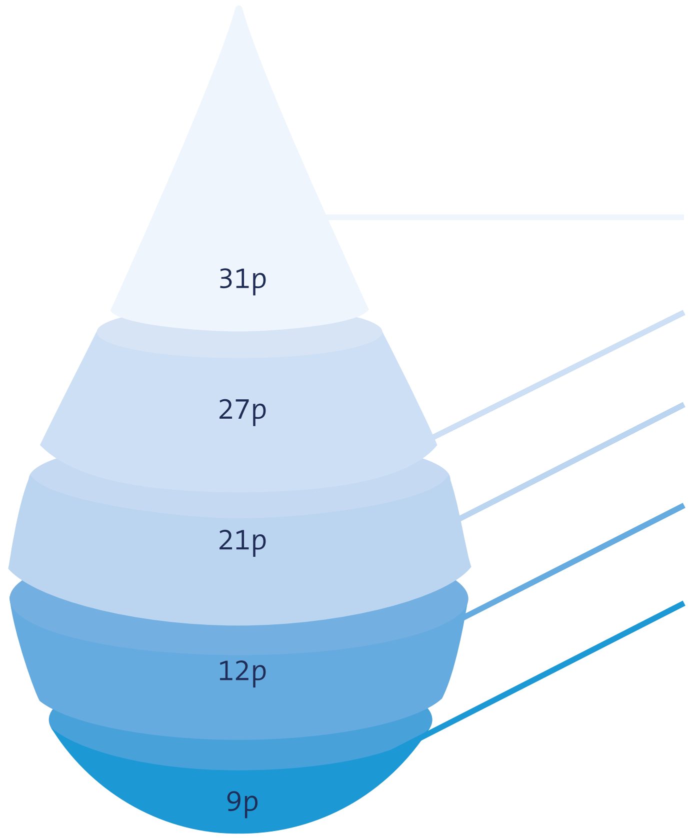
The Committee reviews and approves a discretionary company-wide performance bonus scheme for all employees, who are not otherwise entitled to the discretionary senior manager or selected manager performance bonus scheme. The discretionary company-wide bonus scheme comprises operational and customer performance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

At the date of approval of this annual report and financial statements, the bonus targets for operational, customer and financial performance continued to be aligned for the executive director, senior manager, selected manager and company-wide schemes. This ensures there is a common focus across the business, particularly with respect to service to customers.

Relative importance of spend on pay

The amount spent on our people in 2020/21 has decreased compared to the prior year. While the number of employees as at 31 March 2021 is slightly higher than the headcount at 31 March 2020, the average number of full time equivalent employees throughout the year was lower due to the restructuring of our business in order to be able to deliver the significant efficiencies planned for AMP7. This has been partially offset by a year-on-year pay increase.

Our people is still our third highest expenditure type, after our assets and our suppliers for operating services, and has remained consistent at 21p per pound of each customer bill, as shown below[1]:



Our assets: 31p (2020: 28p)
Investment in our assets

Our suppliers for operating services: 27p (2020: 31p)
Operational cost of suppliers' services

Our people: 21p (2020: 21p)
Wages, salaries and pensions

Our bondholders: 12p (2020: 12p)
Interest paid on debt financing

Local and central government: 9p (2020: 8p)
Corporation tax, business rates, abstraction charges, employer's national insurance, Climate Change Levy and streetworks permits.

Our shareholders: 0p (2020: 0p)
Dividends from our regulated business and interest on shareholder debt.

[1] Figures are based on our regulatory financial statements for the year ended 31 March 2021 and have been rounded.

Governance continued

Remuneration report (continued)

REMUNERATION IMPLEMENTATION REPORT (CONTINUED)

Sections that are audited and unaudited are defined in the relevant headings in the implementation report.

Directors' remuneration 2020/21 (audited)

The following table shows directors' remuneration in respect of 2020/21:.

	Base salary/ fees £000		Taxable benefits[1] £000		Annual bonus £000		LTIP[2] £000		Pension related benefits[3] £000		Other[4] £000		Total fixed remuneration £000		Total variable remuneration £000		Total £000	
	20/21	19/20	20/21	19/20	20/21	19/20	20/21	19/20	20/21	19/20	20/21	19/20	20/21	19/20	20/21	19/20	20/21	19/20
Non-executive																		
Current																		
Ann Bishop	**44**	-	-	-	-	-	-	-	-	-	-	-	**44**	-	-	-	**44**	-
Trevor Didcock	**51**	49	-	-	-	-	-	-	-	-	-	-	**51**	49	-	-	**51**	49
Susan Hooper	**49**	49	-	-	-	-	-	-	-	-	-	-	**49**	49	-	-	**49**	49
Mark Horsley	**44**	13	-	-	-	-	-	-	-	-	-	-	**44**	13	-	-	**44**	13
Chris Newsome	**49**	49	-	-	-	-	-	-	-	-	-	-	**49**	49	-	-	**49**	49
Justin Read	**35**	-	-	-	-	-	-	-	-	-	-	-	**35**	-	-	-	**35**	-
Former																		
Chris Bolt	-	19	-	-	-	-	-	-	-	-	-	-	-	19	-	-	-	19
Patrick O'D Bourke	**25**	49	-	-	-	-	-	-	-	-	-	-	**25**	49	-	-	**25**	49
Company Chair																		
Current																		
Ian Tyler	**44**	-	-	-	-	-	-	-	-	-	-	-	**44**	-	-	-	**44**	-
Former																		
Tony Cocker	**159**	195	-	-	-	-	-	-	-	-	-	-	**159**	195	-	-	**159**	195
Executive																		
Current																		
Stuart Ledger	**210**	209	**6**	6	**57**	140	**76**	-	**42**	32	-	-	**258**	247	**133**	140	**391**	387
Pauline Walsh	**365**	361	**8**	16	**125**	331	**206**	-	**78**	72	-	95	**451**	449	**331**	426	**782**	876
	1,074	993	**14**	22	**182**	471	**283**	-	**120**	104	-	95	**1,209**	1,119	**464**	566	**1,673**	1,686

Neither the company nor its immediate parent entities have any listed shares and so the directors have not been offered any share incentives. The directors appointed by Allianz Capital Partners on behalf of the Allianz Group, DIF and InfraRed Capital Partners Limited on behalf of HICL Infrastructure plc did not receive any emoluments from the company.

[1] Taxable benefits comprise company car allowance, living accommodation benefit, relocation costs and healthcare insurance.
[2] The LTIP amounts disclosed relate to the 2018/19 LTIP which fully vested in the year ended 31 March 2021. This amount will be paid in equal instalments over the three years ending 31 March 2022, 31 March 2023 and 31 March 2024.
[3] Pension related benefits for Stuart Ledger and Pauline Walsh comprised £6,300 and £54,750 respectively of contributions paid to money purchase schemes and £35,700 and £23,725 paid in lieu of being a member of the pension scheme in the second half of the year (2019/20: £32,000 and £72,000 all paid to money purchase schemes); there were no amounts outstanding at year-end.
[4] Other remuneration in 2019/20 for Pauline Walsh related to discretionary payments made in connection with commencement of qualifying services during the year, including compensation for the forfeit of a variable remuneration arrangement with her previous employer.

Annual bonuses for executive directors (unaudited)

The annual bonus scheme is designed to provide a direct link between executive and company operational, customer and financial performance, and the level of bonus awarded, although award and payment remain discretionary. The table below shows the percentage of maximum annual bonus potential awarded in relation to the 2020/21 year for Pauline Walsh and Stuart Ledger for each of the performance measures. No amounts in relation to these bonuses have been deferred.

Performance measure		Link to business model (refer to page 20)	2020/21 target	2020/21 actual	Maximum weighting for 2020/21 (as a % of base salary)		2020/21 achievement (as a % of base salary)	
				Target met	Pauline Walsh	Stuart Ledger	Pauline Walsh	Stuart Ledger
Financial measure	Cash generated by operations: net cash outflow before taxation and financing[1]	Targeting sufficient cash generated by operations ensures we can invest in our assets and provide a great service that customers value	£nil or higher	£(3.0m) ✗	40.00% £146,000	30.00% £63,000	0.00% £nil	0.00% £nil
Operational measures	Leakage: volume of water lost through leaks on the network (Ml/d)	Targeting a continued reduction in leakage will ensure customers have enough water, whilst leaving more water in the environment	157.8 Ml/d or less	171.4 ✗	5.72% £20,878	4.29% £9,009	0.00% £nil	0.00% £nil
	Water quality: CRI score	Targeting a low CRI score ensures customers have high quality water they can trust	2.0 or less	1.31 ✓	5.72% £20,878	4.29% £9,009	5.72% £20,878	4.29% £9,009
	Interruptions to supply: minutes interrupted above 3 hours	Targeting few interruptions to supply ensures we can minimise disruption for customers and the community	11 minutes or less	5 minutes, 49 seconds ✓	5.72% £20,878	4.29% £9,009	5.72% £20,878	4.29% £9,009
	Customer consumption: PCC litres per day	Targeting customer consumption ensures we can make sure customers have enough water whilst leaving more water in the environment	147.4 or less	169.3 ✗	5.72% £20,878	4.29% £9,009	0.00% £nil	0.00% £nil
	Properties at risk of low pressure: per 10,000 properties	Targeting reducing properties at risk of lower pressure ensures we can minimise disruption for customers and the community	1.645 or less	196.850 ✗	5.72% £20,878	4.29% £9,009	0.00% £nil	0.00% £nil
Customer and community measures	C-MeX[2]: position in the league table	Targeting an improvement in the C-MeX positions ensures we focus on providing a great service that customers value	14th or higher	15th ✗	5.72% £20,878	4.29% £9,009	0.00% £nil	0.00% £nil
Safety and health measure	Accident frequency rate (annual target): number of lost time injuries per 100,000 hours worked	Targeting a low accident frequency rate ensures our people can work to deliver our customer outcomes effectively	0.22 or lower	0.12 ✓	5.72% £20,878	4.29% £9,009	5.72% £20,878	4.29% £9,009
Personal performance[3]					20.00% £73,000	15.00% £31,500	17.00% £62,050	14.25% £29,925
Total % of base salary					**100.00%**	**75.00%**	**34.16%**	**27.12%**
Base salary							**£365,000**	**£210,000**
Bonus paid							**£124,684**	**£56,952**

[1] This "non-GAAP" measure is the total of the following line items per the statement of cash flows (refer to page 150): cash generated from operations; purchases of property, plant and equipment; proceeds on disposal of property, plant and equipment; purchase of intangible assets; and principal elements of lease payments. The bonus measure has been adjusted for the impact of timing on revenues earned and capital spend and is before statutory adjustments.
[2] C-MeX is the industry's measure of customer experience.
[3] The Remuneration Committee exercised discretion in determining the level of bonus awarded in relation to the personal performance element of the executive directors' annual bonus within the pre-agreed base salary percentage cap. The Committee considered achievement of personal objectives set at the start of the year in exercising its discretion together with events occurring during the year.

Governance continued

Remuneration report (continued)

REMUNERATION IMPLEMENTATION REPORT (CONTINUED)

Annual bonuses for executive directors (unaudited) (continued)

The operational metrics have been used as these are what we consider our key performance commitments and what matters most to customers in AMP7.

The remuneration policy operated as intended during the year. Executive director bonuses are only being paid where operational and financial targets were met, ensuring the policy was rigorously applied, and base salaries were set at a level that attracted and retained key employees, reflecting their experience and position in the company. The Remuneration Committee believes this was appropriate.

Source data and Remuneration Committee assessment of targets (unaudited)

The Remuneration Committee places reliance on the internal controls in place and external assurance received regarding financial and operational data. The Remuneration Committee only approves the bonus awards across the company once the data has been externally reviewed.

The work of the Audit, Risk and Assurance Committee (detailed on pages 95 to 104) is key to ensuring that an organisation has robust and effective processes relating to financial reporting, internal controls, risk management and ethics. The Audit, Risk and Assurance Committee is the main oversight body for the internal and external Auditor and is central to the company's governance structure. The Remuneration Committee is satisfied the data is accurate given the strong controls in place that are overseen by the Audit, Risk and Assurance Committee.

Percentage change in remuneration of directors and employees (unaudited)

In 2020/21, a one-year pay deal covering the period 1 April 2020 to 31 March 2021 was negotiated with trade unions resulting in the following:

- 2.0% increase to the basic pay of all employees; and
- 2.0% increase in allowances that are taxable and pensionable, primarily flexible and standby allowances.

The maximum potential annual bonus available to employees remained unchanged from 2019/20, although the company has previously worked to steadily increase the maximum bonus potential over AMP6, ensuring that the maximum was at a level at the start of AMP7 that incentivised employees in a performance based environment.

The executive directors have committed to not receiving an increase in their salary for the year 2021/22.

		Total base salary/fees, taxable benefits and annual bonus		Percentage change	
		2020/21 £000	2019/20 £000	%	
NED	Ann Bishop	44	-	N/A	Director appointed on 25 March 2020
NED	Trevor Didcock	51	49	4.1%	Increase reflects additional responsibilities of the director in the current year
NED	Susan Hooper	49	49	0%	
NED	Mark Horsley	44	13	N/A	Director appointed on 19 December 2019
NED	Chris Newsome	49	49	0%	
NED	Justin Read	35	-	N/A	Director appointed on 14 July 2020
Company Chair	Ian Tyler	44	-	N/A	Chair appointed on 11 January 2021
Executive director	Stuart Ledger	273	355	(23.1)%	Reduction due to financial and operational targets not met in the year and a resultant reduction in the annual bonus in the current year
Executive director	Pauline Walsh	498	708	(29.7)%	Reduction due to financial and operational targets not met in the year and a resultant reduction in the annual bonus in the current year

Pay ratios table (unaudited)

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

Year	Methodology used	25th percentile pay ratio	Median pay ratio	75th percentile pay ratio
2020/21	Option B	28.1:1	19.9:1	15.6:1
2019/20	Option B	32.7:1	21.0:1	18.3:1

The ratios above for 2020/21 are calculated using the 5 April 2020 gender pay gap data as permitted under Option B. Option B was used as the gender pay gap reporting date falls within the 2019/20 financial year and is a good representation of the data for the year. As we have a significant employee base, due to the size and complexity of the data it was felt to be overly complicated to prepare single figure calculations for each individual. We have used the 5 April 2020 gender pay gap data to identify three employees at median, 25th and 75th percentiles. The Committee has considered the methodology and is confident the employees identified are reasonable representatives of the employee population as the structure of their remuneration arrangements is in line with that of the majority of the employee population.

Payroll data has then been used to calculate total 2020/21 remuneration for the employees identified, which includes wages and salary, taxable benefits, their accrued 2020/21 annual bonus and pension benefits, but excludes overtime payments to ensure consistency amongst the employees. This has been compared to the CEO's single figure of remuneration reported in the 2020/21 remuneration report including LTIP and including in the prior year the non-recurring discretionary payment made in connection with commencement of qualifying services during 2019/20 shown in the prior year other column in the single figure remuneration. No equivalent payment was made in the current year. There was a decrease in the CEO pay ratio at each percentile in the year due to the non-recurring discretionary payment made in the prior year and the fact that employees received a 2.0% basic pay increase during 2020/21 but the CEO committed to not receiving a salary increase in 2020/21.

2020/21	Salary component of total pay and benefits	Total pay and benefits
25th percentile pay ratio	£25,474	£27,832
Median pay ratio	£36,333	£39,350
75th percentile pay ratio	£43,914	£50,039

We published our latest Gender Pay report of April 2020 data on our website: **affinitywater.co.uk/responsibility** which showed a 1.6% widening in our mean gender pay gap from 19.0% in April 2019 to 20.6% in April 2020, primarily due to the proportion of women in administrative roles increasing, as well as a greater turnover of women in team leader positions.

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

Statutory requirements

This remuneration report has been prepared on behalf of the Board by the Remuneration Committee. The report was approved by the Board on 28 June 2021 and signed on its behalf by:

Susan Hooper
Chair of the Remuneration Committee

Governance continued

Directors' report

INTRODUCTION

The directors present their annual report and the audited statutory financial statements of Affinity Water Limited ('the company') for the year ended 31 March 2021. The company is a limited liability company registered in England and Wales and its immediate parent undertaking is Affinity Water Holdings Limited, a company also registered in England and Wales. The directors consider that Daiwater Investment Limited was the ultimate holding and controlling company in the United Kingdom at 31 March 2021. Details of the ownership of the company and the group structure are set out on pages 105 to 106 of the governance section and note 26 of the financial statements. The address of the principal place of business is Tamblin Way, Hatfield, Hertfordshire, AL10 9EZ.

The strategic report on pages 10 to 63 provides detailed information relating to the company, its strategy, the operation of its business and its results and financial position for the year ended 31 March 2021. Details of the risks and principal uncertainties facing the company are set out on page 38.

DIRECTORS

The directors of the company, together with their periods of office and their biographical details, are shown on pages 69 to 73. The directors who were in office during the year and up to the date of signing the financial statements are summarised below:

Directors
Ann Bishop
Patrick O'D Bourke (resigned 29 September 2020)
Tony Cocker (resigned 29 January 2021)
Trevor Didcock
Susan Hooper
Mark Horsley
Jaroslava Korpanec
Stuart Ledger
Chris Newsome
Justin Read (appointed 14 July 2020)
Tony Roper
Angela Roshier
Ian Tyler (appointed 11 January 2021)
Pauline Walsh

Company Secretary
Sunita Kaushal (appointed 1 April 2020)

SIGNIFICANT EVENTS DURING THE YEAR

Details of the significant events that occurred during the year are set out in the Chief Executive Officer's introduction on page 10.

RESULTS AND FINANCIAL PERFORMANCE

Loss for the year was £51.3m (2020: loss of £21.7m).

The statement of financial position detailed on page 148 shows total equity amounting to £112.6m (2020: £187.0m).

Further analysis of our financial performance can be found in the Chief Financial Officer's review on page 14 of the strategic report.

INFORMATION REQUIRED UNDER THE LISTING RULES

During the year no interest was capitalised by the company (2020: £nil).

For disclosures in relation to relevant requirements of the Listing Rules, refer to the remuneration report on pages 111 to 125.

DIVIDENDS

Our board has agreed to restrict the payment of dividends throughout AMP7 to enable substantial investments to improve our resilience and protect the environment.

Equity dividends of £1.0m were paid from our non-appointed business (the parts of our business not regulated by Ofwat) during the year (2020: £nil), in order to service group debt, reflecting the shareholders' commitment to re-invest all planned returns from the company's appointed business for the benefit of our customers. The Board is not proposing to recommend the payment of a final dividend for the year (2020: £nil). Our dividend policy is available on our website: **affinitywater.co.uk/governance-assurance**.

ENERGY AND CARBON REPORTING

Scope 1
The annual quantity of emissions in tonnes of CO_2 equivalent resulting from activities for which the company is responsible (scope 1) is 5,003 tCO_2e (2020: 8,811 tCO_2e), shown in the table on the next page. Sources of fuel emissions from burning of fossil fuels is the use of Natural Gas used for the heating and cooling of our buildings, and Gas Oil and other fuels used primarily by generators at our water treatment works. Fugitive emissions include ozone used in the disinfection process and waste sludge recycled to land or landfill and refrigerant gases. Fleet fuel emissions result from the combustion of purchased fuel for fleet liveried vehicles.

Scope 2
The annual quantity of emissions in tonnes of CO_2 equivalent resulting from activities for which the company is responsible (scope 2) is 52,200 tCO_2e (2020: 58,350 tCO_2e), shown in the table on the next page. Purchased electricity is total grid electricity which we primarily use for the pumping and treatment of water and a small amount for office use.

Total energy consumption
Our total energy consumption including electricity, natural gas, gas oil, self-generated and fleet vehicles was 244,565,000 kWh (2020: 236,683,000 kWh).

Methodology used
For Scope 1, Scope 2 and selected Scope 3 Greenhouse Gas ('GHG') emissions, we follow the most common approach to calculate GHG emissions from emission sources, which is to take activity data (e.g. units of electricity consumed, or distance travelled) and covert the activity data into tCO_2e. We have reported the common intensity metric for the Water Industry, which is Carbon tCO_2e per Ml, which is our tCO_2e divided by water into supply (Ml).

Governance continued

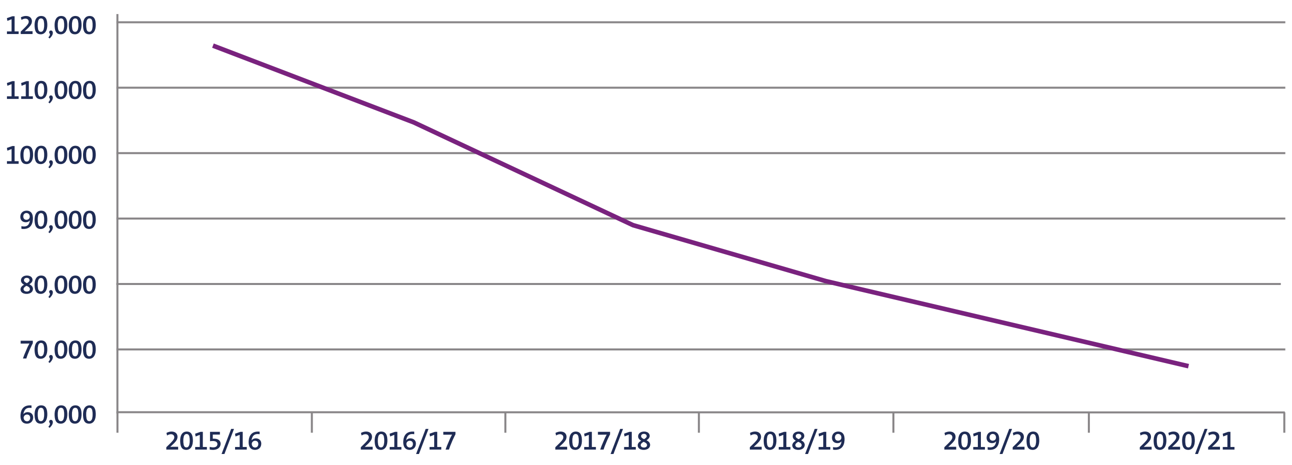
Directors' report (continued)

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

GHG emission source	2020/21 Gross[3] (tCO_2e)	2020/21 Intensity ($kgCO_2e/Ml$)	2019/20 (restated)[2] Gross (tCO_2e)	2019/20 (restated)[2] Intensity ($kgCO_2e/Ml$)
Scope 1	**5,003**	**14.3**	8,811	25.4
Fuel combustion	**683**	**1.9**	1,679	4.8
Process and fugitive emissions	**2,420**	**6.9**	5,198	15.0
Vehicle fleet	**1,900**	**5.4**	1,934	5.6
Scope 2	**52,200**	**149.1**	58,350	168.2
Purchased electricity	**52,200**	**149.1**	58,350	168.2
Statutory total (scope 1 & 2)[4]	**57,203**	**163.4**	67,161	193.6
Scope 3	**7,198**	**20.6**	5,018	14.5
Business travel in other vehicles	**81**	**0.2**	33	0.1
Outsourced activities	**2,627**	**7.5**	31	0.1
Electricity - transmission and distribution	**4,490**	**12.8**	4,954	14.3
Total gross emissions	**64,401**	**183.9**	72,179	208.1
Net emissions Green tariff electricity purchased	**(25,200)**	**N/A**	-	N/A
Total annual net emissions	**39,201**	**112.0**	72,179	208.1

The net operational emissions this year were 39,201 tCO_2e, compared to 72,179 in 2019/20, which is a 45.68% reduction due to 25,200 tCO_2e attributed to green tariff electricity purchased, the gross is a 10.77% reduction, as shown in the graph below:

Total Gross Emissions (tCO_2e)



[1] We report our GHG emissions following the 2013 UK Government Environmental Reporting Guidance and using the 2018 UK Government Conversion Factors for Company Reporting. We have included emissions within the direct management responsibility of the company. This is consistent with our financial reporting boundary with the exception of scope 3 emissions, which are off-balance sheet emissions. Significant scope 3 emissions have been quantified for outsourced data support and emissions from the distribution and transmission of grid electricity. The data has been externally verified as part of our regulatory reporting requirements. All emissions reported relate to emissions in the United Kingdom and offshore area.
[2] The volume of water used in 2019/20 has been restated, subsequently causing the intensity figures to be restated.
[3] We measure our gross GHG emissions in tonnes of carbon dioxide equivalent ('tCO_2e').
[4] Statutory carbon reporting disclosures required by the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013.

The company supplies water to 3,830,000 consumers in our supply area (2020: 3,780,000). The COVID-19 pandemic developed rapidly in 2020 resulting in an increased demand for water we supply due to the impact of the virus and the hot summer of 2020. The way we operate also had to change with the majority of office-based staff working from home, and just a small number of employees at our office locations. Our front-line delivery teams have continued to work at our operational sites and in the community.

We are currently piloting ways to reduce whole life emissions (both operational and embodied) of several large capital projects. There is significant evidence that to evaluate a project through a carbon lens finds efficiencies in both carbon and costs which we aim to achieve through the use of the PAS2080 standard. We are also finding opportunities for wider benefits such as environmental net gain through our carbon reduction projects.

Our plans include moving to a greener vehicle fleet, to develop significant renewable energy and to be part of the water industry's commitment to plant 11 million trees. In addition to this we are working closely with our supply chain partners to reduce carbon emissions (scope 3) from our daily activities and planned investment, both from the materials and energy we use.

This year has seen a decrease of 10.8%, of our gross greenhouse gas emissions compared to last year. Scope 1 Direct Emissions have reduced from 8,811 tCO_2e in the prior year to 5,003 tCO_2e in 2020/21.

There has been a reduction of 3.4% in natural gas usage from last year. This is due to consumption data being supplied which facilitated in more accurate billing of consumption and work was done to reduce consumption outside normal operating times.

There has been a decrease in gas oil consumption against prior year of 30.6%, due to a reduction in projects at sites requiring generators for standby power.

Electricity usage for pumping and treating water accounts for 87.3% of our gross emissions.

Electricity consumption and emissions from outsourced activities, IT services, administration services and courier mileage have been included and in line with the Ofwat net zero road map, it is envisaged this will continue to expand.

There has also been a reduction in the conversion factors for grid electricity and transmission and distribution. The water distributed input has increased by 3.6%, which is used in the intensity measure ($kgCO_2e/Ml$). We used the WKWIR CAWv15 to calculate emissions.

There has been a 0.2% increase in petrol and diesel consumption relating to transport owned by the company, which contributes to our total emissions, due to an increase in petrol consumption, but a small reduction in emissions due to changes in reporting factors of 1.8%.

This compares to an increase in emissions from transport by public transport and private vehicles, this is 0.2% of our total net emissions. This was due to a decrease of 88.2% in air travel. There was also a dramatic drop in the kilometres travelled by national rail of 99.2%. Governance rules for claiming mileage expenses have changed, and expenses must now be claimed in the month they occur, eliminating tardy claims, which in the prior year resulted in an impression at the time of a reduction. There has been an overall reduction in mileage claimed of 53.5% on the revised 2019/20 mileage.

We have also included in our scope 3 emissions:

- Water treatment waste recycled to land;
- Water treatment waste sent to landfill; and
- Other wastes including scrap metals, plastics, cardboard and glass.

During 2020/21 we replaced a number of our borehole, booster and high lift pumps. We have also been optimising one of our main water treatment works to use the most efficient sources where possible. We have also installed new pumps at four of our sites, and refurbished the high lift pumps at a further two sites to improve efficiency. At another of our main water treatment works we have completed ozone upgrades which has reduced the ozone demand thereby reducing the power consumption of the generators.

We have employed microthermal pump monitoring at three of our pump sets to identify the real time pump efficiency and to ensure that we are running in the most energy efficient way. Energy savings of 2-4% have been achieved and we are looking to continue the roll out of these to other sites.

Additionally, by working with Datumpin, we have been able to make better use of the data that we have on our sites, to identify the impact of small changes on the operation of the site. The energy savings of this work are less easy to quantify but it has led to reduced chemical consumption during Ion Exchange regeneration and a lower waste volume needing to be taken away.

Governance continued

Directors' report (continued)

RESEARCH AND DEVELOPMENT ACTIVITIES

The development and application of new techniques and technology is an important part of the company's activities. The company is a member of UK Water Industry Research ('UKWIR') and participates widely in, and benefits from, its research programme. The UKWIR programme relating to Affinity Water is currently divided into the following topics: drinking water quality and health; toxicology; water resources; climate change; water mains and services; leakage and metering and regulatory issues.

The company is also a member of other water industry research and innovation groups: Technology Approval Group, the Water Treatment Technical Working Group, the Sensor for Water Interest Group, the Instrument User Group, the Water Regulations Advisory Scheme and Cranfield Water Network. In addition, the company carried out more specific research during the year in the fields of process performance and energy optimisation, novel technologies for plumbosolvency control, monitoring of biological risks in the network and risks to water quality when changing sources of supply.

INNOVATION

During 2020/21 we paid £1.1m into Ofwat's Innovation in Water Challenge, an industry-wide initiative to drive transformational change and better meet the evolving needs of customers, society and the environment, and in April 2021, Ofwat announced 11 winning projects, two of which we had led on – Seagrass Seeds of Recovery and Smarter Tanks, both of which will improve the efficiency and resilience of our water supplies.

The Seagrass project uses nature itself to enhance coastal communities' ecosystems. Planting and restoring seagrass meadows enhance the stability of the coastal zone, locking carbon into the seabed at a rapid rate, improving water quality and creating habitat for hundreds of thousands of small animals. This innovative project will provide a blueprint for upscaling the restoration of seagrass to enhance the resilience of the estuarine and coastal waters of the Affinity Water and Anglian Water supply regions in Essex and Suffolk.

The Smarter Tanks project will develop a 'business model canvas' to harness real-time monitoring and control solutions for existing water tanks and towers to improve efficiency when water is needed most such as during droughts. The project aims to make the most use of existing water storage assets in a new way in order to build network resilience and pave the way for the industry to explore new solutions further.

POLITICAL CONTRIBUTIONS

No political contributions were made during the year (2020: £nil), in accordance with the company's policy of not making political contributions.

FINANCIAL INSTRUMENTS DISCLOSURES

Details are included within risk number 14 on page 49 of the strategic report and in note A4 of the financial statements.

EMPLOYEE MATTERS

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

We aim to ensure that each employee or applicant for employment receives the same treatment irrespective of race, gender, disability, sexual orientation, religious belief, creed, marital or parental status. This extends through all company policies including recruitment where the candidate's particular aptitudes and abilities are consistent with the requirements of the job. Opportunities are available to disabled employees for training, career development and promotion. Employees who become disabled whilst employed by the company are actively supported to maintain and/or find appropriate employment within the business.

ENGAGEMENT WITH EMPLOYEES

We consult and inform our employees on all aspects of business performance through formal and informal consultation bodies, regular team meetings, email and the intranet. We discuss ways to enhance and improve our communications and consultation channels directly with employees as well as with the Trade Unions to which a number of employees belong.

Employees are kept informed of changes in the business and general, financial and economic factors influencing the company together with performance targets. This is achieved through regular briefings or presentations and electronic mailings.

See page 54 for details in our Section 172(1) statement on how directors have engaged with employees.

ENGAGEMENT WITH OTHER STAKEHOLDERS

See page 54 for details in our Section 172(1) statement on how directors have engaged with suppliers, customers and other stakeholders.

FUTURE DEVELOPMENTS

Likely future developments in the business resulting from expected changes in the regulatory and competitive environments that we operate in are discussed in the strategic report on page 34.

CORPORATE GOVERNANCE

The company's statement on corporate governance, including information required by the Disclosure and Transparency Rules, can be found in the Corporate Governance Statement on pages 74 to 86 of this annual report and financial statements. This section forms part of this Directors' report and is incorporated into it by cross-reference. We have reported our compliance with the Affinity Water Corporate Governance Code which is available on our website at: **affinitywater.co.uk/governance-assurance**.

Governance continued

Directors' report (continued)

EVENTS AFTER THE REPORTING PERIOD

Following approval to transact a power hedging swap when conditions were favourable, as detailed in the section 172(1) statement on page 54 onwards, the company entered into its first energy swap in May 2021, fixing the price on a proportion of our future energy costs. This will be reflected in our financial numbers in the year ending 31 March 2022.

GOING CONCERN

The directors consider it appropriate to adopt the going concern basis of accounting in preparing the financial statements as the company has adequate resources to meet its current operational and financial obligations, and the directors have a reasonable expectation that this will continue for the foreseeable future. This is based on assessment of the principal risks of the company and the other matters discussed in connection with the viability statement on page 50 as well as consideration of the company's budgeted cash flows, short and long-term forecasts and ability to generate future revenues, related assumptions and available debt facilities.

Whilst the current economic environment as a result of COVID-19 is clearly challenging, the company has put in place suitable mitigating actions to ensure that even under a severe but plausible downside scenario, the company is not forecasting any covenant breaches. Due to the nature of the regulated water company's business, the directors consider it appropriate to place reliance on projected financials.

DIRECTORS' QUALIFYING THIRD PARTY INDEMNITY PROVISIONS

The company has not granted any indemnity to its directors against liability in respect of proceedings brought by third parties, subject to the conditions set out in Section 234 of the Companies Act 2006.

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE FINANCIAL STATEMENTS

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulation.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 101 "Reduced Disclosure Framework", and applicable law). Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period.

In preparing the financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- state whether applicable United Kingdom Accounting Standards, comprising FRS 101, have been followed, subject to any material departures disclosed and explained in the financial statements;
- make judgements and accounting estimates that are reasonable and prudent; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006.

The directors are responsible for the maintenance and integrity of the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Directors' confirmations

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

In the case of each director in office at the date the Directors' Report is approved:
- so far as the director is aware, there is no relevant audit information of which the company's auditors are unaware; and
- they have taken all the steps that they ought to have taken as a director in order to make themselves aware of any relevant audit information and to establish that the company's auditors are aware of that information.

INDEPENDENT AUDITOR

In accordance with Section 485 of the Companies Act 2006, a resolution to re-appoint PricewaterhouseCoopers LLP will be proposed at the forthcoming AGM.

By order of the Board

Sunita Kaushal

Company Secretary
28 June 2021

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

Statutory Financial Statements

for the year ended 31 March 2021

CONTENTS

Independent auditors' report	136
Income statement	146
Statement of comprehensive income	147
Statement of financial position	148
Statement of changes in equity	149
Statement of cash flows	150
Accounting policies	151
Notes to the financial statements	155

Affinity Water Limited

(Registered Number 02546950)

Chalk streams are a precious part of our local and natural heritage and a priceless natural resource

Statutory Financial Statements

Independent auditors' report to the member of Affinity Water Limited

Report on the audit of the financial statements

Opinion

In our opinion, Affinity Water Limited's financial statements:

- give a true and fair view of the state of the company's affairs as at 31 March 2021 and of its loss and cash flows for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 101 "Reduced Disclosure Framework", and applicable law); and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements included within the Annual Report and Financial Statements (the "Annual Report"), which comprise: the Statement of financial position as at 31 March 2021; the Income statement, the Statement of comprehensive income, the Statement of changes in equity and the Statement of cash flows for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

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

Our audit approach

Context

The terms of the company's licence under the Water Industry Act 1991 require the company to report as if it had issued equity share capital listed on the London Stock Exchange and therefore the opinion below refers to the Listing Rules of the Financial Conduct Authority (FCA).

Overview

Audit scope

- The company has one finance function, with the audit being carried out by one team - this was predominantly performed remotely due to the impact of COVID-19.

Key audit matters

- Accuracy of the measured income accrual.
- Adequacy of loss allowance for trade receivables.
- Impact of the COVID-19 pandemic.

Materiality

- Overall materiality: £3.9 million (2020: £4.1 million) based on 3.5% of the three year average earnings before interest, tax, depreciation and amortisation ('EBITDA') (2020: based on 3.5% of EBITDA).
- Performance materiality: £2.9 million.

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements.

Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

This is not a complete list of all risks identified by our audit.

'Assessment of cost capitalisation' and 'Assessment of pension assumptions applied in the valuation of the pension scheme', which were key audit matters last year, are no longer included because in our professional judgement, the risk of misstatement has reduced compared to the prior year based on a consistently applied methodology underpinning management's estimates. We therefore no longer consider them to be the areas of most significance to our audit, with the level of audit effort spent in these areas having reduced compared to the prior year. Otherwise, the key audit matters below are consistent with last year.

Key audit matter	How our audit addressed the key audit matter
Accuracy of the measured income accrual Refer to page 95 (Audit, Risk and Assurance Committee Report), page 151 (accounting policies) and page 167 (note 12). A measured income accrual of £36.6 million (31 March 2020: £36.0 million) has been recognised relating to revenue from the provision of water services to metered household customers that had not been billed at the year end date. The determination of the measured income accrual impacts directly on both reported revenue and operating profit. The measured income accrual accounts for the timing difference between the last meter reading and the estimated consumption of water from that point to the year end and is calculated based on the average consumption over the past two years by small geographical groupings of customers. Given the range of factors underlying this estimate, there is a risk that the measured income accrual and associated revenue could be misstated.	The measured income accrual is a manual calculation prepared using data from the Hi-Affinity billing system. We understood the methodology and ensured that it had been applied consistently with previous years. We also tested the mechanics of the spreadsheet used to calculate the measured income accrual. In respect of the integrity of the data within Hi-Affinity, we tested the design and operating effectiveness of key controls within the revenue and receivables cycle, including the reconciliation of reports produced from the Hi-Affinity billing system and the revenue journals posted to the general ledger, and the quarterly review of tariff changes made in the Hi-Affinity billing system. We also validated the accuracy of the data within Hi-Affinity by agreeing a sample of meter readings to the system and tracing actual consumption to the bills raised. We investigated significant variances in the measured income accrual compared to the prior year and corroborated these movements to supporting information, including property statistic reports detailing additional households within the geographical catchment area within which the company operates and the movement of customers from unmeasured to measured tariffs. To assess the overall reasonableness of the accrual, we performed an independent roll forward of the accrual recognised at 31 March 2020 to calculate an expected accrual at 31 March 2021, reflecting the underlying changes in the number of metered customers, pricing tariffs, levels of water consumption and the timing of meter readings.

Statutory Financial Statements continued

Independent auditors' report to the member of Affinity Water Limited (continued)

Key audit matters (continued)

Key audit matter	How our audit addressed the key audit matter
Accuracy of the measured income accrual (continued)	In order to assess the ability of management to prepare appropriate estimates in respect of the measured income accrual, we evaluated the historical accuracy of the estimation process by comparing the bills raised through the year to the amount accrued at 31 March 2020. We also compared the billing subsequent to 31 March 2021 and extrapolated the difference identified against the remainder of the accrual. Based on the procedures performed, we did not identify any material misstatements.
Adequacy of loss allowance for trade receivables Refer to page 95 (Audit, Risk and Assurance Committee Report), page 151 (accounting policies) and page 167 (note 12) and pages 187 to 195 (note A4). The loss allowance for trade receivables of £34.0 million (31 March 2020: £34.6 million) is calculated by applying a range of different percentages to trade receivables based on their respective ageing, with higher percentages applied to those categories of trade receivables which are considered to be of greater risk. We have also considered any significant economic changes that may impact future credit losses. Some customers have difficulty paying their bills or, in certain instances, choose not to pay them. As a result, given there are limited steps that a water company can take to recover debt from household customers, there is an ongoing risk of aged trade receivables not being collected, with this risk being heightened by the economic impact of COVID-19. In order to account for the increased risk of credit loss as a result of COVID-19, consistent with the prior year, management have made use of a third-party tool, Acorn consumer classification, to segment their existing customers into demographic segments. These demographic segments were then grouped into three risk buckets (low, medium and high) and allocated a percentage reflecting management's estimate of the likelihood of potential default. The weighted average across the three buckets was then applied to the previously unprovided trade receivables in order to calculate an incremental loss allowance for trade receivables to reflect the increased risk caused by COVID-19. Given the quantum of trade receivables, and the range of assumptions used in preparing the loss allowance for trade receivables, there is a risk that this estimate could be materially misstated.	We reviewed the methodology for calculating the loss allowance for trade receivables and ensured it had been consistently applied with the prior year. We also understood and tested the mechanics of the spreadsheet used to calculate the initial loss allowance, the measurement basis (measured and unmeasured) and the methodology applied to calculate provision rates and agreed that they are consistent with the prior year. To ensure the appropriate classification of customers into sub-categories to apply the historical expected credit loss methodology, we selected a sample of trade receivables and tested that they have been allocated the appropriate provision rate based on ageing, customer type and measurement basis. In addition, we compared the actual rates used in the calculation of the loss allowance to prior year rates and reviewed the level of bad debt write offs which occurred during the year ended 31 March 2021 to assess the ability of management to prepare appropriate estimates. For the additional loss allowance recognised in relation to COVID-19, we assessed management's use of the Acorn consumer classification system and reviewed the demographic groupings assigned to the household customers and the subsequent risk grouping performed by management. The Acorn consumer classification system is a tool provided by a reputable third party and underpins the UK House Price Index and we therefore consider it to be a reasonable basis for the assessment performed by management. We applied sensitivity analysis on this additional adjustment to previously unprovided trade receivables to consider the risk of this being materially understated or overstated, in light of both cash collection rates and the current economic outlook. Based on the procedures performed, we did not identify any material differences within the loss allowance for trade receivables.

Key audit matters (continued)

Key audit matter	How our audit addressed the key audit matter
Impact of the COVID-19 pandemic Refer to page 95 (Audit, Risk and Assurance Committee Report), page 50 (viability statement) and page 151 (accounting policies). The COVID-19 pandemic has impacted the financial results of the company for the year ended 31 March 2021 and is expected to continue to impact the company into the next financial year, albeit the severity of the impact is expected to reduce over time. Management has considered the impact of COVID-19 on the financial statements including the ability of the company to continue as a going concern, with the directors concluding that there is no material uncertainty in this respect, as well as the impact on other estimates and judgements. Disclosure of the risk to the company of COVID-19 and management's conclusions on going concern and viability have been included within the relevant sections of the financial statements.	In advance of the year end, and throughout the course of our audit procedures, we assessed the risks arising from COVID-19. We focused on areas where significant additional audit effort might be required, as well as those areas that we considered might be susceptible to a material financial impact on the performance and position of the company. We assessed the base case going concern model prepared by management which includes the anticipated future impacts of COVID-19, as well as the downside scenario which has been used to sensitise the base case model. In relation to the base case model, we have agreed the key inputs back to Board approved budgets and have considered the historical accuracy of the budgeting process to assess the reliability of the data. Specifically, in relation to the potential future impact of COVID-19 and the severe but plausible downside modelling conducted by management, we assessed the underlying assumptions within management's forecasts. We challenged these assumptions based on our understanding of the business and our knowledge of the industry, and used sensitivity analysis to consider the impact of changes in these assumptions on the forecasts. We also reviewed management's analysis of both liquidity and covenant compliance to obtain comfort that the company has sufficient liquidity and that there are no covenant breaches anticipated over the period of the assessment in either the base case or the downside scenario prepared. We considered any potential impairment indicators to the carrying value of other assets and the broader impact to the company's financial statements and did not identify any material misstatements. We also considered the impact of COVID-19 on both the accuracy of the measured income accrual and the adequacy of the loss allowance for trade receivables, as set out within the respective key audit matters above. We assessed the COVID-19 disclosures included in the financial statements and consider them to be appropriate.

Statutory Financial Statements continued

Independent auditors' report to the member of Affinity Water Limited (continued)

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the company, the accounting processes and controls, and the industry in which it operates.

The company has one finance function, with the audit being carried out by one team - this was predominantly performed remotely due to the impact of COVID-19.

In scoping our audit, with reference to our risk assessment, we identified and included all material financial statement line items within the scope of our audit procedures.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Overall materiality	£3.9 million (2020: £4.1 million).
How we determined it	Based on 3.5% of the three year average earnings before interest, tax, depreciation and amortisation ('EBITDA') (2020: based on 3.5% of EBITDA).
Rationale for benchmark applied	We have used EBITDA as this is the measure that management focus on internally within their reporting. The use of EBITDA is also consistent with the prior year, though a three year average has been used in the current year due to the impact of COVID-19 on current year profitability.

We use performance materiality to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds overall materiality. Specifically, we use performance materiality in determining the scope of our audit and the nature and extent of our testing of account balances, classes of transactions and disclosures, for example in determining sample sizes. Our performance materiality was 75% of overall materiality, amounting to £2.9 million for the company financial statements.

In determining the performance materiality, we considered a number of factors - the history of misstatements, risk assessment and aggregation risk and the effectiveness of controls - and concluded that an amount at the upper end of our normal range was appropriate.

We agreed with those charged with governance that we would report to them misstatements identified during our audit above £0.2 million (2020: £0.2 million) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Conclusions relating to going concern

Our evaluation of the directors' assessment of the company's ability to continue to adopt the going concern basis of accounting included:

- testing the mathematical accuracy of the base case going concern model prepared by management and agreeing this to Board approved budgets;
- assessing the inputs and underlying assumptions of the base case model, which includes the anticipated future impacts of COVID-19;
- assessing the downside scenario which has been used to sensitise the base case model, including consideration of the underlying assumptions; and
- reviewing management's analysis of both liquidity and covenant compliance to ensure there is sufficient liquidity and no forecast covenant breaches during the going concern period.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the company's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

In auditing the financial statements, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

However, because not all future events or conditions can be predicted, this conclusion is not a guarantee as to the company's ability to continue as a going concern.

In relation to the directors' reporting on how they have applied the UK Corporate Governance Code, we have nothing material to add or draw attention to in relation to the directors' statement in the financial statements about whether the directors considered it appropriate to adopt the going concern basis of accounting.

Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report.

Statutory Financial Statements continued

Independent auditors' report to the member of Affinity Water Limited (continued)

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic report and Directors' report, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on our work undertaken in the course of the audit, the Companies Act 2006 requires us also to report certain opinions and matters as described below.

Strategic report and Directors' report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic report and Directors' report for the year ended 31 March 2021 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic report and Directors' report.

Corporate governance statement

ISAs (UK) require us to review the directors' statements in relation to going concern, longer-term viability and that part of the corporate governance statement relating to the company's compliance with the provisions of the UK Corporate Governance Code, which the Listing Rules of the Financial Conduct Authority specify for review by auditors of premium listed companies. Our additional responsibilities with respect to the corporate governance statement as other information are described in the Reporting on other information section of this report.

Based on the work undertaken as part of our audit, we have concluded that each of the following elements of the corporate governance statement is materially consistent with the financial statements and our knowledge obtained during the audit, and we have nothing material to add or draw attention to in relation to:

- The directors' confirmation that they have carried out a robust assessment of the emerging and principal risks;
- The disclosures in the Annual Report that describe those principal risks, what procedures are in place to identify emerging risks and an explanation of how these are being managed or mitigated;
- The directors' statement in the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and their identification of any material uncertainties to the company's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements;
- The directors' explanation as to their assessment of the company's prospects, the period this assessment covers and why the period is appropriate; and
- The directors' statement as to whether they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of its assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

Our review of the directors' statement regarding the longer-term viability of the group was substantially less in scope than an audit and only consisted of making inquiries and considering the directors' process supporting their statement; checking that the statement is in alignment with the relevant provisions of the UK Corporate Governance Code; and considering whether the statement is consistent with the financial statements and our knowledge and understanding of the company and its environment obtained in the course of the audit.

In addition, based on the work undertaken as part of our audit, we have concluded that each of the following elements of the corporate governance statement is materially consistent with the financial statements and our knowledge obtained during the audit:

- The directors' statement that they consider the Annual Report, taken as a whole, is fair, balanced and understandable, and provides the information necessary for the members to assess the company's position, performance, business model and strategy;
- The section of the Annual Report that describes the review of effectiveness of risk management and internal control systems; and
- The section of the Annual Report describing the work of the audit committee.

We have nothing to report in respect of our responsibility to report when the directors' statement relating to the company's compliance with the Code does not properly disclose a departure from a relevant provision of the Code specified under the Listing Rules for review by the auditors.

Statutory Financial Statements continued

Independent auditors' report to the member of Affinity Water Limited (continued)

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the Statement of directors' responsibilities in respect of the financial statements, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud, is detailed below.

Based on our understanding of the company and industry, we identified that the principal risks of non-compliance with laws and regulations related to industry regulation, including the requirements of The Water Services Regulation Authority ('Ofwat'), employment law and regulation, UK tax legislation and pensions legislation, and we considered the extent to which non-compliance might have a material effect on the financial statements. We also considered those laws and regulations that have a direct impact on the financial statements such as the Companies Act 2006. We evaluated management's incentives and opportunities for fraudulent manipulation of the financial statements (including the risk of override of controls), and determined that the principal risks were related to posting inappropriate journal entries to increase revenue or reduce expenditure, in doing so increasing overall profitability, and management bias within accounting estimates, in particular the potential manipulation of measured income accrual or loss allowance for trade receivables. Audit procedures performed by the engagement team included:

- discussions with management, internal audit and the company's legal team, including inquiring of known or suspected instances of non-compliance with laws and regulation and fraud, and review of board minutes and internal audit reports;
- challenging assumptions made by management when preparing accounting estimates, in particular those that involve the assessment of future events, which are inherently uncertain – the key estimates determined in this respect are those relating to the measured income accrual and loss allowance for trade receivables; and
- identifying and testing journal entries posted, such as those with unusual account combinations or those posted by senior management.

There are inherent limitations in the audit procedures described above. We are less likely to become aware of instances of non-compliance with laws and regulations that are not closely related to events and transactions reflected in the financial statements. Also, the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion.

Our audit testing might include testing complete populations of certain transactions and balances, possibly using data auditing techniques. However, it typically involves selecting a limited number of items for testing, rather than testing complete populations. We will often seek to target particular items for testing based on their size or risk characteristics. In other cases, we will use audit sampling to enable us to draw a conclusion about the population from which the sample is selected.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: *www.frc.org.uk/auditorsresponsibilities*. This description forms part of our auditors' report.

Responsibilities for the financial statements and the audit (continued)

Use of this report

This report, including the opinions, has been prepared for and only for the company's member in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

Companies Act 2006 exception reporting

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not obtained all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the company, or returns adequate for our audit have not been received from branches not visited by us; or
- certain disclosures of directors' remuneration specified by law are not made; or
- the financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Other voluntary reporting

Directors' remuneration

The company voluntarily prepares a Remuneration report in accordance with the provisions of the Companies Act 2006. The directors requested that we audit the part of the Remuneration report specified by the Companies Act 2006 to be audited as if the company were a quoted company.

In our opinion, the part of the Remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006.

Owen Mackney (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Watford

28 June 2021

Statutory Financial Statements continued

Income statement for the year ended 31 March 2021
(Registered Number 02546950)

	Note	2021 £000	2020 £000
Revenue	1	**286,782**	307,240
Cost of sales		**(243,634)**	(227,820)
Gross profit		**43,148**	79,420
Administrative expenses		**(38,918)**	(42,839)
Impairment losses on financial and contract assets	2.1	**(8,318)**	(9,470)
Other income	2.2	**17,657**	18,449
Operating profit	2	**13,569**	45,560
Finance income	4	**15,770**	8,391
Finance costs	4	**(48,621)**	(52,044)
Fair value loss on financial instrument	4	**(44,218)**	(1,816)
Net finance costs	4	**(77,069)**	(45,469)
(Loss)/profit before tax		**(63,500)**	91
Income tax credit/(expense)	5	**12,222**	(21,773)
Loss for the financial year		**(51,278)**	(21,682)

All results of the company in the current period and prior period are from continuing operations.

The notes on pages 151 to 201 are an integral part of these financial statements.

Statement of comprehensive income for the year ended 31 March 2021
(Registered Number 02546950)

	Note	2021 £000	2020 £000
Loss for the financial year		**(51,278)**	(21,682)
Other comprehensive (loss)/income for the year which will not be reclassified to profit or loss:			
Re-measurements of post-employment benefit assets	10	**(32,162)**	38
Deferred tax credit/(charge) on items that will not be reclassified	5	**6,111**	(7)
Other comprehensive (loss)/income for the year, net of tax		**(26,051)**	31
Total comprehensive loss for the year		**(77,329)**	(21,651)

The notes on pages 151 to 201 are an integral part of these financial statements.

Statutory Financial Statements continued

Statement of financial position as at 31 March 2021

(Registered Number 02546950)

	Note	2021 £000	2020 £000
Assets			
Non-current assets			
Property, plant and equipment	6	**1,540,949**	1,479,039
Right-of-use assets	7	**9,508**	12,436
Intangible assets	8	**48,678**	45,768
Investments	9	**100**	100
Retirement benefit surplus	10	**74,532**	104,619
Other receivables	12	**184**	2,300
		1,673,951	1,644,262
Current assets			
Inventories	11	**4,080**	3,017
Other investments	9	**15,132**	25,202
Trade and other receivables	12	**84,201**	82,099
Cash and cash equivalents	13	**84,766**	85,587
		188,179	195,905
Total assets		**1,862,130**	1,840,167
Equity and liabilities			
Equity			
Share capital	14	**30,506**	26,506
Share premium	14	**1,400**	1,400
Capital contribution reserve	14	**30,150**	30,150
Retained earnings		**50,589**	128,918
Total equity		**112,645**	186,974
Liabilities			
Non-current liabilities			
Trade and other payables	15	**150,806**	132,694
Borrowings	16	**1,095,079**	1,090,641
Lease liabilities	17	**6,016**	9,068
Derivative financial instrument	18	**57,691**	9,149
Deferred tax liabilities	19	**181,141**	198,644
Provisions for other liabilities and charges	20	**3,396**	5,507
		1,494,129	1,445,703
Current liabilities			
Trade and other payables	15	**247,900**	199,330
Lease liabilities	17	**3,667**	3,491
Current tax liabilities		**3,611**	4,062
Provisions for other liabilities and charges	20	**178**	607
		255,356	207,490
Total liabilities		**1,749,485**	1,653,193
Total equity and liabilities		**1,862,130**	1,840,167

The notes on pages 151 to 201 are an integral part of these financial statements. The statutory financial statements on pages 146 to 201 were approved by the Board of Directors and were signed and authorised for issue on 28 June 2021 on its behalf by:

Pauline Walsh Chief Executive Officer

Stuart Ledger Chief Financial Officer

Statement of changes in equity for the year ended 31 March 2021

(Registered Number 02546950)

	Note	Share capital £000	Share premium £000	Capital contribution reserve £000	Retained earnings £000	Total equity £000
Balance as at 1 April 2019		26,506	1,400	30,150	150,569	208,625
Loss for the year		-	-	-	(21,682)	(21,682)
Other comprehensive income		-	-	-	31	31
Total comprehensive loss		-	-	-	(21,651)	(21,651)
Dividends	21	-	-	-	-	-
Total transactions with owners recognised directly in equity		-	-	-	-	-
Balance as at 31 March 2020		26,506	1,400	30,150	128,918	186,974
Balance as at 1 April 2020		**26,506**	**1,400**	**30,150**	**128,918**	**186,974**
Loss for the year		-	-	-	**(51,278)**	**(51,278)**
Other comprehensive income		-	-	-	**(26,051)**	**(26,051)**
Total comprehensive loss		-	-	-	**(77,328)**	**(77,328)**
Issuance of share capital	**14**	**4,000**	-	-	**-**	**4,000**
Dividends	**21**	-	-	-	**(1,000)**	**(1,000)**
Total transactions with owners recognised directly in equity		**4,000**	-	-	**(1,000)**	**3,000**
Balance as at 31 March 2021		**30,506**	**1,400**	**30,150**	**50,589**	**112,645**

The notes on pages 151 to 201 are an integral part of these financial statements.

Statutory Financial Statements

Statutory Financial Statements continued

Statement of cash flows for the year ended 31 March 2021
(Registered Number 02546950)

	Note	2021 £000	2020 £000
Cash flows from operating activities			
Cash generated from operations	22.1	**100,512**	110,116
Interest paid		**(35,899)**	(35,336)
Tax paid		**377**	(2,175)
Group relief paid		**-**	(63)
Net cash generated from operating activities excluding capital contributions		**64,990**	72,542
Capital contributions		**56,407**	57,690
Net cash inflow from operating activities		**121,397**	130,232
Cash flows from investing activities			
Investment in short-term deposits		**10,070**	(10,153)
Purchases of property, plant and equipment		**(125,779)**	(122,386)
Proceeds from sale of property, plant and equipment		**1,061**	1,630
Purchases of intangible assets		**(13,487)**	(7,469)
Interest received		**6,548**	962
Net cash outflow from investing activities		**(121,587)**	(137,416)
Cash flows from financing activities			
Principal elements of lease payments	17	**(3,631)**	(3,711)
Issuance of share capital	14	**4,000**	-
Dividends paid	21	**(1,000)**	-
Net cash outflow from financing activities		**(631)**	(3,711)
Net decrease in cash and cash equivalents		**(821)**	(10,895)
Cash and cash equivalents at the beginning of the year		**85,587**	96,482
Cash and cash equivalents at end of year	13	**84,766**	85,587

The notes on pages 151 to 201 are an integral part of these financial statements.

Accounting policies

BASIS OF PREPARATION

These financial statements have been prepared under the historical cost convention modified by revaluation of financial assets and financial liabilities held at fair value through profit and loss and in accordance with the Companies Act 2006 and Financial Reporting Standard 101: 'Reduced disclosure framework' ('FRS 101') as issued by the Financial Reporting Council. Under FRS 101, the company applies the recognition and measurement requirements of EU-adopted International Financial Reporting Standards ('IFRS') but makes amendments where necessary in order to comply with the Companies Act 2006 and The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410).

GOING CONCERN

The directors consider it appropriate to adopt the going concern basis of accounting in preparing the financial statements as the company has adequate resources to meet its current operational and financial obligations, and the directors have a reasonable expectation that this will continue for the foreseeable future. This is based on assessment of the principal risks of the company and the other matters discussed in connection with the viability statement on page 50 as well as consideration of the company's budgeted cash flows, short and long term forecasts and ability to generate future revenues, related assumptions and available debt facilities.

Whilst the current economic environment as a result of COVID-19 is clearly challenging, the company has put in place suitable mitigating actions to ensure that even under a severe but plausible downside scenario, the company is not forecasting any covenant breaches.

To assess the severe but plausible downside scenario, management have considered a base case scenario that reflects the current market conditions under the pandemic and have applied a series of severe downside assumptions including a reduction in revenue and an increase in bad debt as a result of the pandemic. Management also considered the impact of a severe cold weather event over the winter period and a further increase in operating expenditure. The base case has taken into consideration the impact of COVID-19 on the company, reflecting that the pandemic has impacted non-household and household revenues, with only the latter adjusted for as part of the revenue adjustment mechanism. The pandemic also increased our adverse bad debt projections and customer collections and reprofiled capital expenditure from projects delayed during the first year of AMP7.

Due to the nature of the regulated water company's business, the directors consider it appropriate to place reliance on projected financials.

PRINCIPAL ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these financial statements are set out in note A3. These policies have been consistently applied to all the periods presented, unless otherwise stated.

ADOPTION OF NEW AND REVISED STANDARDS

No new standards became applicable for the current reporting period.

The following standards have been revised, although the amendments listed did not have any impact on the amounts recognised in prior periods and are not expected to materially affect the current or future periods:

- Definition of Material – amendments to IAS 1 and IAS 8;
- Definition of a Business – amendments to IFRS 3;
- Interest Rate Benchmark Reform – amendments to IFRS 9, IAS 39 and IFRS 7; and
- Revised Conceptual Framework for Financial Reporting.

NEW STANDARDS, AMENDMENTS AND INTERPRETATIONS NOT YET ADOPTED

In April 2021, the IFRS Interpretations Committee ('IFRIC') agenda decision on the treatment of configuration and customisation costs in a cloud computing arrangement was ratified by the International Accounting Standards Board. The company is currently working through the implications of this guidance and will include any adjustments relating to the treatment of costs associated with cloud computing arrangements in the financial statements for the year ending 31 March 2022, expecting to move these from capitalised costs to expensed items.

There are no other new standards and interpretations, which are not yet effective and have not been early adopted by the company, that will have a material effect on future years.

Statutory Financial Statements continued

Accounting policies (continued)

DISCLOSURE EXEMPTIONS

As permitted by FRS 101, the company has taken advantage of the following disclosure exemptions available under that standard in the preparation of these financial statements:

- Paragraph 38 of IAS 1: 'Presentation of financial statements' comparative information requirements in respect of:
  - paragraph 79(a)(iv) of IAS 1: 'Presentation of financial statements';
  - paragraph 73(e) of IAS 16: 'Property, plant and equipment'; and
  - paragraph 118(e) of IAS 38: 'Intangible assets' (reconciliations between the carrying amount at the beginning and end of the period)
- The following paragraphs of IAS 1: 'Presentation of financial statements':
  - 16 (statement of compliance with all IFRS); and
  - 38B-D (additional comparative information)
- Paragraph 17 of IAS 24: 'Related party disclosures' (key management compensation)
- The requirements in IAS 24: 'Related party disclosures' to disclose related party transactions entered into between two or more members of a group.

PRIOR YEAR RESTATEMENTS AS A RESULT OF ERROR AND CHANGE IN PRESENTATION

Staff costs capitalised in prior year in disclosure note 3 have been restated as a result of a change in reporting methodology used following the implementation of a new ERP system and the availability of more detailed data. This restatement has not had an impact on the income statement or statement of financial position, nor any other note in these financial statements, except for note 2.1.

CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in conformity with FRS 101 requires the use of certain critical accounting estimates.

Estimates are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The company makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

Measured income accrual

The company records an accrual for measured consumption of water that has not yet been billed (refer to note 12). The accrual is estimated using a defined methodology based upon weighted average water consumption by tariff, which is calculated based upon historical information. Revenue for the year ended 31 March 2020 included a measured income accrual of £36,282,000. The value of billing recognised in the year ended 31 March 2021 for consumption in the prior year was £36,018,000. This resulted in a decrease of £264,000 in the current year's revenue due to the over-estimation of the prior year's revenue. This represented 0.09% of 2020/21 revenue and is within acceptable tolerance for accounting estimates.

Non-household wholesale revenue

The company has contracts with third parties operating in the non-household retail market for the supply of clean water (wholesale supply). The underlying performance obligation is the development and maintenance of the network, and ensuring its continued availability to such third party retailers on behalf of non-household consumers. Revenue is recognised at the point at which the company has a right to receive the revenue. For non-household retailers, the amount which the company has a right to receive is determined by non-household consumption volume data.

As a result of changing consumption levels due to the COVID-19 pandemic, we have used DI (distribution input) figures to estimate non-household consumption and have recognised revenue on this basis.

Loss allowance of trade receivables and contract assets

The company makes an estimate of the recoverable value of trade receivables and contract assets and records a loss allowance based on experience (refer to note 12). This provision is based on, amongst other things, a consideration of actual collection history. At each reporting date, the company takes into consideration any significant economic changes that may impact its credit loss model and future credit losses and resultantly has accounted for an additional bad debt charge given the COVID-19 health pandemic. This was calculated by applying an additional loss allowance provision to each segment of our customer base, based on the likely impact to that segment of the pandemic. The actual level of receivables collected may differ from the estimated levels of recovery, which could impact operating results positively or negatively. A 2% increase in the loss allowance for trade receivables and contract assets would result in an additional bad debt charge of £682,000 (2020: £691,000) and a corresponding reduction in net assets. A 2% decrease in the loss allowance for trade receivables and contract assets would result in a reduction in the bad debt charge of £682,000 (2020: £691,000) and corresponding increase in net assets.

Useful economic lives of property, plant and equipment

The annual depreciation charge for property, plant and equipment is sensitive to changes in the estimated useful economic lives and residual values of the assets. The useful economic lives and residual values are re-assessed annually. They are amended when necessary to reflect current estimates, based on management's judgement and experience, which include the knowledge and research of the company's dedicated asset management teams. Refer to note 6 for the carrying amount of property, plant and equipment and note A3 for the useful economic lives for each class of assets.

Based on the current useful lives, the carrying amount of property, plant and equipment at 31 March 2021 is £1,540,949,000 (2020: £1,479,039,000). If the useful lives of the assets were 10% shorter, the carrying amount would instead be £1,104,713,000 (2020: £1,087,417,000) and if they were 10% longer, the carrying amount would be £1,657,069,000 (2020: £1,631,125,000).

Based on the current useful lives, the carrying amount of intangible assets, excluding goodwill, at 31 March 2021 is £33,717,000 (2020: 30,807,000). If the useful lives of the assets were 10% shorter, the carrying amount would instead be £29,666,000 (2020: £26,625,000) and if they were 10% longer, the carrying amount would be £37,768,000 (2020: £34,990,000).

The above estimates have been calculated using the average useful life for each class of asset and assumes that the assets in each category are midway through their useful life.

Defined benefit pension plan

The company has an obligation to pay pension benefits to certain employees. The cost of these benefits and the present value of the obligation depend on a number of factors, including life expectancy, inflation, salary increases, asset valuations and the discount rate on corporate bonds. Management estimates these factors in determining the net pension obligation in the statement of financial position. The assumptions (refer to note A5) reflect historical experience and current trends and may differ from actual results due to changing market and economic conditions and longer or shorter lives of participants. There are no restrictions to the realisability of the surplus relating to the defined benefit section of the pension plan; therefore no adjustment has been made to the retirement benefit surplus recognised in accordance with International Financial Reporting Interpretations Committee 14: 'The limit on a defined benefit asset, minimum funding requirements and their interaction'. A sensitivity analysis has been performed based on changing different assumptions – see note A5 for the impact of changes in assumptions used.

Statutory Financial Statements continued

Accounting policies (continued)

CRITICAL ACCOUNTING JUDGEMENTS IN APPLYING THE ENTITY'S ACCOUNTING POLICIES

The preparation of financial statements also requires management to exercise its judgement in the process of applying the company's accounting policies. The areas involving a higher degree of judgement or complexity are disclosed below.

Revenue recognition

IFRS 15 requires revenue to be recognised in line with the satisfaction of performance obligations identified within contracts between an entity and its customers, at an amount that reflects the transaction price allocated to each performance obligation. Particular challenges exist within the water industry as formal written contracts do not exist for most transactions with customers. Contracts are instead implied through statute and regulation. Judgement is therefore required in identifying the services contained within the contract and the customer with whom the contract is entered into, which in turn impacts on how the performance obligations are considered and therefore revenue recognised.

Refer to note 1 for the amount of revenue recognised in the income statement.

Grants and contributions

Grants and contributions (consisting of contributions for diversions and requisitioned mains/extensions, and infrastructure charges) are received in respect of property, plant and equipment. Judgement is required in identifying what the performance obligation is for each type of contribution, which in turn impacts on how revenue is recognised.

Contributions received in respect of diversions, requisitioned mains/extensions and infrastructure charges are recognised over a period of time. Contributions received in respect of connections charges are recognised immediately in the income statement. Refer to note A3 for more further detail on our accounting policies in relation to these. Refer to note 1 for the amount of revenue recognised in the income statement.

Included within grants and contributions are contributions received relating to the HS2 rail programme, which crosses our supply area. These are shown within capital contributions in the statement of cash flows.

Cost capitalisation

The company capitalises expenditure on its infrastructure assets to property, plant and equipment where such expenditure enhances or increases the capacity of the network, or relates to material replacements of network components. Any expenditure classed as maintenance is expensed in the period it is incurred.

Distinguishing between enhancement and maintenance expenditure is a subjective area, particularly when projects have both elements within them. Refer to note 6 for the carrying amount of property, plant and equipment.

Notes to the financial statements

1. REVENUE

1.1 Disaggregation of revenue from contracts with customers

	2021 £000	2020 £000
Timing of revenue recognition – at a point in time		
Unmeasured supplies	**96,981**	106,577
Measured supplies	**144,124**	137,426
Non-household wholesale revenue	**34,732**	50,015
Connection charges	**7,904**	10,076
Chargeable services	**-**	45
	283,741	304,139
Timing of revenue recognition – over time		
Requisitioned mains/extensions	**576**	576
Diversions	**1,201**	1,375
Infrastructure charges	**1,111**	992
Other	**153**	158
	3,041	3,101
	286,782	307,240

All revenue is derived in the United Kingdom.

1.2 Assets and liabilities related to contracts with customers

The company has recognised the following assets and liabilities related to contracts with customers:

	31 March 2021 £000	31 March 2020 £000	1 April 2019 £000
Net trade receivables	**24,505**	26,868	28,010
Contract assets			
Unbilled accrual for metered customers – household customers	**36,742**	36,013	32,392
Unbilled accrual for metered customers – non-household customers	**2,710**	3,137	-
Contract liabilities			
Payments received in advance – household water supplies	**41,217**	39,191	36,147
Payments received in advance – non-household water supplies	**2,948**	254	-
Deferred income – water supplies	**138**	72	3,122
Deferred income – other	**1,004**	1,605	2,049
Deferred grants and contributions	**154,175**	134,933	117,894
Payments received in advance – grants and contributions	**108,100**	77,577	35,685

'Payments received in advance – grants and contributions' in the table above relate to contributions received from developers where the asset is still work in progress and not yet being depreciated. Once the asset is complete, the contribution is moved from 'payments received in advance – grants and contributions' to 'deferred grants and contributions' and amortised, to ensure the accounting treatment is consistent.

Statutory Financial Statements continued

Notes to the financial statements (continued)

1. REVENUE (CONTINUED)

1.2 Assets and liabilities related to contracts with customers (continued)

Significant changes in contract assets and liabilities

Up to 31 March 2021, the company had been reimbursed £128,376,000 (2020: £79,123,000) for its costs incurred in relation to the HS2 rail project, which will cross the Affinity Water supply area. During the year, in line with the company's accounting policy for grants and contributions received in respect of property, plant and equipment, which include contributions received for diversions, £14,621,000 (2020: £13,408,000) relating to costs for assets that have been commissioned was reclassified from payments in advance – grants and contributions to deferred grants and contributions. At 31 March 2021, £91,916,000 (2020: £55,205,000) of payments received were included in payments in advance – grants and contributions.

Recognition of trade receivables, contract assets and contract liabilities

For metered customers, a receivable is recognised when the customer is billed for the usage. At this point, the consideration is unconditional because only the passage of time is required before the payment is due. Where the company has provided the service before payment is due, an accrual for the consumption of water that has not yet been billed is recognised in the income statement and the company discloses this as a contract asset in the statement of financial position (see table on the previous page).

Where the company has not provided the service before payment is due, deferred income is recognised and the company discloses this as a contract liability in the statement of financial position (see table on the previous page).

For unmetered customers, the customer pays a fixed amount determined by the transaction prices set out in the company's charging scheme and tariff documents. If the payments received exceed the amount the company has the right to receive, the company recognises a payment received in advance and discloses this as a contract liability in the statement of financial position (see table on the previous page).

Some non-household retailers are billed monthly in advance for wholesale charges determined by billing/volume reports created by the market operator. The company recognises deferred income in relation to these accounts and presents this as a contract liability within payables. Where the company has not provided the service before payment is due, deferred income is recognised and the company discloses this as a contract liability in the statement of financial position (see table on the previous page).

As a result of changing consumption levels due to the COVID-19 pandemic, we have used DI (distribution input) figures to estimate non-household consumption and have recognised revenue on this basis.

Developers are billed for connection charges and contributions towards diversions and requisitioned mains/extensions in advance of work being performed by the company. The company recognises these payments as being received in advance and discloses them as contract liabilities in the statement of financial position (see table on the previous page).

Developers are billed for infrastructure charges once the connection has been completed; a trade receivable is immediately recognised at this point as the consideration is unconditional. These receivables are included in net trade receivables in the table on the previous page.

The company does not incur any costs to obtain or fulfil contracts that would be recognised as an asset under IFRS 15.

Revenue recognised in relation to contract liabilities

The following table sets out how much of the revenue recognised in the current reporting period relates to carried forward contract liabilities and how much relates to performance obligations that were satisfied in a prior year:

	2021 £000	2020 £000
Revenue recognised that was included in the contract liability balance at the beginning of the year		
Payments received in advance – household water supplies	**39,191**	36,147
Payments received in advance – non-household water supplies	**254**	-
Deferred income – water supplies	**72**	3,280
Deferred income – other	**434**	1,208
Deferred grants and contributions	**3,041**	3,101
Payments received in advance – grants and contributions	**11,320**	9,027
Revenue recognised from performance obligations satisfied in previous years		
Unbilled accrual for metered customers – household customers	**(264)**	592

Revenue expected to be derived from unsatisfied performance obligations

IFRS 15 requires the disclosure of the aggregate amount of revenue which is expected to be derived from performance obligations which are unsatisfied as at the end of the reporting period, i.e. the aggregate amount of future revenues from existing ongoing contracts.

The company has applied the practical expedient, set out in paragraph 121(a) of IFRS 15, not to disclose this amount in relation to water charges as the performance obligation is part of a contract that has an original expected duration of one year or less.

The unbilled accrual for measured income is a contract asset under IFRS 15. Historical information has proved to be an accurate indicator of current consumption and therefore the company deems it reasonable to conclude that the measured income accrual is materially correct.

At 31 March 2021, £154,175,000 (2020: £134,933,000) of grants and contributions is expected to be derived from performance obligations which were unsatisfied at the end of the reporting period.

Statutory Financial Statements continued

Notes to the financial statements (continued)

2. OPERATING PROFIT

2.1 Operating costs

The following items have been charged/(credited) to either cost of sales or administrative expenses in the income statement:

	2021 £000	2020 (restated) £000
Staff costs (note 3.1)	**55,189**	60,238
Profit on disposal of property, plant and equipment	**(1,061)**	(1,630)
Loss on disposal of infrastructure assets	**1,408**	1,262
Loss on disposal of intangible assets	**-**	12
Purchase of bulk water and water supplied under statutory entitlement	**10,255**	7,960
Water abstraction charges	**3,984**	3,791
Business rates	**15,448**	15,382
Chargeable services direct expenditure	**282**	444
Depreciation of infrastructure assets (note 6)	**14,868**	11,751
Depreciation of other property, plant and equipment (note 6)	**49,928**	51,640
Depreciation of right-of-use assets (note 7)	**3,684**	3,859
Amortisation of intangible assets (note 8)	**10,577**	9,190
Impairment of trade receivables and contract assets (note 12)	**8,318**	9,470
Research and development	**126**	114
Short-term lease rentals	**115**	10
Low-value lease rentals	**91**	44
Auditors' remuneration (note 2.3)	**421**	555
Cost of inventories used	**714**	1,106

Staff costs have been restated from the £64,476,000 reported in prior year. Refer to note 3.1 for more details.

2.2 Other operating income

	2021 £000	2020 £000
Timing of revenue recognition – at a point in time		
Commission and rentals	**17,657**	18,449

The majority of other income relates to commission earned by the company from billing and collecting charges in respect of sewerage and infrastructure within its area on behalf of Thames Water and Anglian Water (refer to note 24).

2.3 Auditors' remuneration

During the year the company obtained the following services from its auditor and its associates:

	2021 £000	2020 £000
Fees payable to the company's auditor and its associates for the audit of the financial statements	**205**	180
Fees payable to the company's auditor and its associates for other services:		
Audit of the company's associates	**99**	113
Audit-related assurance services		
– regulatory reporting	**56**	59
– Thames Water and Anglian Water annual returns	**10**	9
– audit related assurance service - other	**38**	36
Other assurance services including services related to bond issue	**6**	38
Other non-audit services	**7**	120
Total auditors' remuneration	**421**	555

3. EMPLOYEES

3.1 Employee benefit expense (including executive directors)

	2021 £000	2020 (restated) £000
Wages and salaries	**59,742**	60,390
Social security costs	**6,168**	6,007
Other pension costs	**8,223**	8,609
Staff costs	**74,133**	75,005
Staff costs capitalised	**(18,944)**	(14,767)
Staff costs recognised in the income statement	**55,189**	60,238

Staff costs capitalised in 2020 have been restated from the £10,529,000 reported in prior year as a result of a change in reporting methodology used following the implementation of a new ERP system and the availability of more detailed data. This restatement has not had an impact on the income statement or statement of financial position, nor any other note in these financial statements, except for note 2.1.

3.2 Average number of people employed

The average monthly number of full-time equivalent persons (including executive directors) employed by the company during the year was:

By activity	2021 Number	2020 Number
Operations	**760**	776
Customer service	**240**	266
Administration	**262**	254
	1,262	1,296

Statutory Financial Statements continued

Notes to the financial statements (continued)

3. EMPLOYEES (CONTINUED)

3.3 Directors' remuneration

Directors' emoluments were as follows:

	2021 £000	2020 £000
Aggregate emoluments	**1,390**	1,686

Aggregate amounts receivable under long-term incentive schemes were £283,000 (2020: £nil), not included within aggregate emoluments above. The total of £283,000 relates to the 2018/19 LTIP scheme, which vested in the year ended 31 March 2021 and will be paid in three equal instalments in the years ending 31 March 2022, 31 March 2023 and 31 March 2024.

Neither the company nor its immediate parent entities has any listed shares and so the directors have not been offered any share incentives.

The non-executive directors who were appointed by Allianz Capital Partners on behalf of the Allianz group, DIF and InfraRed Capital Partners Limited on behalf of HICL Infrastructure plc did not receive any emoluments from the company, or any company within the Affinity Water group.

Highest paid director

The highest paid director's emoluments were as follows:

	2021 £000	2020 £000
Aggregate emoluments	**576**	876

Aggregate amounts receivable under long-term incentive schemes were £206,000 (2020: £nil), not included within aggregate emoluments above. The total of £206,000 relates to the 2018/19 LTIP scheme, which vested in the year ended 31 March 2021 and will be paid in three equal instalments in the years ending 31 March 2022, 31 March 2023 and 31 March 2024.

The company made £55,000 of contributions to a pension plan in respect of the highest paid director's qualifying services during the year (2020: £72,000). The highest paid director did not hold any share options during the year.

Further information regarding directors' remuneration during the year can be found within the remuneration report on pages 111 to 125.

4. FINANCE INCOME AND COSTS

	2021 £000	2020 £000
Finance income		
Bank interest income	**213**	954
Net interest receivable on RPI linked inflation swap	**6,792**	4,950
Net interest receivable on CPI linked inflation swap	**6,297**	-
Net income from post-employment benefits	**2,468**	2,487
	15,770	8,391
Finance costs		
Interest payable on borrowings held at amortised cost from parent company	**(160)**	(160)
Interest payable on borrowings held at amortised cost from subsidiary undertakings	**(37,510)**	(37,458)
Accretion payable in respect of interest on loans from subsidiary undertakings	**(5,254)**	(10,202)
Accretion payable on financial instrument	**(4,564)**	(3,357)
Interest payable on lease liabilities	**(315)**	(383)
Other	**(818)**	(484)
	(48,621)	(52,044)
Fair value loss on financial instrument	**(44,218)**	(1,816)
Net finance costs	**(77,069)**	(45,469)

5. INCOME TAX (CREDIT)/EXPENSE

5.1 Income tax (credit)/expense included in the income statement

	2021 £000	2020 £000
Current tax:		
– UK corporation tax on (losses)/profits for the year	**-**	3,553
– Adjustment in respect of prior years	**(830)**	(1,457)
Total current tax	**(830)**	2,096
Deferred tax		
– Origination and reversal of temporary differences	**(11,812)**	(2,452)
– Impact of change in tax rate	**-**	20,910
– Adjustment in respect of prior years	**420**	1,219
Total deferred tax	**(11,392)**	19,677
Income tax (credit)/expense	**(12,222)**	21,773

Tax credit assessed for the period is slightly higher (2020: tax expense significantly higher) than the standard rate of corporation tax in the UK for the year ended 31 March 2021 of 19% (2020: 19%). The differences are explained below:

	2021 £000	2020 £000
(Loss)/profit before tax	**(63,500)**	91
Tax calculated at the standard rate of tax in the UK of 19% (2020: 19%)	**(12,065)**	17
Tax effects of:		
– Adjustments in respect of prior years	**(410)**	(238)
– Expenses not deductible for tax purposes	**253**	1,084
– Impact of change in tax rate on deferred tax	**-**	20,910
Income tax (credit)/expense	**(12,222)**	21,773

Statutory Financial Statements continued

Notes to the financial statements (continued)

5. INCOME TAX (CREDIT)/EXPENSE (CONTINUED)

5.2 Income tax (credit)/expense included in the statement of comprehensive income

	2021 £000	2020 £000
Deferred tax:		
- Origination and reversal of temporary differences on retirement benefit surplus	**(6,111)**	7

5.3 Factors that may affect future tax charges

In September 2016, changes were enacted to the main rate of corporation tax in the UK to reduce it from 19% to 17% effective from 1 April 2020.

In the Spring Budget 2020, the Government announced that from 1 April 2020 the Corporation Tax rate would remain at 19% (rather than reducing to 17%, as previously enacted). This new law was substantively enacted on 17 March 2020.

In the Spring Budget 2021, the Government announced that from 1 April 2023 the Corporation Tax rate will increase to 25%. As this proposal had not been substantively enacted at the balance sheet date, its effects are not included in these financial statements.

5.4 Reconciliation of current and deferred tax charge

	2021 £000	2021 %	2020 £000	2020 %
(Loss)/profit before tax	**(63,500)**		91	
Tax on profit on ordinary activities at standard UK tax rate of 19% (2020: 19%)	**(12,065)**	**19%**	17	19%
Tax effect of:				
Depreciation in excess of capital allowances	**12,490**	**(20%)**	4,022	4,419%
Pension movements	**(394)**	**1%**	(644)	(708%)
Increase in provisions	**(29)**	**0%**	103	114%
Expenses not deductible for tax purposes	**(2)**	**0%**	55	60%
Adjustment to tax charge in respect of prior years	**(830)**	**1%**	(1,457)	(1,600%)
Reported current tax charge and effective rate	**(830)**	**1%**	2,096	2,305%
Depreciation in excess of capital allowances	**(12,235)**	**19%**	(2,937)	(3,227%)
Increase in provisions	**29**	**0%**	(92)	(101%)
Pension movements	**394**	**(1%)**	576	633%
Impact of change in tax rate on deferred tax	**-**	**0%**	20,910	22,978%
Adjustments to tax charge in respect of prior years	**420**	**(1%)**	1,219	1,341%
Reported deferred tax charge and effective rate	**(11,392)**	**18%**	19,677	21,624%
Total tax charge and effective rate	**(12,222)**	**19%**	21,773	23,929%

Impact of change in tax rate

In the 2020 Spring Budget the Government announced that the Corporation Tax rate would remain at 19% from 1 April 2020, rather than reducing to 17% as had been previously announced. The deferred tax liability at 31 March 2020 was recalculated at 19%, resulting in an additional deferred tax charge of £20,910,000 in the prior year.

All other significant adjustments to taxable profits for the year ended 31 March 2021 are timing differences. These will reverse in future years, so a higher tax charge in 2020/210 will result in a lower tax charge in a later year and vice versa. The impact on the tax charge in future years is reflected in the deferred tax account.

The proposal to increase the Corporation Tax rate to 25% had not been substantively enacted at the balance sheet date, therefore its effects have not been included in these financial statements. Had it been substantively enacted, its overall effect would have resulted in an additional deferred tax charge in the income statement of approximately £57,120,000, with an equivalent increase to the deferred tax liability.

Depreciation in excess of capital allowances

The tax relief on our infrastructure assets is different from the depreciation of these assets in the accounts (although over the total life of the assets the two amounts will be equal). In 2020/21 the amount written off for tax purposes was lower than the depreciation in the accounts, resulting in a higher tax charge for the year.

Pension movements

Tax relief is given for the amount actually paid into the company's pension plan in the year, not the amount charged in the accounts. In 2020/21 the amount paid into the pension plan was higher than the amount charged in the accounts, resulting in a lower tax charge for the year.

Provisions movements

Some provisions charged in the accounts are not deductible until the amounts provided are actually paid. Taxable profits in 2020/21 have been reduced by payments made in respect of provisions charged in previous years.

Expenses not deductible for tax purposes

These will not reverse in future years, therefore the increase in the tax charge is permanent. Permanent disallowable expenses include fines, business entertaining and certain legal fees.

A penalty that was previously disallowed for tax purposes has been written back in the 2020/21 accounts. The amount written back is not taxable, and this has resulted in a decrease in taxable profits for the year.

Adjustment to tax charge in respect of prior years

The tax provision in the accounts is a best estimate at the time. The estimate is corrected when the tax returns are finalised and submitted to HMRC 12 months after the year-end. The correction made to the tax return for the year ended 31 March 2020 resulted in a lower tax charge, mainly as a result of claiming capital allowances.

Statutory Financial Statements continued

Notes to the financial statements (continued)

6. PROPERTY, PLANT AND EQUIPMENT

	Land, buildings and operational structures £000	Potable water distribution mains £000	Raw water pipes £000	Fixed plant £000	Vehicles and mobile plant £000	Assets in course of construction £000	Total £000
Cost or deemed cost							
At 1 April 2020	305,242	862,843	22,779	844,979	83,049	119,768	**2,238,660**
Additions	-	-	-	-	-	128,114	**128,114**
Transfers	3,237	43,081	-	40,398	1,108	(87,824)	**-**
Disposals	-	(1,541)	(14)	-	-	-	**(1,555)**
At 31 March 2021	308,479	904,383	22,765	885,377	84,157	160,058	**2,365,219**
Accumulated depreciation							
At 1 April 2020	(96,789)	(65,808)	(1,998)	(561,984)	(33,042)	-	**(759,621)**
Charge for the year	(4,507)	(14,547)	(321)	(40,598)	(4,823)	-	**(64,796)**
Disposals	-	146	1	-	-	-	**147**
At 31 March 2021	(101,296)	(80,209)	(2,318)	(602,582)	(37,865)	-	**(824,270)**
Net book amount							
At 1 April 2020	208,453	797,035	20,781	282,995	50,007	119,768	**1,479,039**
Movement in year	(1,270)	27,139	(334)	(200)	(3,715)	40,290	**61,910**
At 31 March 2021	207,183	824,174	20,447	282,795	46,292	160,058	**1,540,949**

All land and buildings are held as freehold.

7. RIGHT-OF-USE ASSETS

	Buildings £000	Vehicles £000	Other £000	Total £000
Cost				
At 1 April 2020	9,079	6,789	402	**16,270**
Additions	-	756	-	**756**
Disposals	-	(24)	-	**(24)**
At 31 March 2021	9,079	7,521	402	**17,002**
Accumulated depreciation				
At 1 April 2020	(1,397)	(2,207)	(230)	**(3,834)**
Charge for the year	(1,397)	(2,115)	(172)	**(3,684)**
Disposals	-	24	-	**24**
At 31 March 2021	(2,794)	(4,298)	(402)	**(7,494)**
Net book amount				
At 1 April 2020	7,682	4,582	172	**12,436**
Movement in year	(1,397)	(1,359)	(172)	**(2,928)**
At 31 March 2021	6,285	3,223	-	**9,508**

8. INTANGIBLE ASSETS

	Goodwill £000	Computer software development costs £000	Total £000
Cost			
At 1 April 2020	14,961	76,805	**91,766**
Additions	-	13,487	**13,487**
At 31 March 2021	14,961	90,292	**105,253**
Accumulated amortisation			
At 1 April 2020	-	(45,998)	**(45,998)**
Charge for the year	-	(10,577)	**(10,577)**
At 31 March 2021	-	(56,575)	**(56,575)**
Net book amount			
At 1 April 2020	14,961	30,807	**45,768**
Movement in year	-	2,910	**2,910**
At 31 March 2021	14,961	33,717	**48,678**

Goodwill includes £8,283,000 relating to the unification of the Affinity Water group's regulated businesses on 27 July 2012. The remaining balance of £6,678,000 relates to goodwill arising from the acquisition of the trade and assets of North Surrey Water Limited on 1 October 2000.

Affinity Water Limited is the only cash generating unit ('CGU') due to the fact it constitutes the smallest identifiable group of assets that generate cash inflows for the entity, by means of supplying drinking water to customers. The recoverable amount has been determined using the RCV of Affinity Water Limited at 31 March 2021. Per management's assessment it has been determined that the headroom is such that no reasonable change in any key assumptions is expected to result in impairment of the goodwill recognised.

Included in the computer software asset category above is £13,461,000 of capitalised intangible assets under construction, which is not amortised. £9,921,000 of intangible projects under construction were completed in the year, and amortisation was charged as at the point in time that the software became fit for purpose and ready to use.

There were individually material computer software development costs in the year ended 31 March 2021 of £2,148,000 (2020: £1,192,000) for the implementation of a new ERP system.

The company is currently working through the implications of the IFRIC agenda decision on the treatment of configuration and customisation costs in a cloud computing arrangement. The company has capitalised costs relating to cloud computing arrangements, and these are currently included within computer software development costs in the table above.

9. INVESTMENTS

	2021 £000	2020 £000
Non-current assets Investments in subsidiaries (refer to note A6)	**100**	100
Current assets Short-term deposits	**15,132**	25,202

The directors confirm that the carrying value of the investments is supported by their underlying net assets.

Statutory Financial Statements continued

Notes to the financial statements (continued)

10. RETIREMENT BENEFIT SURPLUS

Defined benefit section

The net pension expense before taxation recognised in the income statement in respect of the defined benefit plan is:

	2021 £000	2020 £000
Total current service cost of the Affinity Water Pension Plan	**(3,310)**	(3,952)
Contributions from participating employer	**51**	92
Past service cost	**(31)**	(148)
Pension expense charged to operating profit	**(3,290)**	(4,008)
Net pension interest income credited to finance income (note 4)	**2,468**	2,487
Net pension expense charged before taxation	**(822)**	(1,521)

The opening and closing retirement benefit surpluses included in the statement of financial position are summarised as follows:

	2021 £000	2020 £000
At 1 April	**104,619**	101,194
Principal employer contributions	**2,897**	4,908
Net current service cost (per above)	**(3,259)**	(3,860)
Past service cost	**(31)**	(148)
Net interest income	**2,468**	2,487
Net re-measurement (loss)/gain	**(32,162)**	38
At 31 March	**74,532**	104,619

Re-measurement gains and losses are recognised directly in the statement of comprehensive income and are summarised as follows:

	2021 £000	2020 £000
Re-measurement gains/(losses) on plan assets	**40,649**	(18,556)
Re-measurement (losses)/gains on plan liabilities	**(72,811)**	18,594
	(32,162)	38

Further analysis and underlying valuation assumptions of the defined benefit plan are provided in note A5.

11. INVENTORIES

	2021 £000	2020 £000
Raw materials and consumables	**4,080**	3,017

Inventories are stated after provisions for impairment of £364,000 (2020: £538,000).

12. TRADE AND OTHER RECEIVABLES

	2021 £000	2020 £000
Non-current:		
Other receivables	**184**	2,300
Current:		
Trade receivables	**58,532**	61,453
Less: loss allowance for trade receivables	**(34,027)**	(34,585)
	24,505	26,868
Interest receivable from external parties	**7,630**	5,051
Other receivables	**4,868**	5,411
Unbilled accrual for metered customers	**39,452**	39,150
Prepayments and accrued income	**7,746**	5,619
	84,201	82,099

Trade receivables that were fully provided for were sold in the year, resulting in a reduction to trade receivables of £2,213,000 and a corresponding reduction in the loss allowance for trade receivables.

The carrying amounts of trade and other receivables approximate to their fair value.

12.1 Loss allowance for trade receivables and contract assets

Trade receivables and contract assets do not carry interest and are stated net of a loss allowance, as follows:

	Trade receivables		Unbilled accrual for metered customers		Total	
	2021 £000	2020 £000	2021 £000	2020 £000	2021 £000	2020 £000
At 1 April	**34,585**	27,796	**269**	307	**34,854**	28,103
Provision for receivables impairment charged to income statement	**8,536**	9,508	**(218)**	(38)	**8,318**	9,470
Sale of trade receivables that were fully provided for	**(2,213)**	-	**-**	-	**(2,213)**	-
Receivables written off during the year as uncollectable	**(6,881)**	(2,719)	**-**	-	**(6,881)**	(2,719)
At 31 March	**34,027**	34,585	**51**	269	**34,078**	34,854

See note A4 for details of the nature and the calculation of the loss allowance.

£2,346,000 (2020: £1,680,000) of the £8,318,000 (2020: £9,470,000) total provision for receivables impairment charged to the income statement in the year is an additional charge arising as a result of COVID-19.

Statutory Financial Statements continued

Notes to the financial statements (continued)

12. TRADE AND OTHER RECEIVABLES (CONTINUED)

12.2 Ageing analysis of trade receivables

The aged analysis of receivables at the reporting date is as follows:

	2021 £000	2020 £000
Aged less than one year	**22,406**	23,697
Aged between one year and two years	**23,471**	23,610
Aged greater than two years	**12,655**	14,146
	58,532	61,453

13. CASH AND CASH EQUIVALENTS

	2021 £000	2020 £000
Cash at bank and in hand	**43,650**	28,368
Term deposits	**41,116**	57,219
	84,766	85,587

The carrying amounts of cash and cash equivalents approximate to their fair value.

14. SHARE CAPITAL, SHARE PREMIUM AND CAPITAL CONTRIBUTION RESERVE

Allotted and fully paid up	Number of shares (thousands)	Ordinary shares of £0.10 each (£000)	Share premium (£000)	Capital contribution reserve (£000)	Total (£000)
At 1 April 2020	265,058	26,506	1,400	30,150	**58,056**
Issuance of ordinary shares	40,000	4,000	-	-	**4,000**
At 31 March 2021	305,058	30,506	1,400	30,150	**62,056**

All shares rank pari passu in all respects.

In March 2021, the company issued 40,000,000 shares of £0.10 each, increasing its ordinary share capital by £4,000,000 to £30,506,000.

15. TRADE AND OTHER PAYABLES

	2021 £000	2020 £000
Non-current		
Amounts falling due after more than one year:		
Deferred grants and contributions	**10,286**	10,187
Amounts falling due after more than five years:		
Deferred grants and contributions	**140,520**	122,507
	150,806	132,694
Current		
Amounts falling due within one year:		
Trade payables	**23,678**	9,544
Amounts due to group undertakings	**537**	389
Interest payable to subsidiary companies	**13,858**	13,850
Commitment fees	**55**	65
Social security and other taxes	**1,654**	1,559
Other payables	**8,615**	5,221
Capital accruals	**16,833**	14,498
Deferred grants and contributions	**3,369**	2,239
Payments received in advance	**145,319**	116,768
Deferred income	**1,144**	1,677
Other accruals	**32,838**	33,520
	247,900	199,330
	398,706	332,024

The carrying amounts of trade and other payables approximate to their fair value.

Interest payable to subsidiary companies relates to accrued interest on bonds.

16. BORROWINGS

	2021 £000	2020 £000
Borrowings measured at amortised cost:		
Loan from Affinity Water Finance (2004) PLC financed by bond issue	**252,999**	253,462
Loan from Affinity Water Finance PLC financed by bond issue	**838,496**	833,595
Loan from intermediate parent company	**3,550**	3,550
3.5% irredeemable consolidated debenture stock	**-**	-
4% irredeemable consolidated debenture stock	**8**	8
4% irredeemable debenture stock	**1**	1
4.25% irredeemable debenture stock	**-**	-
5% irredeemable debenture stock	**24**	24
5.25% irredeemable debenture stock	**1**	1
	1,095,079	1,090,641

Statutory Financial Statements continued

Notes to the financial statements (continued)

16. BORROWINGS (CONTINUED)

On 13 July 2004, the company's subsidiary Affinity Water Finance (2004) PLC issued a £200,000,000 bond at an interest rate of 5.875% and repayable in July 2026. On 16 July 2014 Affinity Water Finance (2004) PLC completed a tap issue of £50,000,000 on the same terms as the existing £200,000,000 bond.

The net proceeds of the bond and tap issue were lent to the company on the same terms.

On 4 February 2013, the company's former subsidiary Affinity Water Programme Finance Limited issued £80,000,000 Class A Guaranteed Notes maturing in September 2022 with a coupon of 3.625%, £250,000,000 Class A Guaranteed Notes maturing in March 2036 with a coupon of 4.500%, £150,000,000 Class A Guaranteed RPI linked Notes maturing in June 2045 with a coupon of 1.548% and £95,000,000 Class B Guaranteed RPI linked Notes maturing in June 2033 with a coupon of 3.249%.

On 29 October 2015, Affinity Water Programme Finance Limited completed a tap issue of its 1.548% RPI linked Notes maturing in June 2045 of £40,000,000 on the same terms as the existing 2045 Notes.

On 19 February 2016, Affinity Water Programme Finance Limited issued £10,000,000 Class B Guaranteed RPI linked Notes maturing in June 2033 with a coupon rate of 1.024%.

On 22 August 2016, Affinity Water Programme Finance Limited exchanged £65,800,000 of its 3.625% Guaranteed Notes due 2022 for a new issue of 3.278% Guaranteed Notes due 2042. An additional £19,200,000 of 3.278% Guaranteed Notes due 2042 were issued at the same time.

On 22 November 2017, Affinity Water Programme Finance Limited issued £60,000,000 Class A Guaranteed Notes maturing in November 2033 with a coupon of 2.699% and £60,000,000 Class A Guaranteed CPI linked Notes maturing in November 2042 with a coupon of 0.230%.

The net proceeds of the bond issues and the tap issue were lent to the company on the same terms.

On 22 January 2019, the assets and liabilities of Affinity Water Programme Finance Limited were transferred to the company's subsidiary Affinity Water Finance PLC.

On 4 February 2013, the company borrowed an amount of £3,550,000 from Affinity Water Capital Funds Limited, the company's intermediate parent company. The final repayment date of this loan is 31 March 2036, with interest terms having been set at 4.500%.

The company has unconditionally and irrevocably guaranteed the due and punctual payment of all sums from time to time payable by Affinity Water Finance (2004) PLC and Affinity Water Finance PLC in respect of the bonds issued by these companies. These guarantees constitute direct, general and unconditional obligations of the company which will at all times rank at least pari passu with all other present and future unsecured obligations. The bonds issued are also guaranteed by Affinity Water Holdings Limited, the company's immediate parent undertaking.

The fair value of the bonds on-lent from the financing subsidiaries at 31 March 2021 is £1,496,837,000 (2020: £1,348,245,000). The fair value of Class A bonds has been derived from 'level 1' fair value measurements: quoted prices (unadjusted) in active markets for identical liabilities. The fair value of Class B bonds has been derived from 'level 2' fair value measurements: directly observable market inputs other than Level 1 inputs.

The company is subject to a number of covenants in relation to its borrowings, which, if breached, would result in its loans becoming immediately repayable. These covenants specify certain limits in terms of key ratios such as net cash flow to debt interest and net debt to RCV. At the year-end the company was not in breach of any financial covenants.

17. LEASE LIABILITIES

	2021 £000	2020 £000
Non-current		
Lease liabilities	**6,016**	9,068
Current		
Lease liabilities	**3,667**	3,491

The following amounts in respect of leases are included within these financial statements:

	2021 £000	2020 £000
Depreciation charge of right-of-use assets (refer to note 7)	**3,684**	3,859
Interest expense on lease liabilities (refer to note 4)	**315**	383
Expense relating to short-term leases (refer to note 2.1)	**115**	10
Expense relating to leases of low-value assets (refer to note 2.1)	**91**	44
Principal elements of lease payments included within cash flows from financing activities	**3,631**	3,711
Interest payments included within cash flows from operating activities	**315**	383
Total cash outflow for leases in the statement of cash flows	**3,946**	4,094
Additions to right-of-use assets (refer to note 7)	**756**	1,822
Carrying amount of right-of-use assets (refer to note 7)	**9,508**	12,436

18. DERIVATIVE FINANCIAL INSTRUMENT

	2021 £000	2020 £000
Non-current		
Fair value of RPI linked inflation swap	**7,976**	2,430
Accretion on RPI linked inflation swap	**7,721**	4,975
Fair value of CPI linked inflation swap	**40,447**	1,775
Accretion on CPI linked inflation swap	**1,547**	(31)
	57,691	9,149

An RPI linked inflation swap with a nominal value of £135.0m, which is linked to the maturity of the Class A fixed rate £250.0m bond (maturity July 2026), was entered into in August 2018. A further RPI linked inflation swap with a nominal value of £75.0m, which is also linked to the maturity of the Class A fixed rate £250.0m bond (maturity July 2026), was entered into in October 2020, with an effective date of 1 August 2020.

A CPI linked inflation swap with a nominal value of £25.0m, which is linked to the maturity of the Class A fixed rate £250.0m bond (maturity March 2036), was entered into in March 2020. Further CPI linked inflation swaps with a total nominal value of £225.0m, which are also linked to the maturity of the Class A fixed rate £250.0m bond (maturity March 2036), were entered into between April 2020 and June 2020.

The fair value of RPI and CPI linked inflation swaps have been derived from 'Level 2' fair value measurements: directly observable market inputs other than Level 1 inputs.

Statutory Financial Statements continued

Notes to the financial statements (continued)

19. DEFERRED TAX LIABILITIES

19.1 Analysis of deferred tax assets and deferred tax liabilities

	2021 £000	2020 £000
Deferred tax assets:		
– Deferred tax asset to be recovered after more than 12 months	**(570)**	(629)
– Deferred tax asset to be recovered within 12 months	**(30)**	-
	(600)	(629)
Deferred tax liabilities:		
– Deferred tax liability to be settled after more than 12 months	**181,741**	199,273
	181,741	199,273
Deferred tax liabilities - net	**181,141**	198,644

The gross movement on the deferred tax account is as follows:

	£000
At 1 April 2019	178,961
Adjustment to prior year	1,219
Charged to the income statement	18,457
Charged to other comprehensive income	7
At 31 March 2020	**198,644**
Adjustment to prior year	**420**
Credited to the income statement	**(11,812)**
Credited to other comprehensive income	**(6,111)**
At 31 March 2021	**181,141**

The adjustment to prior year is due to the tax provision in the accounts being a best estimate at the time. The estimate is corrected when the tax returns are finalised and submitted to HMRC 12 months after the year-end.

The movement in deferred tax assets and liabilities during the year is as follows:

19.2 Deferred tax liabilities

	Accelerated capital allowances £000	Retirement benefit obligations £000	Total £000
At 1 April 2019	162,259	17,202	179,461
Adjustment to prior year	1,190	-	1,190
Charged to the income statement	15,946	2,669	18,615
Charged to other comprehensive income	-	7	7
At 31 March 2020	**179,395**	**19,878**	**199,273**
Adjustment to prior year	**420**	**-**	**420**
Credited to the income statement	**(12,235)**	**394**	**(11,841)**
Charged to other comprehensive income	**-**	**(6,111)**	**(6,111)**
At 31 March 2021	**167,580**	**14,161**	**181,741**

19.3 Deferred tax assets

	Provisions £000
At 1 April 2019	(500)
Adjustment to prior year	29
Credited to the income statement	(158)
At 31 March 2020	(629)
Charged to the income statement	**29**
At 31 March 2021	**(600)**

Statutory Financial Statements continued

Notes to the financial statements (continued)

20. PROVISIONS FOR OTHER LIABILITIES AND CHARGES

	Insurance £000	Other £000	Total £000
At 1 April 2019	4,237	2,832	7,069
Charged to the income statement	808	-	808
Utilised in the year	(208)	(1,555)	(1,763)
At 31 March 2020	4,837	1,277	6,114
Charged to the income statement	469	-	469
Utilised in the year	(2,580)	(429)	(3,009)
At 31 March 2021	2,726	848	**3,574**

Insurance

Provisions for insurance represent the amount of the company's liability in respect of individual claims. This is based upon data provided by loss adjusters to insurers and is calculated on settlement experience. The full balance of £2,726,000 is presented as a non-current liability in the statement of financial position.

Included within these provisions is an amount of £184,000 (2020: £2,300,000), which is expected to be recoverable from the company's insurer. The provision above is shown gross, with the corresponding receivable disclosed as a non-current other receivable on the company's statement of financial position.

Other provisions

Other provisions include £178,000 (2020: £607,000) in relation to a corporate reorganisation, which is expected will be utilised by 31 March 2022 and therefore presented as a current liability in the statement of financial position, and £670,000 (2020: £670,000) in relation to unfunded pension liabilities for a former non-executive director, which it is expected will be utilised by January 2051, and therefore presented as a non-current liability in the statement of financial position.

21. DIVIDENDS

	2021 £000	2020 £000
First interim paid of 0.38p per share (2020: nil)	**1,000**	-
	1,000	-

22. NOTES TO THE STATEMENT OF CASH FLOWS

22.1 Cash generated from operations

		2021 £000	2020 £000
(Loss)/profit before tax		**(63,500)**	91
Adjustments for:			
Depreciation of property, plant and equipment (note 6)		**64,796**	63,391
Depreciation of right-of-use assets (note 7)		**3,684**	3,859
Amortisation of grants and contributions		**(3,041)**	(3,101)
Amortisation of intangible assets (note 8)		**10,577**	9,190
Profit on disposal of property, plant and equipment		**(1,061)**	(1,630)
Loss on disposal of infrastructure assets		**1,408**	1,262
Loss on disposal of intangible assets		**-**	12
Post-employment benefits		**393**	(900)
Net finance costs (note 4)		**77,069**	45,469
Changes in working capital			
– Inventories		**(1,063)**	(301)
– Trade and other receivables		**14**	(7,421)
– Trade and other payables:	- provision element	**(2,540)**	(955)
	- other	**13,776**	1,150
Cash generated from operations		**100,512**	110,116

Changes in working capital – other of £13,776,000 in the year (2020: £1,150,000) primarily relates to an increase in trade payables, as shown in note 15 on page 169.

Statutory Financial Statements

Statutory Financial Statements continued

Notes to the financial statements (continued)

22. NOTES TO THE STATEMENT OF CASH FLOWS (CONTINUED)

22.2 Reconciliation of liabilities arising from financing activities

	At 1 April 2020 £000	Cash flow £000	Non-cash flows £000	At 31 March 2021 £000
Loan from Affinity Water Finance (2004) PLC financed by bond issue	**253,462**	**-**	**(463)**	**252,999**
Loan from Affinity Water Finance PLC financed by bond issue	**833,595**	**-**	**4,901**	**838,496**
Loan from intermediate parent company	**3,550**	**-**	**-**	**3,550**
Lease liabilities	**12,559**	**(3,945)**	**1,069**	**9,683**
Debenture stock	**34**	**-**	**-**	**34**
Total liabilities arising from financing activities	**1,103,200**	**(3,945)**	**5,507**	**1,104,762**

	At 1 April 2019 £000	Cash flow £000	Non-cash flows £000	At 31 March 2020 £000
Loan from Affinity Water Finance (2004) PLC financed by bond issue	253,922	-	(461)	253,461
Loan from Affinity Water Finance PLC financed by bond issue	823,747	-	9,849	833,596
Loan from intermediate parent company	3,550	-	-	3,550
Lease liabilities	14,494	(4,094)	2,159	12,559
Debenture stock	34	-	-	34
Total liabilities arising from financing activities	1,095,747	(4,094)	11,547	1,103,200

Non-cash flows relate to loan indexation and amortisation of bond issuance costs and net additions of leases.

23. COMMITMENTS

23.1 Capital commitments

Capital expenditure contracted for at the end of the reporting period but not yet incurred is as follows:

	2021 £000	2020 £000
Property, plant and equipment	**19,072**	15,442
Intangible assets	**1,756**	1,137
	20,828	16,579

23.2 Commitments under operating leases

The company leases its vehicles, IT server space and head office building under non-cancellable operating leases expiring within a maximum of six years. The leases have varying terms, clauses and renewal rights.

The company does not expect to extend any vehicles leases after their lease term has expired. The IT server space expired on 31 December 2020 and was renewed until 31 December 2021. The company will assess closer to the expiry of the lease of the head office building whether another formal agreement will be entered in to.

From 1 April 2019, the company has applied IFRS 16 and recognised right-of-use assets for these leases, (except for short-term and low-value leases which are not within the scope of IFRS 16), see note 17 for further information.

The future aggregate minimum lease payments for operating leases not within the scope of IFRS 16 are as follows:

	2021		2020	
	Land and buildings £000	Other £000	Land and buildings £000	Other £000
No later than one year	**-**	**90**	-	72
Later than one year and no later than five years	**-**	**168**	-	212
Later than five years	**-**	**-**	-	-
	-	**258**	-	284

24. BILLING ON BEHALF OF THAMES WATER AND ANGLIAN WATER

The company bills and collects charges in respect of sewerage and infrastructure within its area on behalf of Thames Water and Anglian Water. No amounts are included in these financial statements in respect of uncollected sewerage and sewerage infrastructure charges at 31 March 2021 (2020: £nil) and the company incurs no bad debt risk in relation to this service.

25. EVENTS AFTER THE REPORTING PERIOD

Following approval to transact a power hedging swap when conditions were favourable, as detailed in the section 172(1) statement on page 54 onwards, the company entered into its first energy swap in May 2021, fixing the price on a proportion of our future energy costs. This will be reflected in our financial numbers in the year ending 31 March 2022.

Statutory Financial Statements continued

Notes to the financial statements (continued)

26. ULTIMATE PARENT COMPANY AND CONTROLLING PARTY

The immediate parent undertaking of the company is Affinity Water Holdings Limited, a company registered in England and Wales.

Affinity Water Holdings Limited is wholly owned by Daiwater Investment Limited, a company registered in England and Wales. Daiwater Investment Limited is the parent undertaking of the largest group to consolidate the statutory financial statements of the company. These financial statements are also consolidated in the financial statements of Affinity Water Holdco Finance Limited, the smallest group to consolidate the financial statements of the company.

Copies of the group financial statements of Daiwater Investment Limited and Affinity Water Holdco Finance Limited for the year ended 31 March 2021 may be obtained from the Company Secretary, Tamblin Way, Hatfield, Hertfordshire, AL10 9EZ.

The directors consider Daiwater Investment Limited as the ultimate holding and controlling company in the United Kingdom.

The directors consider the following entities to be the company's ultimate controllers, as they are in a position to exercise material influence over the company's policy and affairs:

- Allianz Infrastructure Holding I Pte. Limited (up until 20 November 2019, Allianz Infrastructure Luxembourg I S.à r.l)
- DIF Management Holding BV
- DIF Management UK Limited
- HICL Infrastructure plc
- Sun Life Financial Inc (up until 1 July 2020, InfraRed Capital Partners (Management) LLP).

Allianz Capital Partners is the Allianz Group's in-house investment manager for alternative equity investments. The investment focus is on infrastructure and renewables as well as private equity funds. Allianz Capital Partners' investment strategy is targeted to generate attractive, long-term and stable returns while diversifying the overall investment portfolio for the Allianz Group insurance companies.

DIF is an independent and specialist fund management company, which invests in infrastructure assets that generate long-term stable cash flows, including public-private partnerships, regulated infrastructure assets and renewable energy projects in Europe, North America and Australia.

HICL Infrastructure plc is a long-term investor in infrastructure assets which are predominantly operational and yielding steady returns. HICL Infrastructure plc has a portfolio of infrastructure investments, which are positioned at the lower end of the risk spectrum, in three target market segments: public-private partnerships, regulated assets and demand-based assets. The Investment Manager to HICL Infrastructure plc is InfraRed Capital Partners Limited, a leading international investment manager focused on infrastructure and real estate.

Notes to the financial statements – appendices

A1. GENERAL INFORMATION

The company owns and manages the water assets and network in an area of approximately 4,500km^2 split over three supply regions, comprising eight separate water resource zones, in the South East of England. The company is the sole supplier of drinking water in these areas.

The company is a private company limited by shares and is incorporated and domiciled in the United Kingdom. The address of its registered office is Tamblin Way, Hatfield, Hertfordshire, AL10 9EZ.

Refer to note 26 for details of the company's parent company and ultimate parent company.

A2. SEGMENTAL REPORTING

In the same way that financial information is reported on a quarterly basis to the Board, the company's chief operating decision maker, during the current and previous financial year on a combined basis, the company presents its results under a single segment for financial reporting purposes.

A3. ACCOUNTING POLICIES

Consolidation

The company is a wholly owned subsidiary of its ultimate holding and controlling company, Daiwater Investment Limited, which is the parent undertaking of the largest group to consolidate the statutory financial statements. It is included in the consolidated financial statements of Daiwater Investment Limited, which will be made publicly available. Therefore the company is exempt by virtue of section 400 of the Companies Act 2006 from the requirement to prepare consolidated financial statements.

Property, plant and equipment

Property, plant and equipment are held at historical cost less accumulated depreciation and impairment charges.

Infrastructure assets comprise a network of mains and associated underground pipe-work. Infrastructure assets are held at deemed cost established through an event-driven valuation on transition to FRS 101 in 2015/16 and subsequent additions are recorded at historical cost less accumulated depreciation and impairment charges.

For accounting purposes the network is segmented into components based on the material used to construct the pipe concerned. The estimated useful economic lives of infrastructure pipes are based on management's judgement and experience, which includes the knowledge and research of the company's dedicated asset management teams. Where management identifies that the actual useful economic life of an asset significantly differs from the estimate used to calculate its depreciation, the depreciation charge is adjusted prospectively.

Expenditure on infrastructure assets relating to increases in capacity, enhancements or material replacements of network components is capitalised where it can be reliably measured, and it is probable that incremental future economic benefits will flow to the company. The carrying amount of the replaced part is derecognised. Costs of day-to-day servicing of network components are recognised in the income statement as they arise.

Cost of other property, plant and equipment includes own work capitalised comprising the direct costs of materials, labour and applicable overheads.

Property, plant and equipment are depreciated to their estimated residual values over their estimated useful lives using the straight-line method, with the exception of freehold land which is not depreciated. Assets in the course of construction are not depreciated until commissioned.

Statutory Financial Statements continued

Notes to the financial statements – appendices (continued)

A3. ACCOUNTING POLICIES (CONTINUED)

Property, plant and equipment (continued)

The estimated useful lives of property, plant and equipment are:

Infrastructure assets		
Potable water distribution mains		50-150 years
Raw water pipes		50-150 years
Other property, plant and equipment		
Buildings		40-60 years
Operational structures		5-85 years
Fixed plant:	– short life	3-10 years
	– other	10-30 years
Vehicles and mobile plant		3-10 years

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in operating profit.

The company is required to evaluate the carrying value of its property, plant and equipment for impairment whenever circumstances indicate, in management's judgement, that the carrying value of such assets may not be recoverable. An impairment review in such circumstances requires management to make subjective judgements concerning the future cash flows, growth rates and discount rates of the asset under review.

Intangible assets

Goodwill
Goodwill represents the excess of the fair value of purchase consideration over the fair value of the net assets acquired. Fair value adjustments based on provisional estimates are amended within one year of the acquisition, if required, with a corresponding adjustment to goodwill.

Goodwill is not amortised but is reviewed for impairment at least annually. Impairment reviews are also carried out if there is an indication that impairment may have occurred, or, where otherwise required, to ensure that intangible assets are not carried above their estimated recoverable amounts. Goodwill is allocated to the CGU that derives benefit from the goodwill for impairment testing purposes. Impairments are recognised immediately in the income statement.

Computer software development costs
Costs associated with maintaining computer software programmes are recognised as an expense as incurred. Development costs that are directly attributable to the design and testing of identifiable and unique software products controlled by the company are recognised as intangible assets only if they meet the criteria of IAS 38: 'Intangible Assets', in that it is a separable, identifiable asset and it has a future economic benefit. Other development expenditures that do not meet these criteria are recognised as an expense as incurred.

Computer software development costs recognised as assets are amortised on a straight-line basis over their estimated useful lives, which does not exceed five years. Amortisation charged on assets with finite lives is recognised in the income statement in operating costs.

Computer software development costs are reviewed for impairment where indicators of impairment exist. Impairments are recognised immediately in the income statement.

In April 2021, the IFRS Interpretations Committee ('IFRIC') agenda decision on the treatment of configuration and customisation costs in a cloud computing arrangement was ratified by the International Accounting Standards Board. The company is currently working through the implications of this guidance and will include any adjustments relating to the treatment of costs associated with cloud computing arrangements in the financial statements for the year ending 31 March 2022, expecting to move these from capitalised costs to expensed items. See note 8 for details of our intangible assets.

Grants and contributions

Grants and contributions received in respect of property, plant and equipment where the performance obligation is deemed to be satisfied over time (consisting of contributions for diversions and requisitioned mains/extensions, and infrastructure charges), are treated as deferred income and released to revenue over the useful economic life of the property, plant and equipment to which they relate once these assets have been commissioned.

The company may be contracted by developers in its statutory supply area to relocate a pipe which is already in the ground; this is known as a diversion. The company may also be contracted by developers in its statutory supply area to provide a new water main or new sewer; this is known as a requisition/extension. Contributions received in respect of diversions and requisitioned mains/extensions are treated as deferred income and released to revenue over time as the company considers that the obligation to provide these services is highly interrelated with the ongoing obligation to provide water services; therefore the performance obligation is considered to be satisfied over the period that the property, plant and equipment constructed are in service.

Infrastructure charges are charges levied on developers for network reinforcement, which is not site specific, i.e. to fund expenditure which will contribute towards wider network reinforcement work away from the development site. Infrastructure charges are treated as deferred income and released to revenue over time as there is an implied ongoing performance obligation to improve and maintain the wider network in order to provide ongoing supply of water services.

Grants and contributions received in respect of property, plant and equipment where the performance obligation is deemed to be satisfied at a point in time (comprising payments for connection charges) are recognised immediately in the income statement, once the performance obligation is fulfilled.

Connection charges are billed to developers for the provision of a connection to an existing water main, laying a pipe to the boundary of customers' properties and connecting to their supply pipes. Connection charges are recognised in revenue in the income statement in the period that they became receivable; the performance obligation has been identified as the connection of a service pipe to the main. Once the connection is made, the performance obligation is fulfilled and the income recognised immediately in the income statement.

Each of these types of grants and contributions (contributions for diversions and requisitioned mains/extensions, infrastructure charges, and connection charges) is not a government grant within the scope of IAS 20: 'Accounting for government grants and disclosure of government assistance' as the contributions are received from developers. Whilst there may not be a written contract with the customer, the legal duties of the company under the Water Industry Act 1991 would seem to constitute a legally enforceable contract based on the transaction prices set out in the company's charges scheme, tariff documents and invoices; accordingly these grants and contributions fall within the scope of IFRS 15.

Investments

Investment in subsidiaries
Investments in subsidiaries are held at cost less accumulated impairment losses.

Other investments
Other investments include short-term deposits that cannot be withdrawn prior to maturity and are held at cost.

Statutory Financial Statements continued

Notes to the financial statements – appendices (continued)

A3. ACCOUNTING POLICIES (CONTINUED)

Trade and other receivables

Trade and other receivables are recognised initially at transaction price. The company holds the trade receivables with the objective of collecting the contractual cash flows, and therefore the trade and other receivables are subsequently measured at amortised cost using the effective interest method, less expected credit losses.

Expected credit losses are based on historical recoverability and calculated by applying a range of different percentages to trade receivables of different ages. These percentages also vary between categories of trade receivables. Higher percentages are applied to those categories of trade receivable which are considered to be of greater risk and also to trade receivables of greater age.

The historical recoverability of trade receivables is deemed a good estimate of future expected credit losses. At each reporting date the company takes into consideration any significant economic changes that may impact its credit loss model and future credit losses, for example COVID-19. To estimate the impairment to its trade receivables from COVID-19, the company has assessed its debtors based on postcode driven customer demographics. The company has assessed what it believes to be the sensitivity of each demographic to the current and emerging effects of the pandemic on household finances and ability to maintain payments.

The company applies the IFRS 9 simplified approach for measuring expected credit losses which uses a lifetime expected loss allowance for all trade receivables and contract assets. To measure expected credit losses, trade receivables and contract assets are grouped based on shared credit risk characteristics and overdue days. Contract assets relate to unbilled metered consumption and have substantially the same risk characteristics as trade receivables for the same types of contract. The company has therefore concluded that expected loss rates for trade receivables are a reasonable approximation for loss rates for contract assets.

Inventories

Inventories are valued at the lower of cost or net realisable value after allowance for obsolete and slow-moving items. In accordance with established practice in the water industry, no value has been placed upon the water in reservoirs, mains or in the course of treatment.

Cash and cash equivalents

Cash and cash equivalents include cash at bank and in hand, deposits held at call with banks and other short-term highly liquid investments with original maturities of twelve months or less. Term deposits with original maturities longer than three months can be redeemed early, subject to the interest income being forfeited or reduced to reimburse any cost incurred by the counterparty. These are classed as cash and cash equivalents if the deposit can be redeemed to meet short term cash needs and there is no risk of a significant change in value as the result of an early withdrawal. Deposits that cannot be withdrawn prior to maturity are classed as investments.

Current and deferred tax

The tax expense for the year comprises current and deferred tax. Tax is recognised in the income statement, except to the extent that it relates to items recognised in other comprehensive income or directly in shareholder's funds. In this case, the tax is also recognised in other comprehensive income or directly in shareholder's funds, respectively.

The current tax charge is based on taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The company's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the date of the statement of financial position.

Deferred taxation is provided in full, using the liability method, on taxable temporary differences between the tax bases of assets and liabilities and their carrying amounts in the financial statements. A deferred tax asset is only recognised to the extent that it is probable that sufficient taxable profits will be available in the future to utilise it. Deferred taxation is measured on a non-discounted basis using the tax rates and laws that have been enacted or substantively enacted by the date of the statement of financial position and are expected to apply when the related deferred tax asset is realised, or the deferred tax liability is settled.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to taxes levied by the same taxation authority and the company intends to settle its current tax assets and liabilities on a net basis.

Payables

Payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method. Payments received in advance and measured and unmeasured deferred income are contract liabilities under IFRS 15 and relate to advance contributions received in respect of connection charges, diversions and requisitioned mains/extensions and customer payments in advance for measured and unmeasured supplies.

Borrowings

All loans are recognised initially at fair value plus directly attributable transaction costs. The carrying amount of the debt is increased by the amortisation of the finance and transaction costs determined using the effective interest rate in respect of the accounting period and reduced by any payments made in the year. The finance cost recognised in the income statement is allocated to accounting periods over the term of the debt using the effective interest method.

An exchange of debt with substantially different terms is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.

At the point of refinancing, all costs relating to the previous debt are written off to the income statement in full.

Financial instruments

Financial instruments such as derivatives are initially recognised at fair value on the date the derivative contract is entered into and are subsequently re-measured at their fair value at each reporting period. Gains or losses arising on revaluation are recorded in the income statement in the period in which they arise and are shown on the line 'fair value loss on financial instruments' on the face of the income statement. Interest received or incurred on these derivative financial instruments is shown within finance income and finance costs on the face of the income statement.

Provisions

A provision is recognised when the company has a legal or constructive obligation as the result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation, and the amount can be reliably estimated.

Ofwat assesses companies' operational performance against agreed performance commitments. Certain performance commitments contain an ODI, which can carry a financial reward or penalty, or both, which will be recognised as a revenue adjustment in the next charging period. The company adjusts future tariffs to reflect such amounts and therefore the benefit or cost is linked to the provision of future services as well as future performance. Resultantly the company does not recognise a provision for penalties or rewards in the financial year in which they are incurred or achieved as these amounts are not an asset or liability at the balance sheet date.

Statutory Financial Statements continued

Notes to the financial statements – appendices (continued)

A3. ACCOUNTING POLICIES (CONTINUED)

Revenue recognition

The company's core revenue stream is derived from the supply of clean water. The IFRS 15 definition of a contract is met since the UK Government has contracted with the company on behalf of customers by granting the company its water supply licence, where the underlying performance obligation is the development and maintenance of the network and ensuring its continued availability to customers. Under IFRS 15, revenue is measured at the transaction price and is recognised as the customer receives the benefit of the water supply through consuming the water:

- for metered customers, the amount which the company has a right to receive is variable, determined by the volume of water consumed; and
- for unmetered customers, the amount which the company has a right to receive is determined by the passage of time during which a customer occupies a property to which water is supplied by the company.

The company has contracts with third parties operating in the non-household retail market for the supply of clean water (wholesale supply). The underlying performance obligation is the development and maintenance of the network, and ensuring its continued availability to such third party retailers on behalf of non-household consumers. Revenue is recognised at the point in which the company has a right to receive the revenue. For non-household retailers, the amount which the company has a right to receive is determined by non-household consumption volume data. As a result of changing consumption levels due to the COVID-19 pandemic, we have used DI (distribution input) figures to estimate non-household consumption and have recognised revenue on this basis.

For metered household customers, a receivable is recognised when the customer is billed for the usage. At this point, the consideration is unconditional because only the passage of time is required before the payment is due. Where the company has provided the service before payment is due, an accrual for the consumption of water that has not yet been billed is recognised in the income statement offset by a contract receivable within assets. The accrual is estimated using a defined methodology based upon weighted average water consumption by tariff, which is calculated based upon historical information, with an adjustment made for the impact of COVID-19.

Unmetered customers pay a fixed amount determined by the transaction prices set out in the company's charging scheme and tariff documents. If the payments received exceed the amount the company has the right to receive (i.e. unearned income), the company recognises a payment received in advance and discloses this as a contract liability within payables.

Where non-household retailers are billed in advance monthly for wholesale charges, as determined by billing/volume reports created by the market operator, the company recognises deferred income in relation to these accounts and discloses this as a contract liability within payables.

The recognition of revenue from grants and contributions billed to developers is detailed in the grants and contributions accounting policy.

Revenue is recognised if it is probable that it will be received, considering the customer's ability and intention to pay that amount of consideration when it is due.

The company is under a statutory obligation to maintain water services to domestic properties within the areas defined in its water supply licence. As a result, the company may provide water services to customers who are unlikely to pay for these services. The company does not recognise revenue where historical evidence indicates that the company will probably never be able to collect the revenue billed.

The company does not expect to have any contracts where the period between the transfer of the promised goods or services to the customer and the payment terms exceeds one year. The company therefore does not adjust any of its transaction prices for the time value of money.

Other income

Other income includes all income derived from sources associated with the ordinary activities of the business, other than revenue derived from the regulatory activities of the business. Other income, including mast rentals and billing and collections services, involves readily identifiable contracts with customers with clearly defined performance obligations to which prices are allocated. Income is recognised as the contracts are completed and the performance obligations satisfied. It is stated net of value added taxes.

Interest income

Interest income is calculated by applying the effective interest rate to the gross carrying amount of a financial asset, except for financial assets that subsequently become credit-impaired. For credit-impaired financial assets, the effective interest rate is applied to the net carrying amount of the financial asset (after deduction of the loss allowance).

Leases

The company leases its head office building and most of its vehicles. Rental contracts for vehicles are typically for fixed periods of two to five years. The company has an option to extend its leases; however no contracts are reasonably certain to be extended after their lease term has expired. The lease contract of the head office building has a remaining period of 5.5 years. Lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions. The company's lease agreements do not impose any covenants, but leased assets cannot be used as security for borrowing purposes.

The company also leases some physical IT server space that was accounted for under IFRS 16 up to 31 December 2020. The lease was subsequently renewed to 31 December 2021 and treated as a short-term operating lease. All remaining IT server space has been provided through a hosting service, therefore is out of scope of IFRS 16 as there is not a physically distinct identifiable asset. Costs are recognised on a straight-line basis as an expense in profit or loss.

The company applies recognition exemptions to short-term leases and leases of low-value assets. Short-term leases are leases with a term of 12 months or less. Low-value assets comprise small items of office equipment and IT equipment, typically costing no more than £5,000. Costs are recognised on a straight-line basis as an expense in profit or loss.

Leases falling within the scope of IFRS 16 are recognised as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use by the company. Each lease payment is allocated between the liability and finance cost.

The finance cost is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The right-of-use asset is depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis.

The company's accounting policy is for assets and liabilities arising from a lease to be initially measured on a present value basis. Lease liabilities include the net present value of one or more of the following lease payments:

- fixed payments (including in-substance fixed payments), less any lease incentives receivable; and
- payments of penalties for terminating the lease, if the lease term reflects the lessee exercising that option.

Right-of-use assets are measured at cost comprising one or more of the following:

- the amount of the initial measurement of lease liability;
- any lease payments made at or before the commencement date, less any lease incentives received;
- any initial direct costs; and
- restoration costs.

Lease payments may be discounted using the lessee's incremental borrowing rate if the interest rate implicit in the lease cannot be determined. The incremental borrowing rate is the rate that the lessee would have to pay to borrow the funds necessary to obtain an asset of similar value in a similar economic environment with similar terms and conditions. The company uses an independent third-party to determine the incremental borrowing rate for each class of lease. The weighted average lessee's incremental borrowing rate applied to the lease liabilities during the year was 2.37%. The incremental borrowing rate is re-determined annually and applied to new leases for the subsequent year.

The company enters into agreements with employees to use vehicles that it leases from a third party as a company vehicle. These agreements are considered by the company to be part of the overall compensation package of an employee and, as such, the company has applied IAS 19 'Employee benefits' in accounting for these arrangements rather than considering the arrangements as subleases of vehicles to employees under IFRS16.

The company does not use sale and leaseback transactions.

Statutory Financial Statements continued

Notes to the financial statements – appendices (continued)

A3. ACCOUNTING POLICIES (CONTINUED)

Grafham reservoir

Under the Great Ouse Water Act of 1961, the company has an entitlement to water from the Grafham reservoir owned and operated by Anglian Water. The company pays Anglian Water a charge for the supply of water, which covers its share of the overall costs of running Grafham reservoir. These costs are recognised as an expense in the income statement as incurred.

Dividend distributions

Dividend distributions to the company's shareholder are recognised as a liability in the company's financial statements in the period in which the dividends are approved.

Retirement benefits

The company operates a pension plan, the Affinity Water Pension Plan ('AWPP'), as the AWPP's Principal Employer, providing defined benefits based on final pensionable salary. The assets of the plan are held separately from those of the company.

Affinity Water Limited was the AWPP's Principal Employer up until 31 August 2020, with former group company Castle Water (Southern) Limited (formerly Affinity for Business (Retail) Limited) being a Participating Employer of the AWPP up until this date. Since this date, Affinity Water Limited has been the sole employer.

The cost of providing benefits under the defined benefit plan is determined using the projected unit method, which attributes entitlement to benefits to the current period (to determine current service cost) and to the current and prior periods (to determine the present value of defined benefit obligations) and is based on actuarial advice. Past service costs are recognised immediately in the income statement. When a settlement or a curtailment occurs, the changes in the present value of the plan liabilities and the fair value of the plan assets reflect the gain or loss which is recognised in the income statement. Losses are measured at the date that the employer becomes demonstrably committed to the transaction and gains when all parties whose consent is required are irrevocably committed to the transaction.

The retirement benefit surplus or deficit in the statement of financial position comprises the present value of the defined benefit obligation (using a discount rate based on high quality corporate bonds), less any past service cost not yet recognised and less the fair value of plan assets out of which the obligations are to be settled directly. Fair value is based on market price information and in the case of quoted securities is the published bid price.

Re-measurement gains and losses arising from changes in actuarial assumptions are charged or credited to shareholder's funds in other comprehensive income in the period in which they arise.

The amount charged or credited to finance costs is a net interest amount calculated by applying the liability discount rate to the net defined benefit asset or liability.

Former group company Castle Water (Southern) Limited (formerly Affinity for Business (Retail) Limited) contributed to the AWPP on behalf of its eligible employees up until 31 August 2020. As the Principal Employer, Affinity Water Limited recognises all the remeasurement gains and losses on the plan assets and liabilities. Affinity Water Limited recognises current service costs net of contributions from Castle Water (Southern) Limited (formerly Affinity for Business (Retail) Limited).

Contributions to the defined contribution section of the plan are recognised in the income statement in the period in which they become payable.

The company also has an obligation to pay pensions to former non-executive directors of predecessor companies. A provision in respect of the obligation is included within the net pension asset or liability.

A4. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Risk management

The company's financial instruments comprise borrowings, derivatives, debentures, cash and liquid resources, lease liabilities, and various items, such as trade receivables and trade payables that arise directly from operations. The main purpose of these financial instruments is to provide finance for the company's operations. The company finances its operations through a mixture of retained profits, borrowings from its subsidiary companies, borrowings from Affinity Water Capital Funds Limited, its intermediate parent, and debentures.

It is the company's policy, and has been throughout the year under review, that no trading in financial instruments shall be undertaken.

The main risks arising from the company's financial instruments are liquidity risk, credit risk, and interest rate and inflation risk. Treasury policies in relation to these risks are agreed in conjunction with the wider Affinity Water group.

The Board reviews and agrees policies for managing each of these risks (refer to our principal risks and uncertainties section beginning on page 38 for further information on management of these risks). These policies have remained unchanged during the year.

Day-to-day responsibility for operational compliance with the treasury policies rests with the treasurer. A treasury report is provided quarterly to the Board, which summarises treasury activities and includes details on the company's position in regard to debt and cash at the end of each quarter.

The company's treasury function does not act as a profit centre and does not undertake speculative transactions.

Statutory Financial Statements continued

Notes to the financial statements – appendices (continued)

A4. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

Liquidity risk

The objective of the company's liquidity risk management policy is to ensure that the company has banking arrangements and adequate, though not excessive, cash balances, revolving credit facilities and standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business and service objectives.

Liquidity risk is primarily managed by maintaining a level of liquidity such that there are sufficient cash balances and committed loan facilities capable of immediate draw down to cover as a minimum the next 12 months' forecast cash requirement ensuring that over-reliance is not placed on any one counterparty, whether through cash holdings or available facilities.

Liquidity is actively monitored by the company's treasury function and reported to the Board on a quarterly basis through the treasury report.

At 31 March 2021, the company had £254,898,000 (2020: £271,789,000) of available liquidity, which comprised £99,898,000 (2020: £110,789,000) of cash and term deposits and £155,000,000 (2020: £161,000,000) of undrawn committed borrowing facilities.

The company entered into RPI linked inflation swaps in August 2018 and October 2020, and between March 2020 and June 2020, entered into a series of CPI linked inflation swaps, as detailed in the interest rate and inflation risk section of note A4.

These transactions lead to a net interest receivable cashflow over the life of the swaps, offset by an accretion payment on maturity (2026 for the RPI swaps and either 2030 or 2036 for the CPI swaps). There is no liquidity risk prior to these dates as there is no requirement to pay collateral prior to maturity. On maturity, a final accretion payment will be made based on the mark to market valuation at that date, resulting in a total forecast cash payment of £76,653,000 (2020: £40,544,000), included in the maturity analysis table. The mark to market valuation is reviewed on a monthly basis and a forecast accretion payment is reviewed annually to ensure sufficient cash balances can be made available if required.

Undrawn borrowing facilities	2021 £000	2020 £000
Floating rate:		
– Expiring within one year	**55,000**	61,000
– Expiring in more than one year	**100,000**	100,000
	155,000	161,000

The facilities expiring within one year comprise two standby facilities with different counterparties in the event of a liquidity shortfall: a 364 day revolving Debt Service Reserve Facility of £32,000,000 (2020: £38,000,000), which is intended for the purpose of funding any debt service payments, and a 364 day revolving Operations and Maintenance Reserve Facility of £23,000,000 (2020: £23,000,000), which is intended for the purpose of funding operating and capital maintenance expenditure.

The facilities expiring in more than one year comprise two revolving credit facilities, £60,000,000 (2020: £60,000,000) provided by Barclays Bank PLC and £40,000,000 (2020: £40,000,000) provided by Lloyds Bank PLC. The facilities are intended for the purpose of financing capital expenditure and working capital requirements to the extent that additional funding is required and have a maturity date of July 2024 and July 2023 respectively. These facilities were renewed on 24 June 2020 and use SONIA as the reference rate and have sustainability performance measures included.

Maturity analysis

Additional risk may arise if large cash flows are concentrated within particular time periods. The maturity profile in the following table represents the forecast future contractual principal and interest cash flows in relation to the company's non-derivative financial liabilities (borrowings and lease liabilities) with agreed repayment periods on an undiscounted basis.

At 31 March 2021 Non-derivatives	1 year or less £000	1-2 years £000	2-3 years £000	3-4 years £000	4-5 years £000	More than 5 years £000	Total £000
Loans from subsidiaries	**38,464**	**52,561**	**38,255**	**38,411**	**38,571**	**1,377,401**	**1,583,663**
Loan from intermediate parent	**160**	**160**	**160**	**160**	**160**	**5,146**	**5,946**
Lease liabilities	**3,220**	**2,689**	**2,019**	**1,662**	**650**	**-**	**10,240**
Total non-derivatives	**41,844**	**55,410**	**40,434**	**40,233**	**39,381**	**1,382,547**	**1,599,849**

At 31 March 2020 Non-derivatives	1 year or less £000	1-2 years £000	2-3 years £000	3-4 years £000	4-5 years £000	More than 5 years £000	Total £000
Loans from subsidiaries	38,403	38,628	52,807	38,585	38,830	1,432,315	1,639,568
Loan from intermediate parent	160	160	160	160	160	5,306	6,106
Lease liabilities	3,798	3,045	2,506	1,845	1,547	645	13,386
Total non-derivatives	42,361	41,833	55,473	40,590	40,537	1,438,266	1,659,060

Statutory Financial Statements continued

Notes to the financial statements – appendices (continued)

A4. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

Liquidity risk (continued)

Maturity analysis (continued)

The maturity profile in the following table represents the forecast future net cash flows in relation to the company's derivatives estimated using the forward rates applicable at the year-end.

At 31 March 2021 Derivatives	1 year or less £000	1-2 years £000	2-3 years £000	3-4 years £000	4-5 years £000	More than 5 years £000	Total £000
RPI linked inflation swap net payment/ (receivable)	**(7,439)**	**(7,575)**	**(7,479)**	**(7,382)**	**(7,283)**	**15,080**	**(22,078)**
CPI linked inflation swap net payment/ (receivable)	**(7,057)**	**(7,004)**	**(6,951)**	**(6,897)**	**(6,843)**	**(1,652)**	**(36,404)**
Total derivatives	**(14,496)**	**(14,579)**	**(14,430)**	**(14,279)**	**(14,126)**	**13,428**	**(58,482)**

At 31 March 2020 Derivatives	1 year or less £000	1-2 years £000	2-3 years £000	3-4 years £000	4-5 years £000	More than 5 years £000	Total £000
RPI linked inflation swap net payment/ (receivable)	(4,876)	(4,784)	(4,690)	(4,592)	(4,492)	20,580	(2,854)
RPI linked inflation swap net payment/ (receivable)	(715)	(706)	(698)	(689)	(681)	2,664	(825)
Total derivatives	(5,591)	(5,490)	(5,388)	(5,281)	(5,173)	23,244	(3,679)

Credit risk

Credit risk arises principally from trading (the supply of services to customers) and treasury activities (the depositing of cash).

The financial assets that are subject to the expected credit loss model are trade and other receivables, contract assets relating to the unbilled accrual for metered customers and cash and cash equivalents. While cash and cash equivalents are also subject to the impairment requirements of IFRS 9, the identified impairment loss is nil.

Contract assets and trade and other receivables

The company applies the IFRS 9 simplified approach for measuring expected credit losses which uses a lifetime expected loss allowance for all trade receivables and contract assets. To measure expected credit losses, trade receivables and contract assets are grouped based on shared credit risk characteristics and overdue days. Contract assets relate to unbilled metered consumption and have substantially the same risk characteristics as trade receivables for the same types of contract. The company has therefore concluded that expected loss rates for trade receivables are a reasonable approximation for loss rates for contract assets.

The company manages its credit risk of trade and other receivables through effective management of customer relationships. Concentrations of credit risk with respect to trade receivables are limited due to the company's customer base consisting of a large number of unrelated households and non-household retailers. The Water Industry Act 1991 (as amended by the Water Industry Act 1999) prohibits the disconnection of a water supply and the limiting of supply with the intention of enforcing payment for certain premises, including domestic dwellings. However allowance is made by Ofwat in revenue limits at each price review for a proportion of receivables deemed to be irrecoverable.

Expected credit losses for household receivables are based on historical recoverability and calculated by applying a range of different percentages to trade receivables of different ages. These percentages also vary between categories of trade receivables. Higher percentages are applied to those categories of trade receivables which are considered to be of greater risk and also to trade receivables of greater age; these receivables have higher expected credit losses. The company's policy is to write-off closed and live accounts that fall under the following categories: bankruptcy, liquidation, debt relief orders, deceased accounts where there is no estate, failed legal action and receivable amounts from customers who have moved out of the property with no forwarding address or are no longer responsible for payment of a water bill; the company concludes that there is no reasonable expectation of recovery under these circumstances. The historical recoverability of trade receivables is deemed a good estimate of future expected credit losses. At each reporting date the company takes into consideration any significant economic changes that may impact its credit loss model and future credit losses, for example COVID-19.

Amounts are also written off on accounts where the company is still supplying the customer and where all reasonable internal and external debt collection activities have been undertaken. Under these circumstances, if the total receivable contains amounts over six years old, the amount over six years old or more is written off. The company's write-off policy on household receivables has remained unchanged and has been consistently applied in the current year compared with the previous year.

Since 1 April 2017, the company has supplied wholesale water to third party retailers operating in the non-household market. Retailers operating in the non-household market have been granted a licence by Ofwat, with the financial resources of the retailer assessed on licence application and monitored on a continual basis. The company uses this assurance and monitors the recoverability of these receivables by assessing cash collection rates since market opening to ensure any uncertain receivables are provided for. At each reporting date, the company takes into consideration any significant economic changes that may impact the recoverability of these debtors and future credit losses.

Statutory Financial Statements continued

Notes to the financial statements – appendices (continued)

A4. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

At each reporting date management takes into consideration any significant economic changes that may impact the model and future credit losses. Therefore the directors of the company do not believe there is any further credit risk provision required in excess of the expected credit losses of trade receivables (see note 12).

The loss allowance as at 31 March 2021 and 31 March 2020 was determined as follows for both trade receivables and contract assets (unbilled accrual for metered customers):

At 31 March 2021	Current £000	Current £000	Less than 1 year £000	1-2 years £000	2-3 years £000	3-4 years £000	More than 4 years past due £000	Total £000
Expected loss rate – metered household receivables	0.14%	0.00%	2%	7%	16%	33%	100%	
Gross carrying amount – metered household receivables	-	-	15,679	3,506	2,119	1,344	1,649	24,297
Gross carrying amount – unbilled accrual for metered customers (household)	36,793	-	-	-	-	-	-	36,793
Gross carrying amount – unbilled accrual for metered customers (non-household)	-	2,710	-	-	-	-	-	2,710
Provision at expected loss rate	51	-	236	238	329	443	1,649	2,946
Additional provision for COVID-19	-	-	1,612	-	-	-	-	1,612
Amounts provided at 100%	-	-	3,748	4,192	3,230	1,979	1,614	14,763
Loss allowance	51	-	5,596	4,430	3,559	2,422	3,263	19,321

	Current £000	Less than 1 year £000	1-2 years £000	2-3 years £000	3-4 years £000	More than 4 years past due £000	Total £000
Expected loss rate – unmetered household receivables	0.00%	2%	5%	11%	27%	100%	
Gross carrying amount – unmetered household receivables	-	5,845	3,084	1,630	1,104	1,402	13,066
Provision at expected loss rate	-	114	139	186	297	1,402	2,138
Additional provision for COVID-19	-	734	-	-	-	-	734
Amounts provided at 100%	-	2,635	3,023	2,544	1,850	684	10,736
Loss allowance	-	3,483	3,162	2,730	2,147	2,086	13,608

	Less than 3 months £000	3-6 months £000	6-9 months £000	9-12 months £000	More than 12 months past due £000	Total £000
Expected loss rate – developer services	0%	43%	59%	70%	100%	
Gross carrying amount – developer services	1,569	353	184	240	724	3,070
Loss allowance	-	150	108	167	724	1,149
Total loss allowance						34,078

At 31 March 2020	Current £000	Current £000	Less than 1 year £000	1-2 years £000	2-3 years £000	3-4 years £000	More than 4 years past due £000	Total £000
Expected loss rate – metered household receivables	0.74%	0.00%	8%	26%	47%	66%	100%	
Gross carrying amount – metered household receivables	-	-	15,805	4,855	2,850	2,147	2,862	28,519
Gross carrying amount – unbilled accrual for metered customers (household)	36,282	-	-	-	-	-	-	36,282
Gross carrying amount – unbilled accrual for metered customers (non-household)	-	3,137	-	-	-	-	-	3,137
Provision at expected loss rate	269	-	1,203	1,273	1,349	1,416	2,862	8,372
Additional provision for COVID-19	-	-	840	-	-	-	-	840
Amounts provided at 100%	-	-	2,689	3,287	1,830	1,097	820	9,723
Loss allowance	269	-	4,732	4,560	3,179	2,513	3,682	18,935

	Current £000	Less than 1 year £000	1-2 years £000	2-3 years £000	3-4 years £000	More than 4 years past due £000	Total £000
Expected loss rate – unmetered household receivables	0.00%	9%	19%	35%	54%	100%	
Gross carrying amount – unmetered household receivables	-	7,000	3,897	2,492	1,853	3,228	18,470
Provision at expected loss rate	-	633	743	863	1,005	3,228	6,472
Additional provision for COVID-19	-	840	-	-	-	-	840
Amounts provided at 100%	-	2,169	2,295	1,656	1,035	75	7,230
Loss allowance	-	3,642	3,038	2,519	2,040	3,303	14,542

	Less than 3 months £000	3-6 months £000	6-9 months £000	9-12 months £000	More than 12 months past due £000	Total £000
Expected loss rate – developer services	0%	49%	50%	74%	98%	
Gross carrying amount – developer services	2,064	593	155	87	959	3,858
Loss allowance	0	290	78	64	945	1,377
Total loss allowance						34,854

A reconciliation between the opening and closing loss allowances for trade receivables and contract assets for the year ended 31 March 2021 is shown in note 12.

Statutory Financial Statements continued

Notes to the financial statements – appendices (continued)

A4. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

At 31 March 2021 and 31 March 2020, the maximum exposure to credit risk was represented by the carrying amount of each financial asset in the statement of financial position:

	2021 £000	2020 £000
Cash and term deposits (note 13)	84,766	85,587
Short-term deposits (note 9)	15,132	25,202
Trade and other receivables (excluding prepayments and amounts recoverable from the company's insurer)	79,572	77,897
	179,470	188,686

The company manages its risk from treasury activities by ensuring counterparties meet the minimum credit requirements approved by the Board, which include a maximum peak exposure limit and minimum credit rating. Credit exposure is monitored regularly by the company's treasury function and is reported quarterly to the Board through the treasury report.

The breakdown of cleared cash and cash equivalents and short-term deposits treated as investments exposed to credit risk at each of the credit ratings per Standard & Poor's at 31 March is:

	2021 £000	2020 £000
AAA	41,116	42,106
A-1+	-	10,105
A-1	52,098	57,959
A	5,084	-
	98,298	110,170

These are all short-term ratings.

Interest rate and inflation risk

The company seeks to manage its interest rate risk by maintaining its exposure within a board approved range, primarily through using a mixture of fixed, inflation linked and floating rate borrowings. An RPI linked inflation swap with a nominal value of £135.0m, which is linked to the maturity of the Class A fixed rate £250.0m bond (July 2026), was entered into in August 2018 as this was the most efficient way to switch to a higher proportion of index linked debt. A further RPI linked inflation swap with a nominal value of £75.0m, also linked to the maturity of the Class A fixed rate £250.0m bond (July 2026), was entered into in October 2020, although backdated to 1 August 2020. A series of CPI linked inflation swaps with a total nominal value of £250.0m, linked to the maturity of the Class A fixed rate £250.0m bond (March 2036), were entered into between March 2020 and June 2020.

These swaps will lead to net interest receivable cashflow over the life of the swaps, which is expected to increase the headroom against our covenant limits, offset by an accretion payment on maturity. Movements in RPI/CPI forward rates create fair value profits or losses, which will flow through the income statement.

The company earns an economic return on its RCV, comprising a real return through revenues and an inflation return as an uplift to its RCV. To the extent that nominal debt liabilities finance a proportion of the RCV, there is an asset liability mismatch which potentially exposes the company to the risk of economic loss where actual inflation is lower than that implicitly locked in through nominal debt. The company's index-linked borrowings, which are linked to inflation, form a partial economic hedge of the company's regulatory assets, which are also linked to inflation.

Interest rate and inflation risks are reported quarterly to the Board through the treasury report.

Interest rate and inflation risk (continued)

The interest rate profile of the company's debt is as follows:

As at	Fixed rate debt £000	RPI linked debt £000	CPI linked debt £000	Total £000
31 March 2021	672,411	360,188	62,480	1,095,079
31 March 2020	673,030	355,610	62,001	1,090,641

Sensitivity analysis

Sensitivity analysis has not been performed on movements in interest rates as the company's fixed rate debts had no exposure to interest rates as at 31 March 2021. The following table details the sensitivity of profit before taxation to changes in RPI and CPI on the company's index-linked borrowings, RPI linked inflation swap and CPI linked inflation swap. The analysis relates to the position at the reporting date and is not indicative of the years then ended, as these factors would have varied throughout the year.

Impact on profit before taxation	2021 £000	2020 £000
1% increase in RPI	(3,559)	(3,542)
1% decrease in RPI	3,640	3,542
1% increase in CPI	(630)	(625)
1% decrease in CPI	631	625

Currency risk

The company has no material net exposure to movements in currency rates.

Capital risk management

The gearing policy approved by the Board is a target measured as net debt (as defined in the company's WBS documentation, refer to note 1E of the company's regulatory Annual Performance Report) to RCV, of 80%.

This allows sufficient headroom within the company's financial covenants, which are triggered at a level of more than 90%. The company's gearing on this basis was 76.0% at 31 March 2021 (78.9% at 31 March 2020).

Assuming no significant changes to existing credit rating agencies' methodologies or sector risk assessments, the company aims to maintain its existing credit ratings of A3 with Moody's, BBB+ with Standard & Poor's and BBB+ with Fitch for the Class A bonds issued by its financing subsidiaries. These ratings are used by the industry's economic regulator, Ofwat, to assess the company's ability to comply with its licence requirement to maintain an investment grade credit rating.

The company looks to manage its risk by monitoring and maintaining the relevant key financial ratios used by the credit rating agencies to determine the credit ratings given. Further detail on the precise measures and methodologies used to assess water companies' credit ratings can be found in the methodology papers published by the rating agencies. Gearing and credit ratings are reported quarterly to the Board through the treasury report.

Statutory Financial Statements continued

Notes to the financial statements – appendices (continued)

A5. RETIREMENT BENEFITS

Defined benefit section

The company's pension plan providing benefits based on final pensionable salary is closed to new members (the two precursor plans closing in April 1996 and September 2004). The assets of the AWPP are held separately from those of the company. The plan's corporate trustee (the 'Trustee') is a subsidiary of Affinity Water Capital Funds Limited, an intermediate parent of the company.

The risks of the plan are as follows:

Asset volatility

The plan liabilities are calculated using a discount rate set with reference to high quality corporate bond yields. If plan assets underperform this yield, this will create a deficit.

The assets of the plan include a proportion of equities, which are expected to outperform corporate bonds in the long-term while providing volatility and risk in the short-term. As the plan has matured, the Trustee has commenced reducing the level of investment risk and will be investing more in assets that better match the liabilities of the plan and expected cash outflows based on the plan's maturity profile.

The company believes that due to the strength of its business and the long-term nature of the plan liabilities, a level of continuing equity investment is an appropriate element of the Trustee's long-term strategy to manage the plan efficiently.

Changes in bond yield

A decrease in corporate bond yields will increase plan liabilities, although this will be partially offset by an increase in the value of the plan's bond holdings.

Life expectancy

The majority of the plan's obligations are to provide benefits for the life of its members, so increases in life expectancy will result in an increase in the plan's liabilities.

Inflation risk

The pension obligations are linked to inflation, and higher inflation will lead to higher liabilities (although, in most cases, caps on the level of inflationary increases are in place to protect the plan against extreme inflation).

Investment strategy

Following a Trustee investment strategy review in 2018/19, and the focus towards a 'cashflow driven investment' strategy, the Trustee implemented the following changes to the plan's portfolio during the prior year:

- increased the level of interest rate and inflation hedging provided by the plan's assets from 90% to 92.5%; and
- introduced a new segregated actively managed investment 'liability driven investment/cashflow driven investment' portfolio managed by Insight Investment Management Limited, which is expected to provide stable returns and regular income to meet the plan's outgoings.

The latest actuarial valuation of the AWPP, determined by an independent qualified actuary, was at 31 December 2017[1], which concluded that the pension plan was fully funded on a self-sufficiency basis. This actuarial valuation was made on the "attained age" funding method, based on the following assumptions:

RPI inflation:	measured by reference to the Bank of England gilt inflation curve;
CPI inflation:	measured by reference to the RPI inflation curve described above less 1.0% per annum;
Pre-retirement discount rate:	measured by reference to the Bank of England gilt yield curves plus 0.25% per annum;
Post retirement discount rate:	measured by reference to the Bank of England gilt yield curves plus 0.25% per annum;
Salary increases:	measured by reference to the CPI inflation curve described above plus 1.0% per annum;
Deferred pension increases:	measured by reference to the CPI or RPI inflation curves described above with an appropriate adjustment for any caps and collars;
Pension increases:	measured by reference to the CPI or RPI inflation curves described above with an appropriate adjustment for any caps and collars.

Defined benefit section – employer contributions

Based on the latest actuarial valuation at 31 December 2017, no further deficit payments are required. The contributions expected to be paid into the AWPP for the year ending 31 March 2022 are £5,000,000, all by the company (£4,954,000 by the company and £5,000,000 taking into account both participating employers in the year ended 31 March 2021), although this is based on the current Schedule of Contributions and will be dependent on the outcome of the actuarial valuation as at 31 December 2020 currently being undertaken.

The weighted average duration of the defined benefit obligation is 17.5 years (2020: 16.3 years).

Defined benefit section - financial and demographic assumptions

Adjustments to actuarial valuations have been made based on the following assumptions:

	2021	2020
Discount rate	**1.95% pa**	2.30% pa
Salary growth	**3.25% pa**	2.70% pa
RPI	**3.25% pa**	2.50% pa
CPI	**2.75% pa**	1.70% pa
Life expectancy for a male pensioner from age 65 (years)	**22**	22
Life expectancy for a female pensioner from age 65 (years)	**24**	24
Life expectancy from age 65 (years) for a male participant currently aged 45 (years)	**23**	24
Life expectancy from age 65 (years) for a female participant currently aged 45 (years)	**26**	26

Deferred pensions are revalued to retirement age in line with the CPI assumption of 2.75% per annum (2020: 1.70% per annum) unless otherwise prescribed by statutory requirements or the plan rules.

[1] Another actuarial valuation, as at 31 December 2020, is currently being undertaken.

Statutory Financial Statements continued

Notes to the financial statements – appendices (continued)

A5. RETIREMENT BENEFITS (CONTINUED)

Defined benefit section - sensitivity analysis

	Change in assumption	Impact on defined benefit obligation	Change in assumption	Impact on defined benefit obligation
2021				
Discount rate	**0.5% decrease**	**9.2% increase**	**0.5% increase**	**9.2% decrease**
Salary growth	**0.5% increase**	**0.9% increase**	**0.5% decrease**	**0.9% decrease**
Pension growth rate	**0.5% increase**	**7.5% increase**	**0.5% decrease**	**7.5% decrease**
Life expectancy	**1 year increase**	**4.0% increase**	**1 year decrease**	**4.0% decrease**
2020				
Discount rate	0.5% decrease	8.5% increase	0.5% increase	8.5% decrease
Salary growth	0.5% increase	0.9% increase	0.5% decrease	0.9% decrease
Pension growth rate	0.5% increase	6.9% increase	0.5% decrease	6.9% decrease
Life expectancy	1 year increase	4.0% increase	1 year decrease	4.0% decrease

The above sensitivity analyses are based on a change in an assumption while holding all other assumptions constant. In practice this is unlikely to occur, and changes in some of the assumptions may be correlated. When calculating the sensitivity of the defined benefit asset to significant actuarial assumptions, the same method (present value of the defined benefit asset calculated using the projected unit credit method at the end of the reporting period) has been applied as when calculating the pension asset recognised within the statement of financial position.

Defined benefit section - net retirement benefit surplus

At 31 March, the fair values of the plan's assets recognised in the statement of financial position were as follows:

	Plan assets %	2021 £000	Plan assets %	2020 £000
Equity securities	**6%**	**33,415**	4%	21,840
Debt securities	**73%**	**392,829**	71%	358,693
Property	**0%**	**266**	0%	288
Infrastructure	**2%**	**9,575**	2%	9,066
Liability driven investments	**13%**	**70,344**	18%	88,507
Cash and cash equivalents	**6%**	**33,941**	5%	22,857
Total fair value of the plan's assets	**100%**	**540,370**	100%	501,251
Present value of defined benefit obligations		**(465,838)**		(396,632)
Net retirement benefit surplus		**74,532**		104,619

The total of assets which are quoted is £450,397,000 (2020: £331,058,000) and the total of assets which are unquoted is £89,973,000 (2020: £170,193,000).

Defined benefit section - fair value of plan assets

Movements in the fair value of the plan's assets were as follows:

	£000	£000
At 1 April 2020/1 April 2019	**501,251**	518,686
Benefits paid	**(16,395)**	(16,670)
Principal employer contributions	**2,897**	4,908
Contributions by plan participants	**552**	557
Interest income	**11,416**	12,326
Re-measurement gains/(losses)	**40,649**	(18,556)
At 31 March 2021/31 March 2020	**540,370**	501,251

Defined benefit section - present value of plan liabilities

Movements in the present value of the defined benefit liabilities are as follows:

	£000	£000
At 1 April 2020/1 April 2019	**(396,632)**	(417,492)
Benefits paid	**16,395**	16,670
Contributions by plan participants	**(552)**	(557)
Net current service cost	**(3,259)**	(3,860)
Past service cost	**(31)**	(148)
Interest expense	**(8,948)**	(9,839)
Re-measurement (losses)/gains	**(72,811)**	18,594
At 31 March 2021/31 March 2020	**(465,838)**	(396,632)

Defined contribution section

At the same time that the defined benefit section became closed to new entrants, the company established a defined contribution section to provide pension benefits to qualifying employees.

The total pension charge for the defined contribution section of the AWPP for the year ended 31 March 2021 was £3,573,000 (2020: £3,281,000). There are no amounts prepaid or outstanding in respect of the defined contribution section at 31 March 2021 (2020: £nil).

Statutory Financial Statements continued

Notes to the financial statements – appendices (continued)

A6. SUBSIDIARIES

Name of company	Country of registration/ incorporation	Registered address	Nature of business	Type of holding	Proportion of voting rights and shares held
Affinity Water Finance (2004) PLC	United Kingdom	Tamblin Way, Hatfield, Hertfordshire AL10 9EZ	Financing company	Ordinary shares	100%
Affinity Water Finance PLC	United Kingdom	Tamblin Way, Hatfield, Hertfordshire AL10 9EZ	Financing company	Ordinary shares	100%
Three Valleys Water Limited	United Kingdom	Tamblin Way, Hatfield, Hertfordshire AL10 9EZ	Dormant company	Ordinary shares	100%
Tendring Hundred Water Services Limited	United Kingdom	Tamblin Way, Hatfield, Hertfordshire AL10 9EZ	Dormant company	Ordinary shares	100%
Folkestone and Dover Water Services Limited	United Kingdom	Tamblin Way, Hatfield, Hertfordshire AL10 9EZ	Dormant company	Ordinary shares	100%
White Cliffs Water Limited	United Kingdom	Tamblin Way, Hatfield, Hertfordshire AL10 9EZ	Dormant company	Ordinary shares	100%

The company has an investment of £50,000 in 100% of the £1 ordinary shares of a subsidiary company, Affinity Water Finance (2004) PLC. The principal activity of Affinity Water Finance (2004) PLC, incorporated in the United Kingdom, is to raise finance for the company. It made a profit of £1,000 for the year ended 31 March 2021 (2020: £1,000), relating to bond management fees charged to Affinity Water Limited.

The company also has an investment of £50,000 in 100% of the £1 ordinary shares of another subsidiary company, Affinity Water Finance PLC. The principal activity of Affinity Water Finance PLC, incorporated in the United Kingdom, is to raise finance for the company. It made a profit of £6,000 for the year ended 31 March 2021 (2020: £6,000), relating to bond management fees charged to Affinity Water Limited.

The four dormant subsidiaries listed above file accounts at Companies House.

A7. RELATED PARTY TRANSACTIONS

Purchases of goods and services

			2021		2020	
Related party	Nature of relationship	In respect of	Value £000	Balance £000	Value £000	Balance £000
Allianz Global Corporate & Speciality	Common ownership	Insurance	**2,093**	**(1,084)**	1,852	(1,009)
Allianz Engineering	Common ownership	Insurance	**1**	**-**	2	(1)
SSE plc	Shared director (up until 29 January 2021)	Electricity	**21,965**	**-**	26,068	5,991

See note 3.3 for disclosure of the directors' remuneration.

Regulatory Annual Performance Report

for the year ended 31 March 2021

CONTENTS

Statement on direction and performance	204
Impact of COVID-19 on our operational results	205
Impact of COVID-19 on our financial results	208
Board statement on the completeness and accuracy of the information	209
Certificates of compliance	210
Statement of risk and compliance	215
Independent auditors' report	216
Section 1 - Regulatory financial reporting	
Income statement	220
Statement of comprehensive income	222
Statement of financial position	223
Statement of cash flows	225
Net debt analysis	226
Financial flows	228
Statement of accounting policies	230
Statement of directors' remuneration and standards of performance	234
Section 2 - Price review and other segmental reporting	239
Section 3 - Performance summary	250
Section 4 - Non-audited additional regulatory information – service level	259
Section 5 - Non-audited additional regulatory information – water resources	272
Section 6 - Non-audited additional regulatory information – water network plus	274
Section 9 - Non-audited additional regulatory information – innovation competition	279
Tax strategy related to the appointed business	285
Assurance	286

The following regulatory Annual Performance Report is prepared to enable the Water Services Regulation Authority (Ofwat) to monitor the financial performance of the regulated water business. This regulatory Annual Performance Report should be read in conjunction with the annual report and financial statements as a whole.

Affinity Water Limited

(Registered Number 02546950)

We have made a commitment to restoring chalk streams in our supply area

Regulatory Annual Performance Report

Statement on direction and performance

We are pleased to introduce our regulatory Annual Performance Report for the year ended 31 March 2021, the first year of AMP7. Going into AMP7, we agreed challenging commitments and we recognise the importance of meeting these.

These commitments are in response to the significant environmental, social and governance challenges we face of a rising population and increased demand for water, as well as a reduction in the availability of water in years ahead. We recognise how crucial our business activities are to the wider environment and understand the need to become even more agile as we need to deliver more for the environment and our customers, for an affordable price. We know we can adjust rapidly and transform our ways of working; the past year and our response to COVID-19 has shown this, and we have made the key first steps towards this transformation. We are proud to have committed to achieving net zero carbon emissions by 2030 whilst continuing to provide high quality water.

As a Board, we spend a significant amount of time aligning our company plans to the interests of customers, employees and wider stakeholders. Our Section 172 statement on page 54 shows how we have engaged with our key stakeholders to make key decisions in the year, including our ongoing response to COVID-19, how we formulated our Strategic Direction Statement and how we approved our AMP7 investment and transformation programme, all of which were approved as meeting stakeholder expectations and delivering on our AMP7 commitments. We have re-invigorated the business considerably in the last three years, with a new executive team, a strengthened Board, committed long-term investors, an excellent team of colleagues, and a clear purpose to help us move forwards. Our Customer Challenge Group, consisting of representatives with experience representing household customers, holds us to account on how we are performing against our performance commitments, all of which can be read on page 22.

How the company has set its aspirations and performed for all those it serves

Our ambition is reflected in our purpose "to provide high quality drinking water for our customers and take care of the environment, for our communities now and in the future". The Board was heavily involved in forming the company purpose and has continued to work with the leadership team to monitor our performance throughout the year. As a Board, we are responsible for fostering the right culture, and we work with senior leadership to reinforce the right behaviours to allow all members of our workforce to bring their true selves to work, to enable them to reach their full potential and deliver on our purpose. By committing to inclusivity, we ensure that our company and its values best reflect the communities we serve and allow us to strive to be world class in what we do. For more details on our purpose and culture, see page 77.

Our shareholders are highly regarded and have experience of long-term asset ownership. They support our plans to invest and enhance our infrastructure to ensure future resilience, as demonstrated by their agreement to restrict dividends paid in AMP7. See details of our finances on page 14, including details on our investment plans and funding of these programmes. Our Board approved dividend and executive remuneration policies ensure that dividends and executive remuneration are proportionate with long-term returns and performance of the company, whilst not impairing its longer term financeability. The dividend policy states that dividends paid by the appointed business must consider an assessment of our performance against the Final Determination for AMP7 for the following areas: financial performance, operational performance, customer and community performance, and safety and health performance.

Our salary and benefit pay policy for executives is based on the market median. Executive annual bonuses are linked to in year delivery of financial, operational, customer and community and health and safety measures, which are linked to our AMP7 commitments where applicable, detailed in our Remuneration Report on pages 111 to 125. The Board is reassured that the pay structure incentivises executives to deliver long-term sustainable performance for customers and communities, employees and shareholders.

This annual report and financial statements includes full and transparent disclosure of our performance in the year and the Board is confident that the plans put in place ensure a stable future for our company.

On behalf of the Board

Ian Tyler
Company Chair

Impact of COVID-19 on our operational results

We have continued to experience significant operating and performance challenges during the reporting year driven by the pandemic.

During the year, we have sought to understand and quantify the extent to which our costs and performance are affected by COVID-19 and lockdown. While we mitigate the impacts wherever possible, we nonetheless saw variances in our 2020/21 performance (especially per capita consumption detailed below) and variances to our 2020/21 costs (especially the costs of treating and pumping additional water) that cannot be explained by the weather. These impacts are caused by the change in our consumers' circumstances during lockdown, which include increased homeworking and therefore a significant increase in household use. The increase in household demand has outstripped the impact of reduced non-household use in our operating area.

Monitoring the impacts of the pandemic on our business is an ongoing exercise. Lockdown restrictions have continued into 2021/22, and it is highly likely that our consumers will behave differently from pre-pandemic norms, even after the restrictions are fully lifted. For example, we expect to see an increased frequency of homeworking. We expect that other performance areas and costs could be impacted in the future as the economic and social impacts of the pandemic continue. Although we cannot quantify these future impacts now, we are looking to predict what could happen, be agile in responding as our customers' needs change and to continue to monitor the direct impacts of the pandemic on our business.

Per capita consumption

We experienced unprecedented high demand whilst more people stayed at home within our supply area under COVID-19 travel restrictions. We have experienced a significant increase in our PCC as the pattern of our customer consumption changes from non-household to significantly greater household consumption as more of our supply area continues to work from home and not take vacations outside of our supply region. During the year, our engineers and technicians worked around the clock to treat and pump more water into the network, while our customers became Water Heroes as they tried to save water and ease demand on our networks by ordering water saving devices – demand for these devices surged by over 40%. These changes impacted both our operational and our financial performance as we incurred additional costs in responding to this increased demand. We welcome Ofwat's decision to not make in-period determinations for PCC and to review this as part of PR24.

Water industry national environment programme (WINEP), National Environment Plan (NEP) and bathing water

The company has not requested any extensions to any of our year one WINEP delivery dates from the Environment Agency and we have no bathing water quality assessments listed under WINEP. Overall there has been no impact upon achieving our 2020/21 WINEP delivery for completion dates on or before the 31 March 2021.

There is a risk that the impacts of COVID-19 will be incurred later in AMP7, with the majority of the impact expected on our River Restoration WINEP commitments due to our project partners and stakeholders being furloughed, or due to the restrictions and safe working practices of the past 15 months delaying site visits and on-site meetings. We are trying to mitigate these impacts as far as practicable. The table below sets out the WINEP projects which have already been, or could potentially be impacted by the COVID-19 delays, where programmes have been condensed or workloads reprioritised.

If alterations to our programmes are required, these will be developed in agreement with the Environment Agency who are aware of the risk and are being kept updated through 3 monthly WINEP technical liaison meetings and other channels. With the COVID-19 situation changing all the time, WINEP delivery is monitored regularly.

Regulatory Annual Performance Report continued

Impact of COVID-19 on our operational results (continued)

OPERATIONAL IMPLICATIONS (CONTINUED)

Water industry national environment programme (WINEP), National Environment Plan (NEP) and bathing water (continued)

Scheme name	Measure Type	Original Completion date
CHELMER - Hempstead	Investigation and Options Appraisal	31/03/2022
CHELMER - Armitage Bridge, Thaxted/Bolford Street, Thaxted and Mill Lane Gt Dunmow	Investigation and Options Appraisal	31/03/2022
North Essex Chalk/Armitage Bridge, Thaxted/Bolford Street, Thaxted and Mill Lane Gt Dunmow	Investigation and Options Appraisal	31/03/2022
North Essex Chalk/Hempstead	Investigation and Options Appraisal	31/03/2022
Higham Bridge/Lattinford Bridge/Shelley Hall/Stoke by Nayland - 1 & 2/ Stratford St Mary(Woodhouse Farm), Dedham P.S.,Lawford P.S.	Investigation and Options Appraisal	31/03/2022
North Essex Chalk/Culters Lane, East Bergholt	Investigation and Options Appraisal	31/03/2022
Dedham and Stratford St Mary	Investigation and Options Appraisal	31/03/2022
Implementation Scheme: Undertake river restoration to mitigate the effects of abstraction.	Land Management/ Habitat Restoration/ Physical Improvement	22/12/2024
Implementation Scheme: Undertake river restoration to mitigate the effects of abstraction.	Land Management/ Habitat Restoration/ Physical Improvement	22/12/2024
CRESCENT ROAD PUMPING STATION	Investigation and Options Appraisal	31/03/2022
KINGS WALDEN PUMPING STATION	Investigation and Options Appraisal	31/03/2022
WATTON PUMPING STATION	Investigation and Options Appraisal	31/03/2022
ASTON PUMPING STATION	Investigation and Options Appraisal	31/03/2022
BROOMIN GREEN PUMPING STATION	Investigation and Options Appraisal	31/03/2022
BALDOCK ROAD,LETCHWORTH	Investigation and Options Appraisal	31/03/2022
BOWRING,LETCHWORTH	Investigation and Options Appraisal	31/03/2022
FULLER,LETCHWORTH	Investigation and Options Appraisal	31/03/2022
WENDEN	Investigation and Options Appraisal	31/03/2022
NEWPORT	Investigation and Options Appraisal	31/03/2022
DEBDEN ROAD,SAFFRON WALDEN	Investigation and Options Appraisal	31/03/2022
SPRINGWELL SOURCE	Investigation and Options Appraisal	31/03/2022
UTTLESFORD BRIDGE SOURCE	Investigation and Options Appraisal	31/03/2022
ALMA ROAD PUMPING STATION	Investigation and Options Appraisal	31/03/2022
CHARTRIDGE PUMPING STATION	Investigation and Options Appraisal	31/03/2022
BERRYGROVE PUMPING STATION	Investigation and Options Appraisal	31/03/2022
BRICKET WOOD PUMPING STATION	Investigation and Options Appraisal	31/03/2022
BUSHEY PUMPING STATION	Investigation and Options Appraisal	31/03/2022
NETHERWILD PUMPING STATION	Investigation and Options Appraisal	31/03/2022
BUSHEY HALL PUMPING STATION	Investigation and Options Appraisal	31/03/2022
BLACKFORD PUMPING STATION	Investigation and Options Appraisal	31/03/2022
CHORLEYWOOD PUMPING STATION	Investigation and Options Appraisal	31/03/2022
MILL END PUMPING STATION	Investigation and Options Appraisal	31/03/2022
WALL HALL PUMPING STATION	Investigation and Options Appraisal	31/03/2022
HOLYWELL PUMPING STATION	Investigation and Options Appraisal	31/03/2022
MUD LANE PUMPING STATION	Investigation and Options Appraisal	31/03/2022
NORTHMOOR PUMPING STATION	Investigation and Options Appraisal	31/03/2022
SPRINGWELL PUMPING STATION	Investigation and Options Appraisal	31/03/2022
STOCKERS PUMPING STATION	Investigation and Options Appraisal	31/03/2022
WEST HYDE PUMPING STATION	Investigation and Options Appraisal	31/03/2022
GERRARDS CROSS PUMPING STATION	Investigation and Options Appraisal	31/03/2022
ALBERT ROAD	Investigation and Options Appraisal	31/03/2022
KENSWORTH LYNCH PUMPING STATION	Investigation and Options Appraisal	31/03/2022
AMERSHAM PUMPING STATION	Investigation and Options Appraisal	31/03/2022
CHALFONT ST GILES PUMPING STATION	Investigation and Options Appraisal	31/03/2022
GREAT MISSENDEN PUMPING STATION	Investigation and Options Appraisal	31/03/2022

Scheme name	Measure Type	Original Completion date
MARLOWES PUMPING STATION	Investigation and Options Appraisal	31/03/2022
CRESCENT ROAD PUMPING STATION	Investigation and Options Appraisal	31/03/2022
SACOMBE PUMPING STATION	Investigation and Options Appraisal	31/03/2022
THUNDRIDGE PUMPING STATION	Investigation and Options Appraisal	31/03/2022
CHIPPING PUMPING STATION	Investigation and Options Appraisal	31/03/2022
STANDON PUMPING STATION	Investigation and Options Appraisal	31/03/2022
WADESMILL ROAD PUMPING STATION	Investigation and Options Appraisal	31/03/2022
SACOMBE PUMPING STATION	Investigation and Options Appraisal	31/03/2022
THUNDRIDGE PUMPING STATION	Investigation and Options Appraisal	31/03/2022
HADHAM MILL PUMPING STATION	Investigation and Options Appraisal	31/03/2022
THUNDRIDGE PUMPING STATION	Investigation and Options Appraisal	31/03/2022
MUSLEY LANE PUMPING STATION	Investigation and Options Appraisal	31/03/2022
THE CAUSEWAY BISHOPS STORTFORD	Investigation and Options Appraisal	31/03/2022
STANSTED MOUNTFITCHET PUMPING STATION	Investigation and Options Appraisal	31/03/2022
NORTH STORTFORD PUMPING STATION	Investigation and Options Appraisal	31/03/2022
PICCOTTS END PUMPING STATION	Investigation and Options Appraisal	31/03/2022
BOREHOLE AT DOVER PRIORY PS - Chalk	Options Appraisal	31/03/2022
STANSTED PUMPING STATION	Investigation and Options Appraisal	31/03/2022
STANSTED MOUNTFITCHET PUMPING STATION	Investigation and Options Appraisal	31/03/2022
STANSTED PUMPING STATION	Investigation and Options Appraisal	31/03/2022
Higham Bridge/Lattinford Bridge/Shelley Hall/Stoke by Nayland - 1 & 2 Stratford St Mary(Woodhouse Farm), Dedham P.S.,Lawford P.S.	Sustainability Change	22/12/2024
CRESCENT ROAD PUMPING STATION	Investigation and Options Appraisal	31/03/2022
DIGSWELL PUMPING STATION	Investigation and Options Appraisal	31/03/2022
KINGS WALDEN PUMPING STATION	Investigation and Options Appraisal	31/03/2022
WATTON PUMPING STATION	Investigation and Options Appraisal	31/03/2022
ASTON PUMPING STATION	Investigation and Options Appraisal	31/03/2022
BROOMIN GREEN PUMPING STATION	Investigation and Options Appraisal	31/03/2022
WHITEHALL PUMPING STATION	Investigation and Options Appraisal	31/03/2022
PORTHILL PUMPING STATION	Investigation and Options Appraisal	31/03/2022
THUNDRIDGE PUMPING STATION	Investigation and Options Appraisal	31/03/2022
HADHAM MILL PUMPING STATION	Investigation and Options Appraisal	31/03/2022
THE CAUSEWAY BISHOPS STORTFORD	Investigation and Options Appraisal	31/03/2022
STANSTED MOUNTFITCHET PUMPING STATION	Investigation and Options Appraisal	31/03/2022
NORTH STORTFORD PUMPING STATION	Investigation and Options Appraisal	31/03/2022
STANSTED PUMPING STATION	Investigation and Options Appraisal	31/03/2022
CULTERS LANE, EAST BERGHOLT	Investigation and Options Appraisal	31/03/2022
LATTINFORD BRIDGE	Investigation and Options Appraisal	31/03/2022
RIVER RESTORATION PROJECTS - UPPER COLNE	Adaptive Management	31/03/2025
RIVER RESTORATION PROJECTS - BULBOURNE	Adaptive Management	31/03/2025
RIVER RESTORATION PROJECTS - CHESS	Adaptive Management	31/03/2025
BOREHOLES AT BROOME PS, NR DENTON - Chalk	Options Appraisal	31/03/2022
BOREHOLES AT RAKESHOLE, TAPPING & DENTON SOUTH - Chalk	Options Appraisal	31/03/2022
BOREHOLES AT OTTINGE, WORLDS WONDER & SKEETE - Chalk	Options Appraisal	31/03/2022
BOREHOLES AT DRELLINGORE & LYE OAK - Chalk	Options Appraisal	31/03/2022
LOWER COLNE U/S MAPLE LODGE SEWAGE TREATMENT WORKS RIVER RESTORATION	Adaptive Management	31/03/2025
BOREHOLES AT BUCKLANDS MILL PS - Chalk	Options Appraisal	31/03/2022

Business void properties

The company does not have any commitments to reduce business void properties and therefore COVID-19 has had no impact on this.

Regulatory Annual Performance Report continued

Impact of COVID-19 on our financial results

We have been financially impacted by COVID-19 throughout 2020/21, and we expect this to continue into 2021/22.

Revenue

Our non-household revenue decreased significantly due to businesses temporarily closing as a result of the pandemic, falling by £15.5m from the previous year. We anticipate that non-household revenue will increase in 2021/22 but the reduction in this revenue in 2020/21 is unrecoverable as part of the revenue adjustment mechanism.

Household revenue remained fairly consistent with the prior year despite consumption increasing significantly as a result of the hot, dry weather over the summer and while more people stayed at home, and within our supply area, following the Government's COVID-19 advice. This is due to a customer bill reduction for 2020/21 and because 40% of our customers are on unmeasured tariffs. The impact of COVID-19 on our household revenue will be recovered as part of the revenue adjustment mechanism in two years' time.

We have seen a significant drop in our new connections revenues and expenditure due to a downturn of activity in this area as a result of the pandemic.

Bad debt charges and our provision

Given the economic uncertainty and fall in cash collections during the year, we have provided for an additional £2.3m of bad debt and increased our support for vulnerable customers during the year. For our customers, we have publicised our Priority Services Register and our collaboration with the National Debtline charity. We also proactively contacted customers who we thought could be more impacted by the pandemic, for example cash payers and have facilitated direct debit payments instead. More than 7,000 people were given payment breaks during 2020/21 and we continue to support 85,000 households in our region with Social Tariffs.

Operational costs

Due to the unprecedented high demand for water we have seen whilst more people stayed at home within our supply area under COVID-19 travel restrictions, our operational costs, particularly bulk water imports and electricity costs, have increased significantly. We have also incurred costs ensuring our business was able to operate in a COVID-19 safe manner, such as ensuring our sites are COVID-19 secure and teams have the appropriate equipment to continue to work safely or work from home. It is estimated that COVID-19 has resulted in a £5.3m increase in our operational costs in the year.

Capital expenditure

Capital expenditure in the year was £139.4m (2020: £129.9m), and was incurred principally in our mains renewals, trunk main replacement, water treatment (including pesticide treatment) and integrated water savings programmes. This excluded £16.5m (2020: £17.2m) of infrastructure renewal expenditure, which is treated as an operating cost under FRS 101. Our capital expenditure programme has been impacted by COVID-19, with some expenditure scheduled for 2020/21 having been delayed until later in AMP7.

Board statement on the completeness and accuracy of information

We want to be open with our customers and other stakeholders about our performance against our commitments. We want them all to have trust in our service and confidence in the information we publish about our performance. We encourage customers and other stakeholders to provide feedback at any time about how we are performing.

We regularly publish information on our performance to demonstrate to customers, stakeholders and our regulators the extent to which we are delivering the services expected of us.

Our Assurance Plan sets out the main assurance activities that we either carry out ourselves or engage third-party providers to carry out independently, so that the information we report to customers, stakeholders and regulators is accurate, transparent, reliable, relevant, complete and up to date. We consider it essential to demonstrate that we report information on our performance that meets these criteria.

This is part of our commitment to demonstrate that we take ownership of the information we report. Our Assurance Plan also describes the main categories of information which we report and the main assurance controls we have in place for each category. We have recently published our draft Assurance Plan for AMP7 on our website at **www.affinitywater.co.uk/governance-assurance** and will be reviewing and updating this as appropriate throughout the AMP, and will shortly be publishing a final version.

On behalf of the Board, our Audit, Risk & Assurance Committee has:

- Reviewed and challenged our draft Assurance Plan prior to publication;
- Received, reviewed and challenged reports from various assurance providers, including our external auditor, in respect of key reports and publications including our Annual Report and Financial Statements and our Annual Performance Report;
- Received, reviewed and challenged reports from the Head of Audit, Risk and Compliance on the effectiveness of the Company's system of internal control and risk management systems; and
- Received, reviewed and challenged individual internal audit reports, in particular with regards to risks to the provision of accurate and complete data and information and how those risks are being mitigated.

The Chair of the Audit, Risk & Assurance Committee reported to the Board in respect of the outcomes of the above reviews.

The various activities referred to above and detailed in full in the Assurance Plan lead the Board to believe that all data and information which the company has provided to Ofwat during 2020/21 and which we have published in our Annual Report and Financial Statements and Annual Performance Report in our role as water undertaker was accurate and complete with no material exceptions to report.

On behalf of the Board

Ian Tyler
Company Chair
28 June 2021

Regulatory Annual Performance Report continued

Certificates of compliance

To: Water Services Regulation Authority, Centre City Tower, 7 Hill Street, Birmingham B5 4UA

RING-FENCING CERTIFICATE

This is to certify that on 28 June 2021 the Board of Affinity Water Limited ('the Appointee') resolved that in its opinion, in accordance with the company's Condition P licence requirements:

1) the Appointee will have available to it sufficient financial resources and facilities to enable it to carry out, for at least the next 12 months, the Regulated Activities (including the investment programme necessary to fulfil the Appointee's obligations under the Appointment); and

2) the Appointee will, for at least the next 12 months, have available to it

   (a) sufficient management resources and systems of planning and internal control; and

   (b) rights and resources other than financial resources

which are sufficient to enable it to carry out the Regulated Activities (including the investment programme necessary to fulfil the Appointee's obligations under the Appointment); and

3) all contracts entered into with any Associated Company include all necessary provisions and requirements in respect of the standard of service to be supplied to the Appointee, to ensure that it is able to carry out the Regulated Activities.

In giving this certificate the main factors which the Board has taken into account are:

Financial resources and facilities:

- the net worth of the company as shown in the financial statements and the budget for the forthcoming year supported by long-term plans and performance against the Final Determination set at the most recent price review, for both operating and investment expenditure;

- the financing arrangements available to the company and management of associated risks (refer to notes 16 and A4 of the company's statutory financial statements and the principal risks and uncertainties section of the company's strategic report beginning on page 38 for further details), including details of the company's credit rating; and

- the results of the stress-testing performed in relation to the company's viability statement for the year ended 31 March 2021 (refer to page 50) which is subject to external assurance (refer to our Board statement on the completeness and accuracy on information on page 209 for details on controls and the levels of assurance obtained during the year).

The Board concludes that the budget for the forthcoming year adequately supports our commitments set in the Final Determination and provides sufficient resources to meet our operating and investment expenditure needs for at least the next 12 months. The company has sufficient financing arrangements available to it to meet these commitments, taking into account the impact of any potential principal risks and uncertainties and the results of stress-testing performed on the base case forecasts and budgets. Therefore, the Board concludes the Appointee will have available to it sufficient financial resources and facilities to enable it to carry out, for at least the next 12 months, the Regulated Activities.

Management resources:

- the Board and its Committees have the resources available to them and the fact that they have sufficient independent membership to ensure they can make high quality decisions that address diverse customer and stakeholder needs; and

- the review of succession planning being performed by the Nomination Committee along with the company's HR and Culture Team, as well as the recruitment process, staff engagement and diversity, the quality of training and development programmes and the company's purpose and principles.

The Board concludes that directors have sufficient time to engage with the company and to discharge their responsibilities effectively. The Board concludes that there is an appropriate mix of skills and experience on the Board and the individual Committees, including sufficient independent membership on Committees for the individual directors to constructively challenge and appropriate division of responsibilities, see the skills matrix in the Corporate Governance Statement on page 84. The Board concludes that there are appropriate steps in place to ensure good succession planning that allows for orderly succession to both the Board and senior management positions, ensuring there is a diverse pipeline for succession that reflects the communities that we serve.

Systems of planning and internal control:

- the comprehensive suite of internal control procedures across both operational and financial matters to ensure maintenance of supply, supported by governance procedures, risk management frameworks, segregation of duties matrices and detailed delegated levels of authority, as well as policies to prevent fraud and other unethical behaviour (including but not limited to the company's whistleblowing policy);

- an Internal Audit team reporting to the Audit, Risk and Assurance Committee, and the availability of specialist planning teams who are deployed to major projects and utilise the resources of acknowledged external specialists in such matters;

- the fact that the company's output is subject to considerable external assurance, both fiscal and operational (refer to our Board statement on the completeness and accuracy on information on page 209 for details on controls and the levels of assurance obtained during the year).

The Board concludes that the internal control procedures are working effectively and that the Internal Audit team has the appropriate skills and qualifications it requires to monitor and improve controls across the company. The Board concludes that the work of the Audit, Risk and Assurance Committee (detailed on pages 95 to 104) overseeing the systems of planning and internal control is sufficient.

Rights and resources other than financial resources:

- the company principles, which are the values of the company that underpin how it delivers its underlying purpose and encourages an integrated approach to working; and

- the assets available to the company, including ensuring that it has effective operational systems, and resourcing plans and schedules in the operational business, that enable a continued supply of water, the maintenance and insurance of these systems, and sufficient physical resources through our abstraction licences and water levels.

The Board concludes that the company principles and clearly defined purpose drive the company and conclude that this and the assets available are sufficient to enable it to carry out the Regulated Activities.

Regulatory Annual Performance Report continued

Certificates of compliance (continued)

RING-FENCING CERTIFICATE (CONTINUED)

Contracting:

- the work of the Contracts Committee, attended by the CFO, which operates to review and award significant contracts with suppliers; and
- no guarantees or cross-default obligations given without Ofwat's written consent.

The Board concludes that the position and status of key contracts in place contain all necessary provisions and requirements in respect of the standard of service to be supplied to the Appointee, to ensure that it is able to carry out its Regulated Activities and it is compliant with cross subsidy obligations.

Material issues or circumstances:

- there are no other material issues or other circumstances that have been taken into account when assessing the sufficiency of financial resources.

In giving this certificate the main factors which the directors have taken into account in relation to contracts entered into with any Associated Company are:

- an examination of the contracts with Associated Companies;
- considerations made by the company's Market Oversight Committee; and
- leaving aside the company's contract to supply wholesale water to and the service agreement with its former associated company Castle Water (Southern) Limited (formerly Affinity for Business (Retail) Limited) until its sale from the Affinity Water group in April 2020, the limited contractual arrangements with Associated Companies.

Any transactions with Associated Companies are disclosed in the transactions with Associated Companies note in section 4 of the company's Regulatory Annual Performance Report for the year ended 31 March 2021 (refer to page 280), which is subject to external assurance under Regulatory Accounting Guideline 5.07; Guideline for transfer pricing in the water and sewerage sectors (refer to our Board statement on the completeness and accuracy on information on page 209 for details on controls and the levels of assurance obtained during the year).

In this certificate, the terms "Appointment", "Associated Company" and "Regulated Activities" have the meanings given in the Appointee's Instrument of Appointment, also referred to as the company's licence.

The Board obtained third-party assurance from the company's external Auditor in relation to the sufficiency of financial resources. A full report of the external Auditor's work on the ring-fencing certificate has been provided to Ofwat with no issues noted.

The Board confirms that it will inform Ofwat in writing if it becomes aware of any circumstances which would change the opinion such that it would not give the opinion contained in this certificate.

This certificate was approved unanimously at the Board meeting on 28 June 2021 by

Ian Tyler
Chair

Susan Hooper
Independent non-executive

Chris Newsome
Independent non-executive

Trevor Didcock
Independent non-executive

Mark Horsley
Independent non-executive

Ann Bishop
Independent non-executive

Justin Read
Independent non-executive

Jaroslava Korpanec
Non-executive

Tony Roper
Non-executive

Angela Roshier
Non-executive

Pauline Walsh
Executive director, CEO

Stuart Ledger
Executive director, CFO

Signed on behalf of the Board members listed above,

Ian Tyler
Chair

Regulatory Annual Performance Report continued

Certificates of compliance (continued)

COMPLIANCE WITH CONDITION P, PARAGRAPH P14

Paragraph P14 of Condition P of the company's licence requires the company to ensure at all times, so far as reasonably practicable, that, if at any time, a special administration order were made in relation to it, it has available to it sufficient rights and resources (other than financial resources) so that a special administrator would be able to manage the affairs, business and property of the appointed business of the company in accordance with the purposes of the special administration order.

The company hereby certifies that at 31 March 2021 it was in compliance with paragraph P14 of Condition P.

STATEMENT OF DISCLOSURE OF TRANSACTIONS WITH ASSOCIATED COMPANIES

With respect to the disclosure of transactions with Associated Companies, the directors declare that to the best of their knowledge:

- all appropriate transactions with Associated Companies have been disclosed;
- transactions with Associated Companies are at arm's length (except where agreed with Ofwat) with no cross-subsidy occurring; and
- no directors have acted as both purchaser and supplier in any transaction with an Associate Company.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

In addition to their responsibilities to prepare financial statements in accordance with the Companies Act 2006, Condition F of the Instrument of Appointment requires the company to prepare a set of regulatory accounting statements records which are in accordance with the Regulatory Accounting Guidelines ('RAGs') published by Ofwat under Condition F.

In the case of each of the persons who are directors of the company at the date when this report was approved, so far as each of the directors is aware there is no relevant audit information of which the company's auditor is unaware; and each of the directors has taken all the steps that he/she ought to have taken as a director in order to make himself/herself aware of any relevant information and to establish that the company's auditor is aware of that information.

Relevant audit information means information needed by the company's auditor in connection with preparing its report. This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

Statement of risk and compliance

PURPOSE OF THIS STATEMENT

The purpose of this statement is:

- to confirm that we have a full understanding of, and are meeting, our relevant statutory, licence and regulatory obligations;
- to confirm that the company is taking appropriate steps to manage or mitigate the risks it faces; and
- to explain any significant matters relevant to the company's performance in 2020/21, as presented in section 3 of this regulatory Annual Performance Report on pages 250 to 258.

The statement explains the company's approach to regulatory compliance and assurance and sets out its statement of compliance. It should be read alongside the company's annual report and financial statements for the year ended 31 March 2021, which include a summary of the company's operational performance for 2020/21 from page 35 and set out how the company manages risk and uncertainty from page 38.

REGULATORY COMPLIANCE AND ASSURANCE

The company's approach to achieving and assuring compliance with its licence and regulatory obligations is based on a sound system of internal controls and governance. To inform themselves about the company's compliance, the company's Board and Audit, Risk and Assurance Committee members carry out a range of activities throughout the year to satisfy themselves as to the proper functioning of those systems. The company's Director of Regulation and Strategy is responsible for monitoring regulatory compliance and is supported in discharging this responsibility by employees in the Regulation, Assurance, Legal and Internal Audit teams.

The company continues to employ an external reporter (the 'Reporter') to scrutinise, challenge and give independent advice on the procedures the company uses to collect and report the information underpinning this compliance statement. The Reporter has highlighted that the company has full understanding of and has sufficient processes and internal systems of controls to meet its reporting obligations. The Reporter also highlighted that the vast majority of reporting processes continue to demonstrate either consistent good practice or improvements from previous years, and where areas of inadequacy in reporting procedures were noted in previous years, these have now been addressed, and clear written procedures are in place for all the AMP7 Performance Commitments.

The Reporter's report is available on the company's website: **affinitywater.co.uk/reports-publications**.

REGULATORY OUTPUTS

The Board has reviewed the performance of the company against its regulatory outputs set at the Final Determination 2019. This regulatory Annual Performance Report identifies differences between the outputs that the company has delivered in the year and those that were assumed in its Final Determination 2019.

COMPLIANCE STATEMENT

As a Board, we confirm that:

- we have a full understanding of, and are meeting, our relevant statutory, licence and regulatory obligations;
- we have taken steps to understand and meet customers' expectations;
- we are satisfied that we have sufficient processes and internal systems of control to meet our obligations; and
- we have appropriate systems and processes in place to allow us to identify, manage, mitigate and review our risks.

On behalf of the Board:

Pauline Walsh
CEO

Justin Read
Independent non-executive director

Regulatory Annual Performance Report continued

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

Report on the Regulatory Accounting Statements contained within the Regulatory Annual Performance Report

Opinion on Regulatory Annual Performance Report

In our opinion, Affinity Water Limited's Regulatory Accounting Statements within the Regulatory Annual Performance Report have been prepared, in all material respects, in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA (RAG1.09, RAG2.08, RAG3.12, RAG4.09 and RAG5.07) and the accounting policies (including the company's published accounting methodology statement, as defined in RAG 3.12, appendix 2) set out on pages 230 to 233.

What we have audited

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

- the regulatory financial reporting tables comprising the income statement (table 1A), the statement of comprehensive income (table 1B), the statement of financial position (table 1C), the statement of cash flows (table 1D), the net debt analysis (table 1E), the financial flows (table 1F) and the related notes; and
- the regulatory price review and other segmental reporting tables comprising the segmental income statement (table 2A), the totex analysis for wholesale water and wastewater (table 2B), the operating cost analysis for retail (table 2C), the historical cost analysis of fixed assets for wholesale and retail (table 2D), the analysis of capital contributions (table 2E), the household water revenues by customer type (table 2F), the revenue analysis (table 2I), the infrastructure network reinforcement costs (table 2J), the infrastructure charges reconciliation (table 2K), the analysis of land sales (table 2L), the revenue reconciliation for wholesale (table 2M), residential retail social tariffs (table 2N) and historical costs analysis of intangible assets (table 2O) and the related notes.

We have not audited the Outcome performance tables (tables 3A to 3I) and the additional regulatory information in tables 4A to 4R, 5A to 5B, 6A to 6D and 9A.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)"), including ISA (UK) 800, and applicable law, except as stated in the section on Auditors' responsibilities for the audit of the Annual Performance Report below, and having regard to the guidance contained in *ICAEW Technical Release Tech 02/16 AAF 'Reporting to Regulators on Regulatory Accounts'* issued by the Institute of Chartered Accountants in England & Wales.

Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the Regulatory Accounting Statements within the Annual Performance Report section of our report. We are independent of the company in accordance with the ethical requirements that are relevant to our audit, including the Financial Reporting Council's ("FRC's") Ethical Standard, and we have fulfilled our ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of matter – special purpose basis of preparation

We draw attention to the fact that the Regulatory Accounting Statements have been prepared in accordance with a special purpose framework, Condition F, the Regulatory Accounting Guidelines, the accounting policies (including the company's published accounting methodology statement, as defined in RAG 3.12, appendix 2) set out in the statement of accounting policies and under the historical cost convention. The nature, form and content of the Regulatory Accounting Statements are determined by the WSRA. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the WSRA's purpose. Accordingly, we make no such assessment. In addition, we are not required to assess whether the methods of cost allocation set out in the accounting methodology statement are appropriate to the circumstances of the company or whether they meet the requirements of the WSRA.

The Regulatory Accounting Statements are separate from the statutory financial statements of the company and have not been prepared under the basis of 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 220 to 279 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.

Our opinion is not modified in respect of this matter.

Conclusions relating to going concern

Our evaluation of the directors' assessment of the company's ability to continue to adopt the going concern basis of accounting included:

- testing the mathematical accuracy of the base case going concern model prepared by management and agreeing this to Board approved budgets;
- assessing the inputs and underlying assumptions of the base case model, which includes the anticipated future impacts of COVID-19;
- assessing the downside scenario which has been used to sensitise the base case model, including consideration of the underlying assumptions; and
- reviewing management's analysis of both liquidity and covenant compliance to ensure there is sufficient liquidity and no forecast covenant breaches during the going concern period.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the company's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

In auditing the Regulatory Accounting Statements, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the Regulatory Accounting Statements is appropriate. However, because not all future events or conditions can be predicted, this conclusion is not a guarantee as to the company's ability to continue as a going concern.

Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report.

Reporting on other information

The other information comprises all of the information in the Annual Performance Report other than the Regulatory Accounting Statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the Regulatory Accounting Statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

Regulatory Annual Performance Report continued

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

Report on the Regulatory Accounting Statements contained within the Regulatory Annual Performance Report (continued)

In connection with our audit of the Regulatory Accounting Statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the Regulatory Accounting Statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the Regulatory Accounting Statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report based on these responsibilities.

Responsibilities for the Regulatory Annual Performance Report and the audit

Responsibilities of the Directors for the Regulatory Annual Performance Report

As explained more fully in the Statement of directors' responsibilities set out on page 214, 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 3.12, appendix 2).

The directors are also responsible for such internal control as they determine is necessary to enable the preparation of the Annual Performance Report that is free from material misstatement, whether due to fraud or error.

In preparing the Regulatory Annual Performance Report, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the Audit of the Regulatory Accounting Statements within the Regulatory Annual Performance Report

Our objectives are to obtain reasonable assurance about whether the Regulatory Accounting Statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these Regulatory Accounting Statements.

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud, is detailed below.

We considered the nature of the company's industry and its control environment, and reviewed the company's documentation of their policies and procedures relating to fraud and compliance with laws and regulations. We also enquired of management and internal audit about their own identification and assessment of the risks of irregularities.

Auditors' responsibilities for the Audit of the Regulatory Accounting Statements within the Regulatory Annual Performance Report (continued)

We obtained an understanding of the legal and regulatory frameworks that the company operates in, and identified the key laws and regulations that:

- had a direct effect on the determination of material amounts and disclosures in the Regulatory Accounting Statements. These included Regulatory Accounting Guidelines as issued by the WRSA, UK Companies Act, pensions legislation and tax legislation; and
- do not have a direct effect on the Regulatory Accounting Statements but compliance with which may be fundamental to the company's ability to operate or to avoid a material penalty. These included the company's operating licence, regulatory solvency requirements and environmental regulations.

In common with all audits under ISAs (UK), we are also required to perform specific procedures to respond to the risk of management override. In addressing the risk of fraud through management override of controls, we tested the appropriateness of journal entries and other adjustments; assessed whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluated the business rationale of any significant transactions that are unusual or outside the normal course of business.

There are inherent limitations in the audit procedures described above. We are less likely to become aware of instances of non-compliance with laws and regulations that are not closely related to events and transactions reflected in the Regulatory Accounting Statements. Also, the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion.

A further description of our responsibilities for the audit of the Regulatory Accounting Statements is located on the Financial Reporting Council's website at: *www.frc.org.uk/auditorsresponsibilities*. This description forms part of our auditors' report.

Use of this report

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 for to anyone other than the company and the WRSA, for our audit work, for this report or for the opinions we have formed.

Our opinion on the Regulatory Accounting Statements is separate from our opinion on the statutory financial statements of the company for the year ended 31 March 2021 on which we reported on 28 June 2021, which are prepared for a different purpose. Our audit report in relation to the statutory financial statements of the company (our "Statutory audit") was made solely to the company's member, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our Statutory audit work was undertaken so that we might state to the company's member those matters we are required to state to it in a statutory audit report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume responsibility for any other purpose or to any other person to whom our Statutory audit report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Watford

28 June 2021

Regulatory Annual Performance Report continued

Section 1 – Regulatory financial reporting

1A - INCOME STATEMENT FOR THE 12 MONTHS ENDED 31 MARCH 2021

		Adjustments			
	Statutory £000	Differences between statutory and RAG definitions £000	Less: non-appointed £000	Total adjustments £000	Total appointed activities £000
Revenue	**286,782**	**(6,620)**	**-**	**(6,620)**	**280,162**
Operating costs	(290,870)	(2,019)	(3,557)	1,538	(289,332)
Other operating income	17,657	(2,968)	12,328	(15,296)	2,361
Operating profit	**13,569**	**(11,607)**	**8,771**	**(20,378)**	**(6,809)**
Other income	-	11,607	-	11,607	11,607
Interest income	13,302	-	-	-	13,302
Interest expense	(48,621)	-	-	-	(48,621)
Other interest expense	2,468	-	-	-	2,468
Profit before tax and fair value movements	**(19,282)**	**-**	**8,771**	**(8,771)**	**(28,053)**
Fair value gains/(losses) on financial instruments	(44,218)	-	-	-	(44,218)
Profit before tax	**(63,500)**	**-**	**8,771**	**(8,771)**	**(72,271)**
UK Corporation tax	830	-	(1,666)	1,666	2,496
Deferred tax	11,392	-	-	-	11,392
Profit for the year	**(51,278)**	**-**	**7,105**	**(7,105)**	**(58,383)**
Dividends	**(1,000)**	**-**	**(1,000)**	**1,000**	**-**
Tax analysis					
Current year	-	-	1,666	(1,666)	(1,666)
Adjustments in respect of prior years	(830)	-	-	-	(830)
UK Corporation tax	**(830)**	**-**	**1,666**	**(1,666)**	**(2,496)**
Analysis of non-appointed revenue					
Imported sludge	-				
Tankered waste	-				
Other non-appointed revenue	12,328				
Revenue	**12,328**				

The table below summarises the differences between statutory and RAG definitions:

	Revenue recognition £000	Third party non-price control revenue £000	Income from providing developer information and administration of new connections £000	Connection charges income £000	Amortisation of deferred grants and contribution £000	Gain on disposal of fixed assets £000	Meter reading commission £000	Rental and sundry income £000	Total £000
Revenue	4,016	309	(1,259)	(6,645)	(3,041)				(6,620)
Operating costs	(4,016)		1,259			514	224		(2,019)
Other operating income						(514)		(2,454)	(2,968)
Other income		(309)		6,645	3,041		(224)	2,454	11,607
Total	-	-	-	-	-	-	-	-	-

£4,016,000 of the difference between statutory and RAG defined revenue relates to the disapplication in the Regulatory Accounts of the provision of IFRS 15, which states that revenue should only be recognised when it is probable that the economic benefits associated with the transaction will flow to the entity (refer to the revenue recognition accounting policy note on page 230). A further £309,000 relates to the reclassification of third party non-price control revenue, which is presented within other income in the Statutory Accounts. These differences are offset by the reclassification of £6,645,000 of connection charges income and £3,041,000 of amortisation associated with deferred grants and contributions, which are presented within other income in the Regulatory Accounts and £1,259,000 of income from the administration of new connections including reviewing applications and providing quotations which offsets operating costs in the Regulatory Accounts.

The difference between statutory and RAG defined operating costs consists of the revenue recognition adjustment described in the previous paragraph of £4,016,000 and the reclassification of a £514,000 net gain on disposal of fixed assets, which is presented within other operating income in the Regulatory Accounts. In addition, £1,259,000 of income from the administration of new connections including reviewing applications and providing quotations included in revenue in the Statutory Accounts and £224,000 of meter reading commission included within other income is offset against operating costs in the Regulatory Accounts.

The difference between statutory and RAG defined other operating income consists of the reclassification of the net gain on disposal of fixed assets from operating costs described in the previous paragraph of £514,000 and the reclassification of £2,454,000 of rental and sundry income, which is presented within other income in the Regulatory Accounts.

The difference between statutory and RAG defined other income consists of the reclassification of £6,645,000 of connection charges income, £3,041,000 of amortisation associated with deferred grants and contributions, £2,454,000 of rental and sundry income, £224,000 of meter reading income and £309,000 third party non-price control revenue.

The non-appointed business activities include services performed on behalf of the sewerage companies in our supply area, including meter reading, billing, cash collection and infrastructure commission. We also have support services and receive unregulated income for value added services.

Analysis of the interest charge

The appointed interest expense of (£48,621,000) and other interest expense of £2,468,000 shown in table 1A is broken down as follows:

	£'000
Interest charged on external borrowings, excluding those relating to DPC arrangements	(4,564)
Interest payable on intra-group borrowings	(43,739)
Interest charges in relation to DPC arrangements under IFRS16	-
Interest payable in relation to other leases under IFRS16	(315)
Amortisation of debt issuance costs	(285)
Amortisation of any debt premiums/discounts	1,100
Preference share dividends	-
Any other financing costs/ interest charges	(818)
Total	**(48,621)**
Interest paid in relation to pension scheme liabilities	(8,948)
Expected return on pension scheme assets	11,416
Total other interest (expense)/credit	**2,468**

Regulatory Annual Performance Report continued

Section 1 – Regulatory financial reporting (continued)

1B - STATEMENT OF COMPREHENSIVE INCOME FOR THE 12 MONTHS ENDED 31 MARCH 2021

		Adjustments			
	Statutory £000	Differences between statutory and RAG definitions £000	Less: non-appointed £000	Total adjustments £000	Total appointed activities £000
Profit for the year	**(51,278)**	**-**	**7,105**	**(7,105)**	**(58,383)**
Actuarial gains/(losses) on post employment plans	(32,162)	-	-	-	(32,162)
Other comprehensive income	6,111	-	-	-	6,111
Total comprehensive income for the year	**(77,329)**	**-**	**7,105**	**(7,105)**	**(84,434)**

1C - STATEMENT OF FINANCIAL POSITION FOR THE 12 MONTHS ENDED 31 MARCH 2021

		Adjustments			
	Statutory £000	Differences between statutory and RAG definitions £000	Less: non-appointed £000	Total adjustments £000	Total appointed activities £000
Non-current assets					
Fixed assets	1,550,457	-	-	-	1,550,457
Intangible assets	48,678	-	-	-	48,678
Investments – loans to group companies	-	-	-	-	-
Investments – other	15,232	(15,132)	-	(15,132)	100
Financial instruments	-	-	-	-	-
Retirement benefit assets	74,532	-	-	-	74,532
Total	**1,688,899**	**(15,132)**	**-**	**(15,132)**	**1,673,767**
Current assets					
Inventories	4,080	-	-	-	4,080
Trade and other receivables	84,385	-	364	(364)	84,021
Financial instruments	-	-	-	-	-
Cash and cash equivalents	84,766	15,132	6,124	9,008	93,774
Total	**173,231**	**15,132**	**6,488**	**8,644**	**181,875**
Current liabilities					
Trade and other payables	(227,698)	91,916	1,882	90,034	(137,664)
Capex creditor	(16,833)	-	-	-	(16,833)
Borrowings	(3,667)	-	-	-	(3,667)
Financial instruments	-	-	-	-	-
Current tax liabilities	(3,611)	-	(2,265)	2,265	(1,346)
Provisions	(3,547)	3,369	-	3,369	(178)
Total	**(255,356)**	**95,285**	**(383)**	**95,668**	**(159,688)**
Net current assets/(liabilities)	**(82,125)**	**110,417**	**6,105**	**104,312**	**22,187**
Non-current liabilities					
Trade and other payables	-	-	-	-	-
Borrowings	(1,101,095)	(9,268)	-	(9,268)	(1,110,363)
Financial instruments	(57,691)	9,268	-	9,268	(48,423)
Retirement benefit obligations	-	-	-	-	-
Provisions	(3,396)	-	-	-	(3,396)
Deferred income – grants and contributions ('G&C's')	(150,806)	(95,285)	-	(95,285)	(246,091)
Deferred income – adopted assets	-	-	-	-	-
Preference share capital	-	-	-	-	-
Deferred tax	(181,141)	-	-	-	(181,141)
Total	**(1,494,129)**	**(95,285)**	**-**	**(95,285)**	**(1,589,414)**
Net assets	**112,645**	**-**	**6,105**	**(6,105)**	**106,540**
Equity					
Called up share capital	30,506	-	-	-	30,506
Retained earnings and other reserves	82,139	-	6,105	(6,105)	76,034
Total equity	**112,645**	**-**	**6,105**	**(6,105)**	**106,540**

Regulatory Annual Performance Report continued

Section 1 – Regulatory financial reporting (continued)

1C - STATEMENT OF FINANCIAL POSITION FOR THE 12 MONTHS ENDED 31 MARCH 2021 (CONTINUED)

The £15,132,000 difference between statutory and RAG defined investments – other and cash and cash equivalents consists of a reclassification of short-term deposits, treated as investments in the statutory accounts and cash and cash equivalents under RAG terminology.

The £91,916,000 difference between statutory and RAG defined trade and other payables consists of the reclassification of payments received for costs incurred in relation to the HS2 rail programme, which will cross the Affinity Water supply area, that have not been commissioned yet for use. In line with our accounting policy for grants and contributions received in respect of property, plant and equipment, which include contributions received for diversions, in the company's statutory financial statements income received is treated as deferred income and released to cost of sales and administrative expenses over the useful economic life of the property, plant and equipment to which it relates once these assets are commissioned (as at 31 March 2021, £36,459,000 of our property, plant and equipment had been commissioned and therefore £36,459,000 of associated payments received have been recognised in deferred income. We have an additional £91,916,000 of contributions received for property, plant and equipment that hasn't been commissioned and therefore these contributions are included within payments in advance in trade and other payables). Given assets constructed by the company under the HS2 programme may not be commissioned for several years, adopting this accounting policy in the Regulatory Accounts would lead to a mismatch of costs incurred and payments received in relation to these costs in the totex tables in sections 2 and 4 of these Regulatory Accounts (tables 2B, 4C and 4D). Therefore the payments received in relation to HS2 within statutory payments in advance have been reclassified to deferred income – G&C's in the Regulatory Accounts and £52,437,000 of payments received in the year are included in the totex tables to offset the expenditure incurred in the year. The payments received in the year have also been included in the diversions lines within the analysis of capital contributions for both Water Resources and Water Network+ (table 2E).

The £3,369,000 difference between statutory and RAG defined provisions within current liabilities relates to the reclassification of current deferred G&C's to deferred income – G&C's.

The £9,268,000 difference between statutory and RAG defined borrowings and financial instruments relates to the reclassification of accretion on the inflation linked swap from financial instruments to borrowings.

The £95,285,000 difference between statutory and RAG defined deferred income – G&C's relates to the reclassifications detailed in the previous paragraphs.

1D - STATEMENT OF CASHFLOWS FOR THE 12 MONTHS ENDED 31 MARCH 2021

		Adjustments			
	Statutory £000	Differences between statutory and RAG definitions £000	Less: non–appointed £000	Total adjustments £000	Total appointed activities £000
Operating activities					
Operating profit	13,569	(11,607)	8,771	(20,378)	(6,809)
Other income	-	11,607	-	11,607	11,607
Depreciation	79,057	-	-	-	79,057
Amortisation – G&C's	(3,041)	-	-	-	(3,041)
Changes in working capital	12,727	-	(1,313)	1,313	14,040
Pension contributions	(2,478)	-	-	-	(2,478)
Movement in provisions	331	-	-	-	331
Profit on sale of fixed assets	347	-	-	-	347
Cash generated from operations	**100,512**	**-**	**7,458**	**(7,458)**	**93,054**
Net interest paid	(35,899)	-	-	-	(35,899)
Tax paid	377	-	(1,680)	1,680	2,057
Net cash generated from operating activities	**64,990**	**-**	**5,778**	**(5,778)**	**59,212**
Investing activities					
Capital expenditure	(139,266)	-	-	-	(139,266)
Grants and contributions	56,407	-	-	-	56,407
Disposal of fixed assets	1,061	-	-	-	1,061
Other	16,618	(10,070)	-	(10,070)	6,548
Net cash used in investing activities	**(65,180)**	**(10,070)**	**-**	**(10,070)**	**(75,250)**
Net cash generated before financing activities	**(190)**	**(10,070)**	**5,778**	**(15,848)**	**(16,038)**
Cashflows from financing activities					
Equity dividends paid	(1,000)	-	(1,000)	1,000	-
Net loans received	(3,631)	-	-	-	(3,631)
Cash inflow from equity financing	4,000	-	-	-	4,000
Net cash generated from financing activities	**(631)**	**-**	**(1,000)**	**1,000**	**369**
Increase/(decrease) in net cash	**(821)**	**(10,070)**	**4,778**	**(14,848)**	**(15,669)**

The cash flow has been prepared in accordance with the RAG templates and resultantly net cash generated from operating activities in the table above does not align to the statutory cash flow. £56,407,000 of capital contributions are treated as operating cash flows in the statutory cash flow and are shown within investing activities in table 1D.

The £11,607,000 difference between statutory and RAG defined operating profit consists of the reclassification of £6,645,000 of connection charges income, £3,041,000 of amortisation associated with deferred grants and contributions and £2,454,000 of rental and sundry income all of which are shown in other income, offset by the reclassification of £309,000 of third party non-price control revenue and £224,000 of meter read commission, which are both presented within other income in the Statutory Accounts. The £10,070,000 difference between statutory and RAG defined other investing activities is the movement in short-term deposits treated as investments in the statutory accounts and cash and cash equivalents under RAG terminology.

Total cash outflow for leases for the year ended 31 March 2021 was £3,946,000, of which £3,631,000 was principal elements of lease payments and £315,000 was interest payments. Under previous accounting standards, the total £3,946,000 would have been included in cash generated from operations. Under IFRS16, £3,631,000 is shown as cashflows from financing activities - net loans received and £315,000 is included in net interest paid.

Regulatory Annual Performance Report continued

Section 1 – Regulatory financial reporting (continued)

1E - NET DEBT ANALYSIS (APPOINTED ACTIVITIES) AT 31 MARCH 2021

	Fixed rate £000	Floating rate £000	Index linked RPI £000	Index linked CPI/CPIH £000	Total £000
Interest rate risk profile					
Borrowings (excluding preference shares)	212,470	-	570,798	314,841	**1,098,109**
Preference share capital	-	-	-	-	-
Total borrowings					**1,098,109**
Cash	-	-	-	-	**(78,642)**
Short term deposits	-	-	-	-	**(15,132)**
Net debt					**1,004,335**
Gearing					
Gearing					**77.06%**
Adjusted gearing					**76.02%**
Interest					
Full year equivalent nominal interest cost	7,430	-	20,536	6,657	**34,623**
Full year equivalent cash interest payment	7,430	-	11,970	4,296	**23,696**
Indicative interest rates:					
Indicative weighted average nominal interest rate	3.66%	-	3.60%	2.12%	**3.18%**
Indicative weighted average cash interest rate	3.66%	-	2.10%	1.37%	**2.18%**
Time to maturity					
Weighted average years to maturity	**17.09**	-	**15.34**	**14.42**	**15.40**

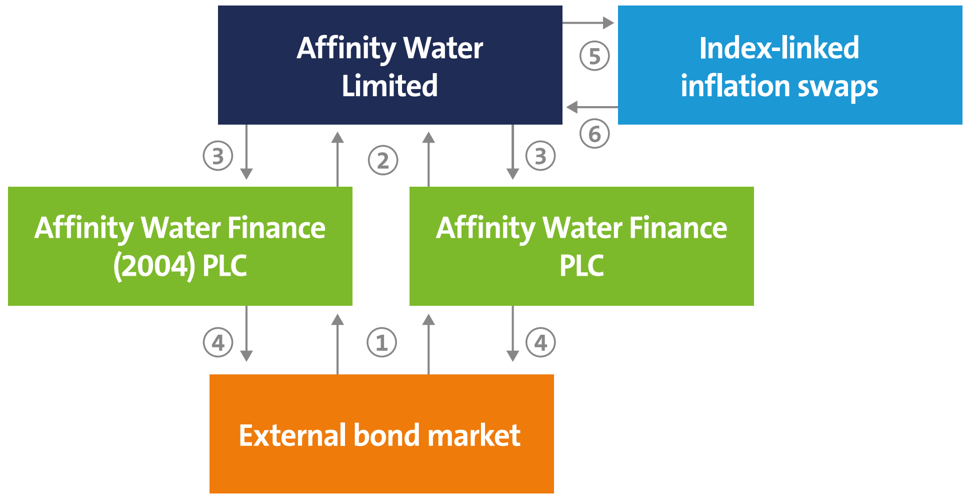
Capitalised debt issue costs and bond premiums/discounts, and amortisation thereon have been excluded from total borrowings presented in the above table. A reconciliation to total borrowings as presented in table 1C is provided below:

	Total £000
Total borrowings (excluding preference shares) presented in table 1C	**1,114,030**
Less: capitalised bond premium/issue costs - Fixed	**(9,623)**
Less: capitalised bond premium/issue costs - RPI	**(7,112)**
Less: capitalised bond premium/issue costs - CPI	**814**
Net debt presented above	**1,098,109**

Adjusted gearing is calculated using the definition of net debt set out in the company's WBS documentation, as presented in the following table.

	Fixed rate £000	Floating rate £000	Index linked RPI £000	Index linked CPI/CPIH £000	Total £000
Borrowings (excluding preference shares)	202,788	-	570,720	314,425	**1,087,933**
Preference share capital	-	-	-	-	-
Less: loan from intermediate parent company	-	-	-	-	**(3,550)**
Add: accrued interest on borrowings	-	-	-	-	**6,228**
Total borrowings					**1,090,611**
All cash and short-term deposits	-	-	-	-	**(99,898)**
Net debt	-	-	-	-	**990,713**

Affinity Water Limited has two financing subsidiaries which have issued bonds listed by the UK Listing Authority. Affinity Water Finance (2004) PLC has issued an external bond of £250.0m and Affinity Water Finance PLC has issued external bonds totalling £764.2m, the proceeds of which have been lent on to and are guaranteed by Affinity Water Limited, as shown in the diagram below. Please refer to pages 109 and 110 for more information on our financing arrangements.



1. Affinity Water Finance (2004) PLC and Affinity Water Finance PLC have raised debt from the external sterling bond market in the form of several bond issuances.
2. The two financing subsidiaries have on-lent the debt to Affinity Water Limited on the same terms.
3. Affinity Water Limited pays interest payments annually to the financing subsidiaries and will repay the principal debt upon maturity of the bond.
4. Affinity Water Finance (2004) PLC and Affinity Water Finance PLC pay interest payments annually to the bondholders, and will repay the principal debt upon maturity of the bond.
5. Affinity Water Limited receives a fixed interest payment annually for the index-linked inflation swap.
6. Affinity Water Limited pays index-linked interest payments annually for the index-linked inflation swap and will make a final accretion payment based on the mark to market valuation at maturity.

Regulatory Annual Performance Report continued

Section 1 – Regulatory financial reporting (continued)

1F – FINANCIAL FLOWS FOR THE 12 MONTHS ENDED 31 MARCH 2021 AND FOR THE PRICE REVIEW TO DATE - (2017-18 FINANCIAL YEAR AVERAGE CPIH)

	%			£000		
12 months ended 31 March 2021	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity
Return on regulatory equity						
Return on regulatory equity	4.04%	2.20%	4.04%	19,415	10,588	10,588
Regulatory equity	480,697	480,697	262,161	-	-	-
Financing						
Gearing	-	1.84%	1.35%	-	3,545	3,545
Gearing benefits sharing	-	(0.48%)	(0.88%)	-	(2,306)	(2,306)
Variance in corporation tax	-	(0.96%)	(1.76%)	-	(4,611)	(4,611)
Group relief	-	-	-	-	-	-
Cost of debt	-	(3.22%)	(6.18%)	-	(15,478)	(16,200)
Hedging instruments	-	2.72%	4.99%	-	13,089	13,089
Return on regulatory equity including financing adjustments	**4.04%**	**2.10%**	**1.57%**	**19,415**	**4,827**	**4,105**
Operational Performance						
Totex out/(under) performance	-	1.75%	3.21%	-	8,420	8,420
ODI out/(under) performance	-	(1.00%)	(1.84%)	-	(4,821)	(4,821)
C-Mex out/(under) performance	-	-	-	-	-	-
D-Mex out/(under) performance	-	-	-	-	-	-
Retail out/(under) performance	-	(0.56%)	(1.03%)	-	(2,701)	(2,701)
Other exceptional items	-	0.09%	0.16%	-	426	426
Operational performance total	**-**	**0.28%**	**0.51%**	**-**	**1,324**	**1,324**
RoRE	4.04%	2.38%	2.07%	19,415	6,152	5,430
Actual performance adjustment 2015-20	(0.48%)	(0.48%)	(0.48%)	(2,385)	(2,385)	(2,385)
Total earnings	3.56%	1.90%	1.59%	17,030	3,767	3,045
RCV growth from inflation	1.01%	1.01%	1.01%	4,869	4,869	2,655
Voluntary sharing arrangements	-	(0.02%)	(0.04%)	-	(100)	(100)
Total shareholder return	4.57%	2.89%	2.57%	21,899	8,536	5,600
Dividends						
Gross dividend	4.19%	-	-	20,141	-	-
Interest received on intercompany loans	-	-	-	-	-	-
Retained value	**0.38%**	**2.89%**	**2.57%**	**1,758**	**8,536**	**5,600**

The regulatory return on equity was 4.04% as determined at PR19. It increases to 5.39% after adjusting for the company's actual capital structure (1.35%, as reported in the gearing line of this table). The PR19 determination was carried out on a notional capital structure with 60% net debt to RCV gearing, the actual average level of gearing of 78.1% creates an adjustment of +1.35%. This is offset by an adverse gearing benefits sharing adjustment of -0.88% and an adjustment before hedging instruments of -6.18% resulting from the company's actual cost of debt underperforming against the 2.42% allowed in the PR19 determination after taking into account the movement in average CPIH during the year of 0.80%. Our hedging instruments have partially offset the adverse adjustment by +4.99%. The variance in corporation tax (calculated as the difference between the amount allowed for corporation tax in the PR19 determination and actual tax payable, before any fair value adjustments, after taking into account adjustments for capital allowances and prior year adjustments, refer to the reconciliation on page 284) decreases the adverse adjustment further by -1.76%.

The 1.57% regulatory return on equity including financing adjustments is increased to 2.07% when considering the impact of operational performance. Totex outperformance in the year results in a +3.21% increase (refer to table 4C), ODI underperformance in the year (refer to table 3A) results in a -1.84% reduction and the performance of the retail business unit (refer to table 2C) creates a -1.03% adverse adjustment. There is no adjustment for C-MeX or D-MeX performance in 2020/21 however there will be an adjustment in future years for future performance in this area. There was a further adjustment of +0.16% for other exceptional items which included 50% of the share of protected land sales in the year as per table 2L.

After factoring in RCV growth due to indexation and voluntary sharing arrangements, the total shareholder return for the year is 2.57%. No dividend was paid out by the regulated business, which equates to a 0.00% return on equity which compares to the 2.57% covered above.

	%			£000		
Average 2020-2025	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity
Return on regulatory equity						
Return on regulatory equity	4.04%	2.20%	4.04%	19,415	10,588	10,588
Regulatory equity	480,697	480,697	262,161	-	-	-
Financing						
Gearing	-	1.84%	1.35%	-	3,545	3,545
Gearing benefits sharing	-	(0.48%)	(0.88%)	-	(2,306)	(2,306)
Variance in corporation tax	-	(0.96%)	(1.76%)	-	(4,611)	(4,611)
Group relief	-	-	-	-	-	-
Cost of debt	-	(3.22%)	(6.18%)	-	(15,478)	(16,200)
Hedging instruments	-	2.72%	4.99%	-	13,089	13,089
Return on regulatory equity including financing adjustments	**4.04%**	**2.10%**	**1.57%**	**19,415**	**4,827**	**4,105**
Operational Performance						
Totex out/(under) performance	-	1.75%	3.21%	-	8,420	8,420
ODI out/(under) performance	-	(1.00%)	(1.84%)	-	(4,821)	(4,821)
C-Mex out/(under) performance	-	-	-	-	-	-
D-Mex out/(under) performance	-	-	-	-	-	-
Retail out/(under) performance	-	(0.56%)	(1.03%)	-	(2,701)	(2,701)
Other exceptional items	-	0.09%	0.16%	-	426	426
Operational performance total	**-**	**0.28%**	**0.51%**	**-**	**1,324**	**1,324**
RoRE	4.04%	2.38%	2.07%	19,415	6,152	5,430
Actual performance adjustment 2015-20	(0.48%)	(0.48%)	(0.48%)	(2,385)	(2,385)	(2,385)
Total earnings	3.56%	1.90%	1.59%	17,030	3,767	3,045
RCV growth from inflation	1.01%	1.01%	1.01%	4,869	4,869	2,655
Voluntary sharing arrangements	-	(0.02%)	(0.04%)	-	(100)	(100)
Total shareholder return	4.57%	2.89%	2.57%	21,899	8,536	5,600
Dividends						
Gross dividend	4.19%	-	-	20,141	-	-
Interest received on intercompany loans	-	-	-	-	-	-
Retained value	**0.38%**	**2.89%**	**2.57%**	**1,758**	**8,536**	**5,600**

Given this is the first year of AMP7, the average for the period 2020-2025 is equal to the performance in 2020/21. See the commentary under the table on the previous page for details.

Regulatory Annual Performance Report continued

Section 1 – Regulatory financial reporting (continued)

STATEMENT OF ACCOUNTING POLICIES

Basis of preparation

These accounts have been prepared in accordance with the relevant RAGs.

Accounting policies used are the same as those adopted in the statutory accounts, except as set out below.

Regulatory accounts are prepared to enable Ofwat to monitor the financial performance of the regulated water business. Note tables 2H, 4E, 4K, 4M, 4N, 4O, 4R, 4S, 4T, 4U and 4W have not been presented as they are not applicable for water supply only companies.

Standards and interpretations which are not yet effective

There are no new standards and interpretations, which are not yet effective and have not been early adopted by the company, that will have a material effect on future years.

Revenue recognition

Revenue represents the fair value of income receivable in the ordinary course of business from the regulated activities of the business in the year exclusive of value added tax. The company recognises revenue when the amount of revenue can be reliably measured, when it is probable that future economic benefit will flow to the entity and when specific criteria have been met.

The company's core revenue stream is derived from the supply of clean water. The UK government has contracted with the company on behalf of customers by granting the company its water supply licence, where the underlying performance obligation is the development and maintenance of the network and ensuring its continued availability to customers. Revenue is recognised as the customer receives the benefit of this through consuming the water:

- for metered customers, the amount which the company has a right to receive is determined by the volume of water consumed; and
- for unmetered customers, the amount which the company has a right to receive is determined by the period of time during which a customer occupies a property to which water is supplied by the company.

The company has contracts with third parties operating in the non-household retail market for the supply of clean water (wholesale supply). The underlying performance obligation is the development and maintenance of the network, and ensuring its continued availability to third party retailers on behalf of non-household consumers. Revenue is recognised at the point in which the company has a right to receive the revenue. For non-household retailers, the amount which the company has a right to receive is determined by non-household consumption volume data.

For metered household customers, a receivable is recognised when the customer is billed for usage. At this point, the consideration is unconditional because only the passage of time is required before the payment is due. Where the company has provided the service before payment is due, an accrual for the consumption of water that has not yet been billed is recognised within trade and other receivables (refer to the measured income accrual section below).

Unmetered customers pay a fixed amount determined by the transaction prices set out in the company's charging scheme and tariff documents. If the payments received exceed the amount the company has the right to receive, the company recognises a payment received in advance within trade and other payables.

Where non-household retailers are billed in advance monthly for wholesale charges, as determined by billing/volume reports created by the market operator, the company recognises deferred income in relation to these accounts and discloses this within trade and other payables.

The company does not expect to have any contracts where the period between the transfer of the promised goods or services to the customer and the payment terms exceeds one year. The company therefore does not adjust any of its transaction prices for the time value of money.

Charges on income arising from court, solicitor and debt recovery agency fees are recognised in revenue.

Measured income accrual

The measured income accrual is an estimation of the amount of mains water unbilled at the year end. The accrual is estimated using a defined methodology based upon weighted average water consumption by tariff, which is calculated based upon historical information. No changes have been made to the methodology in calculating the measured income accrual during the year. The measured income accrual is recognised within revenue.

Revenue for the year ended 31 March 2020 included a measured income accrual of £36,282,000. The value of billing recognised in the year ended 31 March 2021 for consumption in the prior year was £36,018,000. This resulted in a decrease of £264,000 in the current year's revenue due to the over-estimation of the prior year's revenue. This represented 0.09% of 2020/21 revenue and is within acceptable tolerance for accounting estimates.

Adjustments from statutory to regulatory accounts

The Regulatory Accounts disapply the provision of IFRS 15 which states that revenue should only be recognised if it is probable that it will be received, considering the customer's ability and intention to pay that amount of consideration when it is due. For regulatory reporting purposes, companies are required to assume that where an amount is billed it is probable that cash will be collected, thereby deviating from the IFRS 15 requirement in that there is no judgement applied to the probability of collection. Therefore, in the Regulatory Accounts the company does not derecognise revenue where historical evidence indicates that the company will probably never be able to collect the revenue billed.

No further differences exist between the revenue recognition policies in the statutory accounts and in the Regulatory Accounts.

Charging policy

Water charges are payable in full from the date of connection or change of customer on all properties at which it is recorded that water is being used or required. Exceptions to this, where the company waives water charges at its discretion on being informed by customers, include where the customer is in a care home; in long-term hospitalisation; in prison; overseas long-term; or in the event of the death of the customer.

Definition and treatment of properties

The company classifies unoccupied bulk owner properties as 'occupied' if they are empty for less than 26 weeks for short-term situations such as refurbishment or change of tenancy. These properties are billed in full and then a percentage is deducted from the amount owed to recognise that some properties will have been empty. Where properties are unoccupied for more than 26 weeks, the agreement with the bulk owner provides that the local authority will notify the company so that the property can be formally recorded as 'empty' on the company's billing system and, therefore, will not be billed.

The company no longer raises bills addressed to 'The Occupier' when there is no consumption detected at the property. The company's assumption is that these properties are not occupied. The company makes further enquiries and when it receives information that the property has become occupied the status of the account is amended, the customer's name applied to the account and billing commences.

In each of the above cases, if a bill is sent, the company would recognise it within revenue in the Regulatory Accounts.

All new properties are metered. Charges accrue from the date at which the meter is installed. The developer is billed between the date of connection and first occupancy and this is recognised as revenue. If the developer is no longer responsible for the property and no new occupier has been identified the property management process referred to above is followed to identify the new occupier. Until the new occupier has been identified the property is treated as unoccupied and is not billed.

Regulatory Annual Performance Report continued

Section 1 – Regulatory financial reporting (continued)

STATEMENT OF ACCOUNTING POLICIES (CONTINUED)

Capitalisation policy

Expenditure on infrastructure assets relating to increases in capacity, enhancements or material replacements of network components is capitalised where it can be reliably measured and it is probable that incremental future economic benefits will flow to the company. Expenditure generally will only meet the criteria for capitalisation when it relates to specific planned works. Where this work does not involve a mains pipe exceeding a diameter of 300mm (considered qualitatively material due to its strategic importance in the generation of future economic benefits), replacement is considered quantitatively material when the pipe involved is at least 2km long and uses a new material for that location, which enhances the section of network being re-laid.

Costs of day-to-day servicing of network components are recognised in the income statement as they arise.

The company does not capitalise any borrowing costs relating to the purchase of property, plant and equipment, right-of-use assets or intangible assets in its statutory accounts, as the costs do not meet the criteria for capitalisation set out in IAS 23: 'Borrowing costs'.

Bad debt

At each reporting date, the company evaluates the collectability of trade receivables and records a loss allowance based on experience. The loss allowance is charged to operating costs to reflect the company's assessment of the risk of non-recovery of trade receivables. The loss allowance is calculated by applying a range of different percentages to trade receivables of different ages. These percentages also vary between categories of receivable. Higher percentages are applied to those categories of receivables which are considered to be of greater risk and also to trade receivables of greater age. The value of the loss allowance is sensitive to the specific percentages applied. The specific percentages applied are updated annually to reflect the latest collection performance data from the company's billing system. All trade receivables greater than five years old are fully provided for. Actual amounts recovered may differ from the estimated levels of recovery which could impact on operating results.

The company applies the IFRS 9 simplified approach to measuring expected credit losses which uses a lifetime expected loss allowance for all trade receivables and contract assets. To measure the expected credit losses, trade receivables and contract assets have been grouped based on shared credit risk characteristics and the days past due. The contract assets relate to unbilled metered consumption and have substantially the same risk characteristics as the trade receivables for the same types of contracts.

The company has therefore concluded that the expected loss rates for trade receivables are a reasonable approximation of the loss rates for the contract assets.

Our bad debt provision decreased during the year as a result of a debt sale that took place, where fully provided for debt was sold outside of the company. Partially offsetting this was an increase in the provision in the year as a result of the current COVID-19 pandemic. There has been a resultant decrease in the provision from £34,585,000 at 31 March 2020 to £34,027,000 at 31 March 2021 as a result of the above reasons.

The company's policy is to write-off closed and live accounts that fall under the following categories: bankruptcy, liquidation, debt relief orders, deceased accounts where there is no estate, failed legal action and receivable amounts from customers who have moved out of the property with no forwarding address or are no longer responsible for payment of a water bill.

Accounts are written off following all internal recovery activity and subsequent external debt collection agency activity, except as follows:

- Closed accounts under £15 are written off without any internal recovery activity.
- Closed accounts under the name of 'the Occupier' are written off without any internal recovery action.
- Closed accounts under £50 are written off following all internal recovery activity where there is a forwarding address for the customer.
- Closed accounts under £100 are written off following all internal recovery activity where there is no forwarding address for the customer.

Amounts are also written off on accounts where the company is still supplying the customer and where all reasonable internal and external debt collection activities have been undertaken. Under these circumstances, if the total debt contains amounts over six years old, the amount over six years old or more is written off.

The company's write-off policy has remained unchanged and has been consistently applied in the current year compared with the previous year. The amount of debt written off increased from £2,719,000 in 2019/20 to £9,094,000 in 2020/21 primarily due to a large proportion of household write-offs being delayed in 2019/20 pending potential sale of receivables in 2020/21, and the subsequent sale in the current year.

There has been a decrease in trade receivables during the year (£24,505,000 at 31 March 2021; £26,868,000 at 31 March 2020) due to an improvement in collection rate seen in March 2021 compared to in March 2020 and the timing of the annual billing.

Grants and contributions

Grants and contributions received in respect of property, plant and equipment (including infrastructure charges, and contributions for diversions and requisitioned mains/extensions), where the performance obligation is deemed to be satisfied over time, are treated as deferred income and released to revenue over the useful economic life of the property, plant and equipment to which they relate once these assets have been commissioned.

For contributions received in respect of diversions and requisitioned mains/extensions, the assets constructed are considered to have no economic value without the promise to provide ongoing supply of water services; therefore the performance obligation is considered to be satisfied over the period that the property, plant and equipment constructed are in service.

Infrastructure charges are charges levied on developers for network reinforcement which is not site specific, i.e. to fund expenditure which will contribute towards wider network reinforcement work away from the development site. There is an implied ongoing performance obligation to improve and maintain the wider network in order to provide ongoing supply of water services.

Grants and contributions considered to be given in compensation for expenses incurred with no future related costs, including charges billed to developers for new connections ('connection charges'), are recognised in revenue in the income statement in the period that they became receivable; the performance obligation has been identified as the connection of a service pipe to the main. Once the connection is made, the performance obligation is fulfilled and the income recognised immediately in the income statement.

These grants and contributions are not government grants within the scope of IAS 20: 'Accounting for government grants and disclosure of government assistance' and fall within the scope of IFRS 15, as, whilst there may not be a written contract with the customer, the legal duties of a company under the Water Industry Act 1991 would seem to constitute a legally enforceable contract with the transaction prices set out in the company's charges scheme, tariff documents and invoices.

Regulatory Annual Performance Report continued

Section 1 – Regulatory financial reporting (continued)

STATEMENT OF DIRECTORS' REMUNERATION AND STANDARDS OF PERFORMANCE

Executive directors' remuneration comprises a package of base salary together with an annual performance-related bonus and a long-term incentive plan. Executive directors' bonuses paid by the company are linked to the standards of performance of the company and are therefore in accordance with RAG 3.12. The elements of the 2020/21 remuneration arrangements for executive directors were established by the company's Remuneration Committee in 2020/21.

No changes have been made to the remuneration policy for executive directors since the publication of the annual report and financial statements for the year ended 31 March 2020; however targets and their weighting for the AMP7 annual bonus plan and LTIP for executive directors and senior management have been finalised by reference to the company's final determination for AMP7. The details are presented in the following table, which sets out all elements of executive director remuneration.

Given the tough challenges the company faces in AMP7, the executive directors did not receive a salary increase for the year 2020/21 and will not receive an increase in 2021/22.

Purpose and link to strategy	Policy and approach	Maximum potential value (as percentage of base pay)	Performance metrics	Changes for 2021/22
LTIP				
To incentivise executives to achieve long-term shareholder value whilst achieving high levels of customer experience performance, although both award and payment are discretionary.	Base awards are granted as a percentage of salary and are paid out in cash at the end of a three-year performance period, with 33% of the amount earned paid at the end of year four, 33% paid at the end of year five and 33% paid at the end of year six subject to the achievement of performance conditions. The scheme is based on three-year targets that are aligned to strategic delivery for AMP7. The targets for each metric are set in each year of the AMP. No award will be made for a metric if performance is below target/plan and additional award will be made if the company meets its stretch targets. Base awards include clawback and malus provisions, as detailed below. The awards do not automatically vest on change of control of the business.	Up to 150% of base salary for the CEO and 125% of base salary for the CFO if stretch targets are achieved.	The award is determined based on the performance of the company over the three years. For the 2020/21 LTIP, 40% of the scheme pay-out is based on financial targets, including cash generated from operations and investment targets; 50% based on customer service and stakeholder commitments, including C-MeX (6.25%) and D-MeX (6.25%) position, water quality (6.25%), helping vulnerable customers (6.25%), leakage (6.25%), consumption (6.25%), mains bursts (6.25%) and environmental innovation (6.25%); and 10% based on employee commitments, including culture surveys (5%) and safety (5%). These arrangements were formally agreed during the February 2020 Remuneration Committee meeting.	No changes have been made to the policy for 2021/22 up to the date of approval of this annual report and financial statements.

Purpose and link to strategy	Policy and approach	Maximum potential value (as percentage of base pay)	Performance metrics	Changes for 2021/22
Base salary				
To provide competitive fixed remuneration that will attract and retain key employees and reflect their experience and position in the company.	To target around market median, dependent on experience in the role.	N/A	N/A	No changes have been made to the policy for 2021/22 up to the date of approval of this annual report and financial statements.
Other taxable benefits				
To provide market competitive benefits.	Private health care insurance cover, life assurance and income protection are provided, together with a fully expensed company car (or car allowance).	N/A	N/A	No changes have been made to the policy for 2021/22 up to the date of approval of this annual report and financial statements.
Annual bonus plan				
The annual bonus plan is designed to provide a direct link between executive and company performance and the level of bonus awarded, although award and payment remain discretionary.	Maximum bonus potential is set at a market competitive level. The bonus is based on budgeted non-financial and financial targets that are aligned to the company's AMP7 commitments, plus individual targets.	Up to 100% of base salary for the CEO and up to 75% of base salary for the CFO. Where discretion is applied to executives relating to the performance of measures, the same level of discretion must be applied to all employees and managers.	40% of the total bonus is determined on the achievement of the financial performance target, which is based on net cash outflow before taxation and financing. 40% of the total performance is on customer service and stakeholder commitments including C-MeX (5.7%), leakage (5.7%), consumption (5.7%), water quality (5.7%), water pressure (5.7%), interruptions to supply (5.7%) and safety (5.7%). 20% of the total bonus is determined on the achievement of personal objectives. No payment will be awarded if achievement is below the target/plan for that metric. There is also the introduction of a check that stops pay-out of the bonus if either the customer or the financial elements of the bonus fall below a set level to ensure equal focus across all metrics. Reduction in the discretion of the Committee to award any bonus outside performance delivery targets. This was approved by the Remuneration Committee in April 2020.	No changes have been made to the policy for 2021/22 up to the date of approval of this annual report and financial statements.

Regulatory Annual Performance Report continued

Section 1 – Regulatory financial reporting (continued)

STATEMENT OF DIRECTORS' REMUNERATION AND STANDARDS OF PERFORMANCE (CONTINUED)

Purpose and link to strategy	Policy and approach	Maximum potential value (as percentage of base pay)	Performance metrics	Changes for 2021/22
Pension related benefits				
To provide competitive post-retirement benefits.	Executives joining the company after 2004 are invited to participate in the company's defined contribution pension plan. No current executives joined prior to this date. Under the defined contribution scheme, executives who joined the company before 1 April 2020 contribute at a rate of 7% of salary and the company contributes at 20%. Executives who joined the company after this date are aligned to contributions made by the general employee population, with the company doubling contributions made by the executive up to a maximum company contribution of 12%.	20% of executive salary for executives appointed before 1 April 2020, 12% of executive salary for executives appointed after this date. Where executive directors are not members of the defined contribution scheme, the directors received a taxable allowance of 26% of base pay for the CEO and 20% of base pay for the CFO.	N/A	No changes have been formally approved however options are being looked into to align current executive director contributions to those of the workforce.
Compensation for the forfeit of variable remuneration from previous employer				
To provide compensation for forfeited remuneration from previous employers.	The Committee may make additional cash awards if deferred pay is forfeited by an executive director on leaving a previous employer. Such awards would take into account the nature of awards forfeited (i.e. cash or shares), time horizons, attributed expected value and performance conditions.	N/A	N/A	No changes have been made to the policy for 2021/22 up to the date of approval of this annual report and financial statements.

Directors' remuneration 2020/21 (audited)

The following table shows directors' remuneration in respect of 2020/21.

Tony Cocker was appointed as Chair of the company on 30 January 2018 for an initial period of three years. Tony Cocker stepped down as Chair of the company on 29 January 2021. Ian Tyler was appointed as his replacement and joined the company on 11 January 2021 and took on the role of Chair from 29 January 2021. Both Tony Cocker and Ian Tyler receive a fixed annual fee for their services, reflecting the time commitment and responsibilities of the role.

	Base salary/ fees £000		Taxable benefits[1] £000		Annual bonus £000		LTIP[2] £000		Pension related benefits[3] £000		Other[4] £000		Total fixed remuneration £000		Total variable remuneration £000		Total £000	
	20/21	19/20	20/21	19/20	20/21	19/20	20/21	19/20	20/21	19/20	20/21	19/20	20/21	19/20	20/21	19/20	20/21	19/20
Non-executive																		
Current																		
Ann Bishop	**44**	-	-	-	-	-	-	-	-	-	-	-	**44**	-	-	-	**44**	-
Trevor Didcock	**51**	49	-	-	-	-	-	-	-	-	-	-	**51**	49	-	-	**51**	49
Susan Hooper	**49**	49	-	-	-	-	-	-	-	-	-	-	**49**	49	-	-	**49**	49
Mark Horsley	**44**	13	-	-	-	-	-	-	-	-	-	-	**44**	13	-	-	**44**	13
Chris Newsome	**49**	49	-	-	-	-	-	-	-	-	-	-	**49**	49	-	-	**49**	49
Justin Read	**35**	-	-	-	-	-	-	-	-	-	-	-	**35**	-	-	-	**35**	-
Former																		
Chris Bolt	-	19	-	-	-	-	-	-	-	-	-	-	-	19	-	-	-	19
Patrick O'D Bourke	**25**	49	-	-	-	-	-	-	-	-	-	-	**25**	49	-	-	**25**	49
Company Chair																		
Current																		
Ian Tyler	**44**	-	-	-	-	-	-	-	-	-	-	-	**44**	-	-	-	**44**	-
Former																		
Tony Cocker	**159**	195	-	-	-	-	-	-	-	-	-	-	**159**	195	-	-	**159**	195
Executive																		
Current																		
Stuart Ledger	**210**	209	**6**	6	**57**	140	**76**	-	**42**	32	-	-	**258**	247	**133**	140	**391**	387
Pauline Walsh	**365**	361	**8**	16	**125**	331	**206**	-	**78**	72	-	95	**451**	449	**331**	426	**782**	876
	1,074	993	**14**	22	**182**	471	**283**	-	**120**	104	-	95	**1,209**	1,119	**464**	566	**1,673**	1,686

The remuneration policy operated as intended during the year. Executive director bonuses are only being paid where operational targets were met and base salaries were set at a level that attracted and retained key employees, reflecting their experience and position in the company. Given the tough challenges the company faces in AMP7, the executive directors did not receive a salary increase for the year 2020/21 and will not receive an increase in 2021/22. The Remuneration Committee believes this was appropriate.

[1] Taxable benefits comprise company car allowance, living accommodation benefit, relocation costs and healthcare insurance.
[2] The LTIP amounts disclosed relate to the 2018/19 LTIP which fully vested in the year ended 31 March 2021. This amount will be paid in equal instalments over the three years ending 31 March 2022, 31 March 2023 and 31 March 2024.
[3] Pension related benefits for Stuart Ledger and Pauline Walsh comprised £6,300 and £54,750 respectively of contributions paid to money purchase schemes and £35,700 and £23,725 paid in lieu of being a member of the pension scheme in the second half of the year (2019/20: £32,000 and £72,000 all paid to money purchase schemes); there were no amounts outstanding at year-end.
[4] Other remuneration in 2019/20 for Pauline Walsh related to discretionary payments made in connection with commencement of qualifying services during the year, including compensation for the forfeit of a variable remuneration arrangement with her previous employer.

Regulatory Annual Performance Report continued

Section 1 – Regulatory financial reporting (continued)

STATEMENT OF DIRECTORS' REMUNERATION AND STANDARDS OF PERFORMANCE (CONTINUED)

Achievement against performance related measures (annual bonus)

The annual bonus scheme is designed to provide a direct link between executive and company operational, customer and financial performance, and the level of bonus awarded, although award and payment remain discretionary. The table below shows the percentage of maximum annual bonus potential awarded in relation to the 2020/21 year for Pauline Walsh and Stuart Ledger for each of the performance measures. No amounts in relation to these bonuses have been deferred.

Performance measure		Link to business model (refer to page 20)	2020/21 target	2020/21 actual	Maximum weighting for 2020/21 (as a % of base salary)		2020/21 achievement (as a % of base salary)	
				Target met	Pauline Walsh	Stuart Ledger	Pauline Walsh	Stuart Ledger
Financial measure	Cash generated by operations: net cash outflow before taxation and financing[1]	Targeting sufficient cash generated by operations ensures we can invest in our assets and provide a great service that customers value	£nil or higher	£(3.0m) ✗	40.00% £146,000	30.00% £63,000	0.00% £nil	0.00% £nil
Operational measures	Leakage: volume of water lost through leaks on the network (Ml/d)	Targeting a continued reduction in leakage will ensure customers have enough water, whilst leaving more water in the environment	157.8 Ml/d or less	171.4 ✗	5.72% £20,878	4.29% £9,009	0.00% £nil	0.00% £nil
	Water quality: CRI score	Targeting a low CRI score ensures customers have high quality water they can trust	2.0 or less	1.31 ✓	5.72% £20,878	4.29% £9,009	5.72% £20,878	4.29% £9,009
	Interruptions to supply: minutes interrupted above 3 hours	Targeting few interruptions to supply ensures we can minimise disruption for customers and the community	11 minutes or less	5 minutes, 49 seconds ✓	5.72% £20,878	4.29% £9,009	5.72% £20,878	4.29% £9,009
	Customer consumption: PCC litres per day	Targeting customer consumption ensures we can make sure customers have enough water whilst leaving more water in the environment	149 or less	169.3 ✗	5.72% £20,878	4.29% £9,009	0.00% £nil	0.00% £nil
	Properties at risk of low pressure: per 10,000 properties	Targeting reducing properties at risk of lower pressure ensures we can minimise disruption for customers and the community	1.645 or less	196.850 ✗	5.72% £20,878	4.29% £9,009	0.00% £nil	0.00% £nil
Customer and community measures	C-MeX[2]: position in the league table	Targeting an improvement in the C-MeX positions ensures we focus on providing a great service that customers value	14th or higher	15th ✗	5.72% £20,878	4.29% £9,009	0.00% £nil	0.00% £nil
Safety and health measure	Accident frequency rate (annual target): number of lost time injuries per 100,000 hours worked	Targeting a low accident frequency rate ensures our people can work to deliver our customer outcomes effectively	0.22 or lower	0.12 ✓	5.72% £20,878	4.29% £9,009	5.72% £20,878	4.29% £9,009
Personal performance[3]					20.00% £73,000	15.00% £31,500	17.00% £62,050	14.25% £29,925
Total % of base salary					**100.00%**	**75.00%**	**34.16%**	**27.12%**
Base salary							**£365,000**	**£210,000**
Bonus paid							**£124,684**	**£56,952**

[1] This "non-GAAP" measure is the total of the following line items per the statement of cash flows (refer to page 150): cash generated from operations; purchases of property, plant and equipment; proceeds on disposal of property, plant and equipment; purchase of intangible assets; and principal elements of lease payments. The bonus measure has been adjusted for the impact of timing on revenues earned and capital spend and is before statutory adjustments.
[2] C-MeX is the industry's measure of customer experience.
[3] The Remuneration Committee exercised discretion in determining the level of bonus awarded in relation to the personal performance element of the executive directors' annual bonus within the pre-agreed base salary percentage cap. The Committee considered achievement of personal objectives set at the start of the year in exercising its discretion together with events occurring during the year.

Section 2 – Price review and other segmental reporting

ACCOUNTING POLICY FOR PRICE CONTROL SEGMENTS

The tables in this section have been prepared in accordance with RAG 2.08, as detailed in the company's Accounting Separation Methodology Statement, which can be found on the company's website: **affinitywater.co.uk/reports-publications**. The methodology statement explains the basis for the allocations of costs and assets and has been updated for changes to the requirements in the year. Changes to the methodology are also explained within the company's Accounting Separation Methodology Statement on the company's website. Wherever possible, direct costs and assets have been directly attributed to business units. Where this is not possible, appropriate cost allocations have been applied and assets have been allocated to business units based on an assessment of the principal user, as described in the methodology.

2A - SEGMENTAL INCOME STATEMENT FOR THE 12 MONTHS ENDED 31 MARCH 2021

	Retail Household £000	Water resources £000	Water network+ £000	Total £000
Revenue – price control	27,882	35,876	213,335	277,093
Revenue – non price control	-	-	3,069	3,069
Operating expenditure – excluding PU recharge impact	(28,591)	-	-	(28,591)
PU opex recharge	-	-	-	-
Operating expenditure – including PU recharge impact	(28,591)	(18,013)	(163,671)	(210,275)
Depreciation – tangible fixed assets	(1)	(5,497)	(62,982)	(68,480)
Amortisation – intangible fixed assets	(657)	-	(9,920)	(10,577)
PU recharge impact	(600)	-	600	-
Depreciation and amortisation – including PU recharge impact	(1,258)	(5,497)	(72,302)	(79,057)
Other operating income	1,639	45	677	2,361
Operating profit	**(328)**	**12,411**	**(18,892)**	**(6,809)**

During AMP6, wholesale revenue – price control was allocated in full to Water network + in line with RAG guidance. Following the issuance of new RAGs for AMP7, the company has allowed revenues within Water resources as part of our AMP7 business plan. Therefore in the current year, wholesale revenues have been apportioned across Water resources and Water network+. This is detailed in the Accounting Separation Methodology Statement, which can be found on the company's website: **affinitywater.co.uk/reports-publications**.

Regulatory Annual Performance Report continued

Section 2 – Price review and other segmental reporting (continued)

2B - TOTEX ANALYSIS FOR THE 12 MONTHS ENDED 31 MARCH 2021 – WHOLESALE

	Water resources £000	Water network+ £000	Total £000
Base operating expenditure			
Power	3,695	22,695	26,390
Income treated as negative expenditure	-	-	-
Abstraction charges/discharge consents	3,825	-	3,825
Bulk supply/bulk discharge	1,443	8,780	10,223
Renewals expensed in year (Infrastructure)	-	16,514	16,514
Renewals expensed in year (Non-Infrastructure)	-	-	-
Other operating expenditure	6,665	85,425	92,090
Local authority and Cumulo rates	1,937	13,261	15,198
Total base operating expenditure	17,565	146,675	164,240
Other operating expenditure			
Enhancement operating expenditure	448	6,608	7,056
Developer services operating expenditure	-	8,304	8,304
Total operating expenditure excluding third party services	18,013	161,587	179,600
Third party services	-	2,084	2,084
Total operating expenditure	18,013	163,671	181,684
Grants and contributions			
Grants and contributions – operating expenditure	-	6,645	6,645
Capital expenditure			
Base capital expenditure	39,139	67,989	107,128
Enhancement capital expenditure	3,568	14,786	18,354
Developer services capital expenditure	-	15,174	15,174
Total gross capital expenditure (excluding third party)	42,707	97,949	140,656
Third party services	-	648	648
Total gross capital expenditure	42,707	98,597	141,304
Grants and contributions			
Grants and contributions – capital expenditure	29,624	29,364	58,988
Net totex	**31,096**	**226,259**	**257,355**
Cash expenditure			
Pension deficit recovery payments	-	-	-
Other cash items	(38)	(313)	(351)
Totex including cash items	**31,058**	**225,946**	**257,004**

Table 2B above shows our total wholesale expenditure in the year split across Water resources and Water network+, after deducting for grants and contributions received. For analysis of the totex compared to our allowed expenditure, please see table 4C. Base operating expenditure has been split into the prescribed categories above, with power and bulk supply costs having been impacted by COVID-19 during the year, as explained in table 4C. For a breakdown of base capital expenditure, enhancement capital expenditure and developer services capital expenditure, see tables 4J, 4L and 4N respectively.

2C - COST ANALYSIS FOR THE 12 MONTHS ENDED 31 MARCH 2021 – RETAIL

	Household - Total £000
Operating expenditure	
Customer services	7,107
Debt management	2,315
Doubtful debts	7,948
Meter reading	1,785
Services to developers	-
Other operating expenditure	9,323
Local authority and Cumulo rates	113
Total operating expenditure excluding third party services	28,591
Depreciation	
Depreciation on tangible fixed assets existing at 31 March 2015	1
Depreciation on tangible fixed assets acquired after 1 April 2015	-
Amortisation on intangible fixed assets existing at 31 March 2015	37
Amortisation on intangible fixed assets acquired after 1 April 2015	620
Recharges	
Recharge from wholesale for legacy assets principally used by wholesale (assets existing at 31 March 2015)	-
Income from wholesale for legacy assets principally used by retail (assets existing at 31 March 2015)	-
Recharge from wholesale assets acquired after 1 April 2015 principally used by wholesale	600
Income from wholesale assets acquired after 1 April 2015 principally used by retail	-
Net recharges costs	600
Total retail costs excluding third party and pension deficit repair costs	29,849
Third party services operating expenditure	-
Pension deficit repair costs	-
Total retail costs including third party and pension deficit repair costs	**29,849**
Debt written off	
Debt written off	8,309
Capital expenditure	
Capital expenditure	1,053
Other operating expenditure includes the net retail expenditure for the following household retail activities which are part funded by wholesale	
Demand-side water efficiency – gross expenditure	490
Demand-side water efficiency – expenditure funded by wholesale	-
Demand-side water efficiency – net retail expenditure	490
Customer-side leak repairs – gross expenditure	1,438
Customer-side leak repairs – expenditure funded by wholesale	-
Customer-side leak repairs – net retail expenditure	1,438

Total retail costs including third party and pension deficit repair costs were £29,849,000 in the year against allowed expenditure of £27,022,000, resulting in an overspend in the year of £2,827,000 in current year prices. This was primarily due to higher bad debt costs as a result of the COVID-19 pandemic, with an additional bad debt charge recognised in the year of £2,346,000, all impacting the retail price control. Allowed revenue for the year was £26,998,000, resulting in an overspend to revenue of £2,851,000.

Regulatory Annual Performance Report continued

Section 2 – Price review and other segmental reporting (continued)

2D - HISTORIC COST ANALYSIS OF TANGIBLE FIXED ASSETS AT 31 MARCH 2021

	Water resources £000	Water network+ £000	Retail Household £000	Total £000
Cost				
At 1 April 2020	91,283	2,158,924	4,723	2,254,930
Disposals	-	(1,579)	-	(1,579)
Additions	38,275	90,484	111	128,870
Adjustments	-	-	-	-
Assets adopted at nil cost	-	-	-	-
At 31 March 2021	129,558	2,247,829	4,834	2,382,221
Depreciation				
At 1 April 2020	(13,956)	(748,473)	(1,026)	(763,455)
Disposals	-	171	-	171
Adjustments	-	-	-	-
Charge for the year	(5,497)	(62,982)	(1)	(68,480)
At 31 March 2021	(19,453)	(811,284)	(1,027)	(831,764)
Net book amount at 31 March 2021	110,105	1,436,545	3,807	1,550,457
Net book amount at 1 April 2020	77,327	1,410,451	3,697	1,491,475
Depreciation charge for year				
Principal services	(5,497)	(61,710)	(1)	(67,208)
Third party services	-	(1,272)	-	(1,272)
Total	(5,497)	(62,982)	(1)	(68,480)

The net book value includes £128,114,000 in respect of assets in the course of construction.

Capital expenditure in the year was incurred principally in our mains renewals, trunk main replacement, water treatment (including pesticide treatment) and integrated water savings programmes. Water resources additions in the year largely relate to the construction of assets by the company under the HS2 programme.

2E - ANALYSIS OF 'GRANTS AND CONTRIBUTIONS' FOR THE 12 MONTHS ENDED 31 MARCH 2021 – WATER RESOURCES, WATER NETWORK+ AND WASTEWATER NETWORK+

	Fully recognised in income statement £000	Capitalised and amortised (in income statement) £000	Fully netted off capex £000	Total £000
Grants and contributions – water resources				
Diversions – s185	-	-	-	**-**
Other contributions (price control)	-	-	-	**-**
Price control grants and contributions	-	-	-	**-**
Diversions – NRSWA	-	-	-	**-**
Diversions – other non-price control	-	29,309	-	**29,309**
Other contributions (non-price control)	-	315	-	**315**
Total	-	29,624	-	29,624
Value of adopted assets	-	-	-	-
Grants and contributions – water network+				
Connection charges	6,645	-	-	**6,645**
Infrastructure charge receipts	-	4,994	-	**4,994**
Requisitioned mains	-	945	-	**945**
Diversions – s185	-	819	-	**819**
Other contributions (price control)	-	-	-	**-**
Price control grants and contributions before deduction of income offset	6,645	6,758	-	13,403
Income offset	-	(1,069)	-	**(1,069)**
Price control grants and contributions after deduction of income offset	6,645	5,689	-	12,334
Diversions – NRSWA	-	547	-	**547**
Diversions – other non-price control	-	23,128	-	**23,128**
Other contributions (non-price control)	-	-	-	**-**
Total	6,645	29,364	-	36,009
Value of adopted assets	-	3,355	-	**3,355**

£52,437,000 of payments received in 2020/21 for costs incurred in relation to the HS2 rail programme are included in the diversions – other non-price control lines in the above table, with £29,309,000 included within Water Resources and £23,128,000 included within Water Network+.

	Water resources	Water network+	Total £000
Movements in capitalised grants and contributions			
Brought forward	39,234	150,903	190,137
Capitalised in year	29,624	29,364	58,988
Amortisation (in income statement)	(1,379)	(1,662)	(3,041)
Carried forward	67,479	178,605	246,084

Regulatory Annual Performance Report continued

Section 2 – Price review and other segmental reporting (continued)

2F – RESIDENTIAL RETAIL FOR THE 12 MONTHS ENDED 31 MARCH 2021

	Revenue £000	Number of customers 000s	Average residential revenues £
Residential revenue			
Wholesale charges	214,479		
Retail revenue	27,882		
Total residential revenue	242,361		
Retail revenue			
Revenue Recovered ("RR")	27,882		
Revenue sacrifice	-		
Actual revenue (net)	**27,882**		
Customer information			
Actual customers ("AC")		1,398.453	
Reforecast customers		1,414.167	
Adjustment			
Allowed revenue ("R")	26,998		
Net adjustment	(884)		
Other residential information			
Average residential retail revenue per customer			19.94

Total average household retail revenue per customer has remained consistent with the prior year. A number of customers have moved onto measured tariffs from unmeasured as part of our Water Savings Programme.

2I - REVENUE ANALYSIS FOR THE 12 MONTHS ENDED 31 MARCH 2021

	Household £000	Non-household £000	Total £000	Water resources £000	Water network+ £000	Total £000
Wholesale charge – water						
Unmeasured	89,151	2,040	91,191	13,128	78,063	91,191
Measured	125,328	32,692	158,020	22,748	135,272	158,020
Third party revenue	-	-	-	-	-	-
Wholesale total	214,479	34,732	249,211	35,876	213,335	249,211
Retail revenue						
Unmeasured	9,456	-	9,456			
Measured	18,426	-	18,426			
Other third party revenue	-	-	-			
Retail total	27,882	-	27,882			
Third party revenue – non-price control						
Bulk supplies - water			2,760			
Other third party revenue			309			
Principal services – non-price control						
Other appointed revenue			-			
Total appointed revenue			280,162			

Regulatory Annual Performance Report continued

Section 2 – Price review and other segmental reporting (continued)

2J – INFRASTRUCTURE NETWORK REINFORCEMENT COSTS FOR THE 12 MONTHS ENDED 31 MARCH 2021

Wholesale water network+ (treated water distribution)	Network reinforcement capex £000	On site/site specific capex (memo only) £000
Distribution and trunk mains	6,432	-
Pumping and storage facilities	685	-
Other	-	-
Total	**7,117**	**-**

2K – INFRASTRUCTURE CHARGES RECONCILIATION FOR THE 12 MONTHS ENDED 31 MARCH 2021

	Total £000
Impact of infrastructure charge discounts	
Infrastructure charges	4,994
Discounts applied to infrastructure charges	-
Gross infrastructure charges	**4,994**
Comparison of revenue and costs	
Variance brought forward	136
Revenue	4,994
Costs	(7,117)
Variance carried forward	**(1,987)**

Costs in the year were significantly higher than revenue received. COVID-19 has resulted in a downturn in the number of connections for the year, which is the driver for infrastructure revenue. Despite this, we were able to fulfil our target and complete our planned works during the year. We anticipate that following the COVID-19 pandemic, we will see higher connections activity and infrastructure charges over the remainder of the AMP.

No discounts have been applied to infrastructure charges during the year that would require presentation in the above table. The company's policy is to apply a discount if the new connection was a reconnection and had been disconnected within the past five years.

2L – ANALYSIS OF LAND SALES FOR THE 12 MONTHS ENDED 31 MARCH 2021

	Water resources £000	Water network+ £000	Total £000
Proceeds from disposals of protected land	**-**	**891**	**891**

Proceeds from disposals of protected land are shared with customers on a 50% sharing basis.

2M – REVENUE RECONCILIATION FOR THE 12 MONTHS ENDED 31 MARCH 2021 - WHOLESALE

	Water resources £000	Water network+ £000	Total £000
Revenue recognised			
Wholesale revenue governed by price control	35,876	213,335	249,211
Grants & contributions (price control)	-	12,334	12,334
Total revenue governed by wholesale price control	**35,876**	**225,669**	**261,545**
Calculation of the revenue cap			
Allowed wholesale revenue before adjustments (or modified by CMA)	36,276	215,712	251,988
Allowed grants and contributions before adjustments (or modified by CMA)	-	16,177	16,177
Revenue adjustment	-	-	-
Other adjustments	-	-	-
Revenue cap	**36,276**	**231,889**	**268,165**
Calculation of the revenue imbalance			
Revenue cap	36,276	231,889	268,165
Revenue Recovered	35,876	225,669	261,545
Revenue imbalance	**400**	**6,220**	**6,620**

£3.8m of the variance between allowed and actual revenue under the wholesale price control relates to lower grants and contributions received than allowed in the determination. The remaining £2.4m variance primarily relates to lower non-household income following business closures and resultant reduced consumption due to the national health pandemic, offset by higher measured consumption from our household customers.

Following market reform and the opening of the non-household retail market, new reports of billing/volume data have been created by the market operator in accordance with the operating code of the market. Non-household volume data within these reports include estimates that will not be 'firm' until sometime after the end of any period. This means an inherent additional uncertainty in non-household wholesale revenue recognised while the market and billing/volume data settles over time through to a full and final reconciliation. As a result of changing consumption levels due to the COVID-19 pandemic, we have used DI (distribution input) figures to estimate non-household consumption and have recognised revenue on this basis.

There are no penalties relating to the wholesale water revenue imbalances between the water resources and water network plus controls.

Regulatory Annual Performance Report continued

Section 2 – Price review and other segmental reporting (continued)

2N – RESIDENTIAL RETAIL – SOCIAL TARIFFS

	Revenue £000	Number of customers 000s	Average amount per customer £
Number of residential customers on social tariffs			
Residential water only social tariffs		70.436	
Number of residential customers not on social tariffs			
Residential water only no social tariffs		1,328.017	
Social tariff discount			
Average discount per water only social tariffs customer			75.40
Social tariff cross-subsidy – residential customers			
Total customer funded cross-subsidies for water only social tariffs customers	5,311		
Average customer funded cross-subsidy per water only social tariffs customer			3.80
Social tariff cross-subsidy – company			
Total revenue forgone by company to fund cross-subsidies for water only social tariffs customers	-		
Average revenue forgone by company to fund cross-subsidy per water only social tariffs customer			-
Social tariff support – willingness to pay			
Level of support for social tariff customers reflected in business plan			4.78
Maximum contribution to social tariffs supported by customer engagement			4.78

During the year, we increased our support for vulnerable customers. We have publicised our Priority Services Register and our collaboration with the National Debtline charity. We also proactively contacted customers who we thought could be more impacted by the pandemic, for example cash payers and have facilitated direct debit payments instead. More than 7,000 people were given payment breaks during 2020/21 and we continue to support 85,000 households in our region with Social Tariffs.

2O - HISTORIC COST ANALYSIS OF INTANGIBLE FIXED ASSETS

	Water resources £000	Water network+ £000	Retail Household £000	Total £000
Cost				
At 1 April 2020	352	81,349	10,065	91,766
Disposals	-	-	-	-
Additions	4,432	8,113	942	13,487
Adjustments	-	-	-	-
Assets adopted at nil cost	-	-	-	-
At 31 March 2021	4,784	89,462	11,007	105,253
Amortisation				
At 1 April 2020	-	(40,672)	(5,326)	(45,998)
Disposals	-	-	-	-
Adjustments	-	-	-	-
Charge for the year	-	(9,920)	(657)	(10,577)
At 31 March 2021	-	(50,592)	(5,983)	(56,575)
Net book amount at 31 March 2021	4,784	38,870	5,024	48,678
Net book amount at 1 April 2020	352	40,677	4,739	45,768
Amortisation for year				
Principal services	-	(9,920)	(657)	(10,577)
Third party services	-	-	-	-
Total	-	(9,920)	(657)	(10,577)

Included in the additions above is £13,461,000 of capitalised intangible assets under construction, which is not amortised.

Expenditure in the year related primarily to computer software development costs, including our new ERP system.

Regulatory Annual Performance Report continued

Section 3 – Performance summary

3A - OUTCOME PERFORMANCE - WATER COMMON PERFORMANCE COMMITMENTS

	Unique reference	Unit	Decimal Places	Performance level - actual: Previous reporting year	Performance level - actual: Current reporting year	PCL met?	Outperformance or under-performance payment £m	Forecast of total 2020-25 outperformance or under-performance payment £m
Financial								
Water quality compliance (CRI)	PR19AFW_W-A1	number	2	1.73	1.31	No	0.00	0.00
Water supply interruptions	PR19AFW_W-D1	hh:mm:ss	n/a	00:13:36	00:05:49	Yes	0.357	(0.800)
Leakage	PR19AFW_W-B1	%	1	0.0	1.7	No	(0.288)	0.600
Per capita consumption	PR19AFW_R-B1	%	1	0.0	(3.8)	No	(2.457)	(22.700)
Mains repairs	PR19AFW_W-D4	number	1	125.4	155.8	No	(0.576)	(1.500)
Unplanned outage	PR19AFW_W-D3	%	2	3.42	1.65	Yes	0.00	0.000
Bespoke PCs – Water and Retail (Financial)								
Environmental innovation - delivery of community projects	PR19AFW_W-B2	nr	n/a	0	0	Yes	0.000	1.200
Reducing the total number of void properties by identifying false voids	PR19AFW_R-C4	%	2	2.44	2.37	Yes	0.024	0.000
River restoration	PR19AFW_W-B3	nr	n/a	n/a	7	Yes	0.000	0.400
Abstraction reduction	PR19AFW_W-B4	nr	2	n/a	0.00	Yes	0.000	0.000
Number of sources operating under the Abstraction Incentive Mechanism	PR19AFW_W-B5	nr	n/a	(2,058)	(304)	Yes	0.029	0.000
Properties at risk of receiving low pressure	PR19AFW_W-D5b	nr	3	39.683	196.850	No	(0.869)	(0.900)
Number of occupied properties not billed (Gap sites)	PR19AFW_W-C2	nr	n/a	0	118	Yes	0.000	0.000
Unplanned interruptions to supply over 12 hours	PR19AFW_W-N1	nr	n/a	499	538	No	(0.715)	(0.715)
Customer contacts per 1,000 population for Water Quality (taste, odour & appearance)	PR19AFW_W-N2	nr	2	0.76	0.83	No	(0.326)	(0.800)
Financial water performance commitments achieved		%				53		
Overall performance commitments achieved (excluding C-Mex and D-Mex)		%				64		

Our Business Plan for AMP7 includes a total of 28 stretching performance commitments that will ensure we deliver our four customer outcomes below. These either have financial rewards or penalties attached, or impact us reputationally. Table 3A shows our financial performance commitments and table 3E shows our reputational commitments.

Our four customer outcomes:

- Supplying high quality water you can trust;
- Making sure you have enough water, whilst leaving more water in the environment;
- Providing a great service that you value; and
- Minimising disruption to you and your community.

Our CCG, which consists of individuals with experience of representing household customers and special interest groups, holds us to account as to how we are performing against our performance commitments.

Table 3A shows we have received rewards totalling £0.410m during the year for our performance on water supply interruptions, reducing the total number of void properties by identifying false voids and the number of sources operating under the Abstraction Incentive Mechanism. We have received penalties totalling £5.231m for our performance on leakage, per capita consumption, mains repairs, properties at risk of receiving low pressure, unplanned interruptions to supply over 12 hours and customer contacts per 1,000 population and for water quality (taste, odour & appearance). This resulted in a net penalty of £4.821m which will form part of the revenue adjustment mechanism in two years' time.

We have commented below where we have not met our performance commitment level, or where we have met this and received a reward as a result.

For more details on our operational performance in the year, please see our accompanying document published on our website at **affinitywater.co.uk/corporate/investors/library**, which includes details on our commitments and assumptions made in producing our non-financial numbers.

Water quality compliance (CRI)

A new measure, CRI, has been introduced to measure water quality performance in AMP7 which measures the compliance risk of every exceedance. We have estimated our CRI score for 2020 to be 1.31 (final score to be published in July 2021 by the DWI) which met our deadband performance commitment of having a CRI score of 2.0 or less, however has missed our overall performance commitment of having a score of 0. Another measure of our performance is the number of serious and significant water quality events. During 2020 three events notified to the DWI were classified as serious or significant (2019: one event).

Water supply interruptions

We have achieved our target of 6 minutes and 30 seconds as the average number of minutes our customer base has been affected by a supply interruption in the year. This is the first year this has been a performance commitment for the company, although the metric has been tracked in preceding years. Considerable improvements have been made over the year reducing our impact to customers, reducing our prior year performance by nearly eight minutes from 13 minutes and 36 seconds in 2019/20. Changing the company mentality to concentrate on 'water always on' rather than fixing the burst has been instrumental in improving our performance. We are continuing to look at reductions in response times, availability of resources and innovative methods of ensuring water is always on.

Regulatory Annual Performance Report continued

Section 3 – Performance summary (continued)

3A - OUTCOME PERFORMANCE - WATER COMMON PERFORMANCE COMMITMENTS (CONTINUED)

Leakage

We have committed to reducing leakage by 20% across the whole of AMP7, on top of the 15% delivered in AMP6, but we did not meet our target for the year despite investing both in additional resources and new technology to improve our leakage performance. We recorded leakage of 171.4 Ml/d, a reduction of 9.7 Ml/d compared to the prior year, although not achieving our target of less than 157.8 Ml/d for 2020/21. We invested in the latest acoustic leak detection equipment at the same time as using artificial intelligence to enhance our existing equipment and infrastructure. We also introduced a new customer side leakage policy and process that enables us to carry out free repairs on high volume leaks. We continue to closely monitor lower volume leaks, working collaboratively with our customers to get them fixed.

Leakage is really important to us and we are very disappointed to have missed our target. We understand that it is a critical customer priority and one that raises significant emotion. We need to change our approach if we are to succeed in meeting our stretching leakage targets and are making significant changes to how we manage leakage. This includes bringing in new methods and technologies and targeting our approach to maximise the benefit delivered both in amount of water saved and in managing visible leaks. We have set up an internal taskforce to manage this critically important work.

Per capita consumption

During 2020/21 we recorded PCC of 169.3 l/p/d, which is an increase of 14.3 l/p/d (9.2%) on the prior year (2020: 155.0 l/p/d). We experienced an unprecedented year for demand due to more people staying at home and within our supply area as a result of COVID-19, coupled with the hot weather period from May 2020 to August 2020, and had to adapt our delivery plan as a result, including offering virtual Home Water Efficiency Checks and retraining technicians. We also launched a marketing campaign as outlined in our case study on page 29.

We also met our target of installing 25,000 new meters during 2020/21 as part of our Universal Metering Programme which aims to install 200,000 meters across AMP7, as part of a plan to reduce water wastage by 130 Ml/d by 2025. We met our 2020/21 target despite putting the programme on hold during the first half of the year, and then working to new COVID-19 guidelines when it was safe for us to resume this activity.

Mains repairs

We have failed to meet our target of 150.7 burst repairs per 1,000km of mains in the year. This has been a challenging target particularly over a very cold winter, and performance was on track until the severe weather hit in February 2021, as the number of bursts rose significantly during the freeze and subsequent thaw, with the impact being similar to the previous such incident, the 'Beast from the East' in 2018.

Moving into the new year we will continue to focus on reducing night pressures, reducing volatility of our network and continuing analysis of where and when bursts occur to inform our mains renewals programme.

Reducing the total number of void properties by identifying false voids

We achieved our target in this area and, as a result, earned a reward of £0.024m.

Number of sources operating under the Abstraction Incentive Mechanism

We achieved our target in this area and, as a result, earned a reward of £0.029m.

Properties at risk of receiving low pressure

We have failed to meet our target of 1.645 properties at risk of low pressure per 10,000 properties, as the COVID-19 pandemic has significantly changed the way our customers are using water.

Typically, our water networks are designed to cope with two peaks in demand during the day. The first in the morning before our customers go to work and school, and the second, in the early evening when they return home. This has not been the case during 2020/21 due to the actions taken to control the pandemic, with lockdowns, school closures and more people working at home changing the balance of water consumed by customers and businesses, as well as the volume, and time of day, which has ultimately increased the risk of properties receiving low pressure.

Unplanned interruptions to supply over 12 hours

We have failed to meet our target for unplanned interruptions greater than 12 hours and have incurred the full ODI penalty. This is a very disappointing result as we have been working hard to focus our resources to a 'water always on' mindset. 468 of the properties affected were the result of a single incident where there was no alternative method of supply to these customers. Focus for the coming year remains on improving response times, increasing local resources and alternative methods of continuing to ensure the water supply to customers' properties is not interrupted.

Customer contacts per 1,000 population for Water Quality (taste, odour & appearance)

We did not meet our performance commitment level in that we received 0.83 customer contacts for discolouration per 1,000 customers. Our performance in this area has resulted in a penalty in the year and we are conducting a review led by the SHEDWQ Committee to determine the cause of this increase and whether COVID-19 and the increased demand on our network has had an impact on this performance metric in the year.

3C - CUSTOMER MEASURE OF EXPERIENCE (C-MEX) TABLE

Item	Unit	Value
Annual customer satisfaction score for the customer service survey	Number	77.92
Annual customer satisfaction score for the customer experience survey	Number	77.85
Annual C-MeX score	Number	77.88
Annual net promoter score	Number	13.50
Total household complaints	Number	32,573
Total connected household properties	Number	1,466,811
Total household complaints per 10,000 connections	Number	222.067
Confirmation of communication channels offered	TRUE or FALSE	TRUE

In 2020/21, C-Mex, the new mechanism introduced by Ofwat for measuring customer experience, went live. This followed its successful testing during the 2019/20 shadow year. There are two elements of C-MeX, the Customer Service Survey and the Customer Experience Survey. Our overall C-MeX score during the year ended 31 March 2021 equated to 77.88, compared to an industry average of 81.62. Whilst our score represented a small improvement upon the shadow year, our ranking of 15th of the 17 water companies remained static.

This year, we have worked to bring together Community Operations and Customer Experience into one directorate focused on delivering improved experience right across the customer journey. We have introduced new operating models in operational teams, multi-skilled all contact centres to create a single team, enhanced our customer insights and defined new customer journeys including targeted communications with a single tone of voice, based on newly created personas. We recognise that it is the Customer Experience element of C-MeX, based on customer perception and awareness, that has pulled down our score this year. In 2021/22 we will be launching an unprecedented brand campaign aimed at improving customer awareness, perception of value for money, and trust, in addition to changing behaviours around water usage. Together, this will ensure we are in a stronger position to climb up the C-MeX league table.

Regulatory Annual Performance Report continued

Section 3 – Performance summary (continued)

3D - DEVELOPER SERVICES MEASURE OF EXPERIENCE (D-MEX) TABLE

Item	Unit	Value
Qualitative component annual results	Number	70.72
Quantitative component annual results	Number	98.05
D-MeX score	Number	84.39
Developer services revenue (water)	£000	13,403

Water UK performance metric	Unit	First reporting period (1 April to 30 September	Second reporting period (1 October to 31 March)	Quantitative score (annual)
W1.1 Pre-development enquiry – reports issued within target	%	100.00%	99.00%	
W3.1 s45 quotations - within target	%	99.99%	100.00%	
W4.1 s45 service pipe connections - within target	%	92.46%	99.57%	
W6.1 Mains design <500 plots - quotations within target	%	100.00%	100.00%	
W7.1 Mains design >500 plots - quotations within target	%	100.00%	100.00%	
W8.1 Mains construction within target	%	94.92%	100.00%	
W17.1 Mains diversions (without constraints) - quotations within target	%	100.00%	96.67%	
W17.2 Mains diversions (with constraints) - quotations within target	%	N/A	100.00%	
W18.1 Mains diversions - construction/commissioning within target	%	80.00%	100.00%	
W20.1 Self-lay Point of Connection report < 500 plots etc - reports issued within target	%	100.00%	100.00%	
W21.1 Self-lay Point of Connection reports >500 plots etc - reports issued within target	%	N/A	100.00%	
W23.1 Self-lay design and terms request <500 plots etc - quotations within target	%	98.63%	100.00%	
W24.1 Self-lay design and terms request >500 plots etc - quotations within target	%	100.00%	N/A	
W26.1 Self-lay water for pressure/bacteriological testing - provided within target	%	100.00%	100.00%	
W27.1 Self-lay permanent water supply - provided within target	%	83.33%	100.00%	
W30.1 Self-lay plot references and costing details - issued within target	%	100.00%	100.00%	
WN1.1 % of confirmations issued to the applicant within target period	%	N/A	100.00%	
WN2.2 % Bulk supply offer letters issued to the applicant within target period	%	N/A	100.00%	
D-MeX quantitative score (for the relevant reporting period)	%	96.38	99.72	
D-MeX quantitative score (annual)	Number			0.98

D-MeX is the measure of developer service levels being used by Ofwat in AMP7, following a shadow year in 2019/20. The score is made up of both a qualitative and a quantitative element.

Our D-MeX score during the year ended 31 March 2021 equated to 84.39 compared to an industry average of 82.44. We placed 10th out of 17 companies in the industry league table, up from 16th in the shadow year 2019/20, with consistent improvement in position quarter-on-quarter during 2020/21.

We halted Developer Services works during the first national lockdown as a result of COVID-19, which impacted negatively on our compliance levels of service metric. However, this was recovered following successful remobilisation of our teams at the end of May 2020, as effective planning helped to clear the backlog of jobs, with our quantitative performance average for the year recovering to 98%.

3E - OUTCOME PERFORMANCE – NON FINANCIAL PERFORMANCE COMMITMENTS

	Unique reference	Unit	Decimal Places	Performance level - actual: Previous reporting year	Performance level - actual: Current reporting year	PCL met?
Common						
Risk of severe restrictions in a drought	PR19AFW_W-D2	%	1	43.4	67.7	No
Priority services for customers in vulnerable circumstances – PSR reach	PR19AFW_R-N3	%	1	2.2	4.7	Yes
Priority services for customers in vulnerable circumstances – Attempted contacts	PR19AFW_R-N3	%	1	0.0	62.3	Yes
Priority services for customers in vulnerable circumstances – Actual contacts	PR19AFW_R-N3	%	1	0.0	24.9	Yes
Bespoke PCs						
Average time properties experience low pressure	PR19AFW_W-D5a	nr	0	03:22:23	05:02:48	Yes
Customers in vulnerable circumstances satisfied with our service (receiving financial help)	PR19AFW_R-C2	%	0	94	98	Yes
Customers in vulnerable circumstances who found us easy to deal with (receiving financial help)	PR19AFW_R-C3	%	0	95	97	Yes
BSI accreditation	PR19AFW_R-N4	text	0	ACHIEVED	ACHIEVED	Yes
IT resilience	PR19AFW_R-N6	nr	0	1,296	949	Yes
Customers in vulnerable circumstances satisfied with our service (not receiving financial help)	PR19AFW_R-N7	%	0	94	98	Yes
Customers in vulnerable circumstances who found us easy to deal with (not receiving financial help)	PR19AFW_R-N8	%	0	95	97	Yes
Value for Money Survey	PR19AFW_R-N9	nr	2	7.85	7.48	No
WINEP Delivery	PR19AFW_NEP01	text	0	n/a	Yes	Yes
Non-financial performance commitments achieved		%				77

Regulatory Annual Performance Report continued

Section 3 – Performance summary (continued)

3E - OUTCOME PERFORMANCE – NON FINANCIAL PERFORMANCE COMMITMENTS (CONTINUED)

We have not met our targets for Risk of severe restrictions in a drought or our Value for Money Survey, which have reputational implications.

Risk of severe restrictions in a drought

We have unfortunately failed the performance commitment in 2020/21 due to the high demand we have seen as a result of COVID-19 and the hot weather spells, and our overall leakage position when compared with both the PR19 and the revised baseline. At half year, the target was missed by approximately 50Ml/d, however, the current 'residual' after lockdown was still 4% which could have an impact on our performance in subsequent years of the AMP. If these high levels of demand are sustained in AMP7, the number of customers at risk of severe restrictions will be higher than forecast with the revised performance commitment levels.

Mitigation is to evaluate 'fast track' options to still close the balance in 2024. The 'fast track' options being considered are the acceleration of a trading scheme, the acceleration of the second stage of Supply 2040 combined with a potential reduction of our bulk export to South East Water and non-household demand management activities.

Value for Money Survey

We unfortunately did not meet our Value for Money Survey target in the year, achieving a final average score of 7.48, 0.17 below our target of 7.65. We have unfortunately been under target each quarter of this year. The survey revealed that COVID-19 had made 49% of customers more aware of their household bills and 41% of customers said that COVID-19 had negatively impacted their household finances, having an impact on our score.

3F – UNDERLYING CALCULATIONS FOR COMMON PERFORMANCE COMMITMENTS – WATER AND RETAIL

Performance commitments set in standardised units - Water	Unit	Standardising data indicator	Standardising data numerical value	Performance level – Actual (current reporting year)	Performance level – calculated (i.e. standardised)
Mains repairs – Reactive	Mains repairs per 1000km	Mains length in km	16,836.87	1,948	115.70
Mains repairs – Proactive	Mains repairs per 1000km	Mains length in km	16,836.87	676	40.15
Mains repairs	Mains repairs per 1000km	Mains length in km	16,836.87	2,624	155.85
Per capita consumption (PCC)	lpd	Population	3,904.61	661	169.27

Performance commitments measured against a calculated baseline	Unit	Performance level – actual (2017-18)	Performance level – actual (2018-19)	Performance level – actual (2019-20)	Baseline	Performance level – actual (2020-21)	Performance level 3 year average	Calculated performance level to compare against PCLs
Leakage	Ml/d	181.2	204.1	181.1	188.8	171.4	185.5	1.7
Per capita consumption (PCC)	lpd	151.5	158.8	155.0	155.1	169.3	161.0	(3.8)

Water supply interruptions	Unit	Standardising data indicator	Standardising data numerical value	Performance level – actual number of minutes lost	Number of properties supply interrupted	Calculated performance level
Water supply interruptions	Average number of minutes lost per property per year	Number of properties	1,539.80	8,961,555	25,701	00:05:49

Unplanned or planned outage	Current company level peak week production capacity (PWPC) Ml/d	Reduction in company level PWPC Ml/d	Outage proportion of PWPC %
Unplanned outage	1,365.83	22.55	1.65%

Priority services for customers in vulnerable circumstances	Total residential properties	Total number of households on the PSR (as at 31 March)	PSR reach	Total number of households on the PSR over a 2 year period	Number of attempted contacts	Attempted contacts %	Number of actual contacts	Actual contacts %
Priority services for customers in vulnerable circumstances	1,405.63	66,458	4.7%	19,881	12,390	62.3%	4,945	24.9%

Regulatory Annual Performance Report continued

Section 3 – Performance summary (continued)

3H – SUMMARY INFORMATION ON OUTCOME DELIVERY INCENTIVE PAYMENTS

	Initial calculation of performance payments (excluding C-MeX and D-MeX) £000 (2017-18 prices)
Initial calculation of in period revenue adjustment by price control	
Water resources	(0.71)
Water network plus	(4.14)
Residential retail	0.02
Initial calculation of end of period revenue adjustment by price control	
Water resources	0.00
Water network plus	0.00
Residential retail	0.00
Initial calculation of end of period RCV adjustment by price control	
Water resources	0.00
Water network plus	0.00
Residential retail	0.00

3I – SUPPLEMENTARY OUTCOMES INFORMATION

Unplanned or planned outage	Current company level peak week production capacity (PWPC) Ml/d	Reduction in company level PWPC Ml/d	Outage proportion of PWPC %
Planned outage	1,365.83	40.42	2.96%

Risk of severe restrictions in drought	Deployable output	Outage allowance	Dry year demand	Target headroom	Total population supplied	Customers at risk
Risk of severe restrictions in drought	978.30	38.58	966.77	85.98	3,830,549	2,867,508

Section 4 – Non-audited additional regulatory information – service level

ACCOUNTING SEPARATION POLICY

Tables 4B, 4C, 4D, 4F, 4J, 4L, 4N, 5B, 6D and 9A within sections 4, 5, 6 and 9 have been prepared in accordance with the company's Accounting Separation Methodology Statement, which can be found on the company's website: **affinitywater.co.uk/reports-publications**

The methodology statement explains the basis for the allocations of costs and assets and has been updated for changes to the requirements in the year. Changes to the methodology are also explained within the company's Accounting Separation Methodology Statement on the company's website. Wherever possible, direct costs and assets have been directly attributed to business units. Where this is not possible, appropriate cost allocations have been applied and assets have been allocated to business units based on an assessment of the principal user, as described in the methodology.

For more details on our non-financial reporting methodology in sections 4 to 9, please see our accompanying document published on our website at **affinitywater.co.uk/corporate/investors/library**, which includes assumptions made in producing our non-financial numbers and further explanation where necessary.

Table 4B has not been included within this APR due to its size as permitted by RAG 3.12 but has still been submitted to Ofwat.

Tables and sections relating to wastewater and bioresources have been omitted from this publication as they are not relevant to the company

4A – WATER BULK SUPPLY INFORMATION FOR THE 12 MONTHS ENDED 31 MARCH 2021

	Volume Ml	Operating costs £000	Revenue £000
Bulk supply exports			
Anglian Water – Chalton	40.187	12	-
South East Water – Egham	7,292.989	2,217	2,760
Cambridge Water – Odsey Village	28.496	9	-
NAV 7 – Martello Lakes	17.017	5	-
NAV 5 – Stortfort Fields	61.227	19	-
Total bulk supply exports	**7,439.916**	**2,262**	**2,760**
Bulk supply imports			
Anglian Water - Grafham	19,701.595	9,023	
Cambridge Water - Hadstock	18.172	3	
Essex and Suffolk Water – Days Lane	21.792	32	
South East Water - Kingsdown	1.706	-	
Thames Water	3,852.310	1,165	
Total bulk supply imports	**23,595.575**	**10,223**	

Bulk supply exports and imports detailed in the tables above are as per the bulk supplies register published by Ofwat for 2020/21 with the exception of the bulk supply imports from Thames Water, which have been combined and reported as a whole for the appointee in the table above. The breakdown of Thames Water volume by site is: Snakey Lane 54.712; Stonebridge Park 251.431; Fortis Green and Hampstead Garden (combined) 539.534; Ladymead 716.256; Perivale 1.058; raw water 2,289.319.

Where the company has not exported to, or imported from an appointee, this appointee has been excluded from the tables above.

Regulatory Annual Performance Report continued

Section 4 – Non-audited additional regulatory information – service level (continued)

4C - IMPACT OF PRICE CONTROL PERFORMANCE TO DATE ON RCV

12 months ended 31 March 2021	Water resources	Water network plus
Totex (net of business rates, abstraction licence fees and grants and contributions)		
Final determination allowed totex (net of business rates, abstraction licence fees and grants and contributions)	35,111	216,601
Actual totex (net of business rates, abstraction licence fees and grants and contributions)	24,985	208,121
Transition expenditure	-	-
Disallowable costs	(38)	(186)
Total actual totex (net of business rates, abstraction licence fees and grants and contributions)	25,023	208,307
Variance	(10,088)	(8,294)
Variance due to timing of expenditure	(10,766)	(14,081)
Variance due to efficiency	678	5,787
Customer cost sharing rate	47%	47%
Customer share of totex over/underspend	315	2,692
Company share of totex over/underspend	363	3,095
Totex – business rates and abstraction licence fees		
Final determination allowed totex – business rates and abstraction licence fees	6,331	12,771
Actual totex – business rates and abstraction licence fees	5,762	13,261
Variance – business rates and abstraction licence fees	(569)	490
Customer cost sharing rate – business rates and abstraction licence fees	53%	47%
Customer share of totex over/underspend – business rates and abstraction licence fees	(304)	228
Company share of totex over/underspend – business rates and abstraction licence fees	(265)	262
Totex not subject to cost sharing		
Final determination allowed totex – not subject to cost sharing	4,918	8,426
Actual totex – not subject to cost sharing	311	763
Variance – 100% company allocation	(4,607)	(7,663)
Total company share of totex over/underspend	**(4,509)**	**(4,306)**
RCV		
Total company share of totex over/under spend	(4,509)	(4,306)
PAYG rate	40%	56%
RCV element of totex over/underspend	(2,707)	(1,876)
Adjustment for ODI outperformance payment or underperformance payment	-	-
RCV determined at FD at 31 March	150,416	1,152,824
Projected 'shadow' RCV	147,709	1,150,948

Atypical expenditure (as disclosed in table 4D) relates to one off legal fees associated with advice obtained during the year on our financial covenants and the impact of COVID-19 on these. This totalled £0.759m in the year, with £0.095m included in actual totex (net of business rates, abstraction licence fees and grants and contributions) – water resources and £0.664m included in actual totex (net of business rates, abstraction licence fees and grants and contributions) – water network plus.

Water resources

Totex (net of business rates, abstraction licence fees and grants and contributions)
Actual totex of £25,023,000 against allowed totex of £35,111,000 resulted in an underspend in the year of £10,088,000 in water resources. This was primarily as a result of our capex programmes, which were rephased during the year as a result of the COVID-19 pandemic. Work will be completed in later years across the AMP. There was a slight overspend in operating expenditure of £678,000, with higher power and bulk import costs due to the unprecedented high demand for water we have seen whilst more people stayed at home within our supply area under COVID-19 travel restrictions. Disallowable costs relate to fines and investigation costs including streetworks fines, offset by other cash items as per table 4D.

Totex – business rates and abstraction licence fees
Actual totex of £5,762,000 against allowed totex of £6,331,000 resulted in an underspend in the year of £569,000 in water resources for business rates and abstraction licences. This is due to the apportioning methodology used between water resources and water network + based on the book value of our assets.

Totex not subject to cost sharing
Actual totex of £311,000 against allowed totex of £4,918,000 resulted in an underspend in the year of £4,607,000 in water resources. This was as a result of an underspend on our strategic regional water resources expenditure, for both opex and capex, as per table 4L. Work has been reprofiled across AMP7 as a result of the COVID-19 pandemic.

Overall, this resulted in a projected shadow RCV as at 31 March 2021 of £147,709,000 against the RCV determined as part of the final determination of £150,416,000.

Water network plus

Totex (net of business rates, abstraction licence fees and grants and contributions)
Actual totex of £208,307,000 against allowed totex of £216,601,000 resulted in an underspend in the year of £8,294,000 in water network plus. £14,081,000 resulted from an underspend on capital projects due to the rephasing of our works during the year as a result of the COVID-19 pandemic. Work will be completed in later years across the AMP. There was an overspend in operating expenditure of £5,787,000 with higher power and bulk import costs due to the unprecedented high demand for water we have seen whilst more people stayed at home within our supply area under COVID-19 travel restrictions, and higher renewals expensed in year (infrastructure) due to the mix of renewals work completed in the year. Disallowable costs relate to fines and investigation costs including streetworks fines, offset by other cash items as per table 4D.

Totex – business rates and abstraction licence fees
Actual totex of £13,261,000 against allowed totex of £12,771,000 resulted in an overspend in the year of £490,000 in water resources for business rates and abstraction licences. This is due to the apportioning methodology used between water resources and water network + based on the book value of our assets. Across the wholesale price control, expenditure in this area was in line with our allowed expenditure.

Totex not subject to cost sharing
Actual totex of £763,000 against allowed totex of £8,426,000 resulted in an underspend in the year of £7,663,000 in water network plus. This was as a result of an underspend on our strategic regional water resources expenditure, for both opex and capex, as per table 4L. Work has been reprofiled across AMP7 as a result of the COVID-19 pandemic.

Overall, this resulted in a projected shadow RCV as at 31 March 2021 of £1,150,948,000 against the RCV determined as part of the final determination of £1,152,824,000 for water network plus.

Regulatory Annual Performance Report continued

Section 4 – Non-audited additional regulatory information – service level (continued)

4D - TOTEX ANALYSIS FOR THE 12 MONTHS ENDED 31 MARCH 2021 – WATER RESOURCES AND WATER NETWORK+

	Water resources	Network+				
	£000	Raw water transport £000	Raw water storage £000	Water treatment £000	Treated water distribution £000	Total £000
Operating expenditure						
Base operating expenditure	17,565	4,804	1,095	27,589	113,187	164,240
Enhancement operating expenditure	448	7	9	164	6,428	7,056
Developer services operating expenditure	-	-	-	-	8,304	8,304
Total operating expenditure (excluding third party services)	**18,013**	**4,811**	**1,104**	**27,753**	**127,919**	**179,600**
Third party services	-	-	-	-	2,084	2,084
Total operating expenditure	**18,013**	**4,811**	**1,104**	**27,753**	**130,003**	**181,684**
Grants and contributions						
Grants and contributions – operating expenditure	-	-	-	-	6,645	6,645
Capital expenditure						
Base capital expenditure	39,139	20	-	14,912	53,057	107,128
Enhancement capital expenditure	3,568	449	-	2,281	12,056	18,354
Developer services capital expenditure	-	-	-	-	15,174	15,174
Total gross capital expenditure (excluding third party)	**42,707**	**469**	**-**	**17,193**	**80,287**	**140,656**
Third party services	-	-	-	237	411	648
Total gross capital expenditure	**42,707**	**469**	**-**	**17,430**	**80,698**	**141,304**
Grants and contributions						
Grants and contributions – capital expenditure	29,624	-	-	-	29,364	58,988
Net totex	**31,096**	**5,280**	**1,104**	**45,183**	**174,692**	**257,355**
Cash expenditure						
Pension deficit recovery payments	-	-	-	-	-	-
Other cash items	(38)	(5)	(3)	(47)	(258)	(351)
Totex including cash items	**31,058**	**5,275**	**1,101**	**45,136**	**174,434**	**257,004**

	Water resources	Network+				
Atypical expenditure	£000	Raw water transport £000	Raw water storage £000	Water treatment £000	Treated water distribution £000	Total £000
Atypical legal fees	95	3	6	108	547	759
Total atypical expenditure	**95**	**3**	**6**	**108**	**547**	**759**

The atypical expenditure included in table 4D above relates to one off legal fees associated with advice obtained during the year on our financial covenants and the impact of COVID-19 on these.

4F – MAJOR PROJECT EXPENDITURE FOR WHOLESALE WATER BY PURPOSE FOR THE 12 MONTHS ENDED 31 MARCH 2021

	Expenditure in report year					
	Water resources	Network+				
	£000	Raw water transport £000	Raw water storage £000	Water treatment £000	Treated water distribution £000	Total £000
Major project capital expenditure by purpose						
Brett AMP7 investigations	76	-	-	-	-	76
South Lincolnshire reservoir	334	-	-	111	111	556
Anglian to Affinity transfer	-	-	-	-	292	292
Southeast strategic reservoir	256	-	-	-	-	256
Thames to Affinity transfer	-	127	-	257	-	384
Grand Union canal transfer	-	278	-	209	-	487
Minworth reuse sro	74	-	-	-	-	74
Total major project capital expenditure	**740**	**405**	**-**	**577**	**403**	**2,125**

Regulatory Annual Performance Report continued

Section 4 – Non-audited additional regulatory information – service level (continued)

4H - FINANCIAL METRICS FOR THE 12 MONTHS ENDED 31 MARCH 2021

	Units	Current year	AMP to date
Financial indicators			
Net debt	£m	1,004.335	
Regulatory equity	£m	298.90	
Regulatory gearing	%	77.06%	
Post tax return on regulatory equity	%	(9.21)%	
RORE (return on regulatory equity)	%	1.90%	1.90%
Dividend yield	%	-	
Retail profit margin – Household	%	(1.18)%	
Retail profit margin - Non-household	%	N/A	
Credit rating - Fitch	N/A	N/A	
Credit rating – Moody's	N/A	Baa1	
Credit rating – Standard and Poor's	N/A	N/A	
Return on RCV	%	0.58%	
Dividend cover	dec	-	
Funds from operations (FFO)	£m	45.173	
Interest cover (cash)	dec	2.26	
Adjusted interest cover (cash)	dec	0.71	
FFO/Debt	dec	0.04	
Effective tax rate	%	5.94%	
RCF	£m	45.173	
RCF/Net debt	dec	0.04	
Revenue and earnings			
Revenue (actual)	£000	277,093	
EBITDA (actual)	£000	66,818	
Borrowings			
Proportion of borrowings which are fixed rate	dec	0.1935	
Proportion of borrowings which are floating rate	dec	0.0000	
Proportion of borrowings which are index linked	dec	0.8065	
Proportion of borrowings due within 1 year or less	dec	0.0033	
Proportion of borrowings due in more than 1 year but no more than 2 years	dec	0.0152	
Proportion of borrowings due in more than 2 years but no more than 5 years	dec	0.0032	
Proportion of borrowings due in more than 5 years but no more than 20 years	dec	0.6362	
Proportion of borrowings due in more than 20 years	dec	0.3421	

	Current year	AMP6 to date
Movement in RORE		
Base return	4.04%	4.04%
Variance in corporation tax	(0.96)%	(0.96)%
Totex out/(under) performance	1.75%	1.75%
Retail cost out/(under) performance	(0.56)%	(0.56)%
ODI out/(under) performance	(1.00)%	(1.00)%
Financing out/(under) performance	(0.98)%	(0.98)%
Other factors[1]	(0.39)%	(0.39)%
Regulatory return for the year	1.90%	1.90%

See commentary under table 1F for an explanation of the movement in RORE in the year. The regulatory return for the year is equal to line 'total earnings' and column 'Actual returns and notional regulatory equity'.

[1] Other factors include exceptional items such as land sales and the actual performance adjustment for 2015-20

4I - FINANCIAL DERIVATIVES

	Nominal value by maturity (net) at 31 March			Total value at 31 March		Total accretion at 31 March	Interest rate (weighted average for 12 months to 31 March 2021)	
	1 to 2 years £000	2 to 5 years £000	Over 5 years £000	Nominal value (net) £000	Mark to market £000	£000	Payable %	Receivable %
Interest rate swap (sterling)								
Fixed to index-linked	-	-	460,000	460,000	(48,423)	9,268	1.87	5.13
Total financial derivatives	-	-	460,000	460,000	(48,423)	9,268		

An RPI linked inflation swap with a nominal value of £135.0m, which is linked to the maturity of the Class A fixed rate £250.0m bond (maturity July 2026), was entered into in August 2018. A further RPI linked inflation swap with a nominal value of £75.0m, which is also linked to the maturity of the Class A fixed rate £250.0m bond (maturity July 2026), was entered into in October 2020, backdated to 1 August 2020.

A CPI linked inflation swap with a nominal value of £25.0m, which is linked to the maturity of the Class A fixed rate £250.0m bond (maturity March 2036), was entered into in March 2020. Further CPI linked inflation swaps with a total nominal value of £225.0m, which are also linked to the maturity of the Class A fixed rate £250.0m bond (maturity March 2036), were entered into between April 2020 and June 2020.

The £48.423m mark to market valuation of the fixed to index-linked derivative is shown in non-current liabilities, financial instruments in table 1C of this APR. In line with RAG guidance, we have reclassified accretion on the inflation linked swap from financial instruments to borrowings.

Regulatory Annual Performance Report continued

Section 4 – Non-audited additional regulatory information – service level (continued)

4J - BASE EXPENDITURE ANALYSIS FOR THE 12 MONTHS ENDED 31 MARCH 2021 – WATER RESOURCES AND WATER NETWORK+

	Water resources	Network+				
	£000	Raw water transport £000	Raw water storage £000	Water treatment £000	Treated water distribution £000	Total £000
Operating expenditure						
Power	3,695	3,510	-	2,467	16,718	26,390
Income treated as negative expenditure	-	-	-	-	-	-
Bulk supply	1,443	-	-	8,780	-	10,223
Renewals expensed in year (infrastructure)	-	-	-	-	16,514	16,514
Renewals expensed in year (non-infrastructure)	-	-	-	-	-	-
Other operating expenditure	6,665	977	1,094	13,523	67,965	90,224
Local authority and Cumulo rates	1,937	317	1	2,819	10,124	15,198
Service Charges						
Canal & River Trust abstraction charges/discharge consents	-	-	-	-	-	-
Environment Agency/NRW abstraction charges/discharge consents	3,825	-	-	-	-	3,825
Third party services	-	-	-	-	-	-
Other operating expenditure						
Costs associated with Traffic Management Act	-	-	-	-	1,866	1,866
Costs associated with lane rental schemes	-	-	-	-	-	-
Statutory water softening	-	-	-	-	-	-
Total base operating expenditure	**17,565**	**4,804**	**1,095**	**27,589**	**113,187**	**164,240**
Capital expenditure						
Maintaining the long-term capability of the assets – infra	-	-	-	-	6,978	6,978
Maintaining the long-term capability of the assets – non-infra	39,139	20	-	14,912	46,079	100,150
Total base capital expenditure	**39,139**	**20**	**-**	**14,912**	**53,057**	**107,128**
Traffic Management Act						
Projects incurring costs associated with Traffic Management Act	-	-	-	-	25,216	25,216

4L - ENHANCEMENT EXPENDITURE FOR THE 12 MONTHS ENDED 31 MARCH 2021 – WATER RESOURCES AND WATER NETWORK+

		Expenditure in report year					
		Water resources	Network+				
		£000	Raw water transport £000	Raw water storage £000	Water treatment £000	Treated water distribution £000	Total £000
EA/NRW environmental programme (WINEP/NEP)							
Ecological improvements at abstractions	Capex	973	-	-	-	-	973
Ecological improvements at abstractions	Opex	-	-	-	-	-	-
Ecological improvements at abstractions	Totex	973	-	-	-	-	973
Eels Regulations (measures at intakes)	Capex	-	-	-	-	-	-
Eels Regulations (measures at intakes)	Opex	-	-	-	-	-	-
Eels Regulations (measures at intakes)	Totex	-	-	-	-	-	-
Invasive Non Native Species	Capex	-	-	-	-	-	-
Invasive Non Native Species	Opex	-	-	-	-	-	-
Invasive Non Native Species	Totex	-	-	-	-	-	-
Drinking Water Protected Areas (schemes)	Capex	977	-	-	-	-	977
Drinking Water Protected Areas (schemes)	Opex	-	-	-	-	-	-
Drinking Water Protected Areas (schemes)	Totex	977	-	-	-	-	977
Water Framework Directive measure	Capex	92	3	-	662	963	1,720
Water Framework Directive measure	Opex	-	-	-	-	-	-
Water Framework Directive measure	Totex	92	3	-	662	963	1,720
Investigations	Capex	-	-	-	-	-	-
Investigations	Opex	-	-	-	-	-	-
Investigations	Totex	-	-	-	-	-	-
Total environmental programme expenditure	**Totex**	**2,042**	**3**	**-**	**662**	**963**	**3,670**
Supply-demand balance							
Supply-side improvements delivering benefits in 2020-2025	Capex	7	1	-	4	568	580
Supply-side improvements delivering benefits in 2020-2025	Opex	-	-	-	-	1,043	1,043
Supply-side improvements delivering benefits in 2020-2025	Totex	7	1	-	4	1,611	1,623
Demand-side improvements delivering benefits in 2020-2025 (excl leakage and metering)	Capex	324	41	-	207	1,094	1,666
Demand-side improvements delivering benefits in 2020-2025 (excl leakage and metering)	Opex	-	1	-	-	532	533
Demand-side improvements delivering benefits in 2020-2025 (excl leakage and metering)	Totex	324	42	-	207	1,626	2,199
Leakage improvements delivering benefits in 2020-2025	Capex	-	-	-	-	-	-
Leakage improvements delivering benefits in 2020-2025	Opex	-	6	-	-	4,613	4,619
Leakage improvements delivering benefits in 2020-2025	Totex	-	6	-	-	4,613	4,619
Internal interconnectors delivering benefits in 2020-2025	Capex	-	-	-	-	-	-
Internal interconnectors delivering benefits in 2020-2025	Opex	-	-	-	-	-	-
Internal interconnectors delivering benefits in 2020-2025	Totex	-	-	-	-	-	-
Supply demand balance improvements delivering benefits starting from 2026	Capex	-	-	-	-	-	-
Supply demand balance improvements delivering benefits starting from 2026	Opex	-	-	-	-	-	-
Supply demand balance improvements delivering benefits starting from 2026	Totex	-	-	-	-	-	-
Strategic regional water resources	Capex	664	404	-	578	404	2,050
Strategic regional water resources	Opex	-	-	-	-	-	-
Strategic regional water resources	Totex	664	404	-	578	404	2,050
Total supply demand expenditure	**Totex**	**995**	**453**	**-**	**789**	**8,254**	**10,491**

Regulatory Annual Performance Report continued

Section 4 – Non-audited additional regulatory information – service level (continued)

4L - ENHANCEMENT EXPENDITURE FOR THE 12 MONTHS ENDED 31 MARCH 2021 – WATER RESOURCES AND WATER NETWORK+ (CONTINUED)

		Expenditure in report year					
		Water resources	Network+				
		£000	Raw water transport £000	Raw water storage £000	Water treatment £000	Treated water distribution £000	Total £000
Metering							
New meters requested by existing customers (optants)	Capex	-	-	-	-	1,109	1,109
New meters requested by existing customers (optants)	Opex	-	-	-	-	-	-
New meters requested by existing customers (optants)	Totex	-	-	-	-	1,109	1,109
New meters introduced by companies for existing customers	Capex	-	-	-	-	5,870	5,870
New meters introduced by companies for existing customers	Opex	-	-	-	-	-	-
New meters introduced by companies for existing customers	Totex	-	-	-	-	5,870	5,870
New meters for existing customers - business	Capex	-	-	-	-	-	-
New meters for existing customers – business	Opex	-	-	-	-	-	-
New meters for existing customers - business	Totex	-	-	-	-	-	-
Total metering expenditure	**Totex**					**6,979**	**6,979**
Other enhancement							
Improvements to taste, odour and colour	Capex	185	-	-	291	328	804
Improvements to taste, odour and colour	Opex	-	-	-	-	-	-
Improvements to taste, odour and colour	Totex	185	-	-	291	328	804
Meeting lead standards	Capex	-	-	-	-	1,700	1,700
Meeting lead standards	Opex	-	-	-	-	-	-
Meeting lead standards	Totex	-	-	-	-	1,700	1,700
Addressing raw water deterioration	Capex	-	-	-	539	-	539
Addressing raw water deterioration	Opex	448	-	9	164	240	861
Addressing raw water deterioration	Totex	448	-	9	703	240	1,400
Improvements to river flow	Capex	346	-	-	-	-	346
Improvements to river flow	Opex	-	-	-	-	-	-
Improvements to river flow	Totex	346	-	-	-	-	346
Enhancing resilience to low probability high consequence events	Capex	-	-	-	-	20	20
Enhancing resilience to low probability high consequence events	Opex	-	-	-	-	-	-
Enhancing resilience to low probability high consequence events	Totex	-	-	-	-	20	20
Security - SEMD	Capex	-	-	-	-	-	-
Security - SEMD	Opex	-	-	-	-	-	-
Security - SEMD	Totex	-	-	-	-	-	-
Security – Non-SEMD	Capex	-	-	-	-	-	-
Security – Non-SEMD	Opex	-	-	-	-	-	-
Security – Non-SEMD	Totex	-	-	-	-	-	-
Total other enhancement expenditure	**Totex**	**979**	**-**	**9**	**994**	**2,288**	**4,270**
Total enhancement							
Total enhancement expenditure	Capex	3,568	449	-	2,281	12,056	18,354
Total enhancement expenditure	Opex	448	7	9	164	6,428	7,056
Total enhancement expenditure	**Totex**	**4,016**	**456**	**9**	**2,445**	**18,484**	**25,410**

		Cumulative expenditure on schemes completed in the report year					
		Water resources	Network+				
		£000	Raw water transport £000	Raw water storage £000	Water treatment £000	Treated water distribution £000	Total £000
Supply-demand balance							
Leakage improvements delivering benefits in 2020-2025	Capex	-	-	-	-	-	-
Leakage improvements delivering benefits in 2020-2025	Opex	-	6	-	-	4,613	4,619
Leakage improvements delivering benefits in 2020-2025	Totex	-	6	-	-	4,613	4,619
Total supply demand expenditure	**Totex**	**-**	**6**	**-**	**-**	**4,613**	**4,619**

Expenditure reported in the table above is consistent with the lines included in table WS2 as part of the PR19 business plan submission.

Table 4L details enhancement capital expenditure to deliver improvements to the supply/demand balance (both supply-side and demand-side), together with expenditure for strategic regional water resource options.

The table was populated by first identifying the relevant projects and then including all associated costs. While lockdown restrictions imposed by the Government in response to COVID-19 has caused some delays, for example by cessation of all non-essential construction work, we have resumed all planned programmes. We expect to recover in the next financial year. We remain on track with non-construction activities, such as our Strategic Regional Options programme, as we quickly adapted to working remotely.

4N - DEVELOPER SERVICES EXPENDITURE FOR THE 12 MONTHS ENDED 31 MARCH 2021 – WATER RESOURCES AND WATER NETWORK+

		Expenditure in report year					
		Water resources	Network+				
		£000	Raw water transport £000	Raw water storage £000	Water treatment £000	Treated water distribution £000	Total £000
New connections	Capex	-	-	-	-	-	-
New connections	Opex	-	-	-	-	8,304	8,304
Requisition mains	Capex	-	-	-	-	7,702	7,702
Requisition mains	Opex	-	-	-	-	-	-
Infrastructure network reinforcement	Capex	-	-	-	-	7,117	7,117
Infrastructure network reinforcement	Opex	-	-	-	-	-	-
s185 diversions	Capex	-	-	-	-	355	355
s185 diversions	Opex	-	-	-	-	-	-
Other price controlled activities	Capex	-	-	-	-	-	-
Other price controlled activities	Opex	-	-	-	-	-	-
Total developer services expenditure	Capex	-	-	-	-	15,174	15,174
Total developer services expenditure	Opex	-	-	-	-	8,304	8,304
Total developer services expenditure	**Totex**	**-**	**-**	**-**	**-**	**23,478**	**23,478**

Regulatory Annual Performance Report continued

Section 4 – Non-audited additional regulatory information – service level (continued)

4P - EXPENDITURE ON NON-PRICE CONTROL DIVERSIONS FOR THE 12 MONTHS ENDED 31 MARCH 2021

	Water resources £000	Water network+ £000	Total £000
Non-price control diversions			
Diversions – NRSWA	-	237	237
Diversions – other non-price control	29,309	23,128	52,437
Total expenditure on non-price control diversions	**29,309**	**23,365**	**52,674**

4Q - DEVELOPER SERVICES – NEW CONNECTIONS, PROPERTIES AND MAINS

	Total number
Connections volume data	
New connections (residential – excluding NAVs)	8,654
New connections (business – excluding NAVs)	285
Total new connections served by incumbent	8,939
New connections - SLPs	2,247
Properties volume data	
New properties (residential – excluding NAVs)	8,221
New properties (business – excluding NAVs)	259
Total new properties served by incumbent	8,480
New residential properties served by NAVs	845
New business properties served by NAVs	0
Total new properties served by NAVs	845
Total new properties	9,325
New properties – SLP connections	2,135
	km
New water mains data	
Length of new mains (km) – requisitions	18.19
Length of new mains (km) – SLPs	13.75

4R - CONNECTED PROPERTIES, CUSTOMERS AND POPULATION

	Units	Unmeasured	Measured	Total	Voids
Customer numbers – average during the year					
Residential water only customers	000s	532.426	866.027	1,398.453	34.528
Residential wastewater only customers	000s	-	-	-	-
Residential water and wastewater customers	000s	-	-	-	-
Total residential customers	000s	532.426	866.027	1,398.453	34.528
Business water only customers	000s	8.067	53.819	61.886	11.461
Business wastewater only customers	000s	-	-	-	-
Business water and wastewater customers	000s	-	-	-	-
Total business customers	000s	8.067	53.819	61.886	11.461
Total customers	000s	540.493	919.846	1,460.339	45.989

	Units	Unmeasured	Measured		Total
Property numbers – average during the year					
Residential properties billed	000s	532.426	866.027		1,398.453
Residential void properties	000s				34.528
Total connected residential properties	000s				1,458.789
Business properties billed	000s	8.067	53.819		61.886
Business void properties	000s				11.461
Total connected business properties	000s				73.347
Total connected properties	000s				1,532.136

	Unmeasured				Measured				Total
Property and meter numbers – at end of year (31 March) – 000s	**No meter**	**Basic meter**	**Smart meter**	**Total**	**No meter**	**Basic meter**	**Smart meter**	**Total**	
Total new residential properties connected in year	0.631	-		0.631	-	11.430	5.102	16.532	17.163
Total new business properties connected in year	0.001	-	-	0.001	-	0.001	0.148	0.149	0.150
Residential properties billed at year end	484.016	0.060	38.613	522.689	-	589.474	293.465	882.939	1,405.628
Residential void properties at year end				22.214				11.901	34.115
Total connected residential properties at year end				544.903				921.908	1,466.811
Business properties billed at year end	7.970	-	-	7.97	0.006	44.847	8.277	53.130	61.100
Business void properties at year end				1.736				10.156	11.892
Total connected business properties at year end				9.706				63.286	72.992
Total connected properties at year end				554.609				985.194	1,539.803

Population data	Units	Water
Resident population	000s	3,904.606

Regulatory Annual Performance Report continued

Section 4 – Non-audited additional regulatory information – service level (continued)

4R - CONNECTED PROPERTIES, CUSTOMERS AND POPULATION (CONTINUED)

Our Household Population estimates are drawn from the two main sources:

- The 2019 mid-year population estimate from ONS for both local authority districts and for individual COAs (census output areas); and
- The 2018-based Principal sub-national population projection ('SNPP') from ONS, together with accompanying assumptions on fertility, mortality and migration. These are produced on a consistent basis across all local authorities in England.

The 2018-based Principal SNPP uses a five-year history (2013 to 2018) to derive local fertility and mortality assumptions and a long-term UK net international migration assumption of +190k. The 2018-SNPP also uses a two-year history (2016 to 2018) of internal migration assumptions.

We have not used Census 2011 data for population estimates except where the underlying data has been used to inform the ONS projections.

Section 5 – Non-audited additional regulatory information – water resources

5A - WATER RESOURCES ASSET AND VOLUMES DATA FOR THE 12 MONTHS ENDED 31 MARCH 2021

Water resources	Units	Input
Water from impounding reservoirs	Ml/d	2.64
Water from pumped storage reservoirs	Ml/d	25.02
Water from river abstractions	Ml/d	305.04
Water from groundwater works excluding managed aquifer recharge (MAR) water supply schemes	Ml/d	606.39
Water from artificial recharge (AR) water supply schemes	Ml/d	-
Water from aquifer storage and recovery (ASR) water supply schemes	Ml/d	-
Water from saline abstractions	Ml/d	-
Water from water reuse schemes	Ml/d	-
Number of impounding reservoirs	Nr	2
Number of pumped storage reservoirs	Nr	2
Number of river abstractions	Nr	3
Number of groundwater works excluding managed aquifer recharge (MAR) water supply schemes	Nr	114
Number of artificial recharge (AR) water supply schemes	Nr	-
Number of aquifer storage and recovery (ASR) water supply schemes	Nr	-
Number of saline abstraction schemes	Nr	-
Number of reuse schemes	Nr	-
Total number of sources	Nr	121
Total number of water reservoirs	Nr	4
Total volumetric capacity of water reservoirs	Ml	3,776
Total number of intake and source pumping stations	Nr	120
Total installed power capacity of intake and source pumping stations	kW	15,627
Total length of raw water abstraction mains and other conveyors	Km	-
Average pumping head – raw water abstraction	m.hd	16.99
Energy consumption – raw water abstraction	MWh	30,196
Total number of raw water abstraction imports	Nr	-
Water imported from 3rd parties' raw water abstraction systems	Ml/d	-
Total number of raw water abstraction exports	Nr	-
Water exported to 3rd parties' from raw water abstraction systems	Ml/d	-
Water resources capacity (measured using water resources yield)	Ml/d	1,031.94

5B - WATER RESOURCES OPERATING COST ANALYSIS FOR THE 12 MONTHS ENDED 31 MARCH 2021

	Impounding Reservoir £000	Pumped Storage £000	River Abstractions £000	Groundwater excluding MAR water supply schemes £000	Artificial Recharge (AR) water supply schemes £000	Aquifer Storage and Recovery (ASR) water supply schemes £000	Other £000	Total £000
Power	10	98	1,200	2,386	-	-	-	**3,695**
Income treated as negative expenditure	-	-	-	-	-	-	-	**-**
Abstraction charges/discharge consents	11	102	1,242	2,470	-	-	-	**3,825**
Bulk supply	4	38	469	932	-	-	-	**1,443**
Other operating expenditure								
Renewals expensed in year (Infrastructure)	-	-	-	-	-	-	-	**-**
Renewals expensed in year (Non-infrastructure)	-	-	-	-	-	-	-	**-**
Other operating expenditure excluding renewals - direct	10	94	1,150	2,286	-	-	-	**3,540**
Other operating expenditure excluding renewals - indirect	9	83	1,015	2,018	-	-	-	**3,125**
Local authority and Cumulo rates	5	52	629	1,251	-	-	-	**1,937**
Total operating expenditure (excluding 3rd party)	**49**	**468**	**5,706**	**11,342**	**-**	**-**	**-**	**17,565**

Regulatory Annual Performance Report continued

Section 6 – Non-audited additional regulatory information – water network plus

6A - RAW WATER TRANSPORT, RAW WATER STORAGE AND WATER TREATMENT DATA FOR THE 12 MONTHS ENDED 31 MARCH 2021

Raw water transport and storage	Units	Input
Total number of balancing reservoirs	Nr	3
Total volumetric capacity of balancing reservoirs	Ml	133
Total number of raw water transport stations	Nr	36
Total installed power capacity of raw water transport pumping stations	kW	8,516
Total length of raw water transport mains and other conveyors	Km	205.03
Average pumping head – raw water transport	m.hd	18.69
Energy consumption – raw water transport	mWh	33,216
Total number of raw water transport imports	Nr	1
Water imported from 3rd parties' raw water transport systems	Ml/d	6.27
Total number of raw water transport exports	Nr	-
Water exported to 3rd parties raw water transport systems	Ml/d	-
Total length of raw and pre-treated (non-potable) water transport mains for supplying customers	km	36.53

Water treatment – treatment type analysis	Surface water		Ground water	
	Water treated Ml/d	Number of works	Water treated Ml/d	Number of works
All simple disinfection works	-	-	25.01	6
W1 works	-	-	-	-
W2 works	-	-	12.37	5
W3 works	-	-	37.66	5
W4 works	1.95	-	307.01	59
W5 works	400.32	5	177.65	13
W6 works	-	-	-	-

Water treatment – works size	% of total DI	Number of works
WTWs in size band 1	4.3%	41
WTWs in size band 2	6.0%	19
WTWs in size band 3	10.7%	19
WTWs in size band 4	12.7%	11
WTWs in size band 5	16.1%	7
WTWs in size band 6	9.5%	2
WTWs in size band 7	20.3%	2
WTWs in size band 8	20.2%	1

Water treatment – other information	Units	Input
Total water treated at more than one type of works	Ml/d	-
Number of treatment works requiring remedial action because of raw water deterioration	Nr	6
Zonal population receiving water treated with orthophosphate	000's	2,977.238
Average pumping head – water treatment	m.hd	13.13
Energy consumption – water treatment	mWh	23,333
Total number of water treatment imports	Nr	-
Water imported from 3rd parties' water treatment works	Ml/d	-
Total number of water treatment exports	Nr	-
Water exported to 3rd parties' water treatment works	Ml/d	-

Raw water transport and storage

As per the list of imports/exports for the company, we have one raw water transport import which is received from Thames into our Iver site for treatment.

Water treatment – treatment type analysis

Changes in Treatment Works classifications
- Horsley Cross – updated from GW3 to GW4 as UV has now been installed on site
- Kensworth Lynch – downgraded from GW5 to GW4 as GAC has been decommissioned on site

We are no longer reporting the following two sites as they have been out of action for over 18 months and they would need to undergo recommissioning to be brought back into use:

- Marlowes (GW) - site offline since April 2019 due to high turbidity issues
- Chartridge (GW4) - site not run since August 2018 as not needed

Impacts on individual reporting lines
- 6A.13 (Simple disinfection works) – dropped one from seven to six as a result of Marlowes no longer being reported
- 6A.16 (W3 works) – dropped from six to five as a result of Horsley Cross having UV installed
- 6A.17 (W4 works) – increased from 58 to 59, two sites (Horsley Cross and Kensworth Lynch) have now been added and one sites (Chartridge) has been removed
- 6A.18 (W5 works) – dropped from 14 to 13 as a result of Kensworth Lynch having its GAC decommissioned

Sites Counted but not used in the year
- Clandon – the site has not run since January 2019 due to water quality issues but is being maintained and could be used in an emergency situation with precautionary advice. It is also due to have the current UV treatment replaced in year 3 of the current AMP.

Changes due in 2021/22

We currently have three sites which are in the process of having their treatment changed as a result of the work surrounding HS2. West Hyde, Northmoor and Amersham all have had membranes added as pretreatment to the existing treatment on site.

Both Northmoor and West Hyde have used this new membrane treatment intermittently to put water into supply from late March 2021 and Amersham membrane pretreatment has not yet been commissioned. We are not planning to change the sites treatment category for all three sites to GW5 until 2021/22 as none of these sites have undergone a full performance test as part of the project final sign off.

Water treatment – other information

As per the list of imports/exports for the company we do not currently have any water treatment imports or exports.

Regulatory Annual Performance Report continued

Section 6 – Non-audited additional regulatory information – water network plus (continued)

6B - TREATED WATER DISTRIBUTION – ASSETS AND OPERATIONS FOR THE 12 MONTHS ENDED 31 MARCH 2021

Assets and operations	Units	Input
Total installed power capacity of potable water pumping stations	kW	54,237
Total volumetric capacity of service reservoirs	Ml	1,528.4
Total volumetric capacity of water towers	Ml	37.8
Distribution input	Ml/d	961.97
Water delivered (non-potable)	Ml/d	1.63
Water delivered (potable)	Ml/d	848.02
Water delivered (billed measured residential)	Ml/d	345.94
Water delivered (billed measured business)	Ml/d	120.09
Total annual leakage	Ml/d	171.44
Distribution losses	Ml/d	113.44
Water taken unbilled	Ml/d	5.50
Proportion of distribution input derived from impounding reservoirs	Propn 0 to 1	0.003
Proportion of distribution input derived from pumped storage reservoirs	Propn 0 to 1	0.083
Proportion of distribution input derived from river abstractions	Propn 0 to 1	0.308
Proportion of distribution input derived from groundwater works, excluding managed aquifer recharge (MAR) water supply schemes	Propn 0 to 1	0.606
Proportion of distribution input derived from artificial recharge (AR) water supply schemes	Propn 0 to 1	0.000
Proportion of distribution input derived from aquifer storage and recovery (ASR) water supply schemes	Propn 0 to 1	0.000
Proportion of distribution input derived from saline abstractions	Propn 0 to 1	0.000
Proportion of distribution input derived from water reuse schemes	Propn 0 to 1	0.000
Total number of potable water pumping stations that pump into and within the treated water distribution system	Nr	274
Number of potable water pumping stations delivering treated groundwater into the treated water distribution system	Nr	80
Number of potable water pumping stations delivering surface water into the treated water distribution system	Nr	1
Number of potable water pumping stations that re-pump water already within the treated water distribution system	Nr	189
Number of potable water pumping stations that pump water imported from a 3rd party supply into the treated water distribution system	Nr	4
Total number of service reservoirs	Nr	111
Number of water towers	Nr	44
Energy consumption - treated water distribution	Nr	162,835
Average pumping head – treated water distribution	m.hd	91.63
Total number of treated water distribution imports	Nr	13
Water imported from 3rd parties' treated water distribution systems	Ml/d	58.37
Total number of treated water distribution exports	Nr	7
Water exported to 3rd parties' treated water distribution systems	Ml/d	20.38

Disappointingly, we have not met our leakage target for 2020/21, though we are still committed to reducing leakage from water pipes by 20% over AMP7, following a 15% reduction achieved in AMP6, the industry's largest percentage reduction target for AMP6. We achieved a leakage performance to 171.44 Ml/d compared to a target of 157.8 Ml/d or less in 2020/21 and therefore recognise we need to improve.

We plan to spend approximately £100m to tackle leaks in AMP7 and meet our target. Our plan is to fix 50% of visible leaks in 24 hours, 70% within 48 hours and 90% within five days, use quantum technologies to detect and fix leaks, use new techniques to monitor flows and fast logging and pressure reduction schemes to locate leaks so we can target them more effectively and maximise the amount of water we save and offer more free repairs to customers where there are leaks on the pipe supplying their home.

6C - WATER NETWORK+ - MAINS, COMMUNICATION PIPES AND OTHER DATA FOR THE 12 MONTHS ENDED 31 MARCH 2021

Treated water distribution – mains analysis	Units	Input
Total length of potable mains as at 31 March	Km	16,836.9
Total length of potable mains relined	Km	0.0
Total length of potable mains renewed	Km	22.4
Total length of new potable mains	Km	38.9
Total length of potable water mains (≤320mm)	Km	15,559.8
Total length of potable water mains >320mm and ≤450mm	Km	607.1
Total length of potable water mains >450mm and ≤610mm	Km	492.3
Total length of potable water mains >610mm	Km	177.6
Communication pipes		
Number of lead communication pipes	Nr	313,751
Number of galvanised iron communication pipes	Nr	246,584
Number of other communication pipes	Nr	510,254
Treated water distribution – mains age profile		
Total length of potable mains laid or structurally refurbished pre-1880	Km	76.9
Total length of potable mains laid or structurally refurbished between 1881 and 1900	Km	203.2
Total length of potable mains laid or structurally refurbished between 1901 and 1920	Km	611.9
Total length of potable mains laid or structurally refurbished between 1921 and 1940	Km	2,523.9
Total length of potable mains laid or structurally refurbished between 1941 and 1960	Km	3,877.6
Total length of potable mains laid or structurally refurbished between 1961 and 1980	Km	3,728.2
Total length of potable mains laid or structurally refurbished between 1981 and 2000	Km	2,756.5
Total length of potable mains laid or structurally refurbished post 2001	Km	3,058.6
Other		
Company area	km^2	4,515
Number of lead communication pipes replaced for water quality	Nr	968
Supply-side improvements delivering benefits in 2020-25	Ml/d	0.07
Demand-side improvements delivering benefits in 2020-25 (excluding leakage and metering)	Ml/d	0.56
Leakage improvements delivering benefits in 2020-25	Ml/d	9.66
Internal interconnectors delivering benefits in 2020-25	Ml/d	10.70
Event Risk Index	Nr	19

Internal interconnectors delivering benefits in 2020-25

During 2020/21, one scheme was included within the scope of the project, with two elements as per the table below.

Area	Scope	Rationale
New main	New Main and PRV, Magnolia Gardens: A new main from the existing 21" (Edgware Way) in Clay Lane was linked to the 12" (Hale Lane) in Uphill Drive using a 560mm SDR17 (493.9mm internal), with length 570m	Provide network capacity to supply developments
New Control Valve	New PRV (maximum flow approximately 200l/s)	Control pressure at night in Harrow umbrella

Regulatory Annual Performance Report continued

Section 6 – Non-audited additional regulatory information – water network plus (continued)

6D - DEMAND MANAGEMENT – METERING AND LEAKAGE ACTIVITIES FOR THE 12 MONTHS ENDED 31 MARCH 2021

Metering activities – Totex expenditure	Units	Basic meter	Smart meter
New optant meter installation	£000	-	1,109
New selective meter installation	£000	-	5,870
New business meter installation	£000	-	-
Residential meters renewed	£000	-	1,136
Business meters renewed	£000	-	58
Metering activities – Explanatory variables			
New optant meters installed	000s	-	2.635
New selective meters installed	000s	-	25.658
New business meters installed	000s	-	0.019
Residential meters renewed	000s	-	10.656
Business meters renewed	000s	0.002	0.522
New residential meters installation – supply-demand balance benefit	Ml/d	-	0.49
New business meters installation – supply-demand balance benefit	Ml/d	-	0.13
Residential meters renewed – supply-demand balance benefit	Ml/d	-	(0.30)
Business meters renewed – supply-demand balance benefit	Ml/d	-	0.01
Residential properties – meter penetration	%	41.9	20.9

Leakage activities – Totex expenditure	Units	Maintaining leakage	Reducing leakage	Total
Total leakage activity	£000	5,900	4,053	9,953

Per capita consumption (excluding supply pipe leakage)	Units	Input
Per capita consumption (measured customers)	l/h/d	148.25
Per capita consumption (unmeasured customers)	l/h/d	202.63

Metering activities

We have met our operational target to install the 25,000 new selective meters in the year to 31 March 2021, despite the operational challenges arising as a result of COVID-19 including despite three National lockdowns and working to new safety guidelines. This is part of a plan to reduce water wastage by 130 million litres a day by 2025. Work was delayed for the first half of the year, with an acceleration of work completed in the second half. Costs have remained within the allowed expenditure as per our business plan.

We have not installed any meters that utilise smart metering technologies. Wherever possible we install AMR (automated meter reading) meters, but these are not smart meters. With AMR meters, we can obtain a reading from the meter by walking or driving past the property, without the need to lift a cover or enter the property. This makes meter reading more efficient and has also been of considerable benefit in the need to maintain social distancing during the COVID-19 pandemic. Some customers are vehemently opposed to smart meters, and we have gone to some lengths to explain and reassure that AMR is not a smart meter. As required in the Regulatory Accounting Guidance documents, we have reported AMR installations in table 6D in the 'smart meter' rather than 'basic meter' column, although we are not comfortable with this. However, we note that in the revisions to the guidance and tables proposed for 2021/22 reporting, Ofwat are correcting this by differentiating between AMR and true smart meter installations.

Leakage activities

See commentary under table 6B for our leakage performance in the year. The maintaining leakage total of £5,900,000 reported in this table differs to that reported in 4L of £4,619,000 as the above total includes customer side leakage expenditure which is not an enhancement activity.

Activities included within the £5,900,000 maintaining leakage total are for surveys undertaken in the year, stop tap fitting, major fitting sounding, acoustic sound logging and enforced and free customer repairs.

Section 9 – Non-audited additional regulatory information – innovation competition

9A – INNOVATION COMPETITION

Allowed	Current year £000
Allowed innovation competition fund prize control revenue	1,004
Revenue collected for the purposes of the innovation competition	
Price control revenue collected from customers	1,004
Non-price control revenue (eg. royalties)	-
Revenue collected from customers and transferred into the innovation competition fund	1,004

Allowed	Bids accepted and awarded funding for innovation competition	Forecast expenditure on innovation projects funded through the innovation competition	Actual expenditure on innovation projects funded through the innovation competition in year	Difference between actual and forecast expenditure	Cumulative spend on innovation projects	Allowed future expenditure on innovation projects funded through the innovation competition	Expenditure on innovation projects funded by shareholders
Seagrass Seeds of recovery	1	-	-	-	-	250	-
Smarter Tanks to build a resilient network	1	-	-	-	-	95	-
Total	**2**	**-**	**-**	**-**	**-**	**345**	**-**

Administration	
Administration charge for innovation partner	-

As at 31 March 2021, no awards had been granted under the Innovation competition and no actual expenditure had been incurred on projects funded through the scheme. £1,004,000 has been charged to and collected from customers and as at 31 March 2021 this had not been paid over to Ofwat and is included within the £93,774,000 appointed cash and cash equivalents as per table 1C. We have recognised the full liability of £1,004,000 within trade and other payables as an amount owed to Ofwat to the fund. In April 2021, two awards were made to the company, as shown in the table above with forecast future expenditure of £345,000 on these schemes. This funding will only be used to finance the schemes and specific details of our expenditure will be included in our 2021/22 APR.

Regulatory Annual Performance Report continued

Non-audited additional regulatory information

TRANSACTIONS WITH ASSOCIATED COMPANIES

Service received	Company	Turnover of associate £000	Terms of supply	Value £000
Interest paid on loan	Affinity Water Capital Funds Limited*	-	Market rate at time of loan inception	160
Interest paid on loan	Affinity Water Finance (2004) PLC*	-	At market rate, on-lent by associate on the same terms	14,213
Interest paid on loan	Affinity Water Finance PLC*	-	At market rate, on-lent by associate on the same terms	28,551

Service provided	Company	Turnover of associate £000	Terms of supply	Value £000
Support services	Affinity Water Capital Funds Limited*	-	No market – services charged at a fixed annual fee based on actual cost or recharged by time allocation	261

The company has applied a materiality threshold of £100,000 for disclosing transactions with individual related parties. No contracts individually exceeded this threshold.

Following the sale of Castle Water (Southern) Limited (formerly Affinity for Business (Retail) Limited) outside of the Affinity Water group on 1 April 2020, there were no related party transactions with this entity in the current year.

In 2004, Affinity Water Limited borrowed £200,000,000 from its wholly owned subsidiary, Affinity Water Finance (2004) PLC, the loan being the proceeds of the latter's £200,000,000 Class A bonds issued in that year and maturing in July 2026 with an annual coupon of 5.875% and lent on the same terms. On 16 July 2014 Affinity Water Finance (2004) PLC completed a tap issue of £50,000,000 on the same terms as the existing £200,000,000 bond. The net proceeds of both the bond and the tap issue have been lent to the company on the same terms. The amount outstanding at year end, net of amortised debt issuance costs, was £252,999,000 (2020: £253,462,000).

As part of the WBS in February 2013, all existing loans and revolving credit facilities, except for the above £250,000,000 bond, were replaced by the following four new bonds issued on 4 February 2013 by the company's former subsidiary, Affinity Water Programme Finance Limited: £80,000,000 Class A Guaranteed Notes maturing in September 2022 with a coupon of 3.625%, £250,000,000 Class A Guaranteed Notes maturing in March 2036 with a coupon of 4.500%, £150,000,000 Class A Guaranteed RPI linked Notes maturing in June 2045 with a coupon of 1.548% and £95,000,000 Class B Guaranteed RPI linked Notes maturing in June 2033 with a coupon of 3.249%.

On 29 October 2015 Affinity Water Programme Finance Limited completed a tap issue of £40,000,000 on the same terms as its existing £150,000,000 Class A Guaranteed RPI linked Notes.

On 19 February 2016 Affinity Water Programme Finance Limited issued £10,000,000 Class B guaranteed RPI linked Notes maturing in June 2033 with a coupon rate of 1.024%.

On 22 August 2016, Affinity Water Programme Finance Limited exchanged £65,800,000 of its 3.625% Guaranteed Notes due 2022 for a new issue of 3.278% Guaranteed Notes due 2042. An additional £19,200,000 of 3.278% Guaranteed Notes due 2042 were issued at the same time.

On 22 November 2017, Affinity Water Programme Finance Limited issued £60,000,000 Class A Guaranteed Notes maturing in November 2033 with a coupon of 2.699% and £60,000,000 Class A Guaranteed CPI linked Notes maturing in November 2042 with a coupon of 0.230%.

On 22 January 2019, the assets and liabilities of Affinity Water Programme Finance Limited were transferred to the company's subsidiary Affinity Water Finance PLC.

The net proceeds of the bond issues and the tap issue have been lent to the company on the same terms. The amount outstanding at year end, net of amortised debt issuance costs, was £838,496,000 (2020: £833,595,000).

On 4 February 2013, the company borrowed an amount of £3,550,000 from Affinity Water Capital Funds Limited, the company's intermediate parent company. The final repayment date of this loan is 31 March 2036, with interest terms having been set at 4.500%.

There are no loans to group companies.

* These companies do not have turnover.

Regulatory Annual Performance Report continued

Dividend policy

Our dividend policy was approved in September 2020, with only minor changes from our previously published dividend policy, primarily changing our licence condition from Condition I to Condition P.

The dividend policy of Affinity Water Limited is to pay a dividend commensurate with the long-term returns and performance of the business and allowing shareholders to earn an appropriate return from an investment in the company, whilst not impairing the company's longer term financeability and taking into account commitments to its stakeholders and customers. In determining the level of dividend, the financial performance of the appointed and non-appointed businesses are considered separately. Our dividend policy was changed in the previous year to ensure that any group debt above Affinity Water Limited can be serviced from the non-appointed business before a distribution to shareholders is considered.

The base dividend for the appointed business will be set in reference to the company's internal Business Plan and will not exceed a nominal 5% yield on equity as an annual average over the AMP, based on the company's actual financial structure. Dividends can be increased or lowered from the base depending on the actual performance of the company. An assessment will be completed by the Board to determine if the payment or part payment of the dividend reflects and/or would compromise the long-term social, financial and operational commitments made to stakeholders, such assessment includes the following areas: customer service; operational commitments; community commitment; and employees and the health of the pension plans.

This assessment also demonstrates that the dividend policy for AMP7 takes account of obligations and commitments to customers and other stakeholders, including performance of delivery against the final determination for AMP7. This includes in particular assessment of performance commitments with associated ODIs as set in the final determination and any ODI penalties or rewards earned. It will also require an assessment of the long-term financial resilience of the company in relation to liquidity, distributable profits of the company, cash facilities available and financial ratios.

Finally, the Board tests any proposed dividend payments against legal and regulatory requirements and restrictions, including the management of economic risk and compliance with financial covenants.

We are restricting dividends to our shareholders throughout AMP7 to enable the substantial investments to improve resilience and protect the environment. Equity dividends of £1.0m were paid from our non-appointed business (the parts of our business not regulated by Ofwat) during the year (2020: £nil), in order to service group debt, reflecting the shareholders' commitment to re-invest all planned returns from the company's appointed business for the benefit of our customers.

Viability statement

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

Our strategy aims to enhance our long-term prospects by making sure that our operations and finances are sustainable. The directors have assessed the company's long-term prospects in the context of our WRMP, which sets out our plan to secure the long-term provision of resilient and sustainable water supplies for customers from 2020 to 2080. The results of financial modelling presented to the Board over this period to enable the assessment of the company's long-term prospects reflect the expected level of investment implied by this plan and recovery of this investment from customers.

The directors have assessed the company's financial viability over a shorter ten-year period to 31 March 2031 (the 'lookout period'). The company's viability statement, including information on the company's approach to producing this statement, can be found within the strategic report on pages 61 to 64. The sensitivities used in stress-testing the base case cash flow forecast were in some instances more severe than the sensitivities specified by Ofwat to be used in stress-testing AMP7 Business Plans.

Stress-testing was performed on a Board approved base case cash flow forecast prepared by management. The base case has taken into consideration the impact of COVID-19 on the company, reflecting that the pandemic has impacted non-household and household revenues, with only the latter adjusted for as part of the revenue adjustment mechanism, increased our adverse bad debt projections and customer collections and reprofiled capital expenditure from projects delayed during the first year of AMP7.

The Audit, Risk and Assurance Committee considered and provided input into the determination of which of the company's principal risks and combinations thereof might have an impact on the company's financial viability, and reviewed the results of management's stress testing of the company's base cash flow forecasts. The results of management's stress-testing and the viability statement were reviewed by the Board in approving the strategic report.

To address Ofwat's previous feedback relating to our 2018/19 viability statement, cross references have been added to the viability statement linking key risks to further details provided in our strategic report on operational activities. The viability statement also includes mitigating actions the company might put in place for the scenarios in the stress testing. Following a further query from Ofwat in 2020/21, we conclude that our higher levels of gearing do not impact our viability. Our stress test scenarios indicate sufficient headroom against the trigger level in all but one year of the viability period when no mitigating actions are taken, and show sufficient headroom in all years when the appropriate mitigating actions are taken. The base case has also taken into consideration our forecast gearing against notional gearing, using a gearing sharing mechanism consistent with methodology prescribed by Ofwat in our final determination with a one AMP delay.

Details of the third party assurance obtained over the viability statement, which included assurance over the accuracy of the underlying calculations for the stress testing underpinning the viability statement, can be found within our draft Assurance Plan for AMP7, which is published on our website: **affinitywater.co.uk**. PwC did not include any matters in its independent auditors' report on pages 142 to 148 in relation to the viability statement. The Board has signed the Board statement on the completeness and accuracy of information confirming it is satisfied the data and assumptions made are accurate and complete.

Regulatory Annual Performance Report continued

Current tax reconciliations

The appointed current tax charge assessed for the period is lower than the standard rate of corporation tax in the UK of 19% for the year ended 31 March 2021. The differences are explained below:

	£000
Loss on appointed activities before tax and fair value movements	**(28,053)**
Tax calculated at the standard rate of tax in the UK of 19%	(5,330)
Tax effects of:	
– Adjustments in respect of prior years	(829)
– Expenses not deductible for tax purposes	238
– Accelerated capital allowances	12,590
– Other timing differences - pension	(394)
– Other timing differences – grants and contributions	(368)
– Fair value movements	(8,401)
Appointed current tax charge	**(2,495)**

Significant variations between the appointed current tax charge and the total current tax charge for the year ended 31 March 2021 allowed in the company's price limits are explained below:

	£000
Appointed current tax charge	**(2,495)**
Variance in profit before tax excluding fair value movements	5,951
Variance in fair value movements	8,401
Adjustments in respect of prior years	829
Variance in assumptions - capital allowances	(11,738)
Other timing differences – pensions	352
Other timing differences – grants and contributions	610
Variance due to increase in tax rate	(180)
Other	(200)
Total current tax charge allowed in price limits	**1,529**

FACTORS AFFECTING FUTURE TAX CHARGES

In September 2016, changes were enacted to the main rate of corporation tax in the UK to reduce it from 19% to 17% effective from 1 April 2020.

In the Spring Budget 2020, the Government announced that from 1 April 2020 the Corporation Tax rate would remain at 19% (rather than reducing to 17%, as previously enacted). This new law was substantively enacted on 17 March 2020.

In the Spring Budget 2021, the Government announced that from 1 April 2023 the Corporation Tax rate will increase to 25%. As this proposal had not been substantively enacted at the balance sheet date, its effects are not included in these financial statements.

Tax strategy related to the appointed business

Our approach to tax is based on the values incorporated in the "Behave ethically" section of Affinity Water's Code of Conduct:

We always act honestly, openly and responsibly, so that we are trusted. We uphold our Standards of Conduct together by complying with the law and regulatory requirements, making decisions with integrity, and speaking up when we believe that conduct falls short of our Principles.

We are transparent in our dealings with government and regulators, fulfilling our obligations honestly and promptly. We don't hide information that should be in the public domain and we don't disclose information that we shouldn't. We are clear and honest about our services, processes, policies, achievements and prospects. We encourage people to speak up whenever they see conduct that falls short of our Principles and we take their concerns seriously.

Our tax strategy includes the following:

1. Approach to risk management and governance
2. Attitude to tax planning
3. Level of acceptable risk in relation to UK tax
4. Approach to dealing with HM Revenue and Customs ('HMRC')

APPROACH TO RISK MANAGEMENT AND GOVERNANCE

The Group CFO is ultimately responsible for our tax strategy. Responsibility for day to day tax matters, and for reporting to the Audit, Risk and Assurance Committee and the Board on significant tax risks and developments, is delegated to the Group Tax Manager. Tax strategy is part of our overall risk management and governance framework, which is overseen by the Audit, Risk and Assurance Committee and the Board.

We consider our main tax risk to be the introduction of new legislation or changes in tax practice, which could result in increased tax payments that have not been included in the current regulatory settlement.

ATTITUDE TO TAX PLANNING

We do not use artificial tax avoidance schemes or tax havens to reduce our tax liabilities, and we always comply with what we understand to be both the letter and the spirit of the law. We operate solely in the UK and all our customers are based here. All our profits are reported and taxed in the UK. No funds are held off-shore, and all finance is raised and held within the UK.

Whilst we do not interpret tax legislation aggressively, we try to minimise our tax liability so that our customers are not funding excessive and unnecessary charges through increased bills.

We seek external advice when necessary, in order to ensure that our interpretation of current tax law and practice is correct.

LEVEL OF ACCEPTABLE RISK IN RELATION TO UK TAX

Our approach to tax risk is part of our wider risk management framework, in the context of our regulatory settlement.

DEALING WITH HMRC

We have an open relationship with HMRC, and we advise them of any complex issues so that we can work with them to determine the correct amount of tax due. We actively engage with HMRC and other relevant authorities on proposed changes to tax legislation, either directly or as part of our industry group.

Regulatory Annual Performance Report continued

Assurance

The data presented in this regulatory Annual Performance Report has been subject to the company's governance, risk management and internal control framework as set out in the governance section of the annual report and financial statements on page 99.

For further information on our assurance procedures and results, please refer to our draft Assurance Plan for AMP7, which is published on our website: **affinitywater.co.uk**.

The rivers and streams in our areas of supply

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Affinity Water