Affinity Water

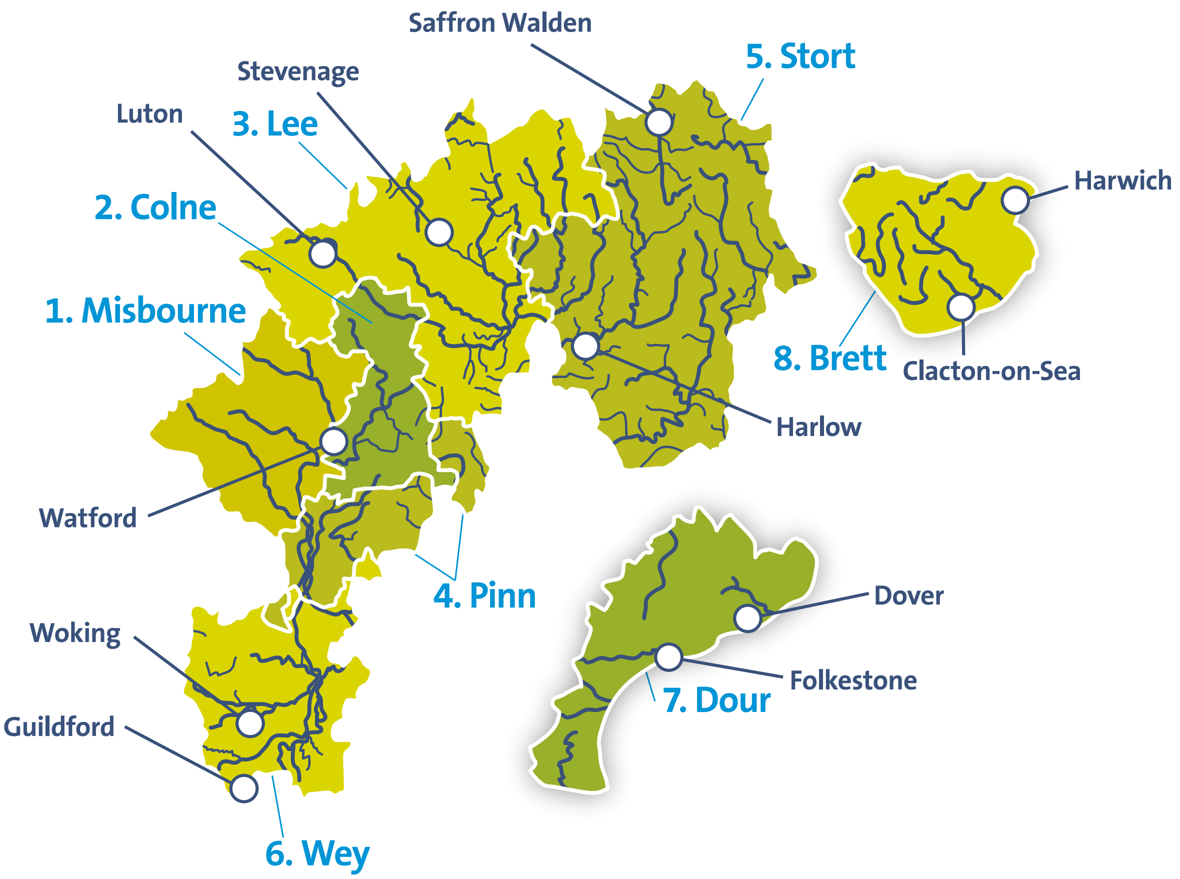
Your local supply, on tap

Annual Report and Financial Statements

for the year ended 31 March 2015

Affinity Water Limited

(Registered Number 02546950)


Saffron Walden
5. Stort
Stevenage
Luton
3. Lee
2. Colne
Harwich
1. Misbourne
8. Brett
Clacton-on-Sea
Harlow
Watford
4. Pinn
Dover
Woking
Folkestone
7. Dour
Guildford
6. Wey

AFFINITY WATER AT A GLANCE

AFFINITY WATER IS THE UK'S LARGEST WATER ONLY SUPPLY COMPANY

About Affinity Water

Affinity Water Limited owns and manages the water assets and network in an area of approximately 4,515km^2 split over three regions, comprising eight separate water resource zones, in the southeast of England. We are the sole supplier of drinking water in these areas.

Our vision is to be the UK's leading community focused water company. We view each of our eight water resource zones as a community and because customer preferences and operating conditions may be unique to that particular community, we are committed to operating primarily at the community level.

As financial information is reported to the Board on a combined basis, the company presents its results under a single segment for financial reporting purposes.

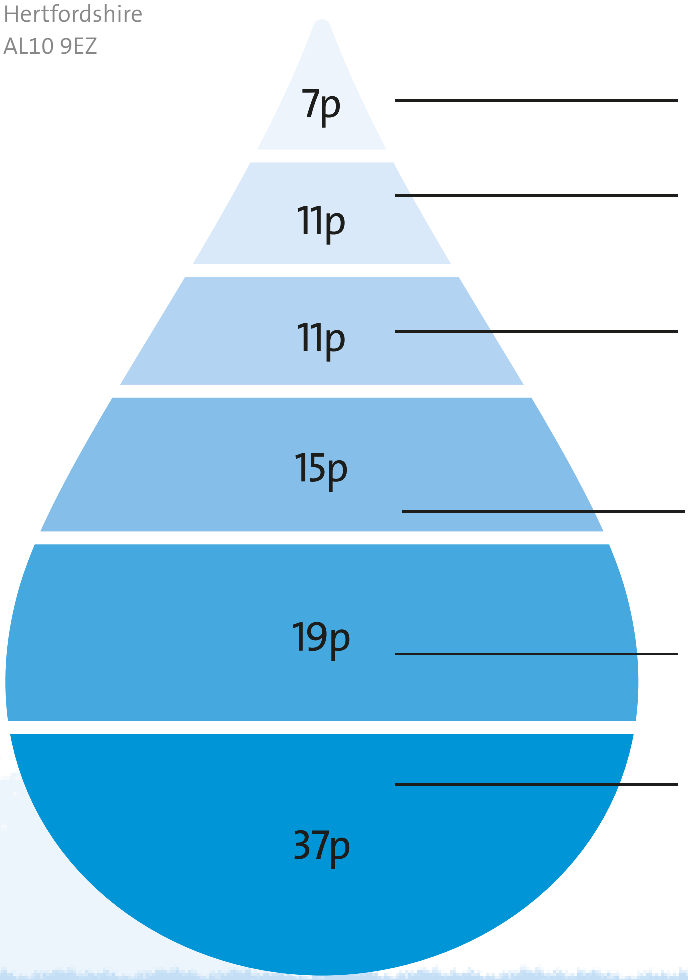
Facts and figures:

- We supply on average 900 million litres of water a day to around 3.6 million people, serving 1.5 million homes and businesses.
- We operate 98 water treatment works to ensure that our water is of the highest quality.
- In 2014, we carried out over 600,000 water quality tests. Our overall compliance performance in 2014, as regulated by the Drinking Water Inspectorate ('DWI'), was 99.97 per cent ('%').
- We distribute our water through a network of over 16,500km of mains.

Our Registered Office

Tamblin Way
Hatfield
Hertfordshire
AL10 9EZ

Where each £1 of your bill is spent



Our shareholders
Dividends

Our bondholders
Interest paid on debt financing

Local and central government
Corporation tax, business rates, abstraction charges, national insurance, Climate Change Levy and streetworks permits

Our people
Wages, salaries and pensions

Our suppliers for operating services
Operational cost of suppliers' services

Our suppliers for assets
Investment in our assets

Figures are based on our statutory financial statements for the year ended 31 March 2015 on pages 65 to 108. Figures have been rounded.

CONTENTS

SEE FURTHER INFORMATION ONLINE:
stakeholder.affinitywater.co.uk

Important information

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.

Terms used in this report:

The 'company', 'Affinity Water' or 'AWL' means Affinity Water Limited; the 'regulated business' or 'regulated activities' means the licensed water activities undertaken by Affinity Water Limited in the southeast of England.

Putting customers and communities at the heart of our business enabled us to achieve strong performance throughout the 2010-2015 price control period (Asset Management Plan 5, 'AMP5'). We have improved the way we communicate and engage with our customers and stakeholders and as a result we have a much clearer insight into their expectations and priorities. This helps us maintain trust and legitimacy as a provider of an important public service.

These performance improvements provided a strong foundation for the Business Plan that we submitted in December 2013 for Price Review 2014 ('PR14'). On 4 April 2014, our economic regulator, Ofwat, awarded us 'enhanced status' for our PR14 Business Plan. The Plan sets out how we plan to deliver against our customers' four key expectations. It provides information about proposed prices and levels of investment from April 2015 to March 2020 ('AMP6'). It was the culmination of a company-wide effort to embed a customer and community-focused ethos across all our teams.

For further information on what our enhanced status means to us, the four customer expectations and the commitments that we have made, **see pages 4** and **11**.

We recognise that there are still areas where we can improve. However, we are encouraged by our progress to date and our business highlights from 2014/15 show that we are in a strong position to deliver against a robust, but realistic, Business Plan for 2015-2020.

HIGHLIGHTS

Protecting our people: We have a successful business because we are passionate about our people. We recognise that we need a fit, healthy and motivated workforce in order to meet our customers' expectations. Our zero harm approach to safety is a core value for our business and a principle on which we will not compromise. We have made solid progress in 2014/15, with work related accidents reducing by 9% during the year. For further information on our safety, health and wellbeing initiatives, **see page 15**.

Providing great customer service: By continually refining our business processes and putting customers at the heart of our business we have worked hard to improve our customer experience in AMP5. During 2014/15 our Net Promoter Score improved from 49 to 59. For further information on our operational performance in 2014/15, **see pages 15 to 18**.

Managing our water resources: We aim to reduce average per capita water use in our area by 7% by 2020. Our Water Saving Programme was launched in January 2015 to help us achieve this. In AMP6 we intend to introduce meters for over 300,000 properties and support customers by offering Home Water Efficiency checks and water saving devices. We also aim to reduce leakage on our network by 27 million litres per day by 2020 (14%). This is the largest planned percentage reduction of any water company in England and Wales. For further information on the supply and demand drivers affecting our business, **see pages 12 to 14**.

Providing an affordable service: We recognise that some of our customers have been impacted by rising costs of living. In April 2014 we launched our new social tariff: 'LIFT', to help support our most financially vulnerable customers. 2014/15 was our pilot year and our target was to support an initial 7,000 customers. By proactively raising awareness of the scheme, we have exceeded that figure. Nearly 21,000 customers were benefiting from the tariff as at 31 March 2015. Further information about this tariff is available on our website: **www.affinitywater.co.uk/i-am-on-a-low-income.aspx**.

Strong governance and accountability: We have taken steps to strengthen our accountability and transparency. In March 2015 we updated our Governance Code to publicly demonstrate to customers, regulators and stakeholders that we operate to the highest standards of governance. For further information on our Board leadership, transparency and governance, **see page 36**.

Financial performance: We ended the year in a strong financial position with earnings before interest, corporation tax, depreciation and amortisation ('EBITDA') increasing by 2%[1]. We have continued to make operating efficiencies reducing our cost of operations in the year by £3 million. Our net profit decreased by £12 million, primarily due to a £23 million higher tax charge for the year offset by a lower charge of £11 million for our infrastructure renewals reflecting investment during AMP5 to stabilise our network. For further information on our financial performance, **see pages 19 to 23**.

[1] The statutory measure is net cash inflow from operating activities, which increased by 10%.

CHAIRMAN'S STATEMENT

DR PHILIP NOLAN
Chairman

I am delighted to present Affinity Water's annual report and financial statements for the year ended 31 March 2015.

This was the final year of AMP5 and I am pleased to report that we have made significant improvements to our business during this time despite the 2009 price determination being a challenging one for us.

Since 2010, we have been focused on driving up service levels whilst at the same time realising £26 million in operating cost net efficiencies. This has resulted in lower bills and a better service for customers.

Between April 2010 and March 2015, we invested over £460 million enhancing and maintaining our extensive network of assets to prevent failure and secure a resilient supply.

We have reduced the unit cost of pipe renewal by re-examining our procurement and design processes. This efficiency saving is reflected in our higher net operating profit for the year (£93 million; 2013/14: £84 million), as our estimate of annual expenditure required to maintain our network was reduced by £11 million.

Our customers continue to benefit from high quality drinking water with 99.97% mean zonal compliance recorded for calendar year 2014, whilst also benefiting from below average bills for water in England and Wales.

We are continually refining our processes to improve our customer experience. Our Net Promoter Score increased from 49 in 2013/14 to 59 in 2014/15.

The improvements that we have made provided a strong foundation for our PR14 Business Plan. This helped us to deliver a plan that Ofwat had confidence in. In April 2014, Ofwat announced that we were one of only two companies to achieve enhanced status for our Business Plan. In February 2015 we accepted Ofwat's final determination of price controls.

Being awarded enhanced status has enabled us to undertake early, detailed planning and preparation for AMP6.

An important principle in the preparation of our Business Plan was our commitment to undertake extensive customer and stakeholder engagement. That engagement has also strengthened our AMP6 preparation. It means that we have a clearer understanding of customer and stakeholder expectations and that we have been able to shape our business to meet those expectations over AMP6.

Our community focus has been important in driving performance improvements, helping us to achieve a much greater focus on the specific needs of our eight water resource zones.

Building on the work that we undertook during PR14, our focus for 2015/16 will be to embed our community focused approach such that it becomes business as usual. We will implement a structured stakeholder and customer plan that will include quantitative and qualitative research, proactive communication about our performance and a tailored engagement plan for each community.

We will test the views of our communities through dedicated community online feedback panels. We will also develop new reporting dashboards to inform our customers about our performance in their communities, not just at a company wide level.

We are acutely aware of the affordability challenges that some of our customers face and we have taken a proactive decision to supporting customers who are particularly affected by rising costs of living. In 2014/15 we opted to keep our prices lower than the levels allowed by Ofwat.

We also implemented a social tariff to support customers on low incomes who may be struggling to pay their bills. We remain committed to providing a value for money service for all customers, which is why we introduced a new survey to understand how customers feel about our service and whether they feel we are offering value for money.

The successes we have seen over the asset management period just ended are the result of hard work from engaged and committed staff members. On behalf of the Board, I would like to thank all of them for their hard work and achievements.

CHIEF EXECUTIVE OFFICER'S WELCOME

SIMON COCKS
Chief Executive Officer

I am delighted to have joined Affinity Water. The team has done an exceptional job in producing an enhanced Business Plan for AMP6 and this is an exciting time for our company and our people.

Having spent time with teams across the business during the past few weeks, I recognise the dedication and commitment of the people who work at Affinity Water. This was key to ensuring the company was able to deliver against a tough regulatory determination in PR09 to become an industry leader just five years later.

I believe that our company's community focus, together with its commitment to continue an enhanced level of communication and engagement with customers throughout AMP6 is critical to our success. By engaging effectively with our communities we understand their needs and can deliver a service that reflects their expectations of us.

The Affinity Water team has done extremely well to achieve an enhanced Business Plan, but that is only the first milestone. I am determined to maintain this momentum and lead a strong team that will set industry-leading standards for many years to come.

WHAT ENHANCED STATUS MEANS TO US

As part of the PR14 process, all water companies developed business plans for the services they plan to deliver for AMP6. We met Ofwat's expectations of a high-quality plan. In particular Ofwat highlighted how we sought views from our customers, as well as the wider consumer interest to shape our business plan. Ofwat concluded that:

"Affinity Water provided convincing evidence that its plan is efficient. It has delivered significant efficiencies during the past four years that are incorporated into its totex (total expenditure) projections, which include further significant efficiencies across its wholesale base totex. It is also proposing to deliver efficiencies in retail costs to offset any input price pressure.

Both Affinity Water's plan and company vision (to be the UK leading community focused water company) are innovative. Affinity Water provided convincing evidence that its Board has provided strategic direction and leadership and it is clear that the CCG (Customer Challenge Group) had good access to the company Board. Its Board states that the plan is high quality and this is supported by external assurance as well as from evidence and data elsewhere in the plan."

Receiving enhanced status has enabled us to focus on closing out AMP5 commitments and preparing for delivery of our AMP6 plan. For example, our Water Savings Programme commenced in January 2015 after a period of detailed preparation and planning with multiple stakeholders. We have been able to actively contribute to market reform workshops at the industry level while developing our own transition plan.

Enhanced status will also have a procedural benefit going forwards. We will be one of only two companies not to have any further assurance requirements prescribed by Ofwat from 1 April 2015, as we have demonstrated that we can deliver information that can be trusted. We will have discretion to deliver self assurance in relation to the additional assurance arrangements we put in place to give our stakeholders the confidence that the information we publish is accurate and reliable.

STRATEGIC REPORT

BOARD'S INTRODUCTION

We are delighted to present Affinity Water's strategic report for the year ended 31 March 2015.

Our vision

We have made significant progress in the past year towards our vision of being the UK's leading community focused water company.

Our focus on communities and a programme of extensive engagement with our customers and stakeholders throughout the last price control period led us to be awarded 'enhanced status' by our regulator Ofwat for our PR14 Business Plan. We were one of only two water companies in England and Wales to achieve this and in December 2014, Ofwat gave our plans final approval.

Our plan responds 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. We operate in the southeast of England in areas that the Secretary of State for the Environment, Food and Rural Affairs has designated as being under serious water stress.

Water is essential for economic development. We have an important role to play in supporting our local economies and regional growth whilst working with our customers to reduce water use to ensure a sustainable supply.

Community focused

As a supplier of an essential public resource, we must focus on our customers' needs and ensure we are accountable for our performance. We will continue to put customers at the heart of our business and will champion openness, fairness and transparency.

Our Customer Challenge Group was integral to developing our Business Plan. The next evolution in this approach was the formation of our Customer Scrutiny Group ('CSG'). The CSG consists of representatives with experience of representing household customers, commercial customers and working for special interest groups. It is chaired independently. These stakeholders will be able to provide a unique insight into issues facing our customers and will help us improve our customer service.

Throughout AMP6, the CSG will test engagement materials to ensure we are communicating and engaging effectively with customers and stakeholders. It will have access to assurance reports from our Reporter and other independent assurance bodies used by us as necessary. The CSG will also have visibility of the information we provide to our customers about our performance against published performance commitments. It will produce an annual report to the Board on the effectiveness of our engagement strategy and highlight its views on where further improvements could be made.

We divide our supply area into eight different communities – based on our existing water resource zones, allowing us to tailor a high quality service to customers at a local level.

This differentiation will also help us prioritise our metering programme throughout AMP6 and into AMP7 as part of our Water Saving Programme ('WSP'). We plan to start with those communities where we need to make the most significant reductions in terms of abstraction.

We aim to install over 300,000 meters by 2020. Metering will go hand in hand with targeted advice and practical support for customers such as providing them with water saving devices to help them use less water.

STRATEGIC REPORT CONTINUED

BOARD'S INTRODUCTION (CONTINUED)

Our commitments

We have set ourselves stretching but realistic targets.

Our final Water Resource Management Plan ('WRMP'), published in June 2014, sets out our 25 year vision to meet our resource challenges.

Our PR14 Business Plan is aligned to the WRMP and explains our immediate commitments over the next five years to help meet the targets set out in the longer term plan.

Our vision reflects our responsibility to minimise our impact on the local environment. Most of the world's chalk streams are in the southeast of England with many flowing through our supply area. We have a responsibility to protect these chalk streams and their biodiversity by leaving more water in the environment. We intend to continue to develop strategic partnerships with non-governmental organisations and local river and community groups to promote biodiversity and wildlife habitats.

Over the next five years, we have committed to reducing the amount of water we take from the environment by 42 million litres per day. We plan to achieve this through our WSP and tougher leakage targets.

From our extensive engagement programmes, we know that reducing leakage is important to our customers as well as our regulators. We have committed to reducing leakage by 14% (27 million litres per day) by 2020. We plan to invest £500 million over the five year period to 2020 in order to strengthen the resilience of our assets, which will help towards our leakage targets.

We estimate that around a third of our total network leakage occurs from our customers' supply pipes. Metering customers may allow these leaks to be more readily identified, potentially saving millions of litres of water every day.

In our PR14 Business Plan we set out our commitment to keep bills as low as possible throughout AMP6. We plan to do this by making efficiency savings of £106 million in our running costs.

We intend to report on the commitments we have set at a community level, not just on a company-wide basis.

Preparing for the future

In addition to delivering an ambitious plan, we are preparing for the biggest transformation of the water industry in England and Wales since privatisation.

On 1 April 2017 the retail market for non-household customers is expected to open up to competition with further reform in other water markets expected to follow. New companies will be able to enter the water market, giving business customers the opportunity to select their retail water service provider.

We have set ourselves ambitious challenges for the next five years – our teams are passionate about delivering against these commitments to ensure a sustainable supply for future generations at an affordable cost to our customers. Our partnership with our communities and our customers will help us realise that vision.

You can read more about how we are planning for the future by visiting our website:

stakeholder.affinitywater.co.uk/our-future-plans.aspx

STRATEGIC REPORT CONTINUED

PROVIDING A CLEAR LINE OF SIGHT

Our vision

Our vision is to be the UK's leading community focused water company.

This vision is our response to three overriding imperatives:

Our business model

Our business model recognises the need to satisfy these three overriding imperatives while providing all processes and capabilities needed to achieve the following:

Drivers and opportunities

We have many drivers and opportunities that affect our business model. These are summarised below:

- **as a provider of a public utility service, to retain public trust and legitimacy;**

To meet our customers' expectations by:

- making sure our customers have enough water, whilst leaving more water in the environment;
- supplying high quality water our customers can trust;
- minimising disruption to our customers and community; and
- providing a value for money service.

Commitment to increase the sustainability and resilience of supply

Increasing water demand as a result of population growth

More stringent water quality standards

Increased expectations of service and interaction

Affordability and value for money

- **to comply with all applicable laws and regulations; and**

To provide assurance to stakeholders of our compliance with all applicable laws and regulations.

Legal and regulatory compliance

Market reform and increased competition

- **to perform efficiently and secure shareholder value.**

To deliver appropriate returns to shareholders and investors.

Shareholder and investor expectations

Financeability of future plans

Pages 9-11

Pages 12-14

2014/15 performance

We measure and publish our performance for Ofwat, the DWI and for internal purposes. As in previous years of AMP5, we have eight internal performance measures and targets which we routinely measure and publish throughout the business.

Internal indicator 1: accidents resulting in more than 3 days' lost time and RIDDOR reportable incidents **12 accidents**

Internal indicator 2: leakage **183 Ml/d**

Internal indicator 3: water quality compliance failures **44 failures**

Internal indicator 4: properties experiencing interruptions for more than 12 hours **1,687**

Internal indicator 5: written complaints **2,940**
Internal indicator 6: unwanted contacts **151,682**
Internal indicator 7: Net Promoter Score **59**

Associated regulatory operational indicators:

Leakage **183 Ml/d**

Mean Zonal Compliance ('MZC') **99.97%**

Number of hours lost due to water supply interruptions **0.45 hours**

Infrastructure serviceability **Stable**

Internal indicator 8 (financial indicator): EBITDA[1] **£168.0 million**

[1] This figure includes £0.7 million of current service costs in relation to the Shared Service division of the Affinity Water Pension Plan, which are excluded from EBITDA for statutory reporting purposes, as the employees in the Shared Service division were only transferred over to the company from another group undertaking at 31 March 2015.

Pages 15-23

Future performance

We have aligned our future internal operational performance measures to key commitments made in our PR14 Business Plan in response to our customers' expectations, as follows:

Leakage, average water use, water available for use, abstraction incentive mechanism and sustainable abstraction reductions

Compliance with water quality standards, customer contacts for discolouration

Unplanned interruptions to supply over 12 hours, mains bursts, customers not notified of planned interruptions, planned works taking longer than notified

Service Incentive Mechanism ('SIM') and value for money survey

During AMP6, for regulatory purposes we will also measure and report our performance against the commitments we have made in our PR14 Business Plan using the performance indicators set out above.

Internal financial indicator: Net cash outflow before taxation and financing

Page 24

Risks and uncertainties

We have in place an established framework in order to identify, evaluate and manage the key risks we face. Our principal risks and uncertainties are as follows::

Injuries and accidents to our people and the public

Failure to supply wholesome water

Unavailability of resources (people and materials)

Information security or privacy failure

Adverse changes to the regulatory framework

Adverse change in the social and/or political climate

Failure to be compliant with laws, our instrument of appointment and other recognised standards

Failure to deliver our business plan obligations

Being required to undertake unremunerated activity

Failure to prepare for market reform

Liquidity risk

Macro economic risk (interest rate and inflation risk)

Breach of and changes to our borrowing covenants

Cost of the defined benefit pension plan

Revenue and debt risk

Pages 28-34

STRATEGIC REPORT CONTINUED

OUR VISION AND BUSINESS MODEL

Our vision

Our vision, to be the UK's leading community focused water company, reflects the importance we place on our people working within and for the communities of customers we serve, and understanding and responding to the needs of different community groups. We are accountable to them at a local level for how well we provide our services. Our economic regulator, Ofwat, has acknowledged that our vision and approach is something that sets us apart from other water companies.

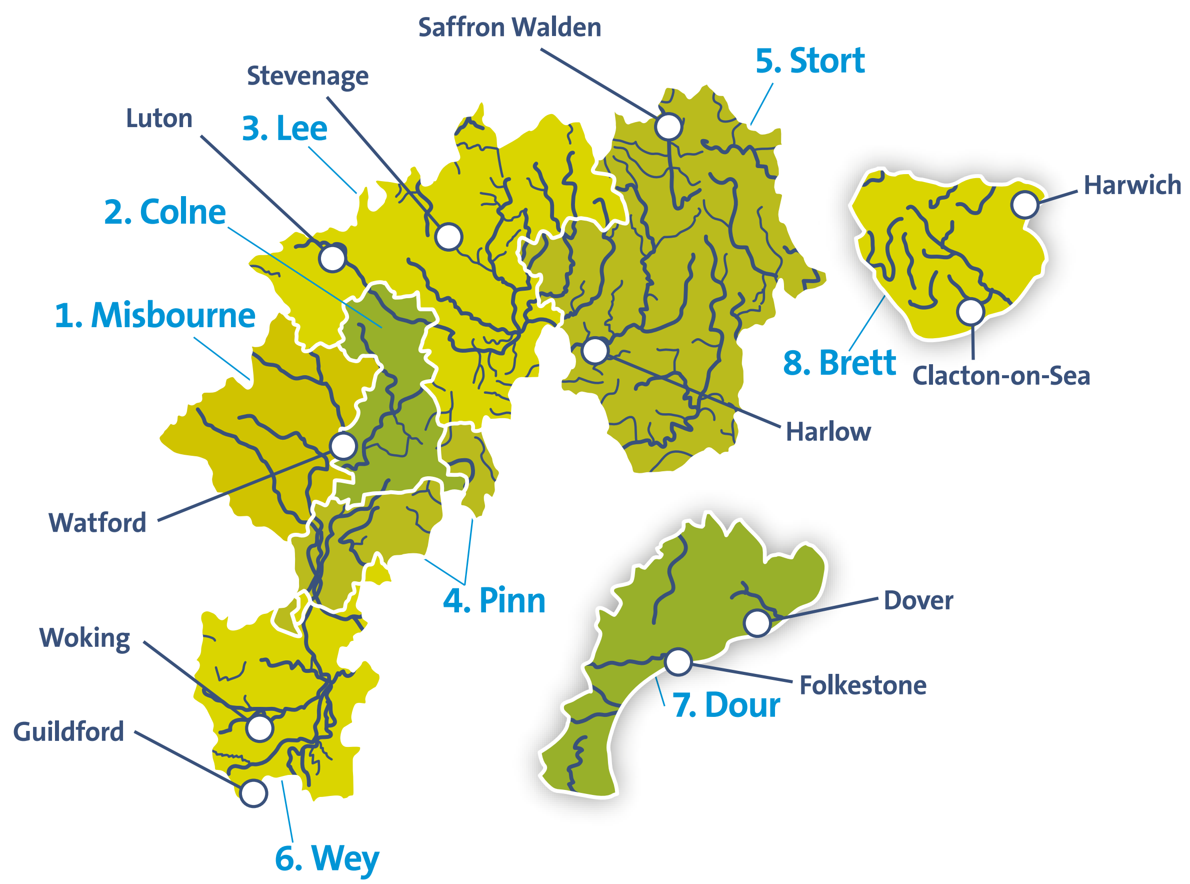
This vision is our response to three overriding imperatives: first, as a private provider of a public utility service, to retain public trust and legitimacy; second, to comply with all applicable laws and regulations; and third, to perform efficiently and secure shareholder value. Our vision and business model seek to resolve the tensions between those imperatives, and balance the sometimes conflicting needs of our stakeholders.

We are privileged to serve our communities. Being the supplier and the 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 in their communities. This is central to achieving our vision.

There are eight communities making up our area of supply. We have named each after a local river to underline the link between the service we provide and the local environment from which we source water. We know that our customers' preferences and operating conditions may be unique to individual communities, therefore we are tailoring our operations and plan to report our operating performance at a community level.

Our business model

Our business model, presented on the next page, recognises the need to satisfy the three overriding imperatives mentioned above, while providing all processes and capabilities needed to deliver value for all of our stakeholders.



Our resources

Raw water

- Boreholes
- Rivers
- Reservoirs

People

- Team members
- Suppliers
- Contractors

Financial

- Equity
- Capital market debt
- Revolving facilities

Delivering value

Creating a safe working environment for our people and customers

Long term strategic planning

- Sustainability
- Resilience
- Market reform

Production and treatment

Network management

Customer services

Training

Customer and stakeholder engagement

Understanding customer expectations and regulatory requirements

Our outputs

Zero harm to our people and customers

Making sure our customers have enough water, whilst leaving more water in the environment

Supplying high quality water our customers can trust

Minimising disruption to our customers and community

Providing a value for money service

VALUE FOR ALL

Ensuring an affordable and sustainable service for customers with long term shareholder value

OUR IMPERATIVES

To retain public trust and legitimacy

To comply with all applicable laws and regulations

To perform efficiently and secure shareholder value

ROBUST GOVERNANCE

STRATEGIC REPORT CONTINUED

OUR VISION AND BUSINESS MODEL (CONTINUED)

Accountability

We want our customers and stakeholders to be able to measure our success and hold us to account. We are currently required each year to report our performance against targets set by Ofwat, the DWI and the Department for the Environment, Food and Rural Affairs ('Defra'). During AMP6 we will report our operational performance against commitments made in our PR14 Business Plan.

On a day-to-day basis during 2014/15, we had eight key internal performance measures and targets that linked our vision and our customers' expectations. These eight performance measures were shared monthly with our teams. Our own targets were more stringent than the performance targets agreed with Ofwat. Refer to **pages 15 to 23** for further details of these performance indicators, and our performance for 2014/15 against both internal targets and those set by our regulators. We have aligned our future internal performance measures to key commitments made in our PR14 Business Plan.

To implement our operational performance reporting to customers, we plan to also publish customer charters for household customers at a community level, and for non-household customers at an aggregated level. These customer charters are planned to be based upon our dashboard reporting and will represent an open commitment to our customers that we intend to be transparent and communicate in a meaningful way so that they understand how we are performing in their community.

Customer expectations and our commitments for 2015-2020

The expectations of our customers shaped our Business Plan for AMP6, the new regulatory period. We undertook extensive research receiving input from more than 12,500 customers. The diagram below summarises customers' four key expectations and the commitments that we made in our Business Plan in relation to these.

Customers' Expectations	Our Commitments
Making sure our customers have enough water, whilst leaving more water in the environment	We will reduce the amount of water we take from the environment by 42 million litres per day.
	We will encourage our customers to use less water through our Water Saving Programme.
	We will invest in increased flexibility in our network so we can transfer water more effectively around our communities.
Supplying high quality water you can trust	We will maintain high quality drinking water.
	We will implement a targeted programme of lead pipe replacement to meet more stringent legal standards.
Minimising disruption to you and your community	We will invest £500 million in our network to reduce leakage by 14 per cent– the equivalent of 27 million litres per day.
Providing a value for money service	Bills will reduce by 1 per cent per year before inflation until 2020.
	We will promote our Lift social tariff to support those least able to pay their bill.
	We will make £106 million of efficiency savings in our running costs to keeps bills as low as possible over the next five years.
	We will make ourselves accountable to our communities for our performance.

STRATEGIC REPORT CONTINUED

DRIVERS AND OPPORTUNITIES

Retaining public trust and legitimacy

Commitment to increase the sustainability and resilience of supply

The Secretary of State for the Environment, Food and Rural Affairs has designated all three of our supply regions as areas of 'serious water stress'[1]. Government and regulators have emphasised the importance of resilience and long-term planning in adapting to increased water stress.

We have a high dependency on groundwater sources, around 64% of our water, which need to be replenished each year by winter rainfall. Other than natural aquifers, we do not have significant storage for untreated water. This means we are particularly susceptible to drought and pollution events as well as being vulnerable to the effects of planned sustainability abstraction reductions.

Most of the world's chalk streams are in the southeast of England with many flowing through our supply area. They are particularly at risk of drying up if water tables in the chalk bedrock are lowered by too much abstraction. We have a responsibility to protect the chalk stream ecosystems and their biodiversity by leaving more water in the environment.

As part of our WRMP, and as a key performance commitment in our Business Plan, we agreed with the Environment Agency ('EA') to reduce the amount of water we take from the environment by 42 million litres per day by 2020. This is around 5% of our resource base. A primary challenge for our business at an operational level is adapting to the reduction in abstraction from a number of our groundwater sources in order to improve flows and habitats in local chalk streams.

We also have to contend with a less predictable and more variable climate, further increasing the pressure to improve the resilience and sustainability of our operations.

Increasing water demand as a result of population growth

The population in our supply area is forecast to increase by 0.7% per year over the next 25 years. This means that if consumption per head remains constant, total domestic water demand in our licence area will increase commensurately and our customers' demand for water could exceed the supplies we have available.

Our PR14 Business Plan includes a number of planned measures to ensure our customers have enough water whilst ensuring we comply with our obligation to leave more water in the environment. This means we have to compensate for lower abstraction by reducing leakage and encouraging our customers to use water more efficiently.

More stringent water quality standards

We face new pressures and obligations to maintain the high quality of our water. Increased use of pesticides and an enhancement to the lead compliance standard means that it is important that we promote effective catchment management, implement improvements to our treatment processes and remove lead communication pipes using a risk based approach.

We submitted detailed water quality proposals to the DWI in June 2013 and we received final letters of support from them in October 2013. Our PR14 Business Plan further outlines how we plan to ensure that our customers continue to receive the high quality of water that they expect in AMP6 and beyond through investment at our treatment works, a targeted lead pipe replacement programme and enhancing our current programme of catchment management, continuing to work in partnership with the EA and environmental groups.

[1] Areas where the current household demand for water is a high proportion of the current effective rainfall which is available to meet that demand; and/or the future household demand for water is likely to be a high proportion of the effective rainfall available to meet that demand.

STRATEGIC REPORT CONTINUED

DRIVERS AND OPPORTUNITIES (CONTINUED)

Retaining public trust and legitimacy (continued)

Increased expectations of service and interaction

Customers rightly expect that we place their interests at the centre of our operations and that their needs shape the way we deliver our services. We are working hard to ensure customers have access to information enabling them to find answers to their questions quickly and easily. We continue to respond and adapt to meet our customers' expectations, whether this is in the way we provide and share information, provide services, enable our customers to manage their bills or provide explanations when we do not meet the standards they expect.

Affordability and value for money

While the economy of southeast England continues to show broad recovery after the recent recession, there is an uneven distribution of the benefits of recovery over our areas of supply. This results in an emphasis across the entire customer population on value for money, but also means that the affordability of our water bills is a particularly acute issue in some of the communities we serve. The increase in Thames Water sewerage charges, as a result of the Thames Tideway Tunnel scheme, which are billed to the majority of our domestic customers and for which we are responsible for cash collection, could exacerbate underlying affordability concerns.

Complying with all applicable laws and regulations

Legal and regulatory compliance

The industry in which we operate is subject to extensive legal and regulatory controls with which we must comply. At a strategic level our business is primarily driven by the need to comply with the laws, regulations and standards, and the policies published by Ofwat, the EA, Defra, the DWI, Natural England and other regulators.

Regulatory compliance further involves compliance with Ofwat guidance for AMP6, which includes meeting requirements to report our performance against commitments made in our PR14 Business Plan.

See **pages 28 to 34** for details of the legal and regulatory risks that we need to manage.

Market reform and increased competition

The water industry is facing a progressive reform of its market to facilitate greater competition. This will result in new entrants to the water market and allow non-household customers to exercise choice, in order to drive efficiencies for the ultimate benefit of customers. These changes present us with opportunities as well as challenges. We operate on the principle that for all our customers we should work hard to be their supplier of choice.

In April 2017 a competitive market for all non-household water and sewerage customers in England is expected to open. Non-household customers will be able to choose their retailer for water and sewerage services, with the ability to select individual retailers for each of the service types provided to their premises. The work needed to introduce these changes is being delivered by the Open Water Programme, working with market participants, Ofwat and Defra. The programme will define the overall market architecture and deliver operational and market codes, central systems and contracts required for the market to function effectively and efficiently. We continue to take an active role in the programme.

The Water Act 2014 has paved the way for further reform of upstream activities. Whilst the reforms are not expected to be implemented before 2020, Ofwat and Defra are considering how principles of contestability might be introduced. We remain closely involved in debates on this issue.

STRATEGIC REPORT CONTINUED

ECONOMIC REGULATION

Our business is a regional monopoly and is subject to incentive-based economic regulation by Ofwat. The tariffs we charge our customers are subject to controls set by Ofwat as part of a five year cycle. Price determinations can have a significant impact on profits and cash flows.

For AMP6 we will be subject to a revenue control regime, created to drive efficient investment decisions and facilitate the introduction of retail competition for our non-domestic customers from April 2017 onwards. Ofwat has set three separate controls in order to separate wholesale activity, related to production and distribution, from customer-facing retail activity, which will itself be divided between domestic and non-domestic customers.

The future wholesale revenue control shares some characteristics and principles with the current price control regime but is based on incentives related to total expenditure, rather than distinguishing between capital expenditure and operating costs. Domestic retail controls are based on an industry-wide 'average cost to serve' principle in order to drive efficiency across the sector. Non-domestic controls will serve as protection for customers as competition develops in the retail market and have been initially set for a two year period prior to market opening.

Performing efficiently and securing shareholder value

Shareholder and investor expectations

Our business is also driven by the expectations of our shareholders and investors, such as achieving the cash returns envisaged in our PR14 Business Plan for the next regulatory period. Our challenge is to maintain or grow shareholder value while achieving the performance commitments in our PR14 Business Plan. Shareholder value can be created by outperforming in selected areas, thereby receiving rewards for doing so, and through effective risk management to reduce cash flow volatility (i.e. offering more predictable cash returns).

Financeability of future plans

We are a business with a long-term outlook and expenditure commitments, which need to be matched with long-term sources of debt finance. We consider the most cost effective way to raise long-term debt is through the debt capital markets. In February 2013 we refinanced £552 million of debt used to fund the acquisition of the company from Veolia Environnement S.A., taking the decision to set up a bond programme in the process, which enables us to issue further bonds without the need for significant additional documentation. In July 2014 we completed a £50 million tap issue of an existing £200 million bond on the same terms as this existing bond.
See pages 47 to 48 for further details of our current financing arrangements.

STRATEGIC REPORT CONTINUED

OUR PERFORMANCE

Our vision and business model and our customer expectations are linked through a series of indicators against which we measure our performance.

We measure and publish our performance for Ofwat, the DWI and for internal purposes. As in previous years of AMP5, we have identified eight internal performance measures and targets which we routinely measure and publish throughout the business, on a weekly, monthly, quarterly and annual basis. Our targets were originally set based on our best ever historical performance and are calibrated on a quarterly basis, reflecting the seasonality of our business, and reflecting the continuous improvements in our performance that we expect and plan to make. The internal performance targets for water quality, unplanned interruptions and leakage are more stringent than the targets set by Ofwat.

Our performance against our eight internal targets and associated targets set by our regulators for 2014/15 is analysed in the sections below.

Ofwat requires companies to use a 'traffic light system' when reporting their performance, as per the table below:

Green – performance is in line with or better than expected.

Amber – performance is not in line with expectations but performance has slipped only slightly.

Red – performance is significantly below target or expectation.

For the year ended 31 March 2015, 8 of the 24 quarterly internal operational and customer performance targets set were achieved and the annual internal leakage target was not achieved. These internal targets are designed to be stretching, to support high standards of services to customers and to incentivise year-on-year improvements in performance. We met all of the associated targets set by our regulators. The financial performance target set was also achieved.

Operational performance

Where relevant in this section, we have grouped together operational performance indicators and targets that help us to evaluate our performance against each of our four customer expectations (as outlined on **page 11**).

Health and safety

Our vision and the customer expectations that we will continue to meet are all set in the context of our commitment to operating our business without harm. We believe that all accidents are preventable and that nothing is so important that we cannot take the time to do it safely.

Performance indicator	2014/15 target[1]	Our performance		Our 2014/15 performance in context
		2014/15	2013/14	
Internal indicator 1: number of accidents resulting in more than three days' lost time and RIDDOR[2] reportable incidents[3]	**Internal:** zero	**12**	14	The total number of incidents under this measure reduced from 14 to 12. However despite this marginal improvement, we have not made the sustained improvement we had targeted. Consequently, we will be redoubling our efforts to drive improvement in this area.

[1] Quarterly internal targets have been converted into annual targets through totalling quarterly targets or calculating the mean average.
[2] Reporting of Injuries, Diseases and Dangerous Occurrences Regulations 2013 ('RIDDOR').
[3] Affinity Water employees only, does not include road traffic accidents or our contractors' accidents.

STRATEGIC REPORT CONTINUED

Making sure our customers have enough water, whilst leaving more water in the environment

Leakage

Our customers expect us to make sure they have enough water, whilst leaving more water in the environment. To do this we need to balance the demand for water against the supplies available. Controlling leakage from our pressurised network and from customers' pipework is one of the ways we ensure we have enough water to satisfy demand.

Performance indicator	2014/15 target	Our performance		Our 2014/15 performance in context
		2014/15	2013/14	
Internal indicator 2: leakage in terms of millions of litres per day (Ml/d)	**Internal:** less than 175 Ml/d	**183**	181	We attach a high priority to meeting leakage targets going into AMP6. For 2014/15 a tough internal target was set at 11% below our regulatory target; unfortunately this target was missed and leakage was similar to last year's figure. Our customers have asked us to reduce leakage further and as part of our PR14 Business Plan and WRMP we have committed to reducing leakage by a further 14% over the next 5 years. This further reduction will help to ensure that we secure supplies to our customers and protect the environment.
Leakage in terms of Ml/d	**Regulatory:** Annual target as set out in the PR09 final determination: less than 198 Ml/d	**183**	181	

Supplying high quality water our customers can trust

Water quality

Performance indicator[1]	2014 target	Our performance		Our 2014 performance in context
		2014	2013	
Internal indicator 3: number of water quality compliance failures	**Internal:** 28 or fewer water quality compliance failures	**44**	43	Of over 174,000 compliance tests performed in 2014 there were 44 failures of the relevant standards. This compares to 43 in 2013 and 101 in 2012. There were 19 instances of detection of coliforms in 2014 compared to 17 in 2013, with none detected at treatment works; one turbidity failure at a treatment works due to corrosion of the sample line, which was subsequently replaced; 12 metaldehyde failures in 2014, which was slightly higher than 2013 when there were eight, but still significantly less than in 2012 when there were 40 failures; three failures of the new standard for lead, which was in force for the first time this year; and nine other minor failures. The internal target was set based on our best ever performance level in 2010 (29 failures), which was prior to the inclusion of extensive monitoring for metaldehyde and the new lead standard. Excluding these, the 2014 background rate is 29, which is in line with our 2010 performance. The failures of the new lead standard were the main reason for the small decrease in MZC performance in 2014. When water quality samples did not meet the standards set, we carried out thorough investigations which established that the failures did not pose a risk to public health.
Mean Zonal Compliance ('MZC') (%)[2]	**Regulatory:** Not applicable – the DWI does not set a target.	**99.97%**	99.99%	

[1] Water quality indicators are based on data for the calendar year.
[2] MZC is the average of the 'mean zonal compliance' performance of 39 water quality parameters and is an important measure of the quality of the water supplied to our customers. The individual results for each parameter are taken from the company's compliance sampling programme and are reported to the DWI.

STRATEGIC REPORT CONTINUED

OUR PERFORMANCE (CONTINUED)

Minimising disruption to our customers and community

Our customers expect us to minimise disruption to them and their community. We measure whether we are succeeding by analysing the trends in customer service and infrastructure serviceability indicators that include measures of asset performance. If these differ dramatically from the levels achieved in the past, it can indicate that we need to act. The performance of our assets tells us that we are maintaining and renewing them appropriately.

Interruptions to our customers

Performance indicator	2014/15 target	Our performance		Our 2014/15 performance in context
		2014/15	2013/14	
Internal indicator 4: number of properties experiencing an interruption for more than 12 hours	**Internal:** not more than 300 properties experiencing an interruption for more than 12 hours[1]	**1,687**	163	35% of properties where supply was interrupted for more than three hours were the result of planned interruptions to carry out essential maintenance work and customers received at least 48 hours prior notice in these cases. The number of properties experiencing an unplanned interruption to supply greater than three hours was 59,793; this is 4% of properties we supply. 1,687 properties suffered an unplanned interruption of longer than 12 hours, compared to 163 in 2013/14. This was predominantly due to a major burst on a strategic mains pipe in Edgware in October 2014. This affected over 13,000 properties for greater than three hours and 1,175 for greater than 12 hours.
Number of hours lost per property served due to water supply interruptions for three hours or longer	**Regulatory:** to deliver a reliable water supply to customers	**0.45**	0.38	

Infrastructure serviceability

Performance indicator	2014/15 target	Our performance		Our 2014/15 performance in context
		2014/15	2013/14	
Serviceability water non-infrastructure	**Regulatory:** **Green:** Improving or Stable **Amber:** Marginal **Red:** Deteriorating	**Stable**	Stable	Serviceability is an assessment of the capability of assets to provide the required level of service to customers and to safeguard the environment now and into the future. This measure is important as, under our operating licence, we are required to maintain our assets such that services to customers can be sustained over the long-term. Ofwat seeks to set price limits so as to allow for sufficient maintenance of these assets. Mains bursts in 2014/15 continue to be within the reference level target. Our serviceability is maintained as 'stable' for both infrastructure and non-infrastructure serviceability and we are committed to maintaining this performance into the future.
Serviceability water infrastructure	**Regulatory:** **Green:** Improving or Stable **Amber:** Marginal **Red:** Deteriorating	**Stable**	Stable	

[1] This level of target has been set as 75 per quarter which sums to just below Ofwat's reference level.

STRATEGIC REPORT CONTINUED

OUR PERFORMANCE (CONTINUED)

Providing a value for money service

We aim to reduce the need for customers to have to call or write to us. In addition, we seek to provide them with web-based easy to use self-serving solutions that are available 24/7.

Performance indicator	2014/15 target	Our performance 2014/15	Our performance 2013/14	Our 2014/15 performance in context
Internal indicator 5: number of written complaints	**Internal:** less than 2,150 written complaints	**2,940**	2,544	Our customer experience for 2014/15 was strong for the first three quarters of the year but was punctuated by a difficult 4th quarter. During the last two months of 2014/15 626,000 2015/16 annual bills were produced and delivered for all unmetered customer accounts. These consolidated bills included 576,000 customers with sewerage charges which increased in price by approximately 12%. Subsequently, written complaints, unwanted contact and NPS linked with Charges and Billing all deteriorated in the 4th quarter.
Internal indicator 6: number of unwanted contacts	**Internal:** less than 129,000 unwanted contacts	**151,682**	146,646	Our 'LIFT' social tariff launched in April 2014 has assisted nearly 21,000 (at 31 March 2015) of the most financially vulnerable customers in budgeting for the overall increase in their water bills.
Internal indicator 7: customer experience measured by Net Promoter Score[1]	**Internal:** achieve a NPS of at least 51	**59**	49	Customer experience internal targets were set in April 2014 before 2015/16 charges schemes for all water companies were agreed and communicated. We categorise our written complaints into: • Charges and Billing • Metering • Clean Water Operational Supply For the first three quarters total complaints were broadly on target at 1,710. Complaints received in the 4th quarter were 1,230, of which 835 related to Charges and Billing – Annual Billing. Despite the 4th quarter increase, the total number of complaints per 10,000 accounts for 2014/15 was 20. This result for the industry benchmark would position us 7th on the 2013/14 Consumer Council for Water league table. Unwanted contact for 2014/15 increased by 3% to 151,682. This was driven by the 4th quarter increase of 8,000 compared to the average for the first three quarters of the year. Charges and Billing processes associated with the annual billing sewerage price increase accounted for the vast majority of the 4th quarter increase. The NPS performance for 2014/15 was strong and reflected an improvement on the previous year and on the internal target. Again, a drop in the Charges and Billing NPS was experienced in the 4th quarter linked to the Annual Billing Programme for unmetered customers. 2015/16 will see a movement away from NPS and an adoption of the Ofwat survey satisfaction metric as part of our Voice of the Customer Programme. Throughout 2014/15 66,000 customers provided feedback enabling continuous improvement opportunities at the company, process and employee level.

[1] Net Promoter Score ('NPS') is a customer loyalty metric based on a direct question: "How likely are you to recommend our company/service/product to your friends and colleagues?". The scoring for this answer is based on a 0 to 10 scale. The NPS score is calculated by subtracting the proportion of customers answering 0-6 out of 10 (known as detractors) from those answering 9-10 (known as promoters).

STRATEGIC REPORT CONTINUED

OUR PERFORMANCE (CONTINUED)

Financial performance

Financial results

Financial results have been prepared in accordance with United Kingdom Generally Accepted Accounting Practice ('UK GAAP'). Our financial results are summarised in the table below:

	2015 £m	2014 £m
Turnover	**291.4**	291.4
Operating costs	**(132.9)**	(135.9)
Other operating income	**10.2**	9.9
EBITDA[1]	**168.7**	165.4
Depreciation and amortisation	**(75.4)**	(81.0)
Operating profit	**93.3**	84.4
Profit on disposal of tangible fixed assets	**-**	1.5
Net interest payable and other finance charges	**(35.7)**	(40.2)
Profit before tax	**57.6**	45.7
Current tax charge	**(8.7)**	(5.5)
Deferred tax (charge)/credit	**(16.0)**	4.2
Profit after tax	**32.9**	44.4
Dividends	**(30.8)**	(45.8)
Transfer to/(from) reserves	**2.1**	(1.4)

In 2014/15 we decided to keep our prices lower than the levels allowed by Ofwat. Our weighted average price increase was 0.36%. Overall our turnover for the year remained consistent with last year at £291.4 million.

Operating costs for year decreased by £3.0 million (2%) to £132.9 million (2014: £135.9 million):

Increases/(decreases) in operating costs	£m
Inflationary increases	2.6
Reimbursement of Environmental Improvement Unit Charges ('EIUC') levied from 2008/09 to 2012/13	(3.8)
Credit notes received from the EA in respect of EIUC levied in 2013/14	(1.7)
EIUC not expensed in 2014/15	(1.7)
Lower power usage	(1.3)
Efficiency savings	(0.9)
Increase in bad debt charge	0.4
Atypical employment costs	2.1
Other increases	1.3
Net decrease in operating costs	**(3.0)**

[1] EBITDA figures presented in this table differ from the EBITDA figures used to internally evaluate our financial performance, as the latter includes £0.7m (2014: £0.7m) of current service costs in relation to the Shared Service division of the Affinity Water Pension Plan. Employees in the Shared Service division were transferred to the company from another group undertaking with effect from 31 March 2015.

STRATEGIC REPORT CONTINUED

OUR PERFORMANCE (CONTINUED)

Financial performance (continued)

Financial results (continued)

The efficiency savings were primarily derived from renegotiating supplier contracts on more favourable terms, increasing the productivity of teams and existing supplier contracts, pumping system and source optimisation, and reducing customer contact through digital engagement.

Expressed as a percentage of turnover the bad debt charge for 2015 was relatively unchanged at 2.7% compared with 2.6% in 2014. There has been continued management focus on customer debt collection with the implementation of an enhanced debt management system during the year.

Depreciation and amortisation (2015: £75.4 million; 2014: £81.0 million) has decreased, consistent with a lower charge for infrastructure renewals (2015: £36.1 million; 2014: £47.3 million) offset by depreciation on newly commissioned assets.

The £11.2 million reduction in the infrastructure renewals charge ('IRC')[1] in 2014/15 reflects lower renewals expenditure forecast for AMP6 in our PR14 Business Plan than previously forecast in our calculation of IRC. In AMP5 we reduced the unit cost of pipe renewal by re-examining our procurement and design processes. This efficiency saving is reflected in AMP6 forecast renewals expenditure, together with the investment we have made during AMP5 to stabilise our network from a 'marginal' assessment given by Ofwat of the serviceability of our assets at the start of AMP5.

Operating profit increased to £93.3 million as a result of the decrease in operating costs and depreciation noted above.

Net interest payable and other finance charges decreased by 11.2% from £40.2 million in 2014 to £35.7 million in 2015. This was primarily as a result of lower inflation on index-linked debt offset by a modest increase in finance charges from the £50.0 million bond tap issue in July 2014 and higher returns on pension scheme assets.

Taxation

The total tax charge of £24.8 million (2014: £1.3 million) comprised a current tax charge of £8.7 million (2014: £5.5 million) and a deferred tax charge of £16.0 million (2014: a deferred tax credit of £4.2 million).

The current tax charge on profit before tax of £57.6 million (2014: £45.7 million) was £8.7 million. As in previous years, the effective current tax rate (15.1%; 2014: 12.0%) was lower than the UK corporation tax rate of 21% (2014: 23%) as a result of capital allowances claimed on our capital investment and the tax deductibility of pension contributions. This has the effect of deferring tax to later years.

In the prior year we had a large deferred tax credit due to the impact on our deferred tax liability of reductions in the UK corporation tax rate substantively enacted in July 2013. Our effective deferred tax rate in the current year of 28.0% is higher than future enacted UK corporation tax rates due to a £10.4 million reduction in the deferred tax discount as a result of lower yields on UK government bonds.

Total tax paid or collected in the year to 31 March 2015, other than corporation tax, amounted to £27.9 million (2014: £28.2 million) consisting of employee payroll taxes, business rates, environmental taxes and streetworks permits.

[1] IRC is the estimated level of annual expenditure required to maintain the operating capability of the network, which is based on our independently certified asset management plan.

STRATEGIC REPORT CONTINUED

OUR PERFORMANCE (CONTINUED)

Financial performance (continued)

Capital Expenditure

Gross capital expenditure in the appointed (regulated) business for the year was £114.5 million (£94.0 million on capital maintenance and infrastructure renewals, £20.5 million on capital enhancement) compared to £113.5 million in 2014. Projects that progressed during the year included increasing the resilience of our assets through enhancing flood protection and security at our operational sites, and continuing the work already done in AMP5 on leakage detection and repair.

Cumulatively capital expenditure for AMP5, which included a number of AMP6 projects started in the year, was in line with our forecast. £6.4 million primarily for the completion of mains cleaning projects and the replacement of our work management information system has been allocated to our AMP6 programme, which involves planned investment in our infrastructure of over £500 million over the five year period.

Cash flow

Net cash inflow from operations in the year amounted to £171.2 million compared to £156.2 million in the previous year. This cash inflow contributed to the servicing of finance of £34.2 million (2014: £34.2 million) and taxation of £6.5 million (2014: £7.1 million).

Cash investment in our fixed assets amounted to £112.8 million (2014: £117.1 million), for which £11.7 million was received by way of capital contributions (2014: £8.0 million). Equity dividends of £30.8 million were paid during the year (2014: £45.8 million). Details of our dividend policy are provided on **page 41**.

Net debt increased to £796.9 million at the end of March 2015 compared to £793.3 million at the end of March 2014. The £50.0 million tap issue of Affinity Water Finance (2004) PLC's existing Class A 2026 £200.0 million bond in July 2014, which was lent on to the company on the same terms as our existing intercompany loan, increased our gross debt. This was offset by the repayment of £17.2 million of short-term credit facilities during the year. The total value of our issued bonds can be reconciled to our net debt position as follows:

	2015 £m	2014 £m
Nominal value of Class A fixed interest bonds issued	**580.0**	530.0
Nominal value of Class A index linked bonds issued	**150.0**	150.0
Nominal value of Class B index linked bonds issued	**95.0**	95.0
Total nominal value of bonds issued	**825.0**	775.0
Accretion on Class A index linked bonds	**5.9**	4.2
Accretion on Class B index linked bonds	**3.7**	2.6
Capitalised bond issue costs and net premium/discount related to Class A bonds	**(1.9)**	(10.5)
Capitalised bond issue costs related to Class B bonds	**(1.3)**	(1.4)
Loan from intermediate parent company	**3.6**	3.6
Floating rate short-term credit facilities	**-**	17.2
Financing of shared reservoir assets	**20.8**	19.4
Cash in hand	**(58.9)**	(16.8)
Net debt at 31 March	**796.9**	793.3

STRATEGIC REPORT CONTINUED

OUR PERFORMANCE (CONTINUED)

Financial performance (continued)

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 2015, we had cash balances of £58.9 million (2014: £16.8 million). The increase in cash held compared to the prior year primarily reflects £58.6 million of proceeds from the bond tap issue detailed above offset by the repayment of £17.2 million of short-term credit facilities during the year. The proceeds of the bond tap issue are being used to fund our capital expenditure programmes.

The maturity profile of the bonds issued by our subsidiaries is set out on **page 48**. The maturity profile of all of our borrowings is set out in **note 25 on pages 103 to 105** of our financial statements.

To the extent that additional funding is required, we have access to £100.0 million of facilities (2014: £100.0 million), which were undrawn at 31 March 2015 (2014: £17.2 million drawn down), to finance capital expenditure and working capital requirements. In addition, we have access to a further £58.0 million of liquidity facilities (2014: £55.0 million), consisting of a 364 day revolving £38.0 million 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 £20.0 million to fund operating and capital maintenance expenditure in the event of a liquidity shortfall.

The following table presents net debt and gearing as per the definitions contained in our securitisation financing agreement.

	£m
Net debt	**788.1**[1]
Regulatory capital value ('RCV')	987.2
Gearing at 31 March 2015	79.8%
RCV including midnight adjustments for the end of AMP5[2]	1,027.2
Gearing at 1 April 2015	76.7%

Interest rates

Interest rate exposure is primarily managed by using a mixture of fixed rate, floating rate and RPI-linked borrowings. At the year-end, 69.9% of our borrowings excluding the financing of assets used by us and operated by other parties were at fixed rates (2014: 66.4%), 30.1% (2014: 31.4%) at rates indexed to RPI and none (2014: 2.2%) were at floating rates.

Pension funding

The pension asset (before deferred tax) under Financial Reporting Standard 17: 'Retirement benefits' at 31 March 2015 stood at £38.2 million compared to an asset of £3.1 million at 31 March 2014. This increase reflects a substantial increase in the pension plan's assets over the year, which has mainly been driven by asset performance. This increase more than offset an increase in the pension plan's liabilities caused by a decrease in the discount rate which was partially offset by a reduction in inflation.

[1] Net debt calculated per the securitisation financing agreement, as presented in **note 9 of our regulatory financial statements on page 139**.
[2] Midnight adjustments are applied to the calculation of the opening RCV for AMP6 at 1 April 2015. These adjustments relate to our performance during AMP5 as well as our £4 million reward for achieving enhanced status for our PR14 Business Plan. The adjustments are set out in detail within our final determination.

STRATEGIC REPORT CONTINUED

OUR PERFORMANCE (CONTINUED)

Financial performance (continued)

Performance Indicators

Our financial performance indicators and targets set out in the following table are used to evaluate how we are performing in terms of maintaining or growing shareholder value, while meeting commitments made for the AMP5 regulatory period. These include the four financial key performance indicators recommended by Ofwat.

Performance indicator	2014/15 target	Our performance		Our 2014/15 performance in context
		2014/15	2013/14	
Internal indicator (financial indicator) 8: EBITDA[1]	**Internal:** £164.3 million[2]	**£168.0 million[2]**	£164.7 million	Outperformance of our EBITDA target is chiefly explained by the refund and credit note received in relation to EIUC levied in previous years (£5.5m). This was partially offset by unbudgeted payroll related and recruitment costs. Efficiency savings of £0.9 million and £1.9m of cost savings from lower than budgeted power usage further offset increases in inflation-linked costs.
Post tax return on capital[3]	**Regulatory:** post-tax return on capital as assumed in price limits for the reporting year	**6.4%**	5.8%	A reconciliation of our opening to closing RCV for the year is included in the non-audited supplementary regulatory information on **page 144** of our regulatory financial statements[4].
Credit rating[5]	**Regulatory:** maintain investment grade credit rating **Financial covenant:** Maintain at least BBB+/Baa1	**A-/A3**	A-/A3	We continue to maintain stable investment grade credit ratings in line with those of our peers in the water sector.
Gearing[6]	**Regulatory:** Not applicable – no target has been set **Financial covenant trigger event:** more than 90%	**80%**	79%	The policy approved by the Board is a target gearing level of 80%. This allows sufficient headroom within our financial covenants which are triggered at a level of more than 90%.
Interest cover[7] (times)	**Regulatory:** not applicable – no target has been set **Financial covenant trigger event:** less than 1.1 times	**2.0 times**	1.4 times	Our interest cover remains comfortably above our financial covenant minimum requirements. Higher cash receipts from customers ahead of the year-end compared to 2013/14 when flooding in February 2014 interrupted our annual billing processes largely contributed to the higher interest cover ratio at 31 March 2015.

[1] As in previous years, we have selected the "non-GAAP" measure: EBITDA to internally evaluate our financial performance, as it serves as a proxy for our operating cash flow.

[2] Our 2014/15 and 2015/16 internal targets, and the actual performance presented for 2014/15 include £0.7 million of current service costs in relation to the Shared Service division of the Affinity Water Pension Plan. These costs are excluded from the EBITDA of the company for statutory reporting purposes, as the employees in the Shared Service division were only transferred over to the company from another group undertaking at 31 March 2015.

[3] Current cost operating profit less tax as a return on regulatory capital value ('RCV').

[4] Under Condition F of our licence, we are obliged to provide the Water Services Regulation Authority ('WSRA') with additional accounting information to that contained in our statutory financial statements. This information is presented in our regulatory financial statements on **pages 107 to 140** and provides an analysis of our appointed (regulated) and non-appointed businesses.

[5] The credit ratings given to the long-term Class A bonds issued by the company's subsidiaries by rating agencies, which are used to assess the company's ability to comply with its licence requirement to maintain an investment grade credit rating. For a summary of the bonds issued by the company's subsidiaries, **see pages 47 to 48**.

[6] Gearing performance indicator is on the basis of our Senior Regulated Asset Ratio, as defined in our financial covenants. This is our net debt divided by our RCV. An analysis of net debt and gearing is included in **note 9 of the regulatory financial statements on page 139**.

[7] Interest cover performance indicator is on the basis of our Senior Adjusted Interest Cover Ratio, as defined in our financial covenants. This is our operating cash flow less tax paid less Ofwat published current cost depreciation ('CCD') and Ofwat published infrastructure renewals charge ('IRC') divided by interest paid.

STRATEGIC REPORT CONTINUED

Our future performance

During AMP6 we will measure and report our performance against the commitments we have made in our PR14 Business Plan for the period using the following performance indicators and targets.

Making sure our customers have enough water, whilst leaving more water in the environment

Performance indicator	2015/16	2016/17	2017/18	2018/19	2019/20
Leakage (Ml/d)	183.9	178.5	173.1	167.7	162.2[1]
Average water use (l/person/d)	156.3	155.6	153.3	150.3	147.4
Water available for use (Ml/d)	1,110.4	1,103.5	1,100.8	1,068.1	1,067.0
Abstraction incentive mechanism[2]	to be determined				
Sustainable abstraction reductions (Ml/d)	6.7	12.5	14.1	42.1	42.1

Supplying high quality water you can trust

Performance indicator	2015/16	2016/17	2017/18	2018/19	2019/20
Compliance with water quality standards (percentage)	99.95	99.95	99.95	99.95	99.95
Customer contacts for discolouration (number per 1,000 people)	0.66	0.66	0.66	0.66	0.66

Minimising disruption to you and your community

Performance indicator	2015/16	2016/17	2017/18	2018/19	2019/20
Unplanned interruptions to supply over 12 hours (number of properties)	320	320	320	320	320
Mains bursts (number)	3,100	3,100	3,100	3,100	3,100
Customers not being notified of planned interruptions (number of events)	110	110	110	110	110
Planned works taking longer than notified (number of events)	550	550	550	550	550

Providing a value for money service

Performance indicator	2015/16	2016/17	2017/18	2018/19	2019/20
SIM[3] (relative position)	2nd quartile	2nd quartile	2nd quartile	2nd quartile	2nd quartile
Value for money survey[4]	to be determined				

The price control regime for AMP6 is based on incentives related to totex, rather than distinguishing between capital expenditure and operating costs. Therefore we will no longer use EBITDA, used as a proxy for operational cash flow, as an internal financial performance measure to evaluate whether we are performing efficiently and securing shareholder value, but we will use a measure more closely related to totex i.e., net cash outflow before taxation and financing. Our internal target for 2015/16 is £14.4 million.

[1] Our PR14 Business Plan commitment to reduce leakage by 27 Ml/d assumes a starting level of 189.3 Ml/d.

[2] The Abstraction incentive mechanism ('AIM') was introduced by Ofwat as part of the PR14 price setting methodology. It is designed to incentivise companies to reduce abstraction at low flows from environmentally sensitive sites. Affinity Water, Thames Water and South East Water have agreed to help drive the implementation of the reputational AIM in 2015/16 by leading a sector wide task force.

[3] SIM is a customer experience performance measure with a qualitative element, produced by independent market research surveys of customer satisfaction, and a quantitative element based on the number of 'unwanted' phone calls received, combined with the number of complaints received and the company's effectiveness at resolving those complaints. Unwanted calls are those where customers express any dissatisfaction with the service, including customers who hang up while in call queues, plus any calls that could have been avoided if service had fully met customer expectations.

[4] Value for money surveys are being conducted with a third party expert during 2015/16 in order to establish a baseline level of performance. This baseline will enable us to determine future reputational performance targets for the remainder of AMP6.

STRATEGIC REPORT CONTINUED

THE AFFINITY WAY

We continue to adapt our ways of working to meet the needs and expectations of our customers and stakeholders. We are committed to being the leading community focused water company, listening and responding to our customers and the communities we serve while balancing the sometimes conflicting requirements of our various stakeholders.

This year we introduced a new Corporate Responsibility Steering Group so that we can develop and implement a structured corporate responsibility strategy, 'The Affinity Way'. This will be a clearly defined programme, one that is understood and valued by our internal and external stakeholders, and centred on issues which are material to the responsible delivery of our Business Plan.

The Affinity Way is being developed and integrated into our business across four 'areas' of activity relating to: 'Community', 'Customer', 'People' and 'Environment'. We are establishing a performance framework for AMP6 so we can assess the effectiveness of our programmes across these areas, and measure our performance against commitments made in our Business Plan. As a first step, in March 2015 we published our Environment Policy clearly setting out our environmental commitments. This is available on our website: **https://stakeholder.affinitywater.co.uk/docs/environment-policy-march-2015-rev.pdf**.

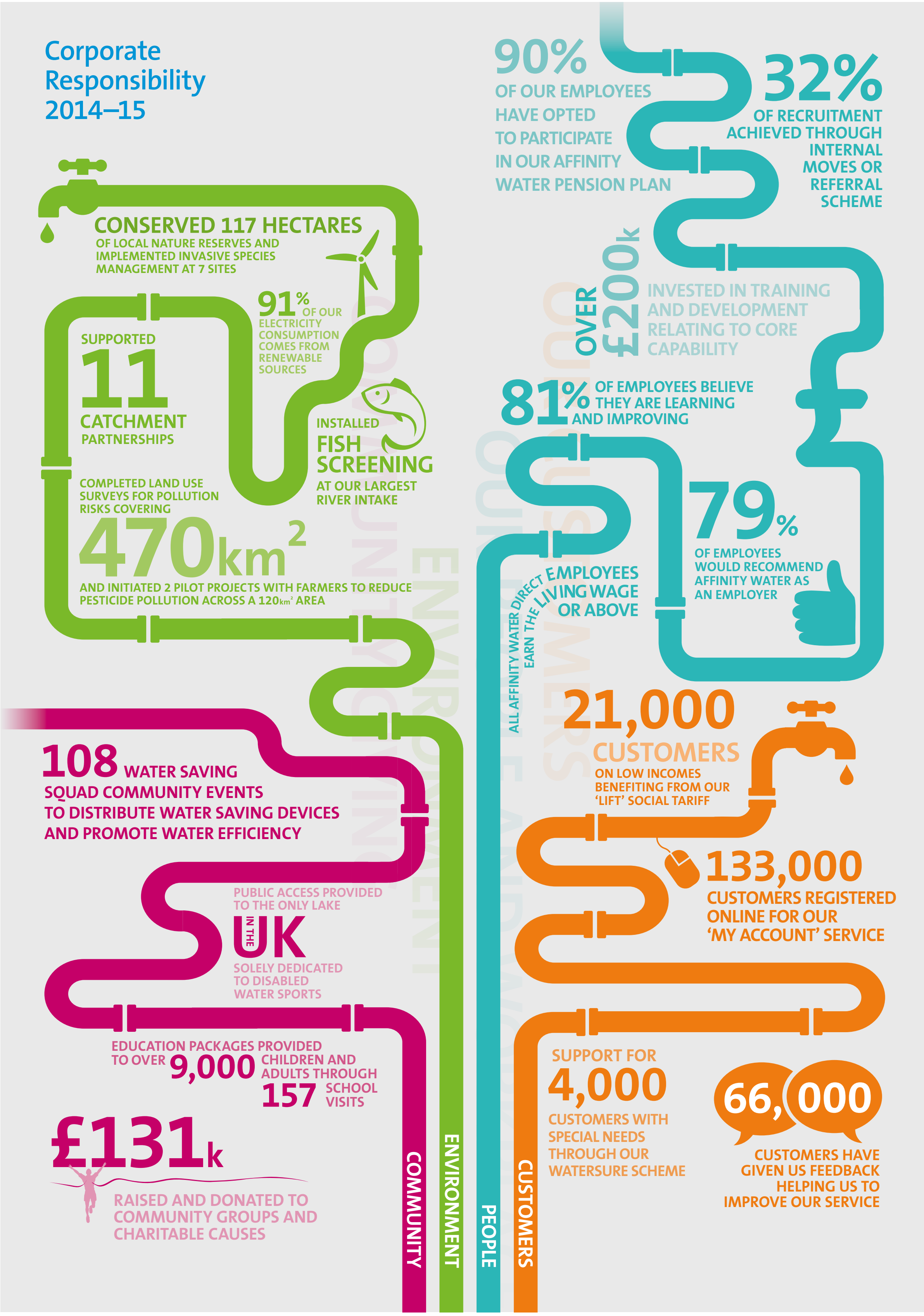
We have appointed our major supply chain partners for our AMP6 programme and we are committed to working with them to embed the Affinity Way principles of responsible business practice. We have established framework agreements with our key suppliers and these frameworks encourage and reward responsible business practice.

We have existing long term partnerships with a number of charities and community groups and are now actively building on these relationships to form a structured programme of community-focused projects. These will bring together supply chain and employee volunteering opportunities to support the locally based charity partner initiatives in each of our eight communities.

2014/15 highlights

We have set out in this section our performance highlights in 2014/15 in relation to issues that we perceive matter most to our stakeholders and those which have the most profound effect on our business.

STRATEGIC REPORT CONTINUED



STRATEGIC REPORT CONTINUED

THE AFFINITY WAY (CONTINUED)

Greenhouse gas emissions ('GHG') statement[1]

GHG emission source	2014/15 Gross[2] (tCO_2e)	2014/15 Intensity[3] ($kgCO_2e/Ml$)	Restated Baseline year - 2013/14 Gross (tCO_2e)	Restated Baseline year - 2013/14 Intensity ($kgCO_2e/Ml$)
Scope 1	**6,260**	**18.6**	7,011	20.7
Fuel combustion	**1,451**	**4.3**	1,956	5.8
Process and fugitive emissions	**2,616**	**7.8**	2,713	8.0
Vehicle fleet	**2,193**	**6.5**	2,342	6.9
Scope 2	**105,813**	**315.6**	98,073	288.7
Purchased electricity	**105,813**	**315.6**	98,073	288.7
Statutory total (scope 1 & 2)[4]	**112,073**	**334.2**	105,084	309.4
Scope 3	**9,697**	**28.9**	8,961	26.4
Business travel in other vehicles	**38**	**0.1**	9	0.0
Outsourced IT activities	**406**	**1.2**	566	1.7
Electricity- transmission and distribution	**9,253**	**27.6**	8,386	24.7
Total gross emissions	**121,770**	**363.1**	114,045	335.8

Our gross GHG emissions have increased by 7% in the year. Similar to businesses across the UK, our purchased electricity GHG emissions (accounting for 94% of our statutory total) were adversely affected by an increase in the carbon intensity of the grid (a factor beyond our control). This more than offset the impact of a reduction in electricity usage on our GHG emissions. Whilst over 90% of our electricity comes from renewable sources, we are required to report carbon emissions according to the UK grid average.

Gender diversity disclosures

The following table provides a breakdown of the gender of directors and employees at 31 March 2015:

	2015[5] Men	2015[5] Women	2014 Men	2014 Women
Company directors[6]	**8**	**1**	10	1
Other senior managers[7]	**5**	**-**	6	-
All other employees	**698**	**397**	587	333

Our position on human rights

The Companies Act 2006 requires us, to the extent necessary for an understanding of the development, performance or position of the company's business, to include information about human rights issues. Given the nature of our business and area of operations, we do not believe it is necessary to include such information. However, the safety and wellbeing of our people and suppliers is something we take very seriously. For further information on our safety, health and wellbeing performance in 2014/15, **refer to page 15**.

[1] We report our GHG emissions following the 2014 UK Government Environmental Reporting Guidance and using the 2014 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.

[2] We measure our gross GHG emissions in tonnes of carbon dioxide equivalent ('tCO2e').

[3] We also monitor our relative operational GHG emissions from year to year through expressing our emissions by way of an industry standard intensity ratio, kilograms of CO2e per megalitre ('kgCO2e/Ml') of clean water supplied.

[4] Statutory carbon reporting disclosures required by the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013.

[5] The 2015 data includes employees transferred from Affinity Water Shared Service Limited, a fellow group undertaking, at 31 March 2015.

[6] Company directors consist of our Board members, as detailed on **pages 36 to 38**.

[7] 'Other senior managers' is as defined in the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013, and includes persons responsible for planning, directing or controlling the activities of the company.

STRATEGIC REPORT CONTINUED

PRINCIPAL RISKS AND UNCERTAINTIES

We have an established framework for identifying, evaluating and managing the key risks we face. Operational risks are identified and ranked by teams during the year. Based on the rankings given by teams, the most significant risks are discussed by the senior management team and included in the strategic risk register, presented to the Board and the Audit Committee. The latter reviews senior management's work on risk management and reports to the Board on the effectiveness of risk management processes.

A key aim is to foster a culture in which teams throughout the business manage all risks as part of their management of day-to-day operations. Operational risks are recorded and assessed, including existing management processes, and an action plan is prepared, if necessary, for further mitigation. Activities against these plans are monitored on an on-going basis.

The following have been identified from our risk management process as potentially having a material adverse effect 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 a material adverse impact. Factors beside those listed could also have a material adverse effect on our business activities.

Key:

◆ Unchanged during the year ▲ Increased during the year ▼ Decreased during the year

Risk	Commentary	Mitigation
Operational		
Injuries and accidents to our people and the public ◆	Failing to manage this risk may result in disruption to operations, reputational damage, criminal fines, civil damages and regulatory penalties.	We seek to operate our business to the OHSAS18001 safety standard and help our employees to take personal responsibility for their own safety and the safety of others. Risk assessments, training and role definitions are reviewed and reaffirmed, with health and safety training and awareness for all our people prioritised.

STRATEGIC REPORT CONTINUED

PRINCIPAL RISKS AND UNCERTAINTIES (CONTINUED)

Key:

Unchanged during the year | Increased during the year | Decreased during the year

Risk	Commentary	Mitigation
Operational (continued)		
Failure to supply wholesome water (Unchanged)	We are required to maintain a continuous supply of high quality water for our customers. Interruptions to supply caused by the contamination of water supplies, pollution and flooding events, and water resource restrictions could impact on the health, safety and security of our people or communities, or on our financial position and our reputation. This risk is relatively high for us, as we operate in an area of serious water stress (**refer to pages 12 to 14** for further details of our supply and demand drivers). Plans for any fracking in our catchment areas, the construction of the High Speed Two railway and a third runway at Heathrow Airport may further increase this risk in the future.	We manage this risk through: • our WRMP which identifies, over a 25 year period, how we will balance available supplies and required demand. This is available on our website: **stakeholder.affinitywater.co.uk/our-future-plans.aspx**; • our drinking water safety plans which provide a comprehensive risk assessment and risk management approach to our water supply chain, supported by our distribution and operations management strategy. We use these plans to inform our investment and maintenance programmes; • our Drought Management Plan which is approved by the Secretary of State; and • our emergency and business continuity plans. Should water supplies be compromised, we have plans in place to ensure the provision of essential water supplies at all times. Our contingency plans are audited annually by an independent certifier and their reports shared with the Secretary of State. Following the flooding in February 2014, we reviewed our plans to assess the resilience of certain key assets and identified a number of improvements that we are implementing.

STRATEGIC REPORT CONTINUED

PRINCIPAL RISKS AND UNCERTAINTIES (CONTINUED)

Key:

Unchanged during the year | Increased during the year | Decreased during the year

Risk	Commentary	Mitigation
Operational (continued)		
Unavailability of resources (people and materials) ▲	We rely on the availability of skilled employees and contractor resources to maintain service levels and implement our investment plans. In the event of these resources being unavailable, we may experience significant disruption to our service, damage to our reputation and consequent regulatory action. The risk has increased during the year with more construction activity around London and the planned construction of the Thames Tideway Tunnel, reducing contractor availability.	We seek to mitigate this risk by maintaining a constructive relationship with employees regarding their remuneration through the Joint Negotiating and Consultative Committee, succession planning and investing in our employees through training and apprenticeship schemes. 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.
Information security or privacy failure ▲	We must protect customer information and our data from unauthorised disclosure and improper use. Failure to do so may lead to increased costs of operation, reputational damage, criminal fines and civil damages. As the use of online communications, cloud-based technology and the sophistication of hackers continues to increase, so too does the risk of cyber attack.	During the year we continued to strengthen our capabilities to ensure that our technical and organisational controls against the unauthorised disclosure, loss or improper use of data are kept under review and improved where appropriate. We have appointed an interim Chief Information Officer who is leading our response to this evolving threat and have established an IT security and privacy board led by senior executives to help address this risk.

STRATEGIC REPORT CONTINUED

PRINCIPAL RISKS AND UNCERTAINTIES (CONTINUED)

Key:

Unchanged during the year | Increased during the year | Decreased during the year

Risk	Commentary	Mitigation
Regulatory		
Adverse changes to the regulatory framework (Unchanged)	Changes to the regulatory framework by Ofwat or the government may have an adverse effect on our operational or financial performance.	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.
Adverse change in the social and/or political climate (Unchanged)	We are exposed to risks arising from the general social and political climate, for example, political pressure to restrain price increases and other issues, such as objections to universal metering. These pressures may lead to a reduction in revenue or have a reputational impact.	We continue to engage with our customers and their representatives to understand and respond to their issues and concerns. Organising our business into eight communities enables us to do this at a more local level.
Failure to comply with laws, our instrument of appointment and other recognised standards (Unchanged)	We need to ensure that our activities and outputs comply with licence conditions or statutory duties 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.	We have policies, processes and controls in place that seek to ensure that applicable regulation, laws and standards are fully understood and complied with. We continue to operate our abstraction, treatment and supply activities to environmental standard ISO14001.
Failure to deliver our business plan obligations (Unchanged)	We have made a number of performance commitments in our PR14 Business Plan which, if not met, may result in us incurring financial penalties. 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.	We have an established programme management function with the responsibility for delivering the investment programme. The Board and senior management team monitor performance and ensure that corrective action is taken when required.

STRATEGIC REPORT CONTINUED

PRINCIPAL RISKS AND UNCERTAINTIES (CONTINUED)

Key:

Unchanged during the year — Increased during the year — Decreased during the year

Risk	Commentary	Mitigation
Regulatory (continued)		
Being required to undertake unremunerated activity (Decreased)	As a result of our PR14 Business Plan being awarded enhanced status, we benefited from the 'do no harm' principle that protected us from a further reduction in the headline wholesale cost of capital and from any subsequent changes to our business plan performance commitments; therefore reducing this risk during the year. As we enter into AMP6, we may experience unforeseen financial, regulatory or legal obligations or costs which were not taken into account by Ofwat in setting our price controls.	Our Instrument of Appointment provides some protection against unforeseen financial risks materialising during a price control period. We can ask Ofwat to undertake an interim determination of price limits in certain circumstances. Ofwat will make an interim determination only where it is satisfied that a 10% cost threshold has been met. There is no assurance that Ofwat will make an interim determination or that any determination made would provide adequate revenue compensation. Refer to the financial risks section of the table for details of our mitigation in relation to liquidity risks.
Market reform		
Failure to prepare for market reform (**refer to pages 13 to 14** for further details) (Increased)	The requirements for implementing the retail market for non-household customers on 1 April 2017 are still being developed. Delays to the Open Water Programme could affect our preparation, which may lead to additional costs, loss of revenue and regulatory enforcement action. This risk has heightened during the year, as initial market preparations have not progressed as quickly as anticipated.	We continue to take an active role in the Open Water Programme and have a dedicated project team preparing the business for change. During the year we have been formalising the interaction between our wholesale and retail functions, as well as developing our retail offering for non-household customers.
Financial		
Liquidity risk (Unchanged)	Our substantial capital investment programme generates an on-going need for further financing. This results in an exposure to liquidity risk in the event that we are unable to meet our cash flow requirements as and when they fall due.	We have revolving loan facilities and adequate, though not excessive, cash resources and standby loan facilities to maintain a minimum level of liquidity capable of immediate drawdown to cover at least twelve months' forecast cash flow requirements. Our policy is to maintain a diverse portfolio of counterparties through which we can access this liquidity to ensure we are not reliant on any single bank counterparty. We also access the bond markets to meet our longer term funding requirements when appropriate.

STRATEGIC REPORT CONTINUED

PRINCIPAL RISKS AND UNCERTAINTIES (CONTINUED)

Key:

Unchanged during the year · Increased during the year · Decreased during the year

Risk	Commentary	Mitigation
Financial (continued)		
Macro economic risk (interest rate and inflation risk)	Movements in interest rates can result in an increase in the cost of our debt. We have a covenant within our Whole Business Securitisation ('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 RPI 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. In addition, our RCV is also linked to RPI and nominal returns are therefore likely to be further reduced in a low inflation environment.	Interest rate risk is primarily managed by using a mixture of fixed, inflation linked and floating rate borrowings, and approved hedging instruments. Further disclosure on the management of interest rate and liquidity risks is included in **note 25 of the financial statements**. 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 are linked to RPI and therefore offset any reduction in revenue that results from lower inflation.
Breach of and changes to our borrowing covenants	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. Recent changes in the regulatory regime and transition to new accounting standards mean that certain financial covenants are no longer relevant. Robust financial covenants are key in supporting our existing credit ratings from Moody's and Standard & Poors.	We have a monitoring and certification process for our securitisation documentation covenants (both financial and non-financial). Financial covenants, which include gearing and interest cover ratios, are monitored and reported on a regular basis. We made our investors and rating agencies aware at an early stage of our intention to introduce new covenants to address those covenants which are no longer relevant. In June 2015 our Class A bondholders voted in favour of a STID proposal[1] formally incorporating these new covenants into our WBS documentation.
Cost of the defined benefit pension plan	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 out of our control. These include performance of equity markets, gilts, future inflation as well as assumptions around those employees within the scheme itself.	The plan has been closed to new members since September 2004 and the assets of the plan are held separately from those of the company. We continue to make deficit repair contributions into the plan in addition to on-going contributions in respect of future accruals of members' benefits.

[1] A request by the company to the security trustee under the Security Trust and Inter-creditor Deed ('STID') to concur in making any modification, giving any consent or granting any waiver under or in respect of any common document.

STRATEGIC REPORT CONTINUED

PRINCIPAL RISKS AND UNCERTAINTIES (CONTINUED)

Key:

Unchanged during the year | Increased during the year | Decreased during the year

Risk	Commentary	Mitigation
Financial (continued)		
Revenue and debtor risk (Unchanged during the year)	Customer debt and affordability remain key areas of focus for our business. **Refer to page 13** for further details of this driver. 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.	We have processes and teams dedicated to the efficient collection of customer debt. In 2014/15 we launched a new debt management system to assist in this process. For those customers who want to pay their bill but struggle to do so, 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. In 2014/15 we also introduced a new social tariff 'LIFT' to help support customers who are least able to pay their bills.

Approval of the strategic report

By order of the Board

Dr Philip Nolan

Chairman
23 June 2015

GOVERNANCE

LETTER FROM THE CHAIRMAN

DR PHILIP NOLAN
Chairman

We are committed to the highest standards of governance and support the principles of good corporate governance set out in the 2012 UK Corporate Governance Code ('the Code') and the UK Stewardship Code. Our business is owned by private investors and we therefore apply the principles of the Code in this context, having regard to the Guidelines for Disclosure and Transparency in Private Equity (the Walker Guidelines) and the work of the Guidelines Monitoring Group.

We consider that the company complies with the principles of the Code, except in terms of board composition, membership of committees, the director undertaking the role of chair of the Remuneration Committee, appointment of a senior independent director and re-election of directors, which we explain further in this section of the annual report.

Best practice in corporate governance continues to evolve, with greater emphasis being placed on shareholders holding the board to account for the fulfilment of its governance. We explain how we engage with our shareholders and involve them in decision making in our publication: *Engaging with our shareholders*.

Our Governance Code, updated in March 2015, sets out for our customers, investors, regulators and other stakeholders how we govern and operate our business to high standards of governance and transparency.

Board composition

In my role as Chairman of the Board, I am responsible for ensuring that our directors have a diverse range of backgrounds and skills and that they all contribute to our decision making. As a Board, we value the contribution that all our non-executive directors bring to the governance of the company, and believe that their balance of skills, experience, independence and knowledge of the company ensures strong leadership and governance.

During 2014/15, we reduced the number of investor appointed non-executive directors on our Board. We now meet Ofwat's expectations for independent non-executive directors to form the largest single group on the Board, compared to investor-appointed non-executive directors and executive directors.

Board changes

On 31 December 2014, Richard Bienfait resigned as Chief Executive Officer. He played a significant role in the development of the company over the last four years, culminating in our PR14 Business Plan being awarded enhanced status by Ofwat. I would like to thank him for his valuable contribution and wish him well in his future career.

I am delighted that Simon Cocks joined the Board on 1 June 2015 as Chief Executive Officer. The Board is looking forward to working with him. He has extensive cross sector experience and a strong track record in leadership roles in utilities which will help us make the most of the opportunities ahead and to deliver against our Business Plan commitments.

Chris Bolt joined the Board as an independent non-executive director in February 2015. He brings with him extensive experience in the water, rail, energy, airports and telecoms sectors, having been involved at a senior level in the development of UK regulatory and competition frameworks.

Dr Philip Nolan
Chairman

GOVERNANCE CONTINUED

BOARD LEADERSHIP, TRANSPARENCY AND GOVERNANCE

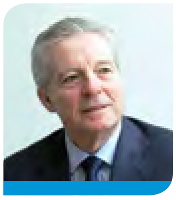
Board of directors

Biographies for our directors are shown below. Where a director holds other directorships within the Affinity Water Group of companies, the numbers listed alongside his or her name may be cross referenced to the relevant company shown on the structure chart on **page 46**. Membership of our Audit Committee: (A), Remuneration Committee: (R) and Nomination Committee: (N) is also listed alongside his or her name.

All directors declare their position when they have a possible conflict of interest and do not vote on any contract, arrangement or proposal in which they have an interest by virtue of other directorships. Directors have access to the advice and services of the Company Secretary and are able to obtain access to independent professional advice where they think it necessary.

Chairman

Dr Philip Nolan R N 12



Dr Philip Nolan was appointed to the Board as Chairman in April 2013[1]. Philip is also Chairman of John Laing Group plc., a specialist investor and manager of infrastructure assets and Ulster Bank Limited. He is also a non-executive director at Providence Resources plc. and EnQuest plc. He was previously Chief Executive of Eircom, Ireland's national telecommunications supplier from 2002 to 2006. Prior to that, he served as an executive director of BG Group and Chief Executive of Transco from 1998 and in 2000, led the demerger of Transco as Chief Executive of the Lattice Group.

Independent non-executive directors

Chris Bolt

Chris Bolt has worked in the field of economic regulation for more than twenty years, holding senior roles in both the public and private sectors. His regulation experience has included Ofwat (from 1989 to 1994), the Office of the Rail Regulator (from 1994 to 1999) and Transco plc. (from 1999 to 2002). More recently, he was the statutory Arbiter for the London Underground Public-Private Partnership Agreements (from 2002 to 2011), and the first Chairman of the Office of Rail Regulation (from 2004 to 2009). Chris now provides independent regulatory advice to the government, companies and regulators.

Patrick O'D Bourke A N

Patrick O'D Bourke was appointed to the Board in July 2013. Patrick is a Chartered Accountant and is Group Finance Director of John Laing Group plc. He was previously Chief Executive of Viridian Group, having first undertaken the role of Group Finance Director and formerly was Group Treasurer of Powergen plc. He chairs our Audit Committee and has a wide range of experience in regulated businesses operating within the private and quoted sectors. Our Board is satisfied that the cross directorship with Dr Philip Nolan does not compromise his ability to act independently[2].

[1] To support the senior management team during the period between Richard Bienfait's resignation and Simon Cocks' appointment as Chief Executive Officer, Dr Philip Nolan agreed to serve as executive Chairman for that period.

[2] On appointment, our Board recognised the existence of a cross directorship relationship with Dr Philip Nolan. Taking into account Patrick O'D Bourke's considerable experience of senior roles within the regulated utility sector and his personal qualities and character, our Board is satisfied that the cross directorship does not compromise Patrick O'D Bourke's ability to act independently. Arrangements have been established to ensure that Dr Philip Nolan and Patrick O'D Bourke are not involved in the evaluation of each other's performance.

GOVERNANCE CONTINUED

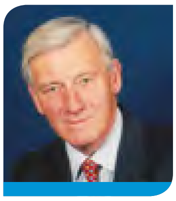
BOARD LEADERSHIP, TRANSPARENCY AND GOVERNANCE (CONTINUED)

Independent non-executive directors (continued)

Baroness Peta Buscombe R N

Baroness Peta Buscombe was appointed to the Board in 2006. She is a barrister, an active member of the House of Lords and has held a number of shadow ministerial positions including responsibility for industry and enterprise, regulatory reform, the media and education. Formerly Chairman of the Press Complaints Commission, she is a non-executive Director of Local World Limited, a member of the Human Rights Joint Committee, served on the Inquiries Act 2005 Committee and is Chairman of the Advisory Board for the Samaritans. Baroness Peta Buscombe will be retiring as an independent non-executive director of our Board and will not be seeking re-appointment at this year's AGM.

Dr Jeffrey Herbert A R



Dr Jeffrey Herbert was appointed to the Board in July 2012. Jeffrey was previously Chairman of Veolia Water East Limited. Jeffrey is an industrialist who has held Chief Executive Officer and Chairman roles for a number of large, international businesses in the automotive, mineral extraction and mechanical engineering sectors. Dr Jeffrey Herbert will be retiring as an independent non-executive director of our Board and will not be seeking re-appointment at this year's AGM.

Executive directors

Simon Cocks – Chief Executive Officer 1 2 3

Simon Cocks was appointed to the Board on 1 June 2015. Simon is an electrical engineer with extensive experience of the water and energy industries. Simon is a board member of UK Water Industry Research ('UKWIR') and a member of Defra's Water Innovation Group. He was previously Severn Trent's Managing Director of Wholesale Operations and has extensive cross sector experience in leadership roles in the utility sector. Prior to joining Severn Trent in 2009, Simon was a senior executive at National Grid and started his career at London Electricity.

Duncan Bates – Chief Financial Officer 1 2 3 4 5 7

Duncan Bates is Chief Financial Officer of Affinity Water Limited, having joined the company in March 2012 and been appointed to the Board in September of that year. He began his career in Veolia in 1992 and held a number of financial posts until his appointment as Veolia Environnement UK's Group Financial Controller in 1999. In 2007, he became Finance Director of Veolia Water's non regulated business, a post he held until joining Affinity Water. He is a Fellow of the Chartered Institute of Management Accountants.

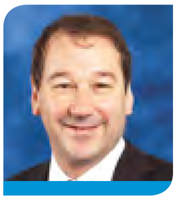
GOVERNANCE CONTINUED

BOARD LEADERSHIP, TRANSPARENCY AND GOVERNANCE (CONTINUED)

Non-executive directors

Stephen Nelson A R N 1 2 3 8 9 10 11 12

Stephen Nelson was appointed a director on 31 March 2015. Stephen is Asset Management Director at Infracapital and has more than 15 years of operating and main board experience encompassing transport infrastructure, regulation as well as extensive experience of consumer businesses. Stephen was Chief Executive of BAA Limited (now Heathrow Airport Holdings Limited) between 2006 and 2008 and prior to this he was Group Retail Director at BAA. He was previously a non-executive director of the Office of Rail Regulation. He has appointed Georgina Dellacha as his alternate.



Nigel Paterson 1 2 3 8 9 10 11 13

Nigel Paterson was appointed a director on 25 July 2014. He is the Chief Operating Officer of Veolia Water UK and is responsible for Veolia Water's operations in the UK, also holding a number of directorships of companies within the Veolia group. He is a Chartered Civil Engineer with many years experience of asset management and asset operations in the water industry.

James Wilmott A R N 8 9 10 11 12

James Wilmott was appointed a director in 2012. He became a member of the Audit Committee on 31 March 2015. James Wilmott is a Managing Director and Head of Europe of Morgan Stanley Infrastructure. He has appointed Yacine Saidji as his alternate.

Former directors

Name	Former role	Period of service
Richard Bienfait	Executive director	9 March 2010 to 31 December 2014
Antonio Botija	Non-executive director	25 July 2012 to 25 July 2014
Kenton Bradbury	Non-executive director	25 July 2012 to 31 March 2015
Olivier Bret	Non-executive director	23 January 2014 to 25 July 2014
Georgina Dellacha	Non-executive director	25 July 2014 to 31 March 2015
Yacine Saidji	Non-executive director	25 July 2012 to 31 March 2015

GOVERNANCE CONTINUED

BOARD LEADERSHIP, TRANSPARENCY AND GOVERNANCE (CONTINUED)

Board leadership

Our Board is collectively responsible for the long-term success of the company. It sets our strategic aims, ensures that the necessary financial and human resources are in place to meet our objectives and reviews management performance. It sets our values and standards and ensures that our obligations to shareholders and others are understood and met.

Our Chairman, Dr Philip Nolan leads our Board and is responsible for ensuring its effectiveness on all aspects of its role. This includes regulatory interactions concerning governance matters that would, for a listed company, be discharged by a senior independent non-executive director. Dr Philip Nolan is also Chairman of our ultimate UK holding company, Affinity Water Acquisitions (Investments) Limited.

The roles of Chairman and Chief Executive Officer are separated, set out in writing and agreed by the Board. Information on the division of responsibilities between the Chairman and Chief Executive Officer is available on the governance pages of our website: **stakeholder.affinitywater.co.uk/our-governance.aspx**. Dr Philip Nolan acted as executive Chairman from 1 January 2015 to 31 May 2015, pending the appointment of Simon Cocks as Chief Executive Officer.

The Chairman meets our independent non-executive directors without executives present. He also meets regularly with our shareholders to listen to their views and any concerns they may have about governance or other matters. In view of the representation of our major investors on our Board we do not consider that the appointment of a senior non-executive director is required. This is a departure from the relevant provision of the Code.

The Board's role is to lead and control the company and to set corporate strategy, objectives and major plans bearing on the success of the business. It is responsible for ensuring that the company has competent, prudent and effective executive management and that all necessary management systems and processes are in place and are working effectively. It also reviews performance, resources and standards of conduct.

The Board reserves to itself the approval of certain key matters such as strategy and management, changes to the company's structure and capital, annual capital and operating budgets, financial statements, declaration of interim dividends and key regulatory submissions, reports and plans. It also approves key policies relating to safety, health and the environment, corporate responsibility and ethical conduct, risk management and business continuity planning. These matters, together with the terms of reference for the Board Committees discussed below, are published on the governance pages of our website: **stakeholder.affinitywater.co.uk/our-governance.aspx**.

Board composition and balance

During the year we reduced the number of investor appointed non-executive directors on the Board from five to three, thereby strengthening the independent voice in decision making and meeting Ofwat's expectation that independent non-executive directors should be the largest single group on the Board. The Board considers this composition appropriate for a company owned by private investors, while noting it is a departure from the Code provision for at least half of the Board, excluding the Chairman, to comprise non-executive directors determined by the Board to be independent.

We consider that the composition of our Board is appropriate for balancing the needs of customers, the environment and our shareholders, as the composition of our Board is such that no single director or group of directors can dominate the Board's decision making.

We consider that our Board and its Committees have the appropriate balance of skills, experience, independence and knowledge to enable them to discharge their respective duties and responsibilities effectively. Our non-executive directors constructively challenge and help develop the strategy of our business. They are of sufficient calibre and have sufficient experience for their views to carry significant weight in Board decisions.

Where potential conflict exists between the interests of the company as a water undertaker and those of other companies in the group, each director has regard exclusively to the interests of the company as a water undertaker.

GOVERNANCE CONTINUED

BOARD LEADERSHIP, TRANSPARENCY AND GOVERNANCE (CONTINUED)

Board composition and balance (continued)

All of our independent non-executive directors are required to retire from office and seek re-election at this year's AGM, together with Stephen Nelson, who was appointed during the year. Baroness Peta Buscombe and Jeffrey Herbert will not be seeking re-appointment. While these arrangements depart from the Code provision with respect to annual re-election of all directors, the Board considers these arrangements for re-election are appropriate for a company owned by private investors.

The terms of the appointment of our independent non-executive directors are available on the governance pages of our website: **stakeholder.affinitywater.co.uk/our-governance.aspx**.

Board accountability

Financial and business reporting

Our Board is responsible for presenting a fair, balanced and understandable assessment of the company's position and prospects in the company's financial statements. The strategic report sets out the basis on which the company generates or preserves value over the longer term and the strategy for meeting the company's objectives.

Having taken into account all matters considered by the Board and brought to its attention during the year, the Board is satisfied that the annual report and financial statements taken as a whole, is fair, balanced and understandable.

The Board believes that the disclosures set out on **pages 5 to 34** of the annual report provide the information necessary for shareholders to assess the company's performance, business model and strategy.

Risk management and internal control

Our Board has overall responsibility for the company's systems of internal control and for reviewing the effectiveness of these systems, including financial, operational and compliance controls and risk management, and is advised by its Audit Committee on these matters. The systems are designed to manage the risk of failure to achieve business objectives (though such risk cannot be completely eliminated), and provide reasonable, and not absolute, assurance against material misstatement or loss.
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 Team, the Head of which reports to the Audit Committee together with other internal control and assurance resources which monitor compliance with policies and procedures;
- the setting and monitoring of annual budgets at a detailed level supported by a long term plan;
- 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.

GOVERNANCE CONTINUED

BOARD LEADERSHIP, TRANSPARENCY AND GOVERNANCE (CONTINUED)

Board accountability (continued)

Risk management and internal control (continued)

The Board approves the company's annual budget and regularly reviews actual performance. There is a defined organisational structure with appropriate delegation of authorities to line management and segregation of duties. All major transactions are reviewed and approved by the Board. Throughout the year, the Board assesses the effectiveness of internal control systems through reports from the Audit Committee, external auditors and other assurance providers. The Board has not identified, nor been advised of, any failings or weaknesses which it has determined to be significant. Therefore a confirmation in respect of necessary actions has not been considered appropriate.

A whistleblowing procedure is in place that supports the open culture that the company promotes in its dealings with members of staff and all people with whom it engages in its business activities. The procedure encourages employees to communicate their concerns about malpractice or misconduct in an open and honest manner without fear of any form of detriment to their employment or career prospects.

We have an established framework for identifying, evaluating and managing the significant risks we face, which has been in place for the year under review and up to the date of approval of this annual report and financial statements. The Chief Executive Officer and executive management team keep under review the management of risks already identified and emerging and expected risks, in order to integrate fully the consideration of risk into the overall management of the business. The Chief Executive Officer appraises the Board of any significant emerging risks. During 2014/15 we further developed our risk management processes, integrating them into the operation and governance of our business. The Board conducted a review of these risk management processes ahead of the approval of this annual report and financial statements through reports from management and the Audit Committee. Refer to **page 28** of the strategic report for further information.

Dividend policy

The Board approves the company's dividend policy. The amount of the dividend is dependent on the success of the company in generating cash flows and achieving its regulatory outputs in the reported period. Under the policy the company distributes earnings equal to the amount required to maintain net debt to RCV at the targeted gearing ratio of 80%. This is consistent with the requirements of Condition F of our Licence that dividends paid will not impair our ability to finance our appointed business, and under a system of incentive regulation, dividends would be expected to reward efficiency and the management of economic risk.

Board Committees

Our Board has established an Audit Committee, Remuneration Committee and Nomination Committee to assist it in discharging its responsibilities. Each Committee operates in accordance with terms of reference approved by our Board and which are published on the governance pages of our website: **stakeholder.affinitywater.co.uk/our-governance.aspx**.

Membership of our Board Committees is noted in the biographies of our directors on **pages 36 to 38**.

GOVERNANCE CONTINUED

BOARD LEADERSHIP, TRANSPARENCY AND GOVERNANCE (CONTINUED)

Board Committees (continued)

The composition of our Board Committees does not meet the relevant Code provisions:

- for the Audit Committee and Remuneration Committee each to comprise at least three independent non-executive directors; and
- for a majority of the members of the Nomination Committee to be independent non-executive directors.

However, our independent non-executive directors are strongly represented on each Committee and this ensures an independent voice and perspective are brought to bear on their work and decision-making.

Further information about our Board Committees is provided in the following sections.

Audit Committee

The Audit Committee is chaired by Patrick O'D Bourke, an independent non-executive director who has relevant and up to date financial experience. The Chief Financial Officer, Head of Internal Audit, external auditor and other parties are invited to attend meetings as appropriate.

The Committee reviews the company's statutory annual financial statements and regulatory financial statements before submission to the Board to ensure that the report and financial statements meet the obligations of the directors and give a true and fair representation of the company's financial position. The key areas of audit focus agreed with the auditor for the year ended 31 March 2015 related to revenue recognition (specifically the measured income accrual), bad debt provisioning, cost capitalisation, contractual and legal claims and pension assumptions. The Committee considers the matters identified by the external auditor in its report to the Committee and, where significant, reports these to the Board. The Committee further provides advice to the Board on whether 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 performance, business model and strategy.

The Committee is responsible for drawing the attention of the Board to, and advising on, any matters which should appropriately be decided by the Board as a whole. It also considers and advises the Board on the policies and procedures for controlling and managing risks throughout the company and supervises actions to define, assess, control and limit risk.

Further information on the work of the Audit Committee is contained in the Audit Committee report on **pages 49 to 51**.

Remuneration Committee

Our Remuneration Committee is responsible for determining and agreeing with the Board the broad policy for the remuneration of the Chairman, independent non-executive directors, executive directors and other members of the executive management team. The Committee is chaired by Dr Philip Nolan. This is a departure from the relevant provision of the Code, which stipulates that a company's chairman may not chair its remuneration committee. However the Board values the experience and knowledge Dr Philip Nolan brings to this role from his chairmanship of other remuneration committees and considers this arrangement appropriate for a business owned by private investors.

The Committee is responsible, in consultation with the Chief Executive Officer, for determining the total individual remuneration package including bonuses and incentive payments of the executive directors and other members of the executive management team. No director or manager is involved in any decisions as to his or her own remuneration. Further information on the work of the Remuneration Committee during the year is contained in the remuneration report on **pages 52 to 60**.

GOVERNANCE CONTINUED

BOARD LEADERSHIP, TRANSPARENCY AND GOVERNANCE (CONTINUED)

Board Committees (continued)

Nomination Committee

The Nomination Committee is established to keep under review the skills and balance of our Board to ensure the right skills and experience which are best able to balance the needs of our business, customers, shareholders, the environment and other stakeholders. The Committee is chaired by Dr Philip Nolan and met once during the year.

During the year, the Nomination Committee oversaw the process to select and recommend to the Board the appointment of Chris Bolt as an independent non-executive director. The Committee did not use an external search consultancy nor open advertising as Chris Bolt was already known to the Chairman and having interviewed him as a candidate, the Nomination Committee was satisfied as to his experience and suitability for the role.

An executive recruitment consulting firm, Spencer Stuart, which is unconnected to the company, was used in the recruitment process for the Chief Executive Officer role. After interviewing short-listed candidates, members of the Nomination Committee recommended Simon Cocks' appointment to the Board.

The Nomination Committee has not developed a diversity policy for the Board's adoption.

Board and Committee attendance, effectiveness and evaluation

Directors are expected to allocate sufficient time to the company to discharge their responsibilities effectively. In addition to formal Board and Committee meetings, directors are encouraged to participate in informal briefings from management. The expected time commitment of our Chairman and independent non-executive directors is recorded in their respective letters of appointment. The following table sets out attendance at meetings for the year ended 31 March 2015.

	Board	Audit Committee	Remuneration Committee	Nomination Committee
Number of meetings in year	**15**	**4**	**6**	**1**
Chairman				
Dr Philip Nolan	15/15	-	6/6	1/1
Independent non-executive directors				
Patrick O'D Bourke	15/15	4/4	-	1/1
Baroness Peta Buscombe	13/15	-	6/6	1/1
Jeffrey Herbert	15/15	4/4	6/6	-
Chris Bolt	1/2*	-	-	-
Executive director				
Duncan Bates	14/15	-	-	-
Non-executive directors				
Stephen Nelson	0/0*	0/0*	0/0*	0/0*
Nigel Paterson	6/8*	-	-	-
James Wilmott	12/15	0/0*	6/6	1/1
Former directors				
Richard Bienfait	11/11*	-	-	-
Antonio Botija	0/7*	-	-	-
Kenton Bradbury	15/15*	3/4*	6/6*	1/1*
Olivier Bret	4/7*	-	-	-
Georgina Dellacha	7/8*	-	-	-
Yacine Saidji	9/15*	2/4*	-	-

- denotes non-membership of that Committee

* denotes not a member of the Board or Committee for the whole 12 months

GOVERNANCE CONTINUED

BOARD LEADERSHIP, TRANSPARENCY AND GOVERNANCE (CONTINUED)

Board and Committee attendance, effectiveness and evaluation (continued)

The Company Secretary is responsible for ensuring that the Board and its Committees receive regular written reports from management of sufficient quality to enable them to discharge their duties. The Company Secretary also advises the Board on governance matters and facilitates information flows between management and the directors. Where a director requires access to independent professional advice the Company Secretary is responsible for making appropriate arrangements at the expense of the company. The appointment and removal of the Company Secretary is a matter for the Board as a whole.

The Board and Audit Committee evaluated their performance during 2014/15 by means of a questionnaire covering the range of their responsibilities and procedures. Details of the Audit Committee evaluation are provided in the Audit Committee's report. The performance of the Remuneration Committee and Nomination Committee is evaluated both informally and from time to time, formally by the Board.

The Board determined it was working effectively and identified opportunities to improve in the following areas: establishing a formal process for succession planning; formally setting and documenting Board objectives; establishing a formal annual plan for the Board; and improving the effectiveness of reporting by Committees to the Board.

Dr Philip Nolan led the evaluation of the performance of individual directors, while Jeffrey Herbert led the evaluation of Dr Philip Nolan and Patrick O'D Bourke, in view of the cross directorship situation.

Relationship with our shareholders

There are a limited number of matters requiring shareholder approval, reflecting the matters that a company with listed equity shares would typically involve shareholders in decision-making. These matters are explained in our publication: Engaging with our shareholders, which is available on the governance pages of our website: **stakeholder.affinitywater.co.uk/our-governance.aspx**.

The presence on our Board of directors appointed by our shareholders facilitates effective dialogue with our shareholders and allows all the members of the Board, in particular the independent non-executive directors, to develop an understanding of their views.

Further information about our shareholders and ownership is provided on **pages 45 to 47**.

Transparency

We are committed to being accountable to our customers and our communities. We aim to maintain legitimacy with them by being open and transparent about our governance. Our Governance Code is therefore published on the governance pages of our website: **stakeholder.affinitywater.co.uk/our-governance.aspx**.

By order of the Board

Tim Monod

Company Secretary
23 June 2015

GOVERNANCE CONTINUED

OWNERSHIP AND FINANCING

Ownership

The effective equity interest in Affinity Water Limited at 31 March 2015 is shown below:

Infracapital Partners II (35%)

Infracapital Partners II is one of a number of European infrastructure funds managed by M&G Investment Management Limited, a subsidiary of Prudential plc. It was established in 2010 to make investments in income-generative infrastructure assets and businesses, including electricity and gas networks, water companies, transport infrastructure and renewable energy. It holds its investment in the company indirectly through Infracapital F2 Rift S.à.r.l., which is a wholly owned subsidiary of Infracapital F2 Rift Holdings S.à.r.l.. Both Infracapital F2 Rift S.à.r.l. and Infracapital F2 Rift Holdings S.à.r.l. are incorporated in Luxembourg.

Beryl Datura Investment Limited (10%)

Beryl Datura Investment Limited (BDIL) is a company established by the State Administration of Foreign Exchange of the People's Republic of China. It is managed by Gingko Tree Investments Limited which focuses on investments in real assets such as infrastructure and real estate and is attracted to relatively stable, predictable, long-term investments. It holds its investment in the company indirectly through Infracapital F2 Rift Holdings S.à.r.l., which is managed by Infracapital Partners II.

Partners Group (5%)

Partners Group is a global private markets investment management firm. It has investment programs under management in private equity, private real estate, private infrastructure and private debt. The firm is listed on the SIX Swiss Exchange. It holds its investment in the company indirectly through Partners Group Global Infrastructure 2012 LP Inc., incorporated in the United States, and Partners Group Direct Infrastructure 2011 LP, registered in Guernsey. It holds its investment in the company indirectly through Rift SLP 2 LP, which is managed by Infracapital Partners II.

North Haven Infrastructure Partners LP (formerly Morgan Stanley Infrastructure Partners) (40%)

North Haven Infrastructure Partners LP (formerly Morgan Stanley Infrastructure Partners) is a global infrastructure investment fund managed by Morgan Stanley Infrastructure Inc., part of the investment management division of Morgan Stanley. It was established in 2007 to make investments in core infrastructure assets that provide essential public goods and services to societies across the globe and seeks to improve asset performance using active management. It holds its investment in the company indirectly through MSIP Dalis B.V., which is incorporated in the Netherlands.

Veolia Water UK Limited (10%)

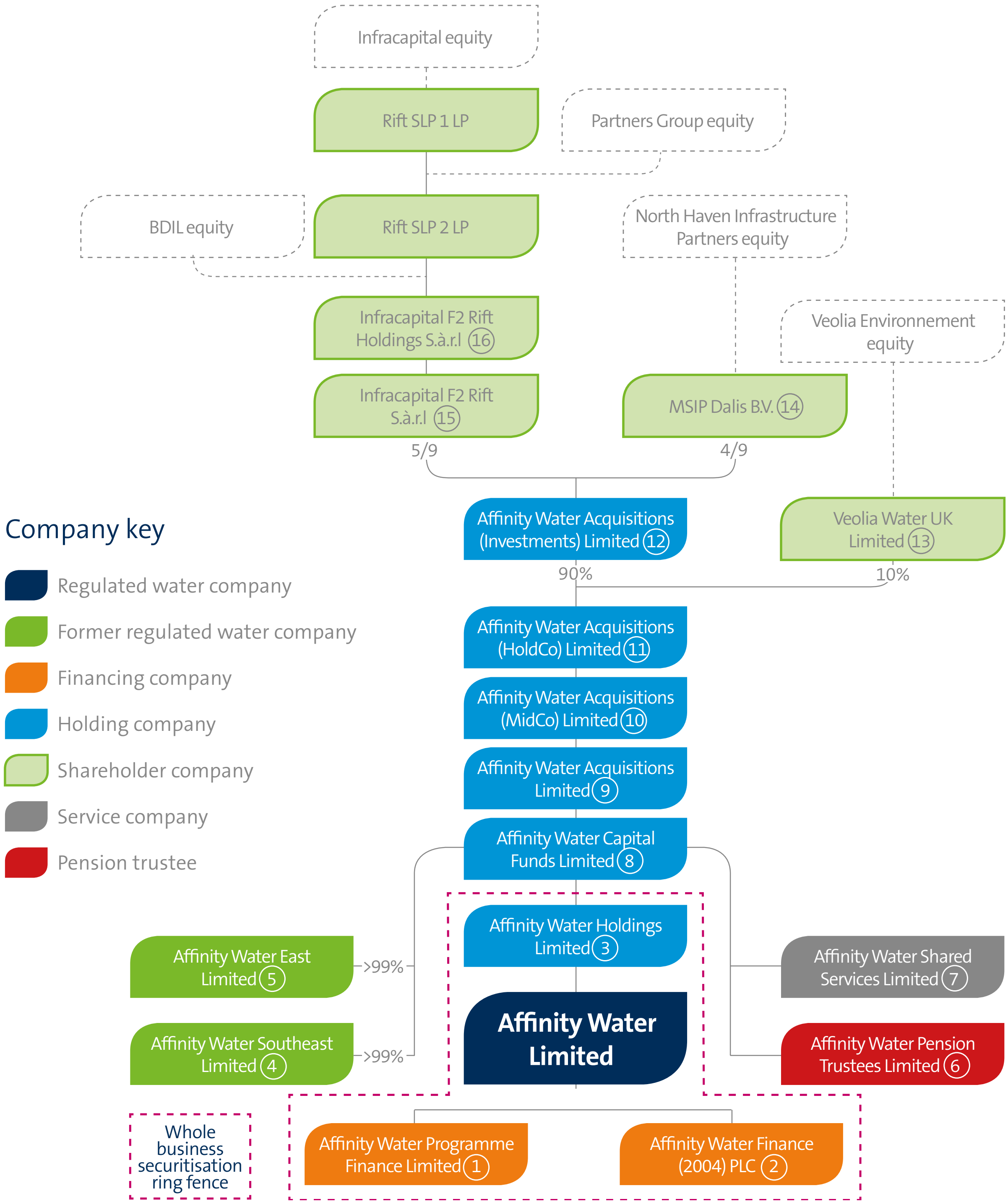
Veolia Water UK Limited is incorporated in England and Wales and is a subsidiary of Veolia Environnement S.A. which is listed on the Paris and New York Stock Exchanges. It holds its investment in the company through its shareholding in Affinity Water Acquisitions (Holdco) Limited and has established with the company a capability sharing arrangement. This arrangement gives it access to the company's knowhow, experience and expertise while the company has access to Veolia Water's advice on global water technologies and developments.

GOVERNANCE CONTINUED

OWNERSHIP AND FINANCING (CONTINUED)

Ownership (continued)

The following chart shows the ownership of the company and the group structure, excluding dormant subsidiaries except for Affinity Water Pension Trustees Limited. Unless otherwise indicated, all companies are wholly owned by the parent company shown.



GOVERNANCE CONTINUED

OWNERSHIP AND FINANCING (CONTINUE)

Ownership (continued)

Our UK holding company is Affinity Water Acquisitions (Investments) Limited and we consider Infracapital Partners II and North Haven Infrastructure Partners LP (formerly Morgan Stanley Infrastructure Partners) to be our ultimate controllers, as they are in a position to exercise material influence over our policy and affairs. These entities 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 the Appointment; and
- use their best endeavours to ensure that our Board maintains three independent non-executive directors, 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 our customers and how these can be respected and protected.

We are satisfied that these undertakings are being properly discharged and that we are able fully to 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.

Our financing

Affinity Water Limited is financially and operationally 'ring-fenced' from the rest of the Affinity Water group by way of a whole business securitisation. The securitisation has further enhanced 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 (formerly Affinity Water Finance (2004) Limited)
- Affinity Water Programme Finance Limited

Affinity Water Programme Finance Limited issued external bonds totalling £575m on 4 February 2013. At the same time, the £200m bonds issued by Affinity Water Finance (2004) PLC in 2004 were brought within the securitisation. Affinity Water Finance (2004) PLC completed a tap issue of £50m on the same terms as its existing £200m bond on 16 July 2014.

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 Programme Finance Limited and Affinity Water Finance (2004) PLC are subject to the Listing Rules and Disclosure and Transparency Rules, being listed by the UKLA.

Affinity Water Programme Finance Limited is incorporated in the Cayman Islands but resident in the United Kingdom for tax purposes, as the bonds were, in part, used to discharge financing put in place by our investors in 2012 to finance their acquisition. It was not possible for us to establish a UK company to act as issuer. By being resident in the United Kingdom for tax purposes we are clear that this arrangement does not avoid UK tax and brings no tax benefit. Further, there are no funds which are held off-shore with all finance being raised and held within the United Kingdom.

GOVERNANCE CONTINUED

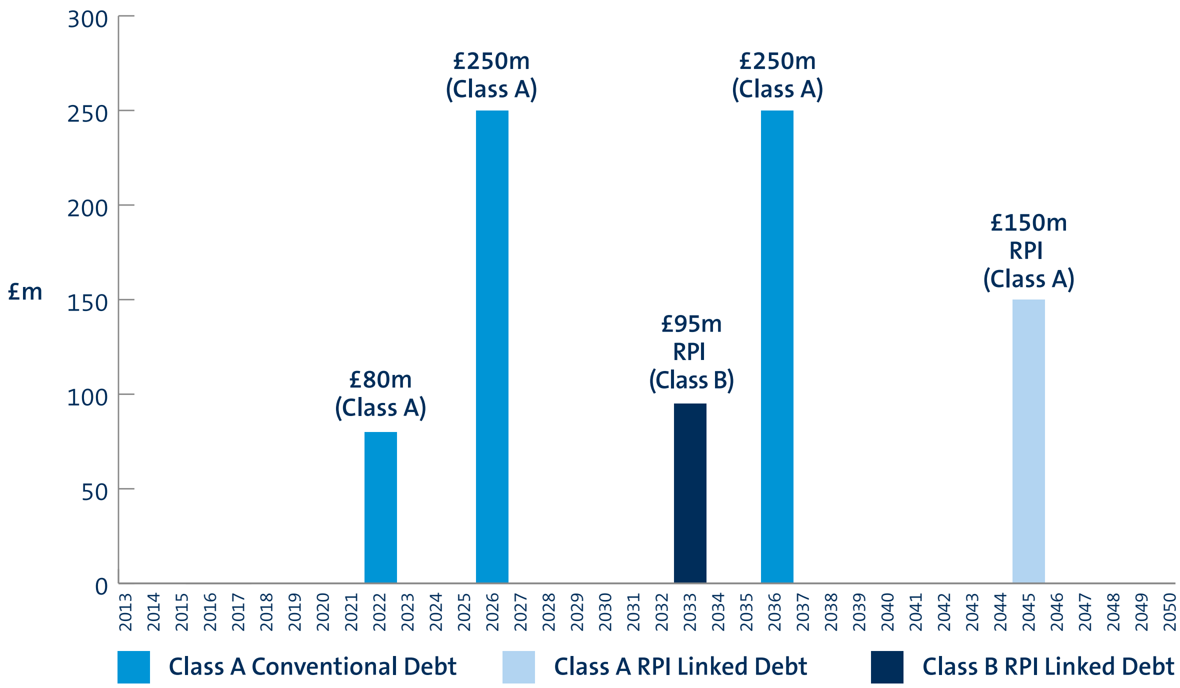
OWNERSHIP AND FINANCING (CONTINUE)

Our financing (continued)

he bonds issued by the company's subsidiaries 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 index linked ('IL') bond 2045	150.0	1.548% (real)	June 2045
Class A fixed rate bond 2036	250.0	4.500%	March 2036
Class A fixed rate bond 2022	80.0	3.625%	September 2022
Total Class A	**730.0**		
Class B IL bond 2033	95.0	3.249% (real)	June 2033
Total Class B	**95.0**		
Total	**825.0**		

The following chart shows the maturity profile of the bonds:



The credit ratings for our bonds assigned by the rating agencies, Moody's and Standard & Poors are:

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

GOVERNANCE CONTINUED

AUDIT COMMITTEE REPORT

PATRICK O'D BOURKE

Current Committee members

- Patrick O'D Bourke (Chairman)
- Jeffrey Herbert
- Stephen Nelson
- James Wilmott

For further information on the responsibilities of the Audit Committee and the qualifications of the Chairman, please refer to **page 42**. Other members of the Committee who served during the year, not listed above, were Kenton Bradbury and Yacine Saidji.

Dear shareholder,

As part of our work over the last year, we concluded that appropriate risk management and internal control systems were in place throughout the year ended 31 March 2015. From the information and assurance provided by the day-to-day work of the Internal Audit function and the external review and audit conducted by the auditor PricewaterhouseCoopers LLP ('PwC') at the half-year and full year respectively; our understanding of the business; and information provided by the executive management team, the Committee was satisfied that the 2014/15 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.

Overview of the actions taken by the Audit Committee to discharge its duties

Since the beginning of 2014/15, we have:

- recommended to the Board the reappointment of PwC as auditor;
- reviewed the September 2014 half-yearly financial results and the March 2015 annual report and financial statements. As part of this, we received a report from PwC on its review of the half-yearly financial results and audit of the annual report and financial statements;
- reviewed the March 2015 regulatory financial statements;
- considered the company's processes used to identify, evaluate and mitigate risks;
- reviewed the effectiveness of the company's internal controls and associated disclosures made in the annual report and financial statements;
- 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 half-yearly report and its audit of the March 2015 financial statements, and fees for non-audit services above pre-approved limits;
- agreed a programme of work for the Internal Audit function;
- received reports from the Head of Internal Audit on the work undertaken by Internal Audit, as well as management responses to proposals made in audit reports issued by the function during the year;
- undertaken an assessment of the qualification, expertise, resources and independence of PwC and the effectiveness of the audit process. This included consideration of a report on PwC's quality control procedures and its annual transparency report;
- reviewed compliance certificates and investor reports required under the company's debt facilities;
- reviewed the information to be provided in the annual performance report to Ofwat before submission to the board to ensure that the information meets Ofwat's reporting requirements;
- received presentations on the company's Financial Reporting Standard 101: 'Reduced disclosure framework' implementation plan, insurance renewals, quality assurance and management systems, whistleblowing and anti-corruption policies, 2015/16 tariffs and charging scheme, the risk and compliance statement management plan, AMP6 performance commitments and Outcome Delivery Incentives ('ODIs'), future regulatory reporting requirements, and the protocol for non-audit services;

GOVERNANCE CONTINUED

AUDIT COMMITTEE REPORT

Overview of the actions taken by the Audit Committee to discharge its duties (continued)

- provided advice to the Board on whether the annual report and financial statements, taken as a whole, are fair, balanced and understandable, and provide the information necessary for shareholders to assess the company's performance, business model and strategy; and
- evaluated our effectiveness as a Committee by means of a questionnaire covering the range of our responsibilities and procedures.

Significant issues considered by the Audit Committee in relation to the 2014/15 financial statements

We considered the on-going appropriateness of the company's accounting policies and any requirement to adopt new financial reporting standards applicable in the 2014/15 accounting period. We also discussed the critical accounting judgements and key sources of estimation uncertainty, and concluded that the estimates, judgements and assumptions used were reasonable based on the information available and that these had been used appropriately in applying the company's accounting policies.

In relation to the company's existing accounting policies and the following principal areas of judgement:

- The estimation methodology for the recognition of revenue (specifically the measured income accrual) during the year was reviewed and it was concluded that the approach taken was appropriate.
- The policy for providing against doubtful debts was reviewed and it was concluded that the approach taken was appropriate.
- The processes and policies in place to distinguish between maintenance and enhancement costs were discussed and it was concluded that these would result in cost capitalisation that was in line with the company's policy and applicable accounting standards.
- Any on-going contractual and legal claims against the company were discussed and it was concluded that the related accounting treatment was appropriate.
- The company's assumptions used in calculating the defined benefit pension asset were reviewed and the reasons for the improvement in the net position discussed.
- The assumptions underpinning the directors' assessment that the company has adequate resources to meet its current operational and financial obligations were reviewed, together with their reasonable expectation that this will continue for the foreseeable future; and therefore the directors' decision to continue to adopt the going concern basis in the financial statements.

External Audit

PwC was appointed as external auditor in 2013/14 following a competitive tendering exercise.

To fulfil our responsibility regarding the independence and objectivity of PwC, we reviewed:

- PwC's plan for the current year, noting the role of the senior statutory audit partner who signs 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
- a report from PwC describing its arrangements to identify, report and manage any conflicts of interest.

A key factor that may impair PwC's independence is a lack of control over the volume of non-audit services. To address this issue, during the year we approved a policy for the provision of non-audit services. Under this policy, all proposals for non-audit work are subject to pre-approved limits. Any non-audit service that exceeds these thresholds requires approval from the Audit Committee.

During the year PwC provided non-audit services, other than audit related services, in the form of consultancy services in relation to the company's pension arrangements with the executive directors and certain members of the senior management team, and on possible ways to reduce the company's exposure to inflation movements within the pension scheme. PwC also provided assurance to the Remuneration Committee on the company's performance in relation to the executive directors and senior management's long term incentive plan targets. PwC further performed a review of the company's debtor management policy and procedures. PwC was engaged to provide these services as it is recognised as having expertise in these areas.

AUDIT COMMITTEE REPORT (CONTINUED)

External Audit (continued)

Auditor objectivity and independence was safeguarded in these instances through the advice being provided by partners and staff who have no involvement in the audit of the financial statements.

PwC was engaged to provide agreed upon procedures as part of the company's regulatory compliance and annual reporting to Thames Water and Anglian Water. PwC was further engaged to audit the company's opening balance sheet at 1 April 2014 prepared under Financial Reporting Standard 101: 'Reduced disclosure framework' in advance of implementation of Financial Reporting Standard 101: 'Reduced disclosure framework' for the 2015/16 financial year and provide assurance over the financial information included within a debt prospectus. None of the procedures performed were advisory in nature.

No services were provided pursuant to contingent fee arrangements.

The auditor's role is considered annually by the Board for reappointment on the recommendation of the Audit Committee.

To assess the effectiveness of PwC, the Audit Committee reviewed:

- the arrangements for ensuring PwC's independence and objectivity;
- its fulfilment of the agreed audit plan and any variations from the plan;
- the robustness and perceptiveness of PwC in 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 2016.

Note 4 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.

Internal Audit

To fulfil our responsibilities relating to the adequacy of the resourcing and plans of the Internal Audit function, we reviewed:

- Internal Audit's terms of reference, reporting lines and access to the Audit 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 Internal Audit 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 Committee as appropriate.

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

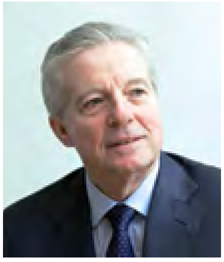
On behalf of the Audit Committee

Patrick O'D Bourke

Chairman of the Audit Committee
23 June 2015

GOVERNANCE CONTINUED

REMUNERATION REPORT



DR PHILIP NOLAN

Committee members

- Dr Philip Nolan (Chairman)
- Baroness Peta Buscombe
- Dr Jeffrey Herbert
- Stephen Nelson
- James Wilmott

I am pleased to present the report on directors' remuneration, which sets out the remuneration paid to the directors of the company in the financial year ended 31 March 2015, and changes to the remuneration policy, as presented in last year's report, for 2015/16.

We continue to align executive pay to the company's performance and strategy of delivering shareholder value through high quality customer and operational performance whilst ensuring the cost of water remains affordable for our customers by incentivising financial efficiencies. We therefore link directors' remuneration 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. The Remuneration Committee established measures of financial and non-financial performance, including health and safety, water quality compliance and other customer experience and operational measures, for the year. The achievement of performance against these targets provides the basis for determining the value of annual bonus awards.

We have also implemented a long term incentive plan (the '2013/14 LTIP'), covering the three year period from 1 April 2013 to 31 March 2016 to incentivise executive directors and senior management to meet targets for cash available for distribution over the three year period and SIM in the final year of the period.

Executive director changes

During the course of the year, the Committee considered the termination arrangements for the former Chief Executive Officer, Richard Bienfait, and the remuneration arrangements for his successor, Simon Cocks. Details of these arrangements are set out in this report.

Remuneration in 2015/16

We believe that the remuneration policy is working well to support the company's strategy. Customers, regulators and stakeholders rightly expect that the remuneration of executive directors and other senior executives is linked to standards of performance experienced by customers.

We have further strengthened this link by aligning the annual bonus plan targets for 2015/16 to the commitments for AMP6 we have made in our Business Plan. These are commitments we have developed in conjunction with our customers and stakeholders.

We consider that the design of both the annual bonus plan targets and the long term incentive plan targets provides assurance to customers and stakeholders that management is appropriately incentivised to focus on providing high standards of service to customers.

During 2015/16 we will continue to ensure that the reward packages for our directors remain market competitive, incentivise company and individual performance, and ensure focus on the achievement of short-term targets that will enable the company to fulfil its long-term strategic objectives.

Dr Philip Nolan

Chairman

GOVERNANCE CONTINUED

REMUNERATION REPORT (CONTINUED)

Introduction

We have prepared this report in accordance with regulations made under Schedule 8 to the Accounting Regulations of the Companies Act 2006 (the 'Act'), which are applicable to companies whose equity shares are listed. The report also meets the relevant requirements of the Listing Rules of the Financial Conduct Authority 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.

In relation to shareholder voting at our 2014 AGM, the single available vote was cast in favour of the resolutions to approve the remuneration policy report, which is subject to a binding vote at least every three years, and the remuneration implementation report, which is subject to an annual advisory vote, presented in the annual report and financial statements for the year ended 31 March 2014.

The Act requires the auditor to report to the company's members 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. We have asked PwC to report on this basis notwithstanding the regulations do not apply to our business.

Remuneration policy report

Remuneration Committee

The Remuneration Committee is responsible for determining the remuneration policy and terms and conditions of employment of the executive directors and senior management. The Committee met on six occasions during the year, and was chaired by Dr Philip Nolan.

The other members of the Committee during the year were Kenton Bradbury, James Wilmott, Stephen Nelson, Baroness Peta Buscombe and Dr Jeffrey Herbert.

Richard Bienfait, the former Chief Executive Officer, and Duncan Bates, the Chief Financial Officer, attended the meetings when requested by the Committee. Tim Monod is the secretary to the Committee. Members of the Committee and attendees are excluded from discussions regarding their own remuneration and conditions of employment.

During the year Baker McKenzie LLP, who are unconnected to the company, continued to provide advice on the design and implementation of a long term incentive plan. They were appointed by the Committee in the previous year. PwC also provided assurance to the Committee on the company's performance in relation to the executive directors and senior management's 2013/14 LTIP targets. They were appointed by the Committee in the year.

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. Their 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. A high priority is placed on achieving high standards of safety. 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.

GOVERNANCE CONTINUED

REMUNERATION REPORT (CONTINUED)

Remuneration policy for non-executive directors

The non-executive directors in office at 31 March 2015 fall into two groups.

Group A	Group B
Patrick O'D Bourke	Stephen Nelson
Chris Bolt	Nigel Paterson
Baroness Peta Buscombe	James Wilmott
Dr Jeffrey Herbert	

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 long-term incentive plans. 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 directors are appointed until the conclusion of the next AGM, unless terminated earlier by either the director or the company giving to the other three months' written notice.

Director fees for the Group A directors in 2014/15 remained unchanged from those reported in the 2013/14 remuneration policy report and will apply during 2015/16, unless the Committee agrees changes during the year.

The directors in Group B are appointed by our shareholders. They do not receive from the company any fees or other forms of remuneration in respect of their services and are not entitled to receive any payment on termination of their appointment.

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 and the interests of shareholders. The remuneration arrangements incorporate performance measures which link to the company's vision and customer expectations (as described in the strategic report on **pages 15 to 24**).

The remuneration packages for all new executive directors are set in line with the company's approved policy. 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 prior year remuneration policy report and on the next page respectively. 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 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 are considered through the presence of two directors appointed by our shareholders on the Committee.

GOVERNANCE CONTINUED

REMUNERATION REPORT (CONTINUED)

Remuneration policy report (continued)

Remuneration policy for executive directors (continued)

The Committee did not consult with employees when drawing up the directors' remuneration policy but considered the average base salary increase of employees, which is subject to inflationary increases, in setting base salaries for the executive directors. The key elements of the remuneration package for Duncan Bates and Richard Bienfait (until his resignation) presented in the 2013/14 remuneration policy report remained unchanged during 2014/15. No changes to the policy relating to these elements have been implemented for 2015/16.

Internal performance measures for the 2015/16 annual bonus scheme have been aligned to the commitments for AMP6 we have made in our Business Plan and are as follows:

- health and safety measure;
- operational and customer measures: leakage, water available for use, compliance with water quality standards, unplanned interruptions to supply over 12 hours, SIM and water meters installed under the WSP; and
- financial measures: cash collection and net cash outflow before taxation and financing.

As presented in the 2013/14 policy report, 50% of the total bonus will continue to be determined on the achievement of the financial performance target; 25% on the achievement of operational and customer performance targets; and 25% on the achievement of personal objectives.

During the year the arrangements for the 2013/14 LTIP for executive directors and senior management were finalised, as presented in the following table.

Purpose and link to strategy	Policy and approach	Maximum potential value (as percentage of base pay)	Performance metrics	Changes for 2015/16
Long-term incentive plan				
To incentivise executives to achieve long-term shareholder value whilst achieving high levels of customer experience performance, although award and payment are discretionary.	Base awards were granted for 2013/14 as a percentage of salary and are paid out in cash at the end of a three year performance period from 1 April 2013 to 31 March 2016, subject to the achievement of performance conditions.	Up to 100% of base salary (although outperformance of the financial performance target could cause this to be higher).	The award will be determined on the performance of the company over the three years in terms of cash available for distribution to shareholders and the third year's SIM performance relative to the industry.	No change to the policy.

GOVERNANCE CONTINUED

REMUNERATION REPORT (CONTINUED)

Remuneration policy report (continued)

Remuneration policy for executive directors (continued)

Dr Philip Nolan was appointed Chairman on 1 April 2013 for a term of three years. He receives a fixed annual fee for his services which is set at a market competitive level. He served as executive Chairman from 1 January 2015 until 31 May 2015 and thereafter his role reverted to non-executive.

On appointment, it was agreed to put in place a bonus arrangement for the Chairman, to align his interests with the longer term interests of shareholders. To this end, it is common practice for the chairs of listed companies to hold shares. As a privately owned company, this is not practicable to implement, so the bonus arrangement has been aligned as closely as possible to the key features of a shareholding in a listed company. Particulars of the arrangement will be communicated at the AGM. We have departed from the Accounting Regulations of the Act in not providing full disclosure of the terms of the arrangement to protect commercial confidentiality but have disclosed the bonus paid during the year in the remuneration implementation report.

Executive directors' service contracts

Notice periods are as follows:

Chief Executive Officer – Simon Cocks	Chief Financial Officer - Duncan Bates
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.

There are no arrangements in place for the remuneration of executive directors by any holding company or other company in the group.

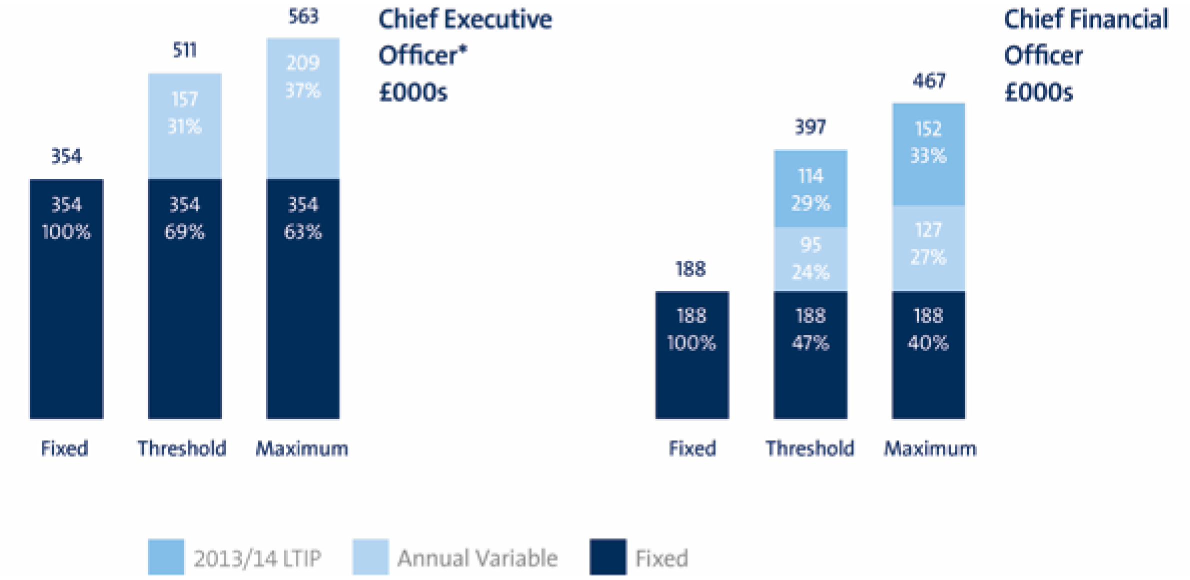
GOVERNANCE CONTINUED

REMUNERATION REPORT (CONTINUED)

Remuneration policy report (continued)

Payouts under different scenarios

The following charts show the payout for 2015/16 under the proposed arrangements for the Chief Executive Officer and Chief Financial Officer under different scenarios.



* Simon Cocks will receive remuneration in 2015/16 representing compensation for the forfeit of variable remuneration arrangements with his previous employer. This is not included in the maximum remuneration above. The disclosure above reflects payout under proposed arrangements under different scenarios for the period from the date of appointment of Simon Cocks (from 1 June 2015 to 31 March 2016).

In developing the scenarios the following assumptions have been made:

Fixed	Consists of base salary, benefits and employer contributions into the company's defined contribution pension scheme
Threshold	Based on what a director would receive if the threshold level of performance were achieved: annual variable and LTIP elements pay out at 75% of maximum (assuming the financial performance target for the 2013/14 LTIP is met)
Maximum	Based on what a director would receive if the highest level of performance were achieved: annual variable and LTIP elements pay out at 100% of maximum (assuming the financial performance target for the 2013/14 LTIP is met)[1]

Chief Executive Officer remuneration

We have not reported the percentage year-on-year change in the remuneration of the director undertaking the role of Chief Executive Officer compared to the percentage change in average employee remuneration, as the role was not filled for the full year.

[1] This scenario excludes the possibility of outperformance of the financial performance target.

GOVERNANCE CONTINUED

REMUNERATION REPORT (CONTINUED)

Remuneration policy report (continued)

Management

We operate a discretionary performance bonus scheme for other senior managers and selected managers who meet the criteria for inclusion in the scheme. They are entitled to participate in a performance-related discretionary bonus scheme of up to 20% of their salary. This is paid after the end of the financial year. Bonus awards are dependent on the success of the company and are determined by reference to three components:

- 50% of the total bonus is dependent on the achievement of financial performance targets, which are identical to the executive directors' annual bonus scheme.
- 25% of the total bonus is dependent on the achievement of operational and customer performance targets, which are identical to the executive directors' annual bonus scheme.
- 25% of the total bonus is dependent on the achievement of personal objectives.

The scheme is designed to provide a direct link between senior management and company performance and bonus award and payment remain discretionary.

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 targets operational and customer performance measures and an annual financial performance measure, as set out on **pages 15 to 24** of the strategic report.

The bonus targets for operational, customer and financial performance are identical 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.

For the year ended 31 March 2015, eight of the 24 quarterly operational and customer performance targets set were achieved and the annual leakage target was not achieved. These targets are designed to be stretching, to support high standards of services to customers and to incentivise year-on-year improvements in performance. The financial performance target set was achieved. The company bonus amount was agreed by the Remuneration Committee based on the targets achieved. Although not all targets were achieved, in recognition of the significant operational and financial improvements made year-on-year over AMP5 the Remuneration Committee agreed to increase the amount by 25%.

There are no provisions for the recovery of sums paid and no payment has been withheld.

Relative importance of spend on pay

Out of each pound of our customers' bills, we spend the following on our people and our suppliers for assets:

Stakeholder	Description	2014/15*	2013/14*
Our people	Wages, salaries and pensions	**15p**	14p
Our suppliers for assets	Investment in our assets	**37p**	39p
Our shareholders	Dividends	**7p**	2p

* Breakdown figures are based on our financial statements for 2014/15 and 2013/14. Figures have been rounded.

Further details of where each pound of our customers' bills is spent are presented in the Affinity Water at a glance section of the annual report.

GOVERNANCE CONTINUED

REMUNERATION REPORT (CONTINUED)

Remuneration implementation report

Directors' remuneration 2014/15 (audited)

The following table shows the remuneration paid by the company to directors in respect of 2014/15.

	Base salary/ fees £000		Taxable benefits[1] £000		Pension related benefits[2] £000		Annual bonus £000		Other bonus award[3] £000		Other[4] £000		Total remuneration £000	
	14/15	**13/14**	**14/15**	**13/14**	**14/15**	**13/14**	**14/15**	**13/14**	**14/15**	**13/14**	**14/15**	**13/14**	**14/15**	**13/14**
Non-executive														
Current														
Patrick O'D Bourke	**47**	28	**-**	-	**-**	-	**-**	-	**-**	-	**-**	-	**47**	28
Baroness Peta Buscombe	**44**	38	**-**	-	**-**	-	**-**	-	**-**	-	**-**	-	**44**	38
Jeffrey Herbert	**44**	38	**-**	-	**-**	-	**-**	-	**-**	-	**-**	-	**44**	38
Chris Bolt	**4**	-	**-**	-	**-**	-	**-**	-	**-**	-	**-**	-	**4**	-
Former														
Fiona Woolf CBE	**-**	26	**-**	-	**-**	-	**-**	-	**-**	-	**-**	-	**-**	26
Executive														
Current														
Duncan Bates	**168**	161	**15**	13	**33**	48	**104**	106	**-**	73	**-**	-	**320**	401
Dr Philip Nolan	**200**	200	**-**	-	**-**	-	**-**	-	**176**	312	**-**	-	**376**	512
Former														
Richard Bienfait	**180**	219	**66**	16	**-**	69	**-**	145	**-**	99	**509**	-	**755**	548
	687	710	**81**	29	**33**	117	**104**	251	**176**	484	**509**	-	**1,590**	1,591

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 who sit on the Board appointed by Infracapital Partners II, North Haven Infrastructure Partners LP (formerly Morgan Stanley Infrastructure Partners) and Veolia Water UK Limited do not receive any emoluments from the company.

Annual bonuses for executive directors (audited)

The annual bonus scheme is designed to provide a direct link between executive and company performance and the level of bonus awarded, although award and payment remain discretionary. The following table shows the percentage of maximum annual bonus potential awarded in relation to the 2014/15 year for Duncan Bates, who was the only executive director entitled to receive remuneration under the scheme for 2014/15.

[1] Taxable benefits comprise company car allowance and healthcare insurance. Taxable benefits for Richard Bienfait further include an allowance that commenced on 1 March 2014 of £59,000 (2014: £7,000) in lieu of being a member of the company's retirement benefit schemes.

[2] Included in pension related benefits is £4,000 relating to contributions for Duncan Bates paid to money purchase pension schemes (2014: £3,000 for Duncan Bates and £12,000 for Richard Bienfait); there were no amounts outstanding at the year end. The amounts also include £29,000 accruing to Duncan Bates in relation to the company's defined benefit pension scheme. This amount has been calculated based on the change during the year of his accrued benefits in the defined benefit pension scheme multiplied by 20 less contributions made by the director in the financial year. The normal retirement date for Duncan Bates is 65 years. The accrued benefit at the start and end of the year for Duncan Bates was £40,000 and £42,000 respectively (change during the year: £2,000).

[3] For Duncan Bates and Richard Bienfait in 2013/14, this includes payments of the maximum award under the adhoc bonus arrangement related to PR14 given the assessment by Ofwat of our PR14 Business Plan as 'enhanced'. The 2014/15 and 2013/14 amounts further include the Chairman's bonus award. 2013/14 remuneration presented in the above table has been restated to reflect the bonus paid to the Chairman in the current year relating to 2013/14. This amount was excluded from the 2013/14 remuneration report, as the particulars of the bonus arrangement were approved by the Remuneration Committee after the approval of the annual report and financial statements for the year ended 31 March 2014.

[4] Other remuneration relates to discretionary payments made to Richard Bienfait in connection with termination of qualifying services during the year. The amount includes a termination payment of £344,000, a bonus of £120,000 linked to company and personal performance during 2014/15 and the reimbursement of legal and outplacement costs of £45,000.

GOVERNANCE CONTINUED

REMUNERATION REPORT (CONTINUED)

Remuneration implementation report (continued)

Annual bonuses for executive directors (audited) (continued)

Performance measure		Weighting for 2014/15 (% of base salary)	2014/15 achievement (as a % of base salary)
Financial measure	Financial: annual EBITDA	37.50%	37.50%
Operational and customer measures	Health and safety: number of accidents resulting in more than three days' lost time and RIDDOR reportable incidents	2.68%	0.00%
	Water quality: number of water quality compliance failures	2.68%	0.67%[1]
	Unplanned interruptions: number of properties experiencing an interruption for more than 12 hours	2.68%	0.67%[2]
	Written complaints: number of written complaints	2.68%	0.67%[3]
	Leakage: leakage in terms of millions of litres per day	2.68%	0.00%
	Unwanted contact: number of unwanted contacts	2.68%	0.67%[4]
	Customer experience: measured by NPS	2.68%	2.68%[5]
Personal performance		18.75%	18.75%[6]
Total % base pay		**75.00%**	**61.61%**
Base salary			**£169,000**
Bonus paid			**£104,000**

No amounts in relation to these bonuses have been deferred.

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 23 June 2015 and signed on its behalf by:

Dr Philip Nolan

Chairman of the Remuneration Committee

[1] One of the quarterly water quality targets for 2014/15 was met.
[2] One of the quarterly unplanned interruptions targets for 2014/15 was met.
[3] One of the quarterly written complaints targets for 2014/15 was met.
[4] One of the quarterly unwanted contact targets for 2014/15 was met.
[5] All of the quarterly customer experience targets for 2014/15 were met.
[6] 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

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 2015.

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 Affinity Water Acquisitions (Investments) Limited is the ultimate holding and controlling company in the United Kingdom. Details of the ownership of the company and the group structure are set out on **pages 45 to 47 of the governance section** and **note 29 of the financial statements**. The address of the principal place of business is Tamblin Way, Hatfield, Hertfordshire, AL10 9EZ.

The strategic report on **pages 5 to 34** 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 2015. Details of the risks and principal uncertainties facing the company are set out on **pages 28 to 34**.

Directors

The directors of the company, together with their periods of office and their biographical details, are shown on **pages 36 to 38**.

Significant events during the year

Details of the significant events that occurred during the year are set out in the highlights, Chairman's statement and Board's introduction on **pages 2 to 6**.

On 5 June 2014 Affinity Water Finance (2004) PLC (formerly Affinity Water Finance (2004) Limited), a wholly owned financing subsidiary of the company, gave notice that its outstanding notes issued would be transferred from the Main Market to the Professional Securities Market of the London Stock Exchange. The transfer took place on 19 June 2014. Affinity Water Finance (2004) PLC registered as a public limited company on 4 July 2014 and completed a tap issue of £50.0m on the same terms as its existing £200.0m bond on 16 July 2014. The proceeds of this issue were £58.6m and have been lent on to the company on the same terms and are being used to fund its capital expenditure programmes.

On 31 March 2015, the Shared Services division of the Affinity Water Pension Plan was transferred to the company from another group undertaking, Affinity Water Shared Services Limited, and was consolidated with the Central, East and Southeast divisions into one final salary section.

Results and financial performance

Profit on ordinary activities after tax for the year was £32,854,000 (2014: £44,412,000). An analysis of turnover compared to our PR09 final determination target is presented in **note 4 of the regulatory financial statements on page 133**.

The balance sheet detailed on **page 75** shows shareholder's funds amounting to £372,370,000 (2014: £352,317,000).

Further analysis of our financial performance can be found on **pages 19 to 23** of the strategic report.

Information required under the Listing Rules

During the year no interest was capitalised by the company (2014: £nil).

Refer to the remuneration report on **pages 52 to 60** for disclosures in relation to relevant requirements of the Listing Rules.

GOVERNANCE CONTINUED

DIRECTORS' REPORT (CONTINUED)

Greenhouse gas emissions statement

Our greenhouse gas emissions statement is presented on **page 27** of the strategic report.

Dividends

The directors declared and paid the following ordinary dividends during the year ended 31 March 2015:

	£000
Paid: First interim of 4.26p per share in July 2014	11,300
Paid: Second interim of 2.45p per share in September 2014	6,500
Paid: Third interim of 2.64p per share in November 2014	7,000
Paid: Fourth interim of 2.26p per share in March 2015	6,000
	30,800

This compares to interim dividends of £45,842,000 declared and paid in the year ended 31 March 2014.

No final dividend is proposed (2014: £nil).

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 and benefits from their research programme. The UKWIR research programme relating to the company 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 carried out more specific research in the fields of improving data, metaldehyde removal, pipeline materials and leakage.

Political contributions

No political contributions were made during the year (2014: £nil), in accordance with the company's policy of not making political contributions.

Employee matters

We consult and inform our employees on all aspects of business performance through formal and informal consultation bodies, regular team meetings and the intranet. We constantly discuss ways to enhance and improve our communications and consultation channels with the Trade Unions to which employees belong. Several initiatives have also been introduced with the aim of improving the health and well-being of the company's employees.

Employees are kept informed of changes in the business and general and financial and economic factors influencing the company together with performance targets. This is achieved through a systematic approach to employee communication, which includes regular briefings or presentations and electronic mailings. We also produce a regular employee magazine, which is sent to all company sites.

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 find appropriate employment within the business.

GOVERNANCE CONTINUED

DIRECTORS' REPORT (CONTINUED)

Financial instruments disclosures

Details are included on **page 33** of the strategic report and in **note 25 of the financial statements**.

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 drivers and opportunities section of our strategic report on **pages 12 to 14**.

Corporate governance

The company's statement on corporate governance, including information required by the Disclosure and Transparency Rules, can be found in the board leadership, transparency and governance section on **pages 39 to 44** of this annual report and financial statements. This report forms part of this directors' report and is incorporated into it by cross-reference. We have voluntarily reported compliance against the principles of the Code within this report.

Post balance sheet events

There were no significant post balance sheet events.

Going concern

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 assessment is based on consideration of the company's budgeted cash flows, long term forecasts and related assumptions, and its available debt facilities. Accordingly, the directors continue to adopt the going concern basis in the statutory financial statements.

Directors' qualifying third party indemnity provisions

The company has granted an indemnity to one of 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. This qualifying third party indemnity provision was in force during the financial year and remains in force as at the date of approving the directors' report.

Statement of directors' responsibilities

The directors are responsible for preparing the strategic report, directors' report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards 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 these financial statements, the directors are required to:

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

GOVERNANCE CONTINUED

DIRECTORS' REPORT (CONTINUED)

Statement of directors' responsibilities (continued)

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 and remuneration report comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

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.

Each of the directors, whose names and functions are listed on **pages 36 to 38** confirm that, to the best of their knowledge:

- the financial statements, which have been prepared in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law), give a true and fair view of the assets, liabilities, financial position and profit of the company; and
- the strategic report contained in the annual report includes a fair review of the development and performance of the business and the position of the company, together with a description of the principal risks and uncertainties that it faces.

Disclosure of information to auditors

In accordance with Section 418 of the Companies Act 2006:

a. so far as each director is aware, there is no relevant audit information of which the company's auditor is unaware; and

b. he or she has taken all the steps that he ought to have taken as a director in order to make himself or herself aware of any relevant audit information and to establish that the company's auditor is aware of that information.

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

Tim Monod

Company Secretary
23 June 2015

Registered Office:

Affinity Water Limited
Tamblin Way
Hatfield
Hertfordshire
AL10 9EZ

Affinity Water

Your local supply, on tap

Statutory Financial Statements

for the year ended 31 March 2015

INDEX

Affinity Water Limited

(Registered Number 02546950)

Independent auditor's report to the member of Affinity Water Limited

Report on the financial statements

Our opinion

In our opinion, Affinity Water Limited's financial statements (the "financial statements"):

- give a true and fair view of the state of the company's affairs as at 31 March 2015 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

What we have audited

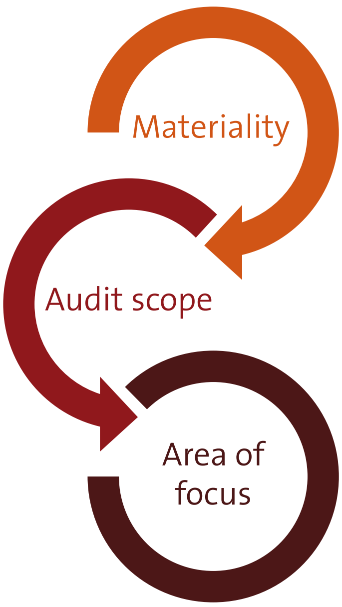
Affinity Water Limited's financial statements comprise:

- the balance sheet as at 31 March 2015;
- the profit and loss account and statement of total recognised gains and losses for the year then ended;
- the cash flow statement for the year then ended
- the note of historical cost profits and losses for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework that has been applied in the preparation of the financial statements is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

Our audit approach

Overview



Materiality

- Overall materiality: £4.2 million (2014: £4.2 million) which represents 2.5% of earnings before interest, tax, depreciation and amortisation ('EBITDA').

Audit scope

- The company has one finance function and operates a single general ledger system.
- The audit was carried out by one team at the UK headquarters in Hatfield, Hertfordshire.

Areas of focus

- Measured income accrual relating to revenue from the provision of water services to customers on water meters that had not been read as at the year end date.
- Bad debt provision, particularly judgements used in its calculation.
- Cost capitalisation, particularly the allocation of costs between capital and non-capital spend.
- Pension assumptions, particularly the key assumptions used in the valuation of the pension obligation and return on the assets.

Independent auditor's report to the member of Affinity Water Limited *(continued)*

Report on the financial statements *(continued)*

Our audit approach (continued)

The scope of our audit and our areas of focus

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)").

We designed our audit by determining materiality and assessing the risks of material misstatement in the financial statements. In particular, we looked at where the directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits, we also addressed the risk of management override of internal controls, including evaluating whether there was evidence of bias by the directors that represented a risk of material misstatement due to fraud.

The risks of material misstatement that had the greatest effect on our audit, including the allocation of our resources and effort, are identified as "areas of focus" in the table below. We have also set out how we tailored our audit to address these specific areas in order to provide an opinion on the financial statements as a whole, and any comments we make on the results of our procedures should be read in this context. This is not a complete list of all risks identified by our audit.

Area of focus	*How our audit addressed the area of focus*
Measured income accrual Refer to **page 50** (Audit Committee Report), **page 78** (accounting policies) and **page 92 (note 15)**. The company recorded a measured income accrual of £39.9 million (2014: £37.8 million) relating to revenue from the provision of water services to customers on water meters that had not been read as at the year end date. The calculation of the measured income accrual was based on the historical usage of water by groups of similar customers ('books') and when the books were last read and billed. Given the range of factors underlying the estimate, there is a risk that the measured income accrual and revenue could be misstated.	We checked that the data used in the calculation of the measured income accrual agreed to the billing system where applicable and we were able to re-perform the calculation successfully using management's assumptions and data. The key assumption affecting the measured income accrual is that the historical usage is an appropriate basis for the current year accrual. As the measured income accrual is based on a six month average consumption for each book, we assessed the impact of seasonality on management's calculations and considered there to be no significant impact. We were also able to obtain satisfactory explanations from management for any changes since the prior year in the measured revenue and corroborated the explanations to monthly management accounts presented to the Board and to other supporting information. We evaluated the measured income accrual as a proportion of the measured revenue against the prior year, taking into account the timing difference in the reading of books. We were satisfied that the proportion was materially consistent. We evaluated the historical accuracy of the estimation process by checking bills raised in the current year for all books accrued at the prior year end. We also evaluated the accuracy of the current year end accrual by checking post year end bills raised for books accrued at the year end though only 28% of these books had been billed by the time of our audit. We found that the differences between the estimated accruals and the subsequent billings were insignificant, being ≤1% in each case.

Area of focus	***How our audit addressed the area of focus***
Bad debt provision Refer to **page 50** (Audit Committee Report) and **page 79** (accounting policies). The bad debt provision is based on a detailed calculation that applies a percentage provision to individual aged debt categories based on historical cash collection rates. The company made a small reduction in the rate of provisioning for all ageing categories following the introduction of a new debt management system in the year. Some customers continue to struggle to pay their bills or in certain instances, choose not to pay them. As there are limited steps that a water company can take to recover debt from domestic customers, there is an ongoing risk of older debt being more difficult to collect. The provision needs to reflect all these factors and accordingly could be materially misstated.	We agreed the calculation of the bad debt provision to the general ledger and performed testing to confirm the accuracy of the ageing with no exceptions arising from this work. We recalculated the bad debt provision and evaluated the reasonableness of the provision, taking into account the following: • collections made against old balances and year on year movement of aged debt categories; • trends in cash receipts compared to billings; • the debt write off policy; and • the calculation of the expected collection period for overdue debts based on historical cash collection rates. We considered the level of provisioning to be acceptable, having been based on historical cash collection rates with reasonable adjustments to take account of the impact of the new debt management system.
Cost capitalisation Refer to **page 50** (Audit Committee Report), **pages 81-82** (accounting policies) and **pages 90-91 (note 12)**. The allocation of costs between capital and non-capital spend can be subjective and has historically formed part of Ofwat's monitoring of the performance of the business. The key judgement is management's assessment of what constitutes a capital infrastructure project or a major repair for capitalisation, and what constitutes a minor repair that is expensed. Given the magnitude of capital spend at £114.5 million (2014: £113.5 million) there is a risk that incorrect classification could give rise to material misstatements.	We checked that items being capitalised were in line with both the accounting policy and accounting standards, for expenditure performed by external and internal contractors. In addition, we evaluated the nature of overheads that were being capitalised and found these to relate to the asset management operations of the business and considered them to be appropriately capitalised. We also scanned the repairs and maintenance expenditure and tested items to assess appropriate classification as an operating expense and there were no material issues with our testing of the classification.
Pension assumptions Refer to **page 50** (Audit Committee Report), **page 80** (accounting policies) and **pages 98-102 (note 24)**. The company has a defined benefit pension plan net asset of £38.2 million (2014: £3.1 million). The plan assets increased from £320.3 million to £419.2 million mainly as a result of asset performance being better than expected. However, the plan liabilities also increased from £313.7 million to £374.1million as a result of a decrease in discount rates, offset by a reduction in inflation.	We agreed the valuation of the pension assets to the valuation reports that we obtained from the fund's investment manager and noted no material differences. We also agreed the actuarial information for a sample of scheme members to the payroll data held by the company and noted no exceptions in our testing. We assessed the competence and independence of the actuary by confirming that they are a member of the Institute and Faculty of Actuaries and confirming that they are appropriately independent of the company.

Independent auditor's report to the member of Affinity Water Limited *(continued)*

Report on the financial statements *(continued)*

Our audit approach (continued)

The scope of our audit and our areas of focus (continued)

Area of focus	*How our audit addressed the area of focus*
Pension assumptions (continued) The net asset recognised has been restricted by £6.9 million (2014: £3.5 million) to the amount that can be recovered through reduced contributions in the future. The valuation of the net pension asset requires significant levels of judgement and technical expertise in choosing appropriate assumptions. Changes in a number of key assumptions (including salaries increase, inflation, discount rates, expected rates of return on plan assets and mortality rates) can have a material impact on the calculation of the net asset.	We agreed the discount and inflation rates, together with the expected rates of return on plan assets used in the valuation by the external actuary to our internally developed benchmarks. We confirmed that these were within our expected ranges. We compared the assumptions on the current base rate of mortality to the scheme specific analysis that was prepared in the prior year by associates of the actuary who are experts in the field of longevity. The allowance for future improvements in longevity was consistent with our internally developed benchmarks. We agreed the salaries increase to be within our expected range based on the Consumer Price Index ('CPI') and Retail Price Index ('RPI').

How we tailored the audit scope

We tailored the scope and approach 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 geographic structure of the company, the nature of the IT systems, the accounting processes and controls, and the industry in which the company operates.

Following unification on 27 July 2012 of Veolia Water Central Limited, Veolia Water East Limited and Veolia Water Southeast Limited, the operations of the three businesses were transferred to one operating system within a single legal entity, Affinity Water Limited. There are certain accounting records where these three divisions (Central, East and Southeast) remain but the company operates as a single division and has a central finance function, with a single general ledger system, and all audit work was carried out by one team.

In establishing the overall approach to our audit, we assessed the risk of material misstatement, taking into account the nature, likelihood and potential magnitude of any misstatement. Following this assessment, we applied professional judgement to determine the extent of testing required over each balance in the financial statements.

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 and to evaluate the effect of misstatements, both individually and 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	£4.2 million (2014: £4.2 million).
How we determined it	2.5% of earnings before interest, tax, depreciation and amortisation ('EBITDA').
Rationale for benchmark applied	Consistent with last year, we used EBITDA as this is the measure that management focus on internally in their reporting, due to the capital-intensive nature of the business. EBITDA also provides us with a consistent year-on-year basis for our audit.

Materiality (continued)

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £0.2 million (2014: £0.2 million) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Other required reporting

Consistency of other information

Companies Act 2006 opinion

In our opinion, the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements

ISAs (UK & Ireland) reporting

The directors have chosen voluntarily to comply with the UK Corporate Governance Code ("the Code") as if the company were a premium listed company. Under ISAs (UK & Ireland) we are required to report to you if, in our opinion:

• information in the Annual Report and Financial Statements (the "Annual Report") is: - materially inconsistent with the information in the audited financial statements; or - apparently materially incorrect based on, or materially inconsistent with, our knowledge of the company acquired in the course of performing our audit; or - otherwise misleading.	We have no exceptions to report arising from this responsibility
• the statement given by the directors on **page 40**, in accordance with provision C.1.1 of the Code, that they consider the Annual Report taken as a whole to be fair, balanced and understandable and provides the information necessary for members to assess the company's performance, business model and strategy is materially inconsistent with our knowledge of the company acquired in the course of performing our audit	We have no exceptions to report arising from this responsibility
• the section of the Annual Report on **pages 49 to 51**, as required by provision C.3.8 of the Code, describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.	We have no exceptions to report arising from this responsibility

Adequacy of accounting records and information and explanations received

Under the Companies Act 2006 we are required to report to you if, in our opinion:
- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Directors' remuneration

Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

Independent auditor's report to the member of Affinity Water Limited *(continued)*

Responsibilities for the financial statements and the audit

Our responsibilities and those of the directors

As explained more fully in the Statement of Directors' Responsibilities set out on **pages 63 to 64**, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and ISAs (UK & Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's members as a body 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.

What an audit of financial statements involves

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the directors; and
- the overall presentation of the financial statements.

We primarily focus our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Charles Joseland (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Cambridge
23 June 2015

STATUTORY FINANCIAL STATEMENTS CONTINUED

PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 31 MARCH 2015

(Registered Number 02546950)

	Note	2015 £000	2014 £000
Turnover	**2**	**291,441**	291,381
Cost of sales		**(162,775)**	(177,686)
Gross profit		**128,666**	113,695
Administrative expenses		**(45,568)**	(39,158)
Other operating income	3	**10,220**	9,880
Operating profit		**93,318**	84,417
(Loss)/profit on disposal of tangible fixed assets		**(24)**	1,480
Profit on ordinary activities before interest and taxation		**93,294**	85,897
Interest receivable and similar income	6	**167**	345
Interest payable and similar charges	7	**(38,743)**	(41,191)
Other finance income	8	**2,907**	654
Profit on ordinary activities before taxation		**57,625**	45,705
Tax on profit on ordinary activities	9	**(24,771)**	(1,293)
Profit on ordinary activities after taxation and for the financial year	**20**	**32,854**	44,412

All profits of the company in the current and prior years are from continuing operations.

The notes on **pages 78 to 108** form part of these financial statements.

STATUTORY FINANCIAL STATEMENTS CONTINUED

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES FOR THE YEAR ENDED 31 MARCH 2015

(Registered Number 02546950)

	Note	2015 £000	2014 £000
Profit for the financial year	**20**	**32,854**	44,412
Actuarial gain recognised in the pension scheme	**20**	**22,499**	14,785
Deferred tax movement relating to actuarial gain	**20**	**(4,500)**	(2,781)
Total recognised gains for the financial year	**21**	**50,853**	56,416

The notes on **pages 78 to 108** form part of these financial statements.

STATUTORY FINANCIAL STATEMENTS CONTINUED

NOTE OF HISTORICAL COST PROFITS AND LOSSES FOR THE YEAR ENDED 31 MARCH 2015

(Registered Number 02546950)

	2015 £000	2014 £000
Reported profit on ordinary activities before taxation	**57,625**	45,705
Adjustment to realisation of property revaluation gains of previous years	-	(896)
Historical cost profit on ordinary activities before taxation	**57,625**	44,809
Historical cost profit for the year retained after taxation	**32,854**	43,516

The notes on **pages 78 to 108** form part of these financial statements.

STATUTORY FINANCIAL STATEMENTS CONTINUED

BALANCE SHEET
AS AT 31 MARCH 2015

(Registered Number 02546950)

	Note	2015 £000	2014 £000
Fixed assets			
Intangible assets	11	14,509	14,961
Tangible assets	12	1,242,807	1,211,963
Investments	13	60	61
		1,257,376	1,226,985
Current assets			
Stocks	14	1,262	1,412
Debtors	15	80,573	81,204
Cash at bank and in hand		58,928	16,826
		140,763	99,442
Creditors – amounts falling due within one year	16	(136,245)	(132,585)
Net current assets/(liabilities)		4,518	(33,143)
Total assets less current liabilities		1,261,894	1,193,842
Creditors – amounts falling due after more than one year	17	(857,701)	(795,230)
Provisions for liabilities	18	(62,356)	(48,784)
Net assets excluding pension asset		341,837	349,828
Net pension asset	24	30,533	2,489
Net assets		372,370	352,317
Capital and reserves			
Called up share capital	19	26,506	26,506
Share premium account	20	1,400	1,400
Capital contribution reserve	20	30,150	30,150
Revaluation reserve	20	208,889	208,889
Profit and loss account	20	105,425	85,372
Total shareholder's funds	21	372,370	352,317

The notes on **pages 78 to 108** form part of these financial statements. The statutory financial statements on **pages 65 to 108** were approved by the Board of directors and were signed and authorised for issue on 23 June 2015 on its behalf by:

Dr Philip Nolan
Chairman

Duncan Bates
Chief Financial Officer

STATUTORY FINANCIAL STATEMENTS CONTINUED

CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 MARCH 2015

(Registered Number 02546950)

	Note	2015 £000	2014 £000
Net cash inflow from operating activities	(a)	**171,160**	156,192
Returns on investments and servicing of finance			
Interest received		**167**	345
Interest paid		**(34,347)**	(34,570)
Net cash outflow from returns on investments and servicing of finance		**(34,180)**	(34,225)
Taxation			
UK corporation tax paid		**(1,817)**	(2,083)
Group relief paid		**(4,700)**	(4,972)
Net cash outflow from taxation		**(6,517)**	(7,055)
Capital expenditure and financial investment			
Purchase of tangible fixed assets		**(112,760)**	(117,101)
Capital contributions		**11,690**	7,969
Proceeds on disposal of tangible fixed assets		**58**	1,743
Net cash outflow from capital expenditure and financial investment		**(101,012)**	(107,389)
Equity dividends		**(30,800)**	(45,842)
Net cash outflow before management of liquid resources and financing		**(1,349)**	(38,319)
Management of liquid resources			
Increase in short-term deposits	(b)	**(15,000)**	-
Net cash outflow from management of liquid resources		**(15,000)**	-
Financing			
Financing of assets used by the company and operated by other parties		**2,084**	2,167
(Repayment)/drawdown of short-term credit facilities		**(17,200)**	17,200
Repurchase of debentures		**(1)**	(1)
Loan from subsidiary		**58,568**	-
Net cash inflow from financing		**43,451**	19,366
Increase/(decrease) in cash	(c),(d)	**27,102**	(18,953)

The notes on **pages 78 to 108** form part of these financial statements.

STATUTORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE CASH FLOW STATEMENT FOR THE YEAR ENDED 31 MARCH 2015

(a) Reconciliation of operating profit to net cash inflow from operating activities

	2015 £000	2014 £000
Operating profit	**93,318**	84,417
Depreciation of tangible fixed assets	**75,199**	80,874
Amortisation of goodwill	**452**	462
Amortisation of deferred credit	**(248)**	(297)
Decrease in stocks	**150**	164
Increase in debtors	**(3,835)**	(3,495)
Decrease in provisions	**(1,078)**	(392)
Increase/(decrease) in creditors	**11,268**	(995)
Pension contributions in excess of operating charge	**(4,066)**	(4,546)
Net cash inflow from operating activities	**171,160**	156,192

(b) Management of liquid resources

This comprises movement in short-term deposits which have maturity dates up to one year.

(c) Reconciliation of cash flow to movement in net debt

	2015 £000	2014 £000
Increase/(decrease) in cash in the year	**27,102**	(18,953)
Cash inflow from increase in liquid resources, debt and finance leasing	**(28,451)**	(19,366)
Non cash inflow from increase in debt and finance leasing	**(2,264)**	(7,167)
Movement in net debt in the year	**(3,613)**	(45,486)
Net debt at the beginning of the year	**(793,335)**	(747,849)
Net debt at the end of the year	**(796,948)**	(793,335)

(d) Analysis of net debt

	At 1 April 2014 £000	Cash flow £000	Non cash flow £000	At 31 March 2015 £000
Cash	16,826	27,102	-	43,928
Amounts placed in short-term deposits	-	15,000	-	15,000
Loans from subsidiary financed by bond issue	(769,975)	(58,568)	(2,948)	(831,492)
Loan from intermediate parent company	(3,550)	-	-	(3,550)
Debentures	(35)	1	-	(34)
External short-term credit facilities	(17,200)	17,200	-	-
Financing of assets used by the company and operated by other parties	(19,401)	(2,084)	684	(20,801)
Net debt	**(793,335)**	**(1,349)**	**(2,264)**	**(796,948)**

The notes on **pages 78 to 108** form part of these financial statements.

STATUTORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2015

1. Statement of accounting policies

Basis of preparation

These financial statements have been prepared on the going concern basis as stated in the directors' report on **page 63**, under the historical cost convention, as modified by the revaluation of certain tangible fixed assets described below, and in accordance with the Large and Medium-sized Companies and Groups Regulations 2008 (SI 2008/410), which form part of the Companies Act 2006, and applicable UK accounting standards, except for the treatment of certain grants and contributions, described below, and non-amortisation of the goodwill relating to the acquisition of North Surrey Water Limited.

The financial statements of Affinity Water Limited and its wholly owned subsidiaries, Affinity Water Finance (2004) PLC and Affinity Water Programme Finance Limited, are not presented in consolidated format as Affinity Water Limited is itself a majority owned subsidiary of Affinity Water Acquisitions (Investments) Limited, a company incorporated in the United Kingdom which is the parent undertaking of the smallest and largest group to prepare consolidated financial statements. The company has not prepared group financial statements as allowed under Section 400 of the Companies Act 2006.

The principal accounting policies have been applied consistently throughout the current and prior year.

Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual outcomes could differ from those estimates.

Revenue recognition

Revenue is recognised in accordance with Financial Reporting Standard 5: 'Reporting the substance of transactions' in the period in which it is earned. The company does not recognise revenue where payment is received in advance. In accordance with Application Note G of Financial Reporting Standard 5: 'Reporting the substance of transactions', the company does not recognise revenue where historic evidence indicates that the company will probably never be able to collect the revenue billed.

Charges billed to customers for water services are recognised in the period in which they are earned. An accrual is estimated for unmeasured consumption that has not yet been billed. The accrual is estimated using a defined methodology based upon weighted average water consumption by tariff, which is calculated based upon historical information.

Where an invoice has been raised and payment made but the service has not been provided in the year this will be treated as a payment in advance. The value of such invoices raised will not be recognised within the current year's turnover but will instead be recognised within creditors as deferred income.

Other operating income

Other operating income includes all income derived from sources associated with the ordinary activities of the business other than turnover, which is derived from the regulatory activities of the business. It is stated net of value added taxes.

STATUTORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2015 (CONTINUED)

1. Statement of accounting policies (continued)

Bad debt provisioning

At each reporting date, the company evaluates the collectability of debtors and records provisions for bad and doubtful debts based on experience. The bad debt provision is calculated by applying a range of different percentages to debtors of different ages.
These percentages also vary between categories of debt. Higher percentages are applied to those categories of debt which are considered to be of greater risk and also to debtors of greater age.
The value of the bad debt provision is sensitive to the specific percentages applied.

Financial instruments

Income and expenditure arising on financial instruments are recognised on an accruals basis and credited or charged to the profit and loss in the financial period in which they arise.

Issue costs on capital instruments are allocated to accounting periods over the term of the instrument as a consistent proportion of the outstanding amount in accordance with the requirements of Financial Reporting Standard 4: 'Capital instruments'.

Research and development

The costs of research and development are written off in the year in which they are incurred.

Current taxation

Current taxation is corporation tax in the United Kingdom based on the taxable profit for the period and is provided at amounts expected to be paid or recovered using tax rates and laws that have been enacted or substantively enacted at the balance sheet date.

Taxable profit differs from the net profit as reported in the profit and loss account as it excludes items of income or expenditure that are taxable or deductible in other years as well as items that will never be taxable or deductible.

Deferred taxation

Deferred tax is provided, except as noted below, on timing differences that have arisen but not reversed by the balance sheet date, where the timing differences result in an obligation to pay more tax, or a right to pay less tax, in the future. Timing differences arise because of differences between the treatment of certain items for accounting and taxation purposes. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered.

In accordance with Financial Reporting Standard 19: 'Deferred tax', deferred tax is not provided on timing differences arising from:

a. revaluation gains on land and buildings, unless there is a binding agreement to sell such assets at the balance sheet date and it is unlikely that any gain will be rolled over;

b. gains on the sale of non-monetary assets, where on the basis of all available evidence it is more likely than not that the taxable gain will be rolled over into replacement assets; and

c. fair value adjustment gains to fixed assets and stock when an acquisition is made.

Deferred tax is measured at the tax rates that are expected to apply in the periods when the timing differences are expected to reverse, based on tax rates and legislation enacted or substantively enacted at the balance sheet date.

STATUTORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2015 (CONTINUED)

Deferred taxation (continued)

Where legislation or accounting standards require gains and losses to be recognised in the statement of total recognised gains and losses, the related taxation is also taken directly to the statement of total recognised gains and losses in due course.

The company has adopted a policy of discounting deferred tax assets and liabilities to reflect the time value of money. Deferred tax assets and liabilities are discounted using a discount rate equivalent to the post tax yield that could be obtained at the balance sheet date on government bonds with similar maturity dates and currencies. The increase or decrease in the discount deducted in arriving at the deferred tax balance is included in the deferred tax charge or credit in the profit and loss account.

Pension costs

The company operates a pension plan providing defined benefits based on final pensionable salary. The plan, which had separate Central, East and Southeast divisions until 31 March 2015 when the Shared Services division was transferred to the company and consolidated with these divisions into one final salary section, closed to new members in April 1996 and September 2004. The assets of the plan are held separately from those of the company.

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 in profit or loss on a straight-line basis over the vesting period or immediately if the benefits have vested. When a settlement or a curtailment occurs, the change 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 profit and loss account. 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 interest element of the defined benefit cost represents the change in present value of plan obligations resulting from the passage of time, and is determined by applying the discount rate to the opening present value of the defined benefit obligation, taking into account material changes in the obligation during the year. The expected return on plan assets is based on an assessment made at the beginning of the year of long-term market returns on plan assets, adjusted for the effect on the fair value of plan assets of contributions received and benefits paid during the year. The difference between the expected return on plan assets and the interest cost is recognised in the profit and loss account as other finance income or expense. Actuarial gains and losses are recognised in full in the statement of total recognised gains and losses in the period in which they occur.

The defined benefit pension asset or liability in the balance sheet comprises the present value of the defined benefit obligation (using a discount rate based on high quality corporate bonds that have been rated at AA or equivalent status), 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. The value of a net defined benefit pension asset is limited to the amount that may be recovered either through reduced contributions or agreed refunds from the plan.

Contributions to the defined contribution section of the plan are recognised in the profit and loss account in the period in which they become payable.

The company also has an unfunded 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.

STATUTORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2015 (CONTINUED)

1. Statement of accounting policies (continued)

Cash deposits

Cash deposits with a maturity of greater than one day but less than twelve months are classified as cash at bank and in hand within the balance sheet but are classified within liquid resources for the purposes of the cash flow statement.

Goodwill and amortisation

Goodwill arising on acquisitions since 1 January 1998 is capitalised, classified as an asset on the balance sheet and amortised on a straight line basis over its useful economic life up to a maximum of 20 years. It is reviewed for impairment at the end of the first full financial year following the acquisition and in other periods if events or changes in circumstances indicate that the carrying value may not be recoverable.

Goodwill relating to the acquisition of the trade and assets of North Surrey Water Limited in the year ended 31 March 2001 amounting to £6,678,000 has been capitalised. The directors consider that this goodwill has an indefinite life and accordingly it is not amortised but is subject to annual review for impairment. This is not in accordance with the Large and Medium-sized Companies and Groups Regulations 2008 (SI 2008/410) which form part of the Companies Act 2006, and which require that all goodwill be amortised. The directors consider that this would not give a true and fair view of the profit for the year and that the economic measure of performance in any period is properly made by reference only to any impairment that may have arisen. The effect on the financial statements of this departure amounts to £334,000 per annum over 20 years. Any impairment charge is included within operating profit.

Tangible fixed assets and depreciation

Financial Reporting Standard 15: 'Tangible fixed assets' requires fixed assets which are carried at revalued amounts to be shown at their current value at the balance sheet date. To achieve this, all tangible fixed assets are subject to a full valuation every five years with an interim valuation carried out in the third year of this cycle.

Tangible fixed assets comprise:

- Infrastructure assets – mains and associated underground pipe-work.
- Other assets – land and buildings, operational structures, fixed plant, vehicles and mobile plant.

Infrastructure assets (being mains and associated underground pipe-work) comprise a network of systems. Expenditure on infrastructure assets relating to increases in capacity or enhancements of the network and on maintaining the operating capability of the network in accordance with defined standards of service is treated as an addition and recorded at cost after deducting grants and contributions.

The depreciation charge for infrastructure assets is the estimated level of annual expenditure required to maintain the operating capability of the network which is based on the company's independently certified asset management plan. The disposal value of infrastructure assets is based on the estimated lives of the assets at the point of replacement.

Cost for other tangible fixed assets includes own work capitalised comprising the direct costs of materials, labour and applicable overheads. Interest costs are not capitalised.

Depreciation is provided on all other tangible fixed assets except freehold land and is calculated to write off their cost over their estimated useful lives on a straight-line basis. Assets acquired under finance leases are depreciated over the shorter of their useful life or the lease term. The performance of assets is continually monitored and where impairment is identified, fixed assets are written down to their recoverable amount. Tangible fixed assets are reviewed for impairment at the end of each reporting period when the estimated remaining useful economic life of the assets exceeds 50 years.

STATUTORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2015 (CONTINUED)

1. Statement of accounting policies (continued)

Tangible fixed assets and depreciation (continued)

The estimated useful lives of these assets are:

Buildings		40–60 years
Operational structures		5–80 years
Fixed plant	**Short life**	3–10 years
	Other	10–30 years
Vehicles and mobile plant		3–10 years

Land and assets in the course of construction are not depreciated.

Any revaluation surplus is credited to the revaluation reserve in equity except to the extent that it reverses a decrease in the carrying value of the same asset previously recognised in profit or loss, in which case the increase is recognised in profit or loss. A revaluation deficit is recognised in profit or loss, except to the extent of any existing surplus in respect of that asset in the revaluation reserve.

Capital contributions

Infrastructure charges received in respect of connections to the mains network are allocated to fixed assets, surface and infrastructure, in accordance with the basis on which the charges are calculated.

Grants and contributions receivable relating to infrastructure assets are deducted from the cost of tangible fixed assets. This is not in accordance with the Large and Medium-sized Companies and Groups Regulations 2008 (SI 2008/410) which form part of the Companies Act 2006, and which require tangible fixed assets to be shown at cost, and hence grants and contributions to be accounted for as deferred income. This departure from the requirements of the Companies Act 2006 is, in the opinion of the directors, necessary for the financial statements to show a true and fair view as, while a provision is made for depreciation of infrastructure assets, these assets have indefinite economic lives and therefore no basis exists on which to recognise grants and contributions in the profit and loss account. The effect of this treatment on the book value of tangible fixed assets is disclosed in **note 12**.

Capital contributions received in respect of tangible fixed assets, other than infrastructure assets, are deferred and credited to the profit and loss account by instalments over the expected useful lives of the related assets.

Leased assets

Assets financed by leases are included in tangible fixed assets and the net obligation to pay future rentals is included within creditors. Instalments are apportioned between the finance element, which is charged to the profit and loss account as interest, and the capital element, which reduces the outstanding obligation for future instalments.

Rentals paid under an operating lease are charged against profits on a straight-line basis over the life of the lease.

Assets held under finance leases, which are leases where substantially all the risks and rewards of ownership of the asset are passed to the company, and hire purchase contracts are capitalised in the balance sheet and are depreciated over the shorter of the lease term and the assets' useful lives. The capital elements of future obligations under leases and hire purchase contracts are included as liabilities in the balance sheet. The interest elements of the rental obligations are charged in the profit and loss account over the periods of the leases and hire purchase contracts and represent a constant proportion of the balance of capital repayments outstanding.

STATUTORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2015 (CONTINUED)

1. Statement of accounting policies (continued)

Fixed asset investments

Fixed asset investments are stated at cost less any provisions in respect of permanent diminution in value.

Grafham reservoir

Under the Great Ouse Water Act of 1961, Affinity Water Limited has an entitlement to water from the Grafham reservoir which is owned and operated by Anglian Water Services Limited ('Anglian Water').

Affinity Water Limited includes within its fixed assets (and RCV) a proportion of the original cost of the reservoir and annual increments related to capital expenditure made by Anglian Water on the reservoir. The other accounting entry is an obligation of around £20,801,000 relating to the original embedded debt of Anglian Water as incremented by subsequent asset additions.

This obligation is treated as a quasi-finance lease within these financial statements under the category of 'financing of assets operated by third parties' (see notes **16, 17** and **23**).

The method utilised for allocating the costs between the company and Anglian Water as required by the legislation results in an interest charge and capital repayment on this quasi-finance lease. The maturity period of the quasi-finance lease is currently assessed as being 28 years, assuming no further capital expenditure on the reservoir by Anglian Water. In practice, both the value of the lease obligation and the maturity period have remained broadly constant for a number of years as the capital repayments made have been similar to the company's proportion of the incremental expenditure by Anglian Water on the reservoir.

Ardleigh reservoir

The company and Anglian Water own the Ardleigh reservoir and ancillary works jointly in approximately equal shares, the company's share of the capital expenditure being included in tangible fixed assets (**see note 12**). The reservoir is operated on behalf of both undertakings through the Ardleigh Reservoir Committee, and the company's share of the expense incurred is included within abstraction licences and bulk purchase within cost of sales in the profit and loss account.

Stocks and work in progress

Stocks 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. Work in progress for chargeable services is valued at cost.

Loans

All loans held with the company's subsidiaries 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 profit and loss account is allocated to accounting periods over the term of the debt using the effective interest method.

Provision for liabilities

A provision is recognised when the company has a legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation.

STATUTORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2015 (CONTINUED)

2. Turnover

Turnover represents income from the supply of water and other chargeable services exclusive of VAT arising wholly within the United Kingdom.

	2015 £000	2014 £000
Unmeasured supplies	**129,975**	130,731
Measured supplies	**161,182**	160,377
Chargeable services	**284**	273
	291,441	291,381

3. Other operating income

	2015 £000	2014 £000
Commission and rentals	**10,220**	9,880

STATUTORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2015 (CONTINUED)

4. Operating profit

		2015 £000	2014 £000
Operating profit is stated after charging/(crediting):			
Purchase of bulk water and water supplied under statutory entitlement		**2,197**	1,681
Water abstraction		**4,546**	6,413
Business rates		**17,081**	16,497
Chargeable services direct expenditure		**617**	1,111
Credit notes received from the Environment Agency in respect of Environmental Impact Unit Charges ('EIUC') levied in 2013/14		**(1,700)**	-
Reimbursement of EIUC levied from 2008/09 to 2012/13		**(3,840)**	-
Depreciation of infrastructure assets		**36,092**	47,309
Depreciation of tangible fixed assets - owned		**38,934**	32,969
Depreciation of tangible fixed assets - leased		**173**	596
Research and development		**162**	212
Hire of equipment not under operating lease		**550**	538
Operating lease rentals - land and buildings		**1,547**	1,547
Operating lease rentals - other		**2,196**	1,837
Amortisation of deferred credit		**(248)**	(297)
Amortisation of goodwill		**452**	462
Pension scheme set up costs		**-**	170
Auditor's remuneration (see below)		**431**	436
Auditor's remuneration			
Fees payable to the company's auditor and its associates for the audit of the financial statements		**147**	125
Fees payable to the company's auditor and its associates for other services			
Audit of the company's associates		**66**	65
Audit-related assurance services	- regulatory reporting	**40**	188
	- Thames Water and Anglian Water annual returns	**8**	8
	- audit related assurance service - other	**22**	-
Other assurance services		**28**	23
All other non-audit services		**120**	27
		431	436

During the year, additional assurance services were commissioned from PwC with respect to the financial information included within a debt prospectus.

The above items are included within cost of sales and administrative expenses in the profit and loss account.

5. Employees and directors

	2015 £000	2014 £000
Staff costs (including executive and non-executive directors) consist of:		
Wages and salaries	**35,936**	33,592
Social security costs	**3,346**	2,824
Defined benefit pension costs (**note 24**)	**3,907**	4,295
Defined contribution pension costs	**974**	722
Other pension administration costs	**703**	544
	44,866	41,977

The monthly average number of employees (including executive and non-executive directors) during the year was as follows:

	2015	2014
Operations	**541**	524
Customer service	**315**	301
Administration	**100**	82
	956	907

Directors' emoluments

	Base salary/ fees £000	Taxable benefits[1] £000	Bonus £000	Other bonus award[2] £000	Other[3] £000	Aggregate emoluments £000		Pension related benefits[4] £000	Total remuneration £000	
	2014/15	2014/15	2014/15	2014/15	2014/15	2014/15	2013/14	2014/15	2014/15	2013/14
Non-executive										
Current										
Patrick O'D Bourke	**47**	-	-	-	-	**47**	28	-	**47**	28
Baroness Peta Buscombe	**44**	-	-	-	-	**44**	38	-	**44**	38
Jeffrey Herbert	**44**	-	-	-	-	**44**	38	-	**44**	38
Chris Bolt	**4**	-	-	-	-	**4**	-	-	**4**	-
Former										
Fiona Woolf CBE	-	-	-	-	-	-	26	-	-	26
Executive										
Current										
Duncan Bates	**168**	**15**	**104**	-	-	**287**	353	**4**	**291**	356
Dr Philip Nolan	**200**	-	-	**176**	-	**376**	512	-	**376**	512
Former										
Richard Bienfait	**180**	**66**	-	-	**509**	**755**	479	-	**755**	491
	687	**81**	**104**	**176**	**509**	**1,557**	1,474	**4**	**1,561**	1,489

[1] Taxable benefits comprise company car allowance and healthcare insurance. Taxable benefits for Richard Bienfait further include an allowance that commenced on 1 March 2014 of £59,000 (2014: £7,000) in lieu of being a member of the company's retirement benefit schemes.

[2] Includes the Chairman's bonus award. 2013/14 emoluments and remuneration presented in the above table have been restated to reflect the bonus paid in the current year relating to 2013/14. This amount was excluded from the 2013/14 financial statements, as the particulars of the bonus arrangement were approved by the Remuneration Committee after the approval of the annual report and financial statements for the year ended 31 March 2014.

[3] Other emoluments relate to discretionary payments paid to Richard Bienfait in connection with termination of qualifying services during the year. The amount includes a termination payment of £344,000, a bonus of £120,000 linked to company and personal performance during 2014/15 and the reimbursement of legal and outplacement costs of £45,000.

[4] Included in pension related benefits is £4,000 (2014: £15,000) relating to contributions paid to money purchase pension schemes; there were no amounts outstanding at the year end.

STATUTORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2015 (CONTINUED)

5. Employees and directors (continued)

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 who sit on the Board and have been appointed by Infracapital Partners II, North Haven Infrastructure Partners LP (formerly Morgan Stanley Infrastructure Partners) and Veolia Water UK Limited do not receive any emoluments from the company, or any company within the Affinity Water group.

Highest paid director

Aggregate emoluments for the highest paid director were £755,000 (2014: £479,000). The highest paid director did not have any amounts accruing under the defined benefit pension scheme at 31 March 2015 (2014: £54,000) and the company did not make any contributions to a pension scheme in respect of the highest paid director's qualifying services during the year (2014: £9,000). The highest paid director did not hold any share options during the year and did not have any benefits accruing under any long term incentive schemes.

6. Interest receivable and similar income

	2015 £000	2014 £000
Bank interest	**167**	345

7. Interest payable and similar charges

	2015 £000	2014 £000
Interest payable to intermediate parent company	**160**	160
Financing costs of assets used by the company and operated by other parties	**942**	1,088
Debenture interest	**1**	2
Interest payable to subsidiaries	**33,794**	31,944
Accretion payable in respect of interest on index-linked loans from subsidiaries	**2,792**	6,780
Other interest payable	**1,054**	1,217
	38,743	41,191

8. Other finance income

	2015 £000	2014 £000
Expected return on pension scheme assets	**16,207**	14,798
Interest on pension scheme liabilities	**(13,300)**	(14,144)
	2,907	654

STATUTORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2015 (CONTINUED)

9. Tax on profit on ordinary activities

	2015 £000	2014 £000
Current taxation		
Current tax on profit for the year	**9,097**	6,595
Adjustment in respect of prior years	**(372)**	(1,080)
Current taxation	**8,725**	5,515
Deferred taxation		
Origination and reversal of timing differences – current year	**5,257**	6,357
Adjustment in respect of prior years	**354**	1,190
Decrease in discounting	**10,435**	1,309
Impact of change in tax rate	**-**	(13,078)
Deferred tax charge/(credit) for the year	**16,046**	(4,222)
Tax on profit on ordinary activities	**24,771**	1,293

The current tax assessed for the year is lower (2014: lower) than the standard rate of corporation tax in the UK in 2014/15 (21%). The differences are explained below:

	2015 £000	2014 £000
Current taxation reconciliation		
Profit on ordinary activities before taxation	**57,625**	45,705
Theoretical tax at UK corporation tax rate of 21% (2014: 23%)	**12,101**	10,512
Effects of:		
Adjustment to tax in respect of prior years	**(372)**	(1,080)
Permanent differences	**724**	552
Accelerated capital allowances	**(2,816)**	(3,428)
Developer contributions	**1,099**	1,141
Other timing differences	**(2,011)**	(2,182)
Actual current taxation charge	**8,725**	5,515

Tax on recognised gains and losses not included in the profit and loss account (**see note 20**):

	2015 £000	2014 £000
Other deferred tax charge relating to pension scheme	**4,500**	2,781

Factors that may affect future tax charges

A change in the main corporation tax rate in the United Kingdom from 21% to 20% with effect from 1 April 2015 was substantively enacted on 2 July 2013. This change was recognised in the deferred tax balance at 31 March 2014.

STATUTORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2015 (CONTINUED)

10. Dividends on equity shares

	2015 £000	2014 £000
Ordinary:		
Paid: First interim of 4.26p per share (2014: 12.37p)	**11,300**	32,792
Paid: Second interim of 2.45p per share (2014: 1.75p)	**6,500**	4,650
Paid: Third interim of 2.64p per share (2014: 3.17p)	**7,000**	8,400
Paid: Fourth interim of 2.26p per share (2014: no fourth interim)	**6,000**	-
	30,800	45,842

11. Intangible assets

	Goodwill £000
Cost at 1 April 2014 and 31 March 2015	**15,720**
Accumulated amortisation	
At 1 April 2014	759
Charge for the year	452
At 31 March 2015	**1,211**
Net Book Value at 31 March 2015	**14,509**
Net Book Value at 31 March 2014	**14,961**

Goodwill includes £7,831,000 relating to the unification of the regulated businesses on 27 July 2012. The directors consider that this goodwill has a life of 20 years and it has been amortised accordingly. In estimating the useful economic life of goodwill, account has been taken of the nature of the unified business and the stability of the industry. The remaining balance relates to the unamortised goodwill arising from the acquisition of the trade and assets of North Surrey Water Limited.

STATUTORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2015 (CONTINUED)

12. Tangible assets

	Land, buildings and operational structures £000	Mains and other infrastructure assets £000	Fixed plant £000	Vehicles and mobile plant £000	Assets in the course of construction £000	Total £000
Cost or valuation						
At 1 April 2014	279,541	1,207,127	571,831	58,033	107,051	2,223,583
Additions at cost	576	40,865	4,200	990	67,872	114,503
Transfers completed	3,901	5,471	34,214	7,795	(51,381)	-
Capital contributions	-	(8,378)	-	-	-	(8,378)
Disposals	(82)	-	-	(21,913)	-	(21,995)
At 31 March 2015	**283,936**	**1,245,085**	**610,245**	**44,905**	**123,542**	**2,307,713**
Accumulated depreciation						
At 1 April 2014	71,759	522,937	370,613	46,311	-	1,011,620
Charge for the year	4,890	36,092	27,764	6,453	-	75,199
Disposals	-	-	-	(21,913)	-	(21,913)
At 31 March 2015	**76,649**	**559,029**	**398,377**	**30,851**	**-**	**1,064,906**
Net book value At 31 March 2015	**207,287**	**686,056**	**211,868**	**14,054**	**123,542**	**1,242,807**
At 31 March 2014	**207,782**	**684,190**	**201,218**	**11,722**	**107,051**	**1,211,963**

Finance leases have been arranged for assets included above at 31 March 2015 and 31 March 2014 as follows:

	Land, buildings and operational structures £000	Mains and other infrastructure assets £000	Fixed plant £000	Vehicles and mobile plant £000	Assets in the course of construction £000	Total £000
At 31 March 2015						
Cost	2,165	23,165	22,255	4,603	-	52,188
Accumulated depreciation	(1,778)	(11,205)	(22,255)	(4,603)	-	(39,841)
Net book value	**387**	**11,960**	**-**	**-**	**-**	**12,347**
At 31 March 2014						
Cost	8,419	23,165	63,874	4,834	-	100,292
Accumulated depreciation	(7,908)	(11,068)	(63,667)	(4,834)	-	(87,477)
Net book value	**511**	**12,097**	**207**	**-**	**-**	**12,815**

Assets with a net book value of £295,000 (cost: £48,104,000; accumulated depreciation: £47,809,000) for which finance leases had been previously arranged have been bought back by the company.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2015 (CONTINUED)

12. Tangible assets (continued)

The net book value of mains and other infrastructure assets for the company is stated after the deduction of grants and contributions received since April 1990 amounting to £190,550,000 (2014: £182,172,000) in order to give a true and fair view. All land and buildings are held as freehold.

Certain classes of the company's tangible fixed assets were professionally valued at October 2009 and March 2010 by PwC in their capacity as independent qualified valuers. These valuations were performed in accordance with Financial Reporting Standard 15: 'Tangible fixed assets' which requires that assets subject to a policy of revaluation should be carried at their current value. Current value is defined in Financial Reporting Standard 15: 'Tangible fixed assets' as the lower of replacement cost and recoverable amount. The recoverable amount is further defined as the higher of Net Realisable Value ('NRV') and Value in Use ('VIU').

Having considered the above definitions of value, PwC concluded that the most reliable valuation method to determine the current value for the tangible fixed assets of a water company in the United Kingdom was a two step approach:

- Step 1: Estimating the business VIU, using a discounted cash flow ('DCF') model to determine the business enterprise value, cross-checked against RCV, followed by:
- Step 2: Allocating the VIU of the business (less relevant working capital balances, deferred tax liabilities and other adjustments) to individual classes of tangible fixed assets.

Such valuations were incorporated into the financial statements with the resulting revaluation adjustments taken to the revaluation reserve.

A full valuation was performed by PwC on 28 June 2012 for the purposes of the sale by Veolia Water UK Limited of Affinity Water Capital Funds Limited, the ultimate parent undertaking prior to the sale, to Affinity Water Acquisitions Limited. An interim valuation was performed by PwC using a consistent basis as at 31 March 2013. Although the June 2012 valuation was not specifically performed for Financial Reporting Standard 15: 'Tangible fixed assets' purposes, the results of the valuation were not materially different to those of the valuation performed at 31 March 2013 when adjustments were made to the statutory accounting records. The revaluation surplus of £84,600,000 at 31 March 2013 was attributed to infrastructure assets and was taken to the revaluation reserve. Deferred tax has not been provided on timing differences arising from the revaluation of fixed assets as a binding commitment to sell the asset had not been entered into by the balance sheet date and it was unlikely that any gain would be rolled over.

The directors have considered whether another interim valuation is required as at 31 March 2015 and have concluded that this is not necessary as there are no indicators that imply significant market price movements and as the company will be preparing its financial statements under Financial Reporting Standard 101: 'Reduced disclosure framework' for the year ending 31 March 2016, where accounting for tangible assets is on a cost basis. As this will require the restatement of the opening balance sheet at 1 April 2014, the opening value of the infrastructure assets will be based on the valuation performed in June 2012.

If the revalued assets were stated on a historical cost basis, the historical cost before depreciation would be £1,765,400,000 (2014: £1,681,200,000). If the revalued assets were stated on a historical cost basis, the net book value would be £703,870,000 (2014: £669,580,000).

Information on the condition of assets is also provided to the Regulator every five years as part of the price review mechanism.

STATUTORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2015 (CONTINUED)

13. Investments

	2015 £000	2014 £000
Investments in subsidiaries	**60**	61

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 £2,000 for the year ended 31 March 2015 (2014: £nil).

On 11 January 2013, Affinity Water Limited incorporated Affinity Water Programme Finance Limited as a special purpose vehicle, registered in the Cayman Islands (resident for the purposes of tax in the United Kingdom). The company invested £10,000 in 100% of the £1 ordinary shares of Affinity Water Programme Finance Limited. The principal activity of Affinity Water Programme Finance Limited is to raise finance for the company. It made a profit of £4,000 in the year ended 31 March 2015 (2014: £3,000).

The directors believe that the carrying value of the investments is supported by their underlying net assets.

14. Stocks

	2015 £000	2014 £000
Raw materials and consumables	**1,262**	1,412

15. Debtors

	2015 £000	2014 £000
Trade debtors and customers' water charges	**30,719**	30,042
Accrual for unbilled metered customers	**39,876**	37,790
Amounts owed by group undertakings	**403**	3,943
Amounts owed by related parties	**309**	402
Other debtors	**3,774**	3,508
Prepayments and accrued income	**5,492**	5,519
	80,573	81,204

STATUTORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2015 (CONTINUED)

16. Creditors – amounts falling due within one year

	2015 £000	2014 £000
Short-term credit facilities	-	17,200
Financing of assets used by the company and operated by other parties (**note 23**)	**1,201**	1,005
Amounts owed to related parties	-	1,166
Amounts owed to group undertakings	**116**	-
Payments received in advance	**41,951**	32,581
Trade creditors	**14,118**	10,827
Interest payable to subsidiary companies	**12,347**	10,321
Interest payable to intermediate parent company	**80**	-
Interest payable to external parties	**159**	146
Corporation tax	**5,622**	3,414
Other taxation and social security	**1,276**	1,038
Other creditors	**12,903**	10,587
Capital accruals	**19,570**	17,826
Other accruals and deferred income	**26,902**	26,474
	136,245	132,585

17. Creditors – amounts falling due after more than one year

	2015 £000	2014 £000
Financing of assets used by the company and operated by other parties (**note 23**)	**19,600**	18,396
Deferred credit – contributions to surface assets	**3,025**	3,274
Loan from Affinity Water Finance (2004) PLC financed by bond issue	**255,411**	197,036
Loan from Affinity Water Programme Finance Limited financed by bond issue	**576,081**	572,939
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	-	1
5% irredeemable debenture stock	**24**	24
5.25% irredeemable debenture stock	**1**	1
	857,701	795,230

During the year the company repurchased £1,000 nominal irredeemable outstanding debenture stock for cancellation (2014: £1,000).

STATUTORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2015 (CONTINUED)

17. Creditors – amounts falling due after more than one year (continued)

On 13 July 2004, 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 have been lent to the company on the same terms.

On 4 February 2013, 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 index-linked Notes maturing in June 2045 with a coupon of 1.548% and £95,000,000 Class B Guaranteed RPI index-linked Notes maturing in June 2033 with a coupon of 3.249%. The net proceeds of these bond issues have been lent to the company on the same terms.

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%.

Refer to **page 48** of the ownership and financing section for a chart showing the maturity profile of the bonds.

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 Programme Finance Limited in respect of the issued bonds. This guarantee constitutes 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. These issues are also guaranteed by Affinity Water Holdings Limited, the immediate parent undertaking of Affinity Water Limited.

All loans from the company's subsidiaries 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 profit and loss account is allocated to accounting periods over the term of the debt using the effective interest method.

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.

STATUTORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2015 (CONTINUED)

18. Provisions for liabilities

	Deferred tax £000	Insurance £000	Other £000	Total £000
At 1 April 2014	(44,958)	(1,609)	(2,217)	(48,784)
Charged to the profit and loss account	(14,650)	(15)	-	(14,665)
Utilised in the year	-	-	1,093	1,093
At 31 March 2015	**(59,608)**	**(1,624)**	**(1,124)**	**(62,356)**

Deferred tax

	2015 £000	2014 £000
Accelerated capital allowances	**94,815**	91,158
Other timing differences	**(1,473)**	(2,031)
Undiscounted provision for deferred tax	**93,342**	89,127
Discount	**(33,734)**	(44,169)
Discounted provision for deferred tax	**59,608**	44,958
Deferred tax liability on pension asset (**see note 24**)	**7,633**	622
Provision at the end of the year including deferred tax on pension asset	**67,241**	45,580

Deferred tax liability relating to pension asset

	2015 £000	2014 £000
At 1 April	**(622)**	3,889
Deferred tax credit to the profit and loss account	**(1,394)**	(1,730)
Deferred tax credit to the statement of total recognised gains and losses (**see note 24**):		
- on actuarial gain	**(4,500)**	(2,457)
- change in tax rate	**-**	(324)
Transfer from group undertaking (**see note 24**)	**(1,117)**	-
At 31 March	**(7,633)**	(622)

A deferred tax liability of £7,633,000 (2014: £622,000) has been deducted in arriving at the net pension asset on the balance sheet.

Factors that may affect future tax charges

Based on current capital investment plans, the group expects to continue to claim capital allowances in excess of depreciation in future years at a similar level to the current year.

STATUTORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2015 (CONTINUED)

18. Provisions for liabilities (continued)

Insurance

Insurance represents the amount of the company's liability in respect of excesses on individual claims. This is based upon data provided by loss adjusters to insurers and is calculated on settlement experience.

Other provisions

Other provisions include £670,000 in relation to unfunded pension liabilities for a former non-executive director, which will be utilised over the 20 years from January 2019. The remaining balance relates to outstanding legal claims at 31 March 2015 anticipated to be utilised within 12 months.

19. Called up share capital

	2015 £000	2014 £000
Allotted, called up and fully paid share capital		
Ordinary shares (2015 and 2014: 265,057,824 of £0.10 each)	**26,506**	26,506

20. Reserves

	Share premium account £000	Capital contribution reserve £000	Revaluation reserve £000	Profit and loss account £000	Total £000
At 1 April 2014	1,400	30,150	208,889	85,372	325,811
Actuarial gain recognised in the pension scheme	-	-	-	22,499	22,499
Deferred tax arising thereon	-	-	-	(4,500)	(4,500)
Profit for the financial year	-	-	-	32,854	32,854
Dividends paid	-	-	-	(30,800)	(30,800)
At 31 March 2015	**1,400**	**30,150**	**208,889**	**105,425**	**345,864**

Non-returnable capital contributions totalling £30,150,000 were received from Affinity Water Capital Funds Limited, an intermediate parent of the company, in the year ended 31 March 2013.

STATUTORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2015 (CONTINUED)

21. Reconciliation of movements in shareholder's funds

	2015 £000	2014 £000
Profit for the financial year	**32,854**	44,412
Actuarial gain recognised in the pension scheme	**22,499**	14,785
Deferred tax arising thereon	**(4,500)**	(2,781)
Total gains recognised for the year	**50,853**	56,416
Dividends paid	**(30,800)**	(45,842)
Net addition to shareholder's funds	**20,053**	10,574
Opening shareholder's funds	**352,317**	341,743
Closing shareholder's funds	**372,370**	352,317

22. Capital commitments

The directors have authorised a programme of capital expenditure (including infrastructure renewals), of which the contracted element not provided for in the financial statements amounts to £13,747,000 (2014: £24,081,000).

23. Commitments under finance and operating leases

The company has no short term obligations due under finance leases.

Financing of assets operated by third parties:

	2015 £000	2014 £000
In one year or less, but on demand	**1,201**	1,005
In more than one year but not more than two years	**885**	1,078
In more than two years but not more than five years	**2,650**	1,509
In more than five years	**16,065**	15,809
Net obligations due	**20,801**	19,401

The company had annual commitments under non-cancellable operating leases as follows:

	2015		2014	
	Land and buildings £000	Other £000	Land and buildings £000	Other £000
Operating leases which expire:				
Within one year	**-**	**138**	-	85
In two to five years	**-**	**1,363**	-	1,415
After five years	**1,547**	**1**	1,547	-
	1,547	**1,502**	1,547	1,500

STATUTORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2015 (CONTINUED)

24. Pensions

Composition of the pension plan

The company operates a pension plan providing benefits based on final pensionable salary. The assets of the plan 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.

A new Affinity Water Pension Plan ('AWPP') was established in February 2013, set up as an identical scheme to the Veolia UK Pension Plan ('VUKPP'), the plan in which the company participated until 28 March 2013. The benefits of employees and former employees of the company were transferred into the AWPP with effect from 28 March 2013.

The VUKPP was a multi-employer sectionalised pension plan with defined benefits and defined contribution sections. The defined benefit section was closed to new entrants in September 2004; since then new members have only been eligible to join the defined contribution section. The sectionalised plan had separate Central, East and Southeast divisions which were replicated in the AWPP.

Each division of the VUKPP was merged with its corresponding division of the Veolia Water Supply Companies' Pension Plan ('VWSCPP') on 31 May 2011, the latter plan having been closed to new entrants in April 1996.

The assets of the plan are measured using market values. Pension plan liabilities are measured using a projected unit method and discounted at the current rate of return on a high quality corporate bond of equivalent term to the liability. Actuarial gains and losses recognised in the year have been included in the statement of total recognised gains and losses.

The latest formal valuation of the AWPP, determined by an independent qualified actuary, was at 31 March 2013. 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 less an allowance for an inflation risk premium of 0.15% per annum;
CPI inflation:	measured by reference to the RPI inflation curve described above less 0.7% per annum;
Pre-retirement discount rate:	measured by reference to the Bank of England gilt yield curves plus 2.5% per annum;
Post retirement discount rate:	measured by reference to the Bank of England gilt yield curves plus 0.5% per annum;
Salary increases:	measured by reference to the RPI inflation curve described above plus 1% 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; and
Pension increases:	measured by reference to the CPI or RPI inflation curves described above with an appropriate adjustment for any caps and collars.

The valuation as at 31 March 2013 stated the market valuations of the plan's assets to be £273,700,000 with a funding level of 88 per cent for the Central division, £20,100,000 with a funding level of 87 per cent for the East division, and £29,200,000 with a funding level of 119 per cent for the Southeast division.

On 31 March 2015, Affinity Water Shared Services Limited ceased to be a participating employer in the plan, having entered a flexible apportionment arrangement with the Trustee and the company. As a result, the Shared Services division was transferred to the company from Affinity Water Shared Services Limited and was consolidated with the Central, East and Southeast divisions into one final salary section: the Affinity Water Pension Plan Final Salary Division.

STATUTORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2015 (CONTINUED)

24. Pensions (continued)

The valuation of the Shared Services division as at 31 March 2013 stated the market valuations of the plan's assets to be £30,100,000 with a funding level of 115 per cent.

Contributions to the AWPP over the year ended 31 March 2015 were paid by members in accordance with the rules of the plan, and by the company, expressed as fixed monetary amounts according to the size of the relevant payroll and any surplus or deficit in the relevant division of the plan.

The contributions expected to be paid in the year ending 31 March 2016 are £9,174,000 (2014: £9,119,000 in the year ending 31 March 2015).

Principal assumptions

The present values of pension liabilities are estimated by discounting pension commitments, including salary growth, at AA rated corporate bond yields.

In calculating the liabilities of the plan, the following financial assumptions have been used:

	2015	2014	2013	2012
Discount rate	**3.15% pa**	4.30% pa	4.20% pa	4.95% pa
Salary growth	**2.90% pa**	3.90% pa	4.20% pa	4.70% pa
RPI	**2.90% pa**	3.30% pa	3.20% pa	3.20% pa
CPI	**1.90% pa**	2.30% pa	2.50% pa	2.50% pa
Life expectancy for a male pensioner from age 65 (years)	**22**	22	23	23
Life expectancy for a female pensioner from age 65 (years)	**25**	24	25	25
Life expectancy from age 65 (years) for a male participant currently aged 45 (years)	**24**	24	25	23
Life expectancy from age 65 (years) for a female participant currently aged 45 (years)	**27**	27	27	25

Deferred pensions are revalued to retirement age in line with the CPI assumption of 1.9 per cent per annum unless otherwise prescribed by statutory requirements or the plan rules.

The assets of the plan are held separately to those of the company, being invested by independent fund managers. Contributions to the plan are charged to the profit and loss account so as to spread the cost of pensions over the employees' working lives with the company.

The total pensions charge including the defined contribution section of the AWPP for the year ended 31 March 2015 was £4,881,000 (2014: £5,017,000). There are no amounts prepaid or outstanding in respect of the defined contribution section at 31 March 2015 (2014: £nil).

The effect of the asset limit charged to the statement of total recognised gains and losses was £3,425,000 (2014: £2,933,000). This has arisen from a change in the maximum allowable surplus relating to the net asset position of the Southeast division, and has been booked to the statement of total recognised gains and losses in the current year as the change relates solely to changes in actuarial assumptions.

STATUTORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2015 (CONTINUED)

24. Pensions (continued)

Principal assumptions (continued)

The assets of the scheme and the weighted average expected rate of return were:

	At 31 March 2015		At 31 March 2014	
	Value £000	Long term rate of return expected (% pa)	Value £000	Long term rate of return expected (% pa)
Equities	**173,244**	**5.25**	148,724	6.54
Bonds	**68,549**	**3.10**	55,512	4.30
Property	**4,037**	**5.70**	6,353	7.00
Cash and cash equivalents	**173,392**	**1.71**	109,741	3.45
Fair value of assets	**419,222**		320,330	

The expected return on scheme assets is determined by considering the expected returns available on the assets underlying the investment policy. Expected yields on fixed interest investments are based on gross redemption yields as at the balance sheet date. Expected returns on equity investments reflect long-term real rates of return experienced in the respective markets.

The actual return on scheme assets in the year was a gain of £69,320,000 (2014: £1,726,000 loss).

The amounts for the current period and the previous four periods are as follows:

Year ended - 31 March	2015	2014	2013	2012	2011
Defined benefit obligation (£m)	**(374.1)**	(313.7)	(340.2)	(256.5)	(246.6)
Plan assets (£m)	**419.2**	320.3	323.9	237.1	217.7
Effect of asset limit (£m)	**(6.9)**	(3.5)	(0.6)	-	-
Surplus/(deficit) (£m)	**38.2**	3.1	(16.9)	(19.4)	(28.9)
Difference between expected and actual return on plan assets:					
Percentage of plan assets	**13.9%**	(5.2%)	4.9%	(4.0%)	1.0%
Experience gains/(losses) on plan liabilities:					
Percentage of plan liabilities	**0.0%**	3.3%	0.0%	1.0%	0.0%

STATUTORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2015 (CONTINUED)

24. Pensions (continued)

Reconciliation of present value of scheme liabilities:

	2015 £000	2014 £000
At 1 April	**313,719**	340,194
Current service cost	**3,907**	4,295
Interest cost	**13,300**	14,144
Liabilities assumed from pension plan transfer[1]	**28,978**	760
Actuarial loss/(gain)	**27,189**	(33,363)
Benefits paid	**(13,714)**	(13,020)
Contributions by scheme participants	**745**	709
At 31 March	**374,124**	313,719

Reconciliation of fair value of scheme assets:

	2015 £000	2014 £000
At 1 April	**320,330**	323,854
Contributions paid by employer	**7,979**	9,753
Contributions by scheme participants	**745**	709
Expected return on scheme assets	**16,207**	14,798
Assets assumed from pension plan transfer[1]	**34,562**	760
Actuarial gain/(loss)	**53,113**	(16,524)
Benefits paid	**(13,714)**	(13,020)
At 31 March	**419,222**	320,330
Surplus of funded plan liabilities	**45,098**	6,611
Effect of asset limit	**(6,932)**	(3,500)
Pension asset before deferred tax	**38,166**	3,111
Related deferred tax	**(7,633)**	(622)
Net pension asset at 31 March	**30,533**	2,489

The amounts recognised in the profit and loss account are as follows:

	2015 £000	2014 £000
Current service cost	**3,907**	4,295
Expected return on scheme assets	**(16,207)**	(14,798)
Interest on pension scheme liabilities	**13,300**	14,144
Total charge	**1,000**	3,641

[1] The current year amount relates to the transfer of the Shared Services division from Affinity Water Shared Services Limited on 31 March 2015.

STATUTORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2015 (CONTINUED)

24. Pensions (continued)

Total actuarial gains and losses included in the statement of total recognised gains and losses:

	2015 £000	2014 £000
Actuarial gains/(losses) on scheme assets	**53,113**	(15,645)
Actuarial (losses)/gains on scheme liabilities	**(27,189)**	33,363
Effect of asset limit	**(3,425)**	(2,933)
Total credit	**22,499**	14,785
Deferred tax arising thereon	**(4,500)**	(2,781)
Credit after deferred tax	**17,999**	12,004

STATUTORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2015 (CONTINUED)

25. Financial instruments and risk management

The company's financial instruments comprise borrowings, debentures, cash and liquid resources, and various items, such as trade debtors and trade creditors that arise directly from operations. The main purpose of these financial instruments is to provide finance for the company's operations.

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 interest rate risk and liquidity risk. The Board reviews and agrees policies for managing each of these risks. These policies have remained unchanged during the year.

The company finances its operations through a mixture of retained profits, borrowings from its subsidiary companies, borrowings from Affinity Water Capital Funds Limited and debentures. Treasury policies are agreed in conjunction with the wider Affinity Water group (including policies relating to liquidity and interest rate risks). The company does not undertake speculative transactions. Interest rate exposure is primarily managed by using a mixture of fixed rate, floating rate and RPI-linked borrowings.

Further disclosures are included in **notes 16 and 17**.

Financial liabilities: excluding non-debt current liabilities

The company has a £3,550,000 loan from Affinity Water Capital Funds Limited, an intermediate parent of the company (2014: £3,550,000).

The interest rate profile of the company's financial liabilities, excluding non-debt current liabilities and deferred credits, was as follows:

As at	Total £000	Fixed rate financial liabilities £000	Floating rate financial liabilities £000	RPI-linked financial liabilities £000
31 March 2015	**855,877**	**604,804**	-	**251,073**
31 March 2014	810,162	544,791	17,200	248,171

Fixed rate liabilities represent loans from Affinity Water Finance (2004) PLC and Affinity Water Programme Finance Limited, irredeemable debenture stock and the financing of assets used by the company and operated by other parties. Floating rate liabilities at 31 March 2014 represent drawdowns on the company's working capital and capital expenditure short-term credit facilities. The RPI-linked liabilities represent loans from Affinity Water Programme Finance Limited.

STATUTORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2015 (CONTINUED)

25. Financial instruments and risk management (continued)

Fixed rate financial liabilities (including RPI linked)

	Weighted average interest rate (%)	Weighted average period for which rate is fixed* (Years)	Weighted average period until maturity (Years)
31 March 2015			
- Loan from subsidiaries	**4.1**	**17.9**	**17.9**
- Loan from intermediate parent	**4.5**	**21.0**	**21.0**
- Other	**6.1**	**26.9**	**26.9**
31 March 2014			
- Loan from subsidiaries	4.1	19.5	19.5
- Loan from parent	4.5	22.0	22.0
- Other	5.3	25.8	25.8

* This calculation excludes the irredeemable debenture stock where the interest rate is fixed in perpetuity (**see note 17**).

The maturity profile of the company's financial liabilities at 31 March 2015 was as follows:

	2015 £000	2014 £000
In one year or less or on demand*	**1,201**	18,205
In more than one year but not more than two years	**885**	1,078
In more than two years but not more than five years	**2,650**	1,509
In more than five years	**851,141**	789,370
	855,877	810,162

* Short-term credit facilities, loans with group undertakings and obligations under finance leases

All financial liabilities due after one year comprise financing of assets used by the company and operated by other parties, irredeemable debenture stock and amounts owed to its subsidiary companies and an intermediate parent company.

The company has various undrawn committed borrowing facilities. The undrawn facilities available at 31 March 2015 in respect of which all conditions precedent had been met were as follows:

	2015 £000	2014 £000
Expiring in one year or less	**58,000**	55,000
Expiring in more than one year but not more than two years	**-**	-
In more than five years	**100,000**	82,800
	158,000	137,800

The company has access to a borrowing facility of £100,000,000 with a tenor of five years from 28 June 2012. This facility consists of a £70,000,000 capital expenditure facility and a £30,000,000 working capital facility. As at 31 March 2015, the company had not drawn any of its facilities.

STATUTORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2015 (CONTINUED)

25. Financial instruments and risk management (continued)

The company has available a 364 day revolving Debt Service Reserve Liquidity Facility of £38,000,000. The facility is intended for the purpose of funding any debt service payments in the event of a liquidity shortfall that would otherwise prevent such payments being made.

The company also has available a 364 day revolving Operations and Maintenance Reserve Facility of £20,000,000. The facility is intended for the purpose of funding operating and capital maintenance expenditure in the event of a liquidity shortfall.

Fair values of financial liabilities

Set out below is a comparison by category of book value and fair value of the financial liabilities of the company as at 31 March 2015, with the exception of the fixed rate liability in respect of the financing of assets used by the company operated by other parties, where the fair value calculated by market interest rates of the financial instrument is not expected to be materially different from book value.

	Book value		Fair value	
	2015 £000	2014 £000	2015 £000	2014 £000
Primary financial instruments held or issued to finance the company's operations:				
Loan from subsidiaries	**831,492**	769,975	**1,006,791**	812,848
	831,492	769,975	**1,006,791**	812,848

The fair value of the bonds on-lent from the two financing subsidiaries, having a combined book value of £831,492,000, has been determined by reference to published and other information, as well as prices from the active markets on which the instruments involved are traded.

The company has taken advantage of the exemption of Financial Reporting Standard 29: 'Financial instruments: Disclosures' and has not disclosed all information required by that standard, as the consolidated financial statements of Affinity Water Acquisitions (Investments) Limited, in which the company is included, provide equivalent disclosures.

26. 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 Utilities Limited and Anglian Water Services Limited. No amounts are included in the financial statements in respect of uncollected sewerage and sewerage infrastructure charges at 31 March 2015 (2014: £nil).

STATUTORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2015 (CONTINUED)

27. Related party transactions

Purchases	Nature of relationship	In respect of	2015 Value £000	2015 Balance £000	2014 Value £000	2014 Balance £000
Affinity Water Capital Funds Limited	Intermediate parent	Interest paid on loan	**160**	**80**	160	-
Affinity Water Capital Funds Limited	Intermediate parent	Loan outstanding	**-**	**3,550**	-	3,550
Affinity Water Holdings Limited	Immediate parent	Dividends paid	**30,800**	**-**	45,842	-
Affinity Water Shared Services Limited	Group undertaking	Support services	**7,291**	**-**	8,240	-
Affinity Water Finance (2004) PLC	Subsidiary undertaking	Interest on bonds	**13,634**	**10,480**	11,908	8,402
Affinity Water Programme Finance Limited	Subsidiary undertaking	Interest on bonds	**22,956**	**1,876**	26,816	1,919
Affinity Water Trust	Trust Fund	Donations	**-**	**-**	565	-
Veolia Water UK Limited	Shareholder[1]	Management and technical support	**50**	**-**	50	1,484
Veolia Environmental Services (UK) Limited	Common ownership[2]	Waste water disposal	**254**	**-**	340	-
Other Veolia entities	Common ownership[2]	Transport and other services	**155**	**-**	6	-

The company has an outstanding loan balance of £255,411,000 (2014: £197,036,000) with Affinity Water Finance (2004) PLC and £576,081,000 (2014: £572,939,000) with Affinity Water Programme Finance Limited.

[1] Veolia Water UK Limited holds a 10% shareholding in Affinity Water Acquisitions (Holdco) Limited, an intermediate parent of the company.

[2] The ultimate parent company of these entities is Veolia Environnement S.A., the ultimate parent company of Veolia Water UK Limited which holds a 10% shareholding in an intermediate parent of the company.

STATUTORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2015 (CONTINUED)

27. Related party transactions (continued)

Sales	Nature of relationship	In respect of	2015 Value £000	2015 Balance £000	2014 Value £000	2014 Balance £000
Affinity Water Shared Services Limited	Group undertaking	Payroll services	**8,077**	**403**	9,064	3,943
Veolia Water UK Limited	Shareholder[1]	Transitional services and capability sharing agreement and other support	**178**	**17**	235	318
Other Veolia entities	Common ownership[2]	Transitional services, capability sharing agreement and laboratory services	**112**	**292**	103	402

There are no other material related party transactions which require disclosure.

28. Post balance sheet events

There were no significant post balance sheet events.

[1] Veolia Water UK Limited holds a 10% shareholding in Affinity Water Acquisitions (Holdco) Limited, an intermediate parent of the company.

[2] The ultimate parent company of these entities is Veolia Environnement S.A., the ultimate parent company of Veolia Water UK Limited which holds a 10% shareholding in an intermediate parent of the company.

STATUTORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2015 (CONTINUED)

29. 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 majority owned by Affinity Water Acquisitions (Investments) Limited, a company registered in England and Wales. Affinity Water Acquisitions (Investments) Limited is the parent undertaking of the smallest and largest group to consolidate the statutory financial statements of this company.

The directors consider that Affinity Water Acquisitions (Investments) Limited is the ultimate holding and controlling company in the United Kingdom.

Copies of the group financial statements of Affinity Water Acquisitions (Investments) Limited for the year ended 31 March 2015 may be obtained from the Company Secretary, Tamblin Way, Hatfield, Hertfordshire, AL10 9EZ.

Affinity Water Acquisitions (Investments) Limited is owned by a consortium of investors led by Infracapital Partners II, the infrastructure investment fund managed by M&G (the European Investment arm of Prudential plc.), and North Haven Infrastructure Partners LP (formerly Morgan Stanley Infrastructure Partners). Veolia Environnement S.A. holds a 10% shareholding in Affinity Water Acquisitions (Holdco) Limited, the direct subsidiary of Affinity Water Acquisitions (Investments) Limited, through its subsidiary Veolia Water UK Limited. The directors consider Infracapital Partners II and North Haven Infrastructure Partners LP (formerly Morgan Stanley Infrastructure Partners) to be the company's ultimate controllers, as they are in a position to exercise material influence over the company's policy and affairs.

Infracapital Partners II is one of a number of European infrastructure funds managed by M&G Investment Management Limited, a subsidiary of Prudential plc. It was established in 2010 to make investments in income-generative infrastructure assets and businesses, including electricity and gas networks, water companies, transport infrastructure and renewable energy.

North Haven Infrastructure Partners LP (formerly Morgan Stanley Infrastructure Partners) is a leading global infrastructure investment fund. It is managed by Morgan Stanley Infrastructure Inc., part of the investment management division of Morgan Stanley. North Haven Infrastructure Partners LP (formerly Morgan Stanley Infrastructure Partners) targets core infrastructure assets that provide essential public goods and services to societies across the globe and seeks to improve asset performance using active management.

Affinity Water

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Non-audited appendix to the financial statements

for the year ended 31 March 2015

The following appendix has been voluntarily prepared to provide information on the company's transition to Financial Reporting Standard 101: 'Reduced disclosure framework' for the year ending 31 March 2016. The information has not been subject to an audit performed in accordance with ISAs (UK & Ireland).

Affinity Water Limited

(Registered Number 02546950)

NON-AUDITED APPENDIX TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2015

Transition to Financial Reporting Standard 101: 'Reduced disclosure framework'

The company has elected to prepare its financial statements under Financial Reporting Standard 101: 'Reduced disclosure framework' for the year ending 31 March 2016. These are the last financial statements prepared under UK GAAP. Therefore the date of transition is, in effect, 1 April 2014.

Reconciliation of equity at 1 April 2014

	As previously reported £000	Effects of transition £000	Under FRS 101 £000
Fixed assets			
Intangible assets	14,961	8,799	23,760
Tangible assets	1,211,963	4,683	1,216,646
Investment	61	-	61
	1,226,985	**13,482**	**1,240,467**
Current assets			
Stocks	1,412	-	1,412
Debtors	81,204	-	81,204
Cash at bank and in hand	16,826	-	16,826
	99,442	**-**	**99,442**
Creditors – amounts falling due within one year	**(132,585)**	**(114)**	**(132,699)**
Net current liabilities	**(33,143)**	**(114)**	**(33,257)**
Total assets less current liabilities	**1,193,842**	**13,368**	**1,207,210**
Creditors – amounts falling due after more than one year	**(795,230)**	**(61,127)**	**(856,357)**
Provisions for liabilities	**(48,784)**	**(142,218)**	**(191,002)**
Net assets excluding pension asset	**349,828**	**(189,977)**	**159,851**
Net pension asset	**2,489**	**4,122**	**6,611**
Net assets	**352,317**	**(185,855)**	**166,462**
Capital and reserves			
Called up share capital	26,506	-	26,506
Share premium account	1,400	-	1,400
Capital contribution	30,150	-	30,150
Revaluation reserve	208,889	(208,889)	-
Profit and loss account	85,372	23,034	108,406
Total shareholder's funds	**352,317**	**(185,855)**	**166,462**

NON-AUDITED APPENDIX TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2015 (CONTINUED)

Transition to Financial Reporting Standard 101: 'Reduced disclosure framework' (continued)

Transitional adjustments

Under Financial Reporting Standard 101: 'Reduced disclosure framework', the company applies the recognition and measurement requirements of EU-adopted International Financial Reporting Standards, 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), given that the financial statements that it prepares are Companies Act accounts.

The company is included in the consolidated financial statements of its ultimate holding and controlling company in the United Kingdom, Affinity Water Acquisitions (Investments) Limited. Affinity Water Acquisitions (Investments) Limited has elected to adopt International Financial Reporting Standards ('IFRS') for the year ending 31 March 2016. In accordance with IFRS 1: 'First-time adoption of IFRS', the company has measured its assets and liabilities at the carrying amounts that would be included in the Affinity Water Acquisitions (Investments) Limited consolidated financial statements.

The differences between the amounts previously reported and those under Financial Reporting Standard 101: 'Reduced disclosure framework' are shown above. The key areas of difference are as follows:

Fixed assets

Intangible assets

Under International Accounting Standard 38: 'Intangible assets', software and development costs, which are capitalised as tangible fixed assets under the previous reporting framework, are classified as intangible assets. This has led to a reclassification of £8,799,000 at 1 April 2014.

Infrastructure assets

Under UK GAAP, the company's infrastructure assets were accounted for in accordance with the renewals accounting provisions of Financial Reporting Standard 15: 'Tangible fixed assets'. Such provisions are not present within International Accounting Standard 16: 'Property, plant and equipment'.

Under renewals accounting, the infrastructure network is assumed to be a single asset. Expenditure on infrastructure assets relating to increases in capacity or enhancements to the network and on maintaining the operating capability of the network in accordance with defined standards of service is capitalised. The depreciation charged is effectively the estimated anticipated level of annual expenditure required to maintain the operating capability of the network. Grants and contributions relating to the infrastructure network have been deducted from the cost of infrastructure assets.

Under International Accounting Standard 16: 'Property, plant and equipment' this treatment may not be applied. Significant parts within the infrastructure network have been identified and useful lives and residual values determined so that each significant part may be depreciated individually.

To determine the opening position on transition the fair value of infrastructure assets established on 28 June 2012 when the majority shareholding in the group of companies, of which the company was a wholly owned subsidiary, and of which Affinity Water Capital Funds Limited was the parent undertaking, was sold by Veolia Water UK Limited to Affinity Water Acquisitions Limited has been used as deemed cost.

NON-AUDITED APPENDIX TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2015 (CONTINUED)

Transition to Financial Reporting Standard 101: 'Reduced disclosure framework' (continued)

Infrastructure assets (continued)

This deemed cost has been adjusted for subsequent depreciation, capital expenditure, transfers at cost from assets in the course of construction and disposals assuming that Financial Reporting Standard 101: 'Reduced disclosure framework' policy for infrastructure assets had been in place during this year to establish the opening position for infrastructure assets at 1 April 2014. This increased fixed assets by £13,482,000 as at 1 April 2014 compared with that previously reported.

The significant parts recognised have been based on the material used to construct the pipe concerned. These have been assigned zero residual values at the end of their useful lives, which range from 50 to 150 years.

Historical grants and contributions at 1 April 2014 of £94,438,000 relating to the enhancement of the infrastructure network have been removed from the cost of infrastructure assets and recognised as deferred income at their amortised amount of £80,643,000 (£1,120,000 due within one year and £79,523,000 due after more than one year), with the amortisation of £13,795,000 recognised in the profit and loss account. £87,734,000 of historical grants and contributions at 1 April 2014 given in compensation for expenses incurred with no future related costs have been removed from the cost of infrastructure assets and recognised in the profit and loss account. Infrastructure assets have been subsequently revalued downwards to the opening position at 1 April 2014 determined through the process described above.

Grafham reservoir

The accounting treatment has been revisited on transition to Financial Reporting Standard 101: 'Reduced disclosure framework', as International Financial Reporting Interpretations Committee 4: 'Determining whether an arrangement contains a lease' provides specific guidance, not provided in UK GAAP accounting standards, on determining whether an arrangement contains a lease.

On assessment, the arrangement was not found to contain a lease under International Financial Reporting Interpretations Committee 4: 'Determining whether an arrangement contains a lease'. Furthermore the arrangement did not meet the definition of a joint arrangement in order to be accounted for as such in accordance with International Financial Reporting Standard 11: 'Joint arrangements'. The arrangement is considered to be a purchase contract for the supply of goods under Financial Reporting Standard 101: 'Reduced disclosure framework' and the treatment of the arrangement as a quasi-finance lease under UK GAAP has been reversed on transition to Financial Reporting Standard 101: 'Reduced disclosure framework'. This led to a reduction in current liabilities of £1,005,000 and in non-current liabilities of £18,396,000 at 1 April 2014.

Retirement benefit obligations

Under UK GAAP, the company applied an asset limit to its net pension asset at 1 April 2014 of £3,500,000. This asset limit has been removed on assessment of the pension assets and liabilities under International Financial Reporting Interpretations Committee 14: 'The limit on a defined benefit asset, minimum funding requirements and their interaction', as the company has an unconditional right to a refund of surplus in the event of a plan wind-up.

In addition, International Accounting Standard 19: 'Employee benefits' requires that deferred tax assets or liabilities associated with pension schemes are presented gross of the associated pension liability or asset.

NON-AUDITED APPENDIX TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2015 (CONTINUED)

Transition to Financial Reporting Standard 101: 'Reduced disclosure framework' (continued)

Transitional adjustments (continued)

Deferred tax

Under UK GAAP, the company had elected to apply discounting to its deferred tax liability. Under International Accounting Standard 12: 'Income taxes', discounting is not permitted. The impact of eliminating discounting from the accounting for deferred tax is to increase the deferred tax liability at 1 April 2014 by £44,169,000.

International Accounting Standard 12: 'Income taxes' takes a different conceptual approach to deferred tax from that applied by Financial Reporting Standard 19: 'Deferred tax'. Under International Accounting Standard 12: 'Income taxes' deferred tax must be provided for on all temporary differences between the carrying amount of an asset or liability in the balance sheet and its tax base, whereas under Financial Reporting Standard 19: 'Deferred tax' must be provided for on timing differences between the treatment of items in the tax computation and the profit and loss account. This change in approach results in deferred tax provisions under Financial Reporting Standard 101: 'Reduced disclosure framework' for items which under Financial Reporting Standard 19: 'Deferred tax' would be permanent differences and hence would not be provided for.

This difference in approach results in deferred tax being provided on previous revaluations to the tangible fixed assets owned by the company, including those revalued prior to the business combination with Affinity Water East Limited and Affinity Water Southeast Limited. For Financial Reporting Standard 101: 'Reduced disclosure framework' purposes, the revaluation of the assets results in an increase in their carrying amount on balance sheet with no corresponding increase in their tax base, as tax relief is not given for the revalued amount, therefore giving rise to a temporary difference on which a deferred tax liability is recognised. The impact on the company's balance sheet under Financial Reporting Standard 101: 'Reduced disclosure framework' is to increase the deferred tax liability at 1 April 2014 by £101,573,000.

Other Financial Reporting Standard 101: 'Reduced disclosure framework' adjustments result in a decrease in the deferred tax liability at 1 April 2014 of £4,146,000.

The net impact of the above adjustments and the reclassification of the deferred tax pension asset of £622,000 from the retirement benefit obligation to deferred tax provisions is to increase the deferred tax liability as at 1 April 2014 by £142,218,000.

2014/15 results under Financial Reporting Standard 101: 'Reduced disclosure framework'

The key areas of difference between the amounts reported under UK GAAP for the year ended 31 March 2015 and those prepared under Financial Reporting Standard 101: 'Reduced disclosure framework' are as follows:

Fixed assets

Intangible assets

Software and development costs with a net book value of £10,308,000 at 31 March 2015, which are capitalised as tangible fixed assets under UK GAAP, are reclassified as intangible assets under International Accounting Standard 38: 'Intangible assets'. The change in treatment does not have an impact on net profit for the year ended 31 March 2015.

NON-AUDITED APPENDIX TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2015 (CONTINUED)

Transition to Financial Reporting Standard 101: 'Reduced disclosure framework' (continued)

Fixed assets

Infrastructure assets

As described previously, the renewals accounting provisions of Financial Reporting Standard 15: 'Tangible fixed assets' are not present in International Accounting Standard 16: 'Property, plant and equipment'. The infrastructure renewals charge of £36,092,000 recognised in cost of sales and infrastructure renewals expenditure of £36,092,000 included within tangible fixed assets under UK GAAP for the year ended 31 March 2015 are not recognised in financial statements prepared under Financial Reporting Standard 101: 'Reduced disclosure framework'.

Expenditure on infrastructure assets during the year ended 31 March 2015 relating to increases in capacity, enhancements or material replacements of network components is capitalised to tangible fixed assets in accordance with International Accounting Standard 16: 'Property, plant and equipment' with the remaining amount recognised within cost of sales in financial statements prepared under Financial Reporting Standard 101: 'Reduced disclosure framework'.

Infrastructure assets are depreciated on a straight-line basis over their useful economic lives in financial statements prepared under Financial Reporting Standard 101: 'Reduced disclosure framework', and are;

- Potable water distribution mains 50-150 years
- Raw water pipes 50-150 years

Depreciation is recognised in cost of sales in financial statements prepared under Financial Reporting Standard 101: 'Reduced disclosure framework', together with the costs of abandoning infrastructure assets before the end of their useful economic lives.

£98,120,000 of grants and contributions netted against infrastructure assets at 31 March 2015 under UK GAAP relating to the enhancement of the infrastructure network are removed from the cost of infrastructure assets and recognised as deferred income at their amortised amount of £83,099,000 in financial statements prepared under Financial Reporting Standard 101: 'Reduced disclosure framework', with amortisation of £1,227,000 recognised in net profit for the year ended 31 March 2015.

£92,430,000 of grants and contributions at 31 March 2015 netted against infrastructure assets at 31 March 2015 under UK GAAP given in compensation for expenses incurred with no future related costs are removed from the cost of infrastructure assets and recognised in the profit and loss account in financial statements prepared under Financial Reporting Standard 101: 'Reduced disclosure framework'. £4,696,000 relating to the year ended 31 March 2015 is recognised in revenue in the income statement prepared under Financial Reporting Standard 101: 'Reduced disclosure framework' with associated expenditure of £4,237,000 recognised in cost of sales.

Infrastructure assets are subsequently revalued downwards to their position at 31 March 2015 determined through applying the treatment described in the paragraphs preceding those relating to the treatment of grants and contributions to the opening position at 1 April 2014.

The net impact of the change in treatment of grants and contributions is to increase net profit for the year ended 31 March 2015 under Financial Reporting Standard 101: 'Reduced disclosure framework' by £1,685,000.

NON-AUDITED APPENDIX TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2015 (CONTINUED)

Transition to Financial Reporting Standard 101: 'Reduced disclosure framework' (continued)

Transitional adjustments (continued)

Grafham reservoir

The treatment of the arrangement as a quasi-finance lease under UK GAAP is reversed in financial statements prepared under Financial Reporting Standard 101: 'Reduced disclosure framework'. This leads to a reduction in current liabilities of £1,201,000 and in non-current liabilities of £19,600,000 at 31 March 2015.

As a result of treating the arrangement as a purchase contract for the supply of goods, an additional £1,029,000 of costs relating to the arrangement are recognised in cost of sales in the income statement for the year ended 31 March 2015 prepared under Financial Reporting Standard 101: 'Reduced disclosure framework'. This includes a reclassification of £942,000 of costs recognised as interest payable in the profit and loss account for the year ended 31 March 2015 prepared under UK GAAP. £1,019,000 of depreciation charged on expenditure capitalised in tangible fixed assets under UK GAAP is reclassified within cost of sales to bulk water purchases in financial statements prepared under Financial Reporting Standard 101: 'Reduced disclosure framework'. The change in treatment of this arrangement reduces net profit for the year ended 31 March 2015 by £87,000 under Financial Reporting Standard 101: 'Reduced disclosure framework'.

Retirement benefit obligations

Under UK GAAP, the company applied an asset limit to its net pension asset at 31 March 2015 of £6,932,000. This asset limit and the associated deferred tax liability of £1,386,000 are removed on assessment of the pension assets and liabilities under International Financial Reporting Interpretations Committee 14: 'The limit on a defined benefit asset, minimum funding requirements and their interaction'.

In addition, the deferred tax liability of £9,019,000 associated with the company's pension plan is presented gross of the associated pension asset in accordance with International Accounting Standard 19: 'Employee benefits'.

Deferred tax

Under International Accounting Standard 12: 'Income taxes', discounting is not permitted. The impact of reversing the decrease in discounting of the deferred tax liability under UK GAAP at 31 March 2015 is to reduce the deferred tax charge under International Accounting Standard 12: 'Income taxes' by £10,435,000 for the year ended 31 March 2015.

Affinity Water

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Regulatory Financial Statements

for the year ended 31 March 2015

The following financial statements are prepared to enable the Water Services Regulation Authority (Ofwat) to monitor the financial performance of the regulated water business.

These regulatory financial statements should be read in conjunction with the preceding annual report and financial statements.

Affinity Water Limited

(Registered Number 02546950)

REGULATORY FINANCIAL STATEMENTS

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REGULATORY FINANCIAL STATEMENTS CONTINUED

CERTIFICATES OF COMPLIANCE

To: Water Services Regulation Authority
Centre City Tower
7 Hill Street
Birmingham B5 4UA

Certificate of compliance with licence condition F6A

This is to certify that on 23 June 2015 the Board of Affinity Water Limited ('the Appointee') resolved that in its opinion:

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. financial resources and facilities;

b. management resources; and

c. systems of planning and internal control

which are sufficient to enable it to carry out those functions; and

3. all contracts entered into with any associated company include all necessary provisions and requirements concerning the standard of service to be supplied to the Appointee, to ensure that it is able to meet all its obligations as a water undertaker.

These statements are based on:

- the net worth of the company as shown in the financial statements, the budget and plan for the forthcoming year, and the financing arrangements available to the company;
- the adequacy of the senior management team and management resources, robust internal control and delegated authority procedures, an internal audit team reporting to the Audit Committee,
  the availability of specialist planning teams, as well as the information from point 1) above itself;
  the company is also subject to considerable external assurance review, both fiscal and operational;
- an examination of the contracts with associated companies.

Tim Monod

Company Secretary
23 June 2015

REGULATORY FINANCIAL STATEMENTS CONTINUED

CERTIFICATES OF COMPLIANCE (CONTINUED)

Compliance with condition K

Paragraph 3.1 of Condition K of the company's Instrument of Appointment requires the company to ensure at all times, so far as reasonably practicable, that if a special administration order were made, it would have available to it sufficient rights and assets (other than financial reserves) to enable a special administrator to manage the affairs, business and property of the appointed business of the company.

The company hereby certifies that at 31 March 2015 it was in compliance with paragraph 3.1 of Condition K.

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 arms 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.

REGULATORY FINANCIAL STATEMENTS CONTINUED

CERTIFICATES OF COMPLIANCE (CONTINUED)

Statement of directors' responsibilities

In addition to their responsibilities to prepare financial statements in accordance with the Companies Act 2006, the directors are also responsible under Condition F of the Instrument of Appointment granted by the Secretary of State for the Environment to the company as a water undertaker as amended by the Variation and Modifications dated 27 July 2012 under what is now the Water Industry Act 1991 and Regulatory Accounting Guidelines issued by Ofwat for:

a. ensuring that proper accounting records are maintained by the Appointee to enable compliance with the requirements of Condition F and having regard also to the terms of guidelines notified by Ofwat to the Appointee from time to time;

b. preparing on a consistent basis for each financial year accounting statements in accordance with Condition F, or as specified under the Variation and Modifications dated 27 July 2012, having regard also to the terms of guidelines notified by Ofwat from time to time, which so far as is reasonably practicable have the same content as the annual financial statements of the Appointee prepared under the Companies Act 2006 and which are prepared in accordance with the formats, accounting policies and principles which apply to these accounts;

c. preparing accounting statements on a current cost basis in respect of the same accounting period in accordance with guidelines issued by Ofwat from time to time or as specified under the Variation and Modifications dated 27 July 2012;

d. preparing such other accounting and related information as is required by Condition F having regard also to the terms of guidelines issued by Ofwat from time to time;

e. preparing accounting separation tables with regards to the guidelines issued by Ofwat from time to time.

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 are 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.

Independent auditor's report to the Water Services Regulation Authority (the 'Authority', referred to as the 'WSRA') and the directors of Affinity Water Limited

Opinion on regulatory accounts

In our opinion, Affinity Water Limited's Regulatory Accounts (the "Regulatory Accounts"):

- fairly present in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA and the accounting policies set out on **pages 125 to 128** (including the accounting separation methodology), the state of the Company's affairs at 31 March 2015 on an historical cost and current cost basis, and its historical cost and current cost profit and its current cost cash flow for the year then ended; and
- have been properly prepared in accordance with Condition F, the Regulatory Accounting Guidelines and the accounting policies (including the accounting separation methodology).

Basis of preparation

In forming our opinion on the Regulatory Accounts, which is not modified, we draw attention to the fact that the Regulatory Accounts have been prepared in accordance with Condition F, the Regulatory Accounting Guidelines, the accounting policies set out in the statement of accounting policies and, in the case of the regulatory historical cost accounting statements, under the historical cost convention.

The Regulatory Accounts 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. Furthermore, the regulatory historical cost accounting statements on **pages 118 to 121** have been drawn up in accordance with Regulatory Accounting Guideline 3.07 in that infrastructure renewals accounting as applied in previous years should continue to be applied and accordingly, that the relevant sections of Financial Reporting Standards 12 and 15 be disapplied. The effect of this departure from Generally Accepted Accounting Practice and a reconciliation of the balance sheet drawn up on this basis to the balance sheet drawn up under the Companies Act 2006 is given on **page 122**.

What we have audited

Affinity Water Limited's Regulatory Accounts comprise:

- the regulatory historical cost accounting statements comprising the regulatory Historic cost profit and loss account for the 12 months ended 31 March 2015, the Historic cost balance sheet as at 31 March 2015, the Statement of total recognised gains and losses (historical cost accounting) for the 12 months ended 31 March 2015 (appointed business only) and the Reconciliation between statutory accounts and regulatory accounts for the year ended and as at 31 March 2015; and

- the regulatory current cost accounting statements, for the Current cost profit and loss account for the 12 months ended 31 March 2015 (appointed business only), Current cost cash flow statement for the 12 months ended 31 March 2015 (appointed business only).

The financial reporting framework that has been applied in their preparation comprises the basis of preparation and accounting policies set out in the additional information required by the Licence and the notes to the current cost financial statements.

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

Independent auditor's report to the Water Services Regulation Authority (the 'Authority', referred to as the 'WSRA') and the directors of Affinity Water Limited (continued)

Opinion on other matters prescribed by Condition F

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

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

Respective responsibilities of the WSRA, the Directors and Auditors

As explained more fully in the Statement of directors' responsibilities set out on **page 114**, the directors are responsible for the preparation of the Regulatory Accounts and for their fair presentation in accordance with the basis of preparation and accounting policies. Our responsibility is to audit and express an opinion on the Regulatory Accounts in accordance with International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)"), except as stated in the 'Scope of the audit of the Regulatory Accounts' below, and having regard to the guidance contained in Audit 05/03 'Reporting to Regulators of Regulated Entities' issued by the Institute of Chartered Accountants in England and Wales. Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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

What an audit of Regulatory Accounts involves

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

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

Other matters

The nature, form and content of Regulatory Accounts 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 WRSA's purposes. Accordingly we make no such assessment.

Our opinion on the Regulatory Accounts is separate from our opinion on the statutory financial statements of the Company for the year ended 31 March 2015 on which we reported on 23 June 2015, which are prepared for a different purpose. Our audit report in relation to the statutory financial statements of the Company (our "Statutory audit") was made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our Statutory audit work was undertaken so that we might state to the Company's members those matters we are required to state to them in a statutory audit report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume responsibility for any other purpose or to any other person to whom our Statutory audit report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Cambridge
23 June 2015

Notes:

1) The maintenance and integrity of the Company's website is the responsibility of the directors and the maintenance and integrity of the Authority's website is the responsibility of the Authority; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the Regulatory Accounts since they were initially presented on the websites.

2) Legislation in the United Kingdom governing the preparation and dissemination of financial statements and Regulatory Accounts may differ from legislation in other jurisdictions..

REGULATORY FINANCIAL STATEMENTS CONTINUED

HISTORIC COST PROFIT AND LOSS ACCOUNT FOR THE 12 MONTHS ENDED 31 MARCH 2015

	2015			2014		
	Appointed £000	Non-appointed £000	Total £000	Appointed £000	Non-appointed £000	Total £000
Turnover	**293,524**	**-**	**293,524**	292,978	-	292,978
Operating costs	**(132,480)**	**(2,543)**	**(135,023)**	(134,990)	(2,424)	(137,414)
Infrastructure renewals charge	**(36,092)**	**-**	**(36,092)**	(47,310)	-	(47,310)
Historical cost depreciation	**(39,311)**	**-**	**(39,311)**	(33,717)	-	(33,717)
Operating income	**2,053**	**-**	**2,053**	3,630	-	3,630
Operating profit/(loss)	**87,694**	**(2,543)**	**85,151**	80,591	(2,424)	78,167
Other income	**-**	**8,143**	**8,143**	-	7,730	7,730
Net interest	**(35,664)**	**(5)**	**(35,669)**	(40,187)	(5)	(40,192)
Profit on ordinary activities before taxation	**52,030**	**5,595**	**57,625**	40,404	5,301	45,705
Taxation						
- current	**(7,550)**	**(1,175)**	**(8,725)**	(4,256)	(1,219)	(5,475)
- deferred	**(16,046)**	**-**	**(16,046)**	4,182	-	4,182
Profit on ordinary activities after taxation	**28,434**	**4,420**	**32,854**	40,330	4,082	44,412
Extraordinary items	**-**	**-**	**-**	-	-	-
Profit for the year	**28,434**	**4,420**	**32,854**	40,330	4,082	44,412
Dividends	**(26,380)**	**(4,420)**	**(30,800)**	(41,760)	(4,082)	(45,842)
Retained profit for the year	**2,054**	**-**	**2,054**	(1,430)	-	(1,430)

REGULATORY FINANCIAL STATEMENTS CONTINUED

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES (HISTORICAL COST ACCOUNTING) FOR THE 12 MONTHS ENDED 31 MARCH 2015 (APPOINTED BUSINESS ONLY)

	2015 £000	2014 £000
Profit for the year	**28,434**	40,330
Actuarial gains on post employment plans	**22,499**	14,785
Other gains and losses	**(4,500)**	(2,781)
Total recognised gains and losses for the year	**46,433**	52,334

REGULATORY FINANCIAL STATEMENTS CONTINUED

HISTORIC COST BALANCE SHEET AS AT 31 MARCH 2015

	2015			2014		
	Appointed £000	Non-appointed £000	Total £000	Appointed £000	Non-appointed £000	Total £000
Fixed assets						
Tangible assets	**1,252,626**	-	**1,252,626**	1,224,386	-	1,224,386
Investments						
- loan to group company	-	-	-	-	-	-
- other	**60**	-	**60**	61	-	61
Total fixed assets	**1,252,686**	-	**1,252,686**	1,224,447	-	1,224,447
Infrastructure renewals accrual	**(9,819)**	-	**(9,819)**	(12,424)	-	(12,424)
Other current assets	**130,987**	**9,776**	**140,763**	89,774	9,668	99,442
Creditors: amounts falling due within one year						
Borrowings	**(1,201)**	-	**(1,201)**	(18,205)	-	(18,205)
Other creditors	**(125,268)**	**(9,776)**	**(135,044)**	(104,712)	(9,668)	(114,380)
Total creditors: amounts falling due within one year	**(126,469)**	**(9,776)**	**(136,245)**	(122,917)	(9,668)	(132,585)
Net current liabilities	**(5,301)**	-	**(5,301)**	(45,567)	-	(45,567)
Total assets less current liabilities	**1,247,385**	-	**1,247,385**	1,178,880	-	1,178,880
Creditors: amounts falling due after more than one year						
Borrowings	**(854,676)**	-	**(854,676)**	(791,957)	-	(791,957)
Other creditors	-	-	-	-	-	-
Total creditors: amounts falling due after one year	**(854,676)**	-	**(854,676)**	(791,957)	-	(791,957)
Provisions for liabilities and charges	**(34,849)**	-	**(34,849)**	(49,567)	-	(49,567)
Preference share capital	-	-	-	-	-	-
Net assets employed	**357,860**	-	**357,860**	337,356	-	337,356
Capital and reserves	**357,860**	-	**357,860**	337,356	-	337,356

REGULATORY FINANCIAL STATEMENTS CONTINUED

HISTORIC COST BALANCE SHEET AS AT 31 MARCH 2015 (CONTINUED)

Explanatory notes to the historical cost balance sheet

The treatment of infrastructure renewals accruals/prepayments within the regulatory accounts differs from that in the historical cost financial statements. For regulatory accounts, Ofwat requires the infrastructure renewals accrual to be shown separately on the balance sheet. Consequently tangible assets in the historical cost balance sheet are reported at £18,101,000 higher (2014: £18,101,000 higher) than in the statutory financial statements.

In the statutory financial statements goodwill of £6,678,000 arose on the acquisition of North Surrey Water Limited on 1 October 2000. The directors consider that this goodwill has an indefinite life and accordingly it is not amortised but is subject to annual review for impairment. As at 31 March 2015, this goodwill had not been impaired. Additionally, goodwill of £9,042,000 arose on the unification of the regulated businesses on 27 July 2012. The directors consider that this goodwill has a life of 20 years and it has been amortised accordingly. In estimating the useful economic life of goodwill, account has been taken of the nature of the unified business and the stability of the industry. No goodwill arises in the regulatory accounts, as the acquisitions have been accounted for as mergers.

REGULATORY FINANCIAL STATEMENTS CONTINUED

RECONCILIATION BETWEEN STATUTORY ACCOUNTS AND REGULATORY ACCOUNTS FOR THE YEAR ENDED AND AS AT 31 MARCH 2015

In the preparation of its annual report and financial statements for the year ended 31 March 2015 ('statutory accounts'), the company has followed common industry practice and adopted the infrastructure renewals accounting basis as set out in Financial Reporting Standard 15: 'Tangible fixed assets'. However for the purposes of the regulatory accounts, Ofwat has requested that Financial Reporting Standard 15: 'Tangible fixed assets' is not applied for infrastructure renewals accounting, thereby providing a basis consistent with prior years. In addition, Ofwat has decided to depart from UK GAAP and disapply the provisions of Application Note G of Financial Reporting Standard 5: 'Reporting the substance of transactions', which states that turnover should not include amounts that the company does not expect to collect.

Reconciliation of certain items in the regulatory accounts to the statutory accounts is set out below:

	Statutory UK GAAP £000	Regulatory £000	
Profit and loss account			
Turnover	291,441	293,524	Disapplication of the provisions of Application Note G of Financial Reporting Standard 5: 'Reporting the substance of transactions' in the regulatory accounts of £2,083,000.
Operating profit	93,318	87,694	Statutory accounts include other operating income of £8,143,000 but exclude loss on disposal of fixed assets which in 2014/15 was £24,000. Non appointed cost excluded from operating profit in the regulatory accounts is £2,543,000.
Balance sheet			
Tangible fixed assets (net book value)	1,242,807	1,252,626	In the statutory accounts the tangible fixed assets include the infrastructure renewals accrual. For regulatory accounts, Ofwat requires the infrastructure renewals accrual to be shown separately on the balance sheet. The infrastructure renewals accrual of £18,101,000 is therefore excluded from the tangible fixed assets net book value. £8,282,000 of capital expenditure in relation to assets used by the company and operated by other parties has also been excluded from the tangible fixed assets net book value for the regulatory accounts, which is consistent with the treatment required by Ofwat in previous years.
Infrastructure renewals accrual	N/A	(9,819)	
Debtors	80,573	80,010	Non appointed debtors excluded from debtors in the regulatory accounts are £563,000.
Deferred income	N/A	3,025	Amount relates to deferred credit for contributions to surface assets of £3,025,000 and has been classified within creditors falling due after more than one year in the statutory accounts.

REGULATORY FINANCIAL STATEMENTS CONTINUED

CURRENT COST PROFIT AND LOSS ACCOUNT FOR THE 12 MONTHS ENDED 31 MARCH 2015 (APPOINTED BUSINESS ONLY)

		Note	2015 £000	2014 £000
Turnover				
Unmeasured	- household		**127,900**	129,145
	- non-household		**2,592**	2,698
Measured	- household		**102,336**	102,870
	- non-household		**56,552**	55,341
Bulk supplies/intercompany payment			**3,040**	2,040
Other third party service (including non-potable water)			**1,104**	884
Other sources			**-**	-
Total turnover			**293,524**	292,978
Current cost operating costs - wholesale			**(184,015)**	(197,791)
Current cost operating costs - retail			**(36,295)**	(32,419)
Other operating (cost)/income			**(979)**	(1,674)
Working capital adjustment			**192**	841
Current cost operating profit		**5**	**72,427**	61,935
Other income			**-**	-
Net interest			**(35,664)**	(40,187)
Financing adjustment			**7,714**	20,592
Current cost profit before taxation			**44,477**	42,340
Net revenue movement (into)/out of tariff basket			**(160)**	10
Back-billing amount identified			**3,540**	2,703

All results for appointed business in the current and prior years are from the provision of water services.

REGULATORY FINANCIAL STATEMENTS CONTINUED

CURRENT COST CASH FLOW STATEMENT FOR THE 12 MONTHS ENDED 31 MARCH 2015 (APPOINTED BUSINESS ONLY)

	2015 £000	2014 £000
Current cost operating profit	**72,427**	61,935
Working capital adjustment	**(192)**	(841)
Movement in working capital	**3,506**	(4,430)
Receipt from other income	**-**	-
Current cost depreciation	**51,738**	47,909
Current cost loss on sale of fixed assets	**3,056**	3,824
Infrastructure renewals charge	**36,092**	47,310
Movement in provisions	**(1,078)**	(392)
Net cash inflow from operating activities	**165,549**	155,315
Returns on investments and servicing of finance	**(34,175)**	(34,220)
Taxation paid	**(5,342)**	(5,836)
Capital expenditure and financial investment		
Gross cost of purchase of fixed assets	**(74,162)**	(71,245)
Receipt of grants and contributions	**11,690**	7,969
Infrastructure renewals expenditure	**(38,598)**	(45,842)
Disposal of fixed assets	**58**	1,743
Movements on long term group loans to group companies	**-**	-
Net cash outflow from investing activities	**(101,012)**	(107,375)
Acquisitions and disposals	**-**	-
Equity dividends paid	**(26,380)**	(41,761)
Net cash outflow from management of liquid resources	**(15,000)**	-
Net cash outflow before financing	**(16,360)**	(33,877)
Net cash inflow from financing	**43,451**	19,366
Increase/(decrease) in cash	**27,091**	(14,511)

REGULATORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE CURRENT COST FINANCIAL INFORMATION

1. Statement of accounting policies

Basis of current cost accounting

These accounts have been prepared in accordance with relevant Regulatory Accounting Guidelines ('RAGs').

The accounting policies used are the same as those adopted in the statutory accounts, except as set out below.

The following accounts are prepared to enable Ofwat to monitor the financial performance of the regulated water business.

Revenue recognition

Turnover represents the income receivable in the ordinary course of business from the regulated activities of the business in the year exclusive of value added tax. Charges billed to customers for water services are recognised in the period in which they are earned. An accrual is estimated for unmeasured consumption that has not yet been billed.

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 turnover.

Where an invoice has been raised and payment made but the service has not been provided in the year this will be treated as a payment in advance. The value of invoices raised will not be recognised within the current year's turnover but will instead be recognised within creditors as deferred income.

Charges on income arising from court, solicitor and debt recovery agency fees are credited to operating costs. They are not recognised in turnover.

Differences between statutory and regulatory accounts

The regulatory accounts disapply the provisions of Application Note G of Financial Reporting Standard 5: 'Reporting the substance of transactions', which states that turnover should not include amounts that the company does not expect to collect.

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 which are recorded as where 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.

REGULATORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE CURRENT COST FINANCIAL INFORMATION (CONTINUED)

1. Statement of accounting policies (continued)

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 in recognition 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 the company 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. Where enquiries give the company reason to believe that the property is inhabited but it has not been possible to obtain the customer's name, a bill is then issued in the name of 'The Occupier'. This only occurs for measured customers.

In each of the above cases, if a bill is sent, the company would recognise it within turnover 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 turnover. 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.

Acquisitions

On 1 October 2000 the company acquired the trade, assets and liabilities of North Surrey Water Limited. Details of the acquisition were given in the statutory accounts of the company for the year ended 31 March 2001. The acquisition was funded by the issue of share capital and debt. The additional debt taken on of £20.0m was added to the opening balance of long-term creditors. No goodwill arises in the regulatory accounts, as the acquisition has been accounted for as a merger.

On 27 July 2012 the company acquired the trade, assets and liabilities of Affinity Water East Limited and Affinity Water Southeast Limited on unification of the water licences. The acquisition was funded by debt. No goodwill arises in the regulatory accounts, as the acquisition has been accounted for as a merger. Any difference between the consideration transferred and the net assets acquired is recognised directly in reserves.

Bad debt

At each reporting date, the company evaluates the collectability of debtors and records provisions for bad and doubtful debts based on experience. The bad debt provision is charged to operating costs to reflect the company's assessment of the risk of non-recovery of debtors. The bad debt provision is calculated by applying a range of different percentages to debtors of different ages. These percentages also vary between categories of debt. Higher percentages are applied to those categories of debt which are considered to be of greater risk and also to debtors of greater age. The value of the debt provision 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 debtors 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.

REGULATORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE CURRENT COST FINANCIAL INFORMATION (CONTINUED)

1. Statement of accounting policies (continued)

Bad debt (continued)

The company's bad and doubtful debts provision policy has remained unchanged and has been consistently applied in the current and prior years. There has not been a significant increase in the provision from £24,325,000 at 31 March 2014 to £24,645,000 at 31 March 2015.

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 debts 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 bad debt write-off policy has remained unchanged and has been consistently applied in the current year compared with the previous year.

There has been an increase in the level of debt written off from £8,456,000 in 2013/14 to £9,448,000 in 2014/15; this increase is a one off event following the implementation of a new debt management system in the year and the timing of recalling closed debt back from the company's debt collection agency compared to the previous system.

Tangible fixed assets

Expenditure on maintaining the operating capability of the network in accordance with defined standards of service is charged as an operating cost. Costs relating to increases in capacity or enhancements to the network are capitalised. No depreciation is charged on the mains network because it is required to be maintained in perpetuity and therefore has no finite economic life.

The treatment in the current cost accounts differs from that in the historical cost accounts in relation to the disapplication of renewals accounting paragraphs of Financial Reporting Standard 15: 'Tangible fixed assets' and Financial Reporting Standard 12: 'Provisions, contingencies and commitments', as required by RAGs. The non-compliance has no effect on the profit and loss account other than to reclassify infrastructure renewals charges as depreciation.

Third party contributions

Infrastructure charges and other third party contributions received since 31 March 1990 are carried forward to the extent that any balance has not been credited to revenue. The balance carried forward is restated for the change in the RPI for the year and treated as deferred income.

Infrastructure charges received in respect of connections to the mains network are allocated to fixed assets, surface and infrastructure, in accordance with the basis on which the charges are calculated. Contributions received relating to infrastructure assets, which are not depreciated, are deducted from the cost of tangible fixed assets in order to show a true and fair view.

REGULATORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE CURRENT COST FINANCIAL INFORMATION (CONTINUED)

1. Statement of accounting policies (continued)

Real financial capital maintenance adjustments

The following adjustments are made to historical cost profit in order to arrive at profit after maintenance of financial capital in real terms.

a. Depreciation adjustment: this is the difference between depreciation based on the current cost value of assets in these accounts and depreciation charged in arriving at historical cost profit.

b. Working capital adjustment: this is calculated by applying the change in the RPI over the year to the opening total of trade debtors and stock less trade creditors.

c. Financing adjustment: this is calculated by applying the change in the RPI over the year to the opening balance of net finance, which comprises all monetary assets and liabilities in the balance sheet apart from those included in working capital.

d. Disposal of fixed asset adjustment – per RAG 1.05: this is calculated by applying the difference between the net book value of the current cost and the net book value of the historical cost of disposed assets, to the profit from disposal of fixed assets as shown in the historical cost accounts.

Accounting separation policy

The tables presenting the analysis of operating costs and fixed assets (activity cost analysis for the appointed business in 2014/15 on **pages 141 and 142** and current cost analysis of tangible fixed assets by type on **pages 135 and 136**) have been prepared in accordance with the company's accounting separation methodology statement, which can be found on the company's stakeholder website: **stakeholder.affinitywater.co.uk**. 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 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, as described in the methodology.

REGULATORY FINANCIAL STATEMENTS CONTINUED

2. Directors' remuneration

Executive directors' remuneration comprises a package of base salary together with an annual performance-related bonus and a long term incentive plan (the '2013/14 LTIP'). Executive directors' bonuses paid by the company are linked to the standards of performance of the company and, therefore, in accordance with RAG 3.07. The elements of the 2014/15 remuneration arrangements for executive directors were established by the company's Remuneration Committee in meetings in 2013/14 and 2014/15.

The following table provides a summary of the key elements of the remuneration package for executive directors:

Purpose and link to strategy	Policy and approach	Maximum potential value (as percentage of base pay)	Performance metrics	Changes for 2015/16
Base salary				
To provide competitive fixed remuneration that will attract and retain key employees and reflect their experience and position in the company.	Reviewed annually. Aims to position salaries for executive directors at slightly below mid-market levels, preferring to compensate total reward with variable remuneration.	N/A	N/A	No change to the policy.
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 change to the policy.
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. Bonus is based on the company's key performance indicators plus individual targets.	Up to 75% of base salary	50% of the total bonus is determined on the achievement of the financial performance target, which is based on EBITDA. 25% of the total bonus is determined on the achievement of the additional seven operational and customer performance targets, which are set out on **pages 15 to 23** of the strategic report. 25% of the total bonus is determined on the achievement of personal objectives.	Change to performance metrics, as presented on **page 58** of the remuneration report. 50% of the total bonus will continue to be determined on the achievement of the financial performance target; 25% on the achievement of operational and customer performance targets; and 25% of the total bonus is determined on the achievement of personal objectives.

REGULATORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE CURRENT COST FINANCIAL INFORMATION (CONTINUED)

2. Directors' remuneration (continued)

Purpose and link to strategy	Policy and approach	Maximum potential value (as percentage of base pay)	Performance metrics	Changes for 2015/16
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 scheme. Executives who joined the company prior to this date may be members of the company's defined benefit scheme. The defined benefit scheme provides retirement benefits up to a scheme cap. Where an executive's base salary is greater than the defined benefit scheme cap, the company invites the executive to join the company's defined contribution scheme to contribute a "top up" for the portion of base salary which exceeds the defined benefit cap. Under the defined contribution scheme, the executive contributes at a rate of 7% of salary and the company contributes at 20%. Duncan Bates is a member of the company's defined benefit scheme and defined contribution "top up" scheme.	Under the company's defined benefit scheme, Duncan Bates is accruing service at 1/60th of pensionable salary for each year of pensionable service. From 1 March 2014, in lieu of being a member of the company's retirement benefit schemes, Richard Bienfait received a taxable allowance of 35% of base salary.	N/A	No change to the policy.
2013/14 LTIP				
To incentivise executives to achieve long-term shareholder value whilst achieving high levels of customer experience performance, although award and payment are discretionary.	Base awards were granted for 2013/14 as a percentage of salary and are paid out in cash at the end of a three year performance period from 1 April 2013 to 31 March 2016, subject to the achievement of performance conditions.	Up to 100% of base salary (although outperformance of the financial performance target may cause this to be higher).	The award will be determined on the performance of the company over the three years in terms of cash available for distribution to shareholders and the third year's SIM performance relative to the industry.	No change to the policy.

REGULATORY FINANCIAL STATEMENTS CONTINUED

Dr Philip Nolan was appointed Chairman on 1 April 2013 for a term of three years. He receives a fixed annual fee for his services which is set at a market competitive level. He served as executive Chairman from 1 January 2015 until 31 May 2015 and thereafter his role reverted to non-executive.

On appointment, it was agreed to put in place a bonus arrangement for the Chairman to align his interests with the longer term interests of shareholders. To this end, it is common practice for the chairs of listed companies to hold shares. As a privately owned company, this is not practicable to implement, so the bonus arrangement has been aligned as closely as possible to the key features of a shareholding in a listed company. Particulars of the arrangement will be communicated at the AGM. The company has departed from the Accounting Regulations of the Act in not providing full disclosure of the terms of the arrangement to protect commercial confidentiality but has disclosed the bonus paid during the year in the table below.

The following table shows the remuneration paid to directors by the company in respect of 2014/15.

	Base salary/fees £000		Taxable benefits[1] £000		Pension related benefits[2] £000		Annual bonus £000		Other bonus award[3] £000		Other[4] £000		Total remuneration £000	
	14/15	13/14	14/15	13/14	14/15	13/14	14/15	13/14	14/15	13/14	14/15	13/14	14/15	13/14
Non-executive														
Current														
Patrick O'D Bourke	**47**	28	**-**	-	**-**	-	**-**	-	**-**	-	**-**	-	**47**	28
Baroness Peta Buscombe	**44**	38	**-**	-	**-**	-	**-**	-	**-**	-	**-**	-	**44**	38
Jeffrey Herbert	**44**	38	**-**	-	**-**	-	**-**	-	**-**	-	**-**	-	**44**	38
Chris Bolt	**4**	-	**-**	-	**-**	-	**-**	-	**-**	-	**-**	-	**4**	-
Former														
Fiona Woolf CBE	**-**	26	**-**	-	**-**	-	**-**	-	**-**	-	**-**	-	**-**	26
Executive														
Current														
Duncan Bates	**168**	161	**15**	13	**33**	48	**104**	106	**-**	73	**-**	-	**320**	401
Dr Philip Nolan	**200**	200	**-**	-	**-**	-	**-**	-	**176**	312	**-**	-	**376**	512
Former														
Richard Bienfait	**180**	219	**66**	16	**-**	69	**-**	145	**-**	99	**509**	-	**755**	548
	687	710	**81**	29	**33**	117	**104**	251	**176**	484	**509**	-	**1,590**	1,591

[1] Taxable benefits comprise company car allowance and healthcare insurance. Taxable benefits for Richard Bienfait further include an allowance that commenced on 1 March 2014 of £59,000 (2014: £7,000) in lieu of being a member of the company's retirement benefit schemes.

[2] Included in pension related benefits is £4,000 relating to contributions for Duncan Bates paid to money purchase pension schemes (2014: £3,000 for Duncan Bates and £12,000 for Richard Bienfait); there were no amounts outstanding at the year end. The amounts also include £29,000 accruing to Duncan Bates in relation to the company's defined benefit pension scheme. This amount has been calculated based on the change during the year of his accrued benefits in the defined benefit pension scheme multiplied by 20 less contributions made by the director in the financial year. The normal retirement date for Duncan Bates is 65 years. The accrued benefit at the start and end of the year for Duncan Bates was £40,000 and £42,000 respectively (change during the year: £2,000).

[3] For Duncan Bates and Richard Bienfait in 2013/14, this includes payments of the maximum award under the adhoc bonus arrangement related to PR14 given the assessment by Ofwat of the company's PR14 Business Plan as 'enhanced'. The 2014/15 and 2013/14 amounts further include the Chairman's bonus award. 2013/14 remuneration presented in the above table has been restated to reflect the bonus paid to the Chairman in the current year relating to 2013/14. This amount was excluded from the 2013/14 financial statements, as the particulars of the bonus arrangement were approved by the Remuneration Committee after the approval of the annual report and financial statements for the year ended 31 March 2014.

[4] Other remuneration relates to discretionary payments made to Richard Bienfait in connection with termination of qualifying services during the year. The amount includes a termination payment of £344,000, a bonus of £120,000 linked to company and personal performance during 2014/15 and the reimbursement of legal and outplacement costs of £45,000.

REGULATORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE CURRENT COST FINANCIAL INFORMATION (CONTINUED)

2. Directors' remuneration (continued)

Annual bonuses for executive directors

The annual bonus scheme is designed to provide a direct link between executive and company performance and the level of bonus awarded, although award and payment remain discretionary. The following table shows the percentage of maximum annual bonus potential awarded in relation to the 2014/15 year for Duncan Bates, who was the only executive director entitled to receive remuneration under the scheme for 2014/15.

Performance measure		Weighting for 2014/2015 (% of base salary)	2014/15 achievement (% of base salary)
Financial measure	Financial: annual EBITDA	37.50%	37.50%
Operational and customer measures	Health and safety: number of accidents resulting in more than three days' lost time and RIDDOR reportable incidents	2.68%	0.00%
	Water quality: number of water quality compliance failures	2.68%	0.67%[1]
	Unplanned interruptions: number of properties experiencing an interruption for more than 12 hours	2.68%	0.67%[2]
	Written complaints: number of written complaints	2.68%	0.67%[3]
	Leakage: leakage in terms of millions of litres per day	2.68%	0.00%
	Unwanted contact: number of unwanted contacts	2.68%	0.67%[4]
	Customer experience: measured by NPS	2.68%	2.68%[5]
Personal performance		18.75%	18.75%[6]
Total % base pay		**75.00%**	**61.61%**
Base salary			**£169,000**
Bonus paid			**£104,000**

No amounts in relation to these bonuses have been deferred.

Further information regarding directors' remuneration during the year and future policy can be found within the remuneration report on **pages 52 to 60** of the annual report and financial statements.

[1] One of the quarterly water quality targets for 2014/15 was met.
[2] One of the quarterly unplanned interruptions targets for 2014/15 was met.
[3] One of the quarterly written complaints targets for 2014/15 was met.
[4] One of the quarterly unwanted contact targets for 2014/15 was met.
[5] All of the quarterly customer experience targets for 2014/15 were met.
[6] 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.

REGULATORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE CURRENT COST FINANCIAL INFORMATION (CONTINUED)

3. Measured income accrual and debt disclosures

In accordance with RAG 3.07, the following comments in respect of turnover for the year are highlighted.

i. Turnover for the year ended 31 March 2014 included a measured income accrual of £37,790,000. The value of billing recognised in the year ended 31 March 2015 for consumption in the prior year was £37,317,000. This has resulted in a decrease in the current year's turnover due to the over-estimation of the prior year's turnover of £473,000. This represents 0.16% of current year turnover and is within acceptable tolerance for accounting estimates.

ii. There has not been a significant decrease in the trade debtor balance from £30,042,000 at 31 March 2014 to £30,719,000 at 31 March 2015 (a 2.3% increase).

4. Revenue reconciliation of price determination projections to actual reported amount

Turnover for 2014/15 of £293,524,000 is £3,282,000 less than the final determination target of £296,806,000. The reasons for this under-performance against the final determination are set out in the reconciliation below.

	2015 £000	2014 £000
Final determination projection	**279,172**	277,744
Impact of higher inflation	**17,634**	20,161
Final determination adjusted for inflation movement	**296,806**	297,905
Tariff basket revenue	**523**	(555)
Large user revenue	**(4,273)**	(3,689)
Rechargeable works and compensation	**(489)**	(487)
Bulk supplies	**370**	(588)
Special agreement (including non-potable supply)	**683**	477
Other appointed business revenue (third party)	**(96)**	(85)
Actual reported revenue	**293,524**	292,978

The non-tariff revenue is £3,805,000 lower than the final determination target, which is mainly driven by a reduction of large users due to the economic climate. There is also an increase in the tariff basket revenue of £523,000 compared to the final determination target driven by higher consumption volumes compared to the final determination target. This is supported by 2,226 additional new properties connected during the year (2014/15: 10,546 new properties compared to the final determination target of 8,320 new properties).

REGULATORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE CURRENT COST FINANCIAL INFORMATION (CONTINUED)

5. Reconciliation of historical cost operating profit to current cost operating profit for appointed business

	2015 £000	2014 £000
Total historical cost operating profit	**87,694**	80,591
Current cost depreciation and amortisation of deferred credit	**(51,738)**	(47,909)
Historic cost deferred credit	**(248)**	(297)
Historical cost depreciation	**39,560**	34,013
Current cost adjustment on disposal of fixed assets	**(3,033)**	(5,304)
Working capital adjustment	**192**	841
Current cost operating profit	**72,427**	61,935

REGULATORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE CURRENT COST FINANCIAL INFORMATION (CONTINUED)

6. Current cost analysis of tangible fixed assets by type

Wholesale business

	Resources £000	Raw water distribution £000	Treatment £000	Treated distribution £000	Total £000
Non infrastructure assets					
Gross replacement cost					
At 1 April 2014	**1,290,341**	**46,974**	**1,899,036**	**1,423,298**	**4,659,649**
AMP adjustment	-	-	-	-	-
Reclassification adjustment	-	-	-	-	-
RPI adjustment	11,648	424	17,141	12,848	42,061
Disposals	(1,557)	-	(1,557)	(74)	(3,188)
Additions	11,145	1,556	14,393	40,444	67,538
At 31 March 2015	**1,311,577**	**48,954**	**1,929,013**	**1,476,516**	**4,766,060**
Depreciation					
At 1 April 2014	**267,005**	**16,467**	**458,714**	**386,041**	**1,128,227**
AMP adjustment				-	-
Reclassification adjustment	-	-	-	-	-
RPI adjustment	2,410	149	4,141	3,485	10,185
Disposals	-	-	-	(74)	(74)
Charge for the year	**17,404**	**614**	**19,070**	11,960	49,048
At 31 March 2015	**286,819**	**17,230**	**481,925**	**401,412**	**1,187,386**
Net book value at 31 March 2015	**1,024,758**	**31,724**	**1,447,088**	**1,075,104**	**3,578,674**
Net book value at 1 April 2014	1,023,336	30,507	1,440,322	1,037,257	3,531,422

	Resources £000	Raw water distribution £000	Treatment £000	Treated distribution £000	Total £000
Infrastructure assets					
Gross replacement cost					
At 1 April 2014	**12,312**	**173,971**	**-**	**5,285,820**	**5,472,103**
AMP adjustment	-	-	-	-	-
Reclassification adjustment	-	-	-	-	-
RPI adjustment	111	1,570	-	47,713	49,394
Disposals	-	-	-	-	-
Additions	-	297	-	7,666	7,963
At 31 March 2015	**12,423**	**175,838**	**-**	**5,341,199**	**5,529,460**

REGULATORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE CURRENT COST FINANCIAL INFORMATION (CONTINUED)

6. Current cost analysis of tangible fixed assets by type (continued)

Retail business

	Household £000	Non-household £000	Total £000
Gross replacement cost			
At 1 April 2014	**195,441**	**11,659**	**207,100**
AMP adjustment	-	-	-
Reclassification adjustment	-	-	-
RPI adjustment	1,764	105	1,869
Disposals	(172)	(8)	(180)
Additions	390	23	413
At 31 March 2015	**197,423**	**11,779**	**209,202**
Depreciation			
At 1 April 2014	**129,783**	**7,738**	**137,521**
AMP adjustment		-	-
Reclassification adjustment	-	-	-
RPI adjustment	1,172	70	1,242
Disposals	(172)	(8)	(180)
Charge for the year	**2,962**	181	3,143
At 31 March 2015	**133,745**	**7,981**	**141,726**
Net book value at 31 March 2015	**63,678**	**3,798**	**67,476**
Net book value at 1 April 2014	65,658	3,921	69,579

REGULATORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE CURRENT COST FINANCIAL INFORMATION (CONTINUED)

7. Analysis of capital expenditure, grants and land sales for the 12 months ended 31 March 2015

	2015			2014		
	Gross £000	Grants and contributions £000	Net £000	Gross £000	Grants and contributions £000	Net £000
Capital expenditure – water						
Base						
Infrastructure renewals expenditure (IRE)	**38,598**	**-**	**38,598**	47,323	-	47,323
Maintenance non-infrastructure (MNI)	**55,368**	**-**	**55,368**	43,582	-	43,582
Enhancements						
Infrastructure enhancements	**7,963**	**(8,378)**	**(415)**	7,756	(8,202)	(446)
Non-infrastructure enhancements	**12,574**	**-**	**12,574**	14,829	-	14,829
Total capital expenditure – water	**114,503**	**(8,378)**	**106,125**	113,490	(8,202)	105,288
Grants and contributions – water						
Developer contributions (i.e. enhancement requisitions, grants and contributions)	**-**	**(780)**	**-**	-	(5,101)	-
Infrastructure charge receipts – new connections	**-**	**(7,598)**	**-**	-	(3,101)	-
Other contributions	**-**	**-**	**-**	-	-	-
Total grants and contributions – water	**-**	**(8,378)**	**-**	-	(8,202)	-
Land sales – proceeds from disposals of protected land	**-**	**-**	**(52)**	-	-	(1,737)

REGULATORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE CURRENT COST FINANCIAL INFORMATION (CONTINUED)

8. Analysis of working capital

		2015 £000	2014 £000
Stocks		**1,262**	1,412
Trade debtors	– measured household	**10,605**	8,074
	– unmeasured household	**10,745**	8,276
	– measured non-household	**7,952**	12,600
	– unmeasured non-household	**272**	203
	– other	**1,145**	891
Measured income accrual		**39,876**	37,790
Prepayments and other debtors		**5,894**	5,519
Trade creditors		**(14,118)**	(10,827)
Deferred income – customer advance receipts		**(30,780)**	(24,723)
Capital creditors		**(19,570)**	(17,826)
Accruals and other creditors		**(27,987)**	(42,658)
Total working capital		**(14,704)**	(21,269)
Total revenue outstanding	– household	**39,412**	39,269
	– non-household	**14,457**	13,919

REGULATORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE CURRENT COST FINANCIAL INFORMATION (CONTINUED)

9. Analysis of net debt, gearing and interest costs

	2015			
	Fixed rate £000	Floating rate £000	Index linked £000	Total £000
Borrowings (excluding preference shares)	604,804	-	251,073	855,877
Preference share capital				-
Total borrowings				**855,877**
Appointed cash				(49,715)
Short term deposits				-
Net debt				**806,162**
Regulatory capital value				987,208
Gearing				81.66%
Full year equivalent nominal interest cost	28,997	-	7,964	36,961
Full year equivalent cash interest payment*	28,997	-	5,621	34,618
Indicative interest rates				
Indicative weighted average nominal interest rate	4.97%		3.13%	4.41%
Indicative weighted average cash interest rate	4.97%		2.21%	4.13%
Weighted average years to maturity**	20.9	-	31.3	24.1

* excludes the impact of RPI

** definition of ‘maturity’ is ‘number of years to maturity from 31 March 2009’, as per RAG4.04.

REGULATORY FINANCIAL STATEMENTS CONTINUED

NOTES TO THE CURRENT COST FINANCIAL INFORMATION (CONTINUED)

9. Analysis of net debt, gearing and interest costs (continued)

Non-audited supplementary information

The following table presents the same analysis of net debt and gearing but borrowings have been adjusted to reflect the definition of net debt per the company's securitisation financing agreement.

	2015			
	Fixed rate £000	Floating rate £000	Index linked £000	Total £000
Borrowings (excluding preference shares)	604,804	-	251,073	855,877
Preference share capital				-
Add: - capitalised bond issue costs				3,151
Less: - financing of assets used by the company and operated by other parties				(20,801)
- loan from intermediate parent company				(3,550)
				834,677
Add: - accrued interest on borrowings				12,347
Total borrowings				847,024
Cash				(58,928)
Short term deposits				-
Net debt				**788,096**
Regulatory capital value				987,208
Gearing				79.83%
Regulatory capital value including midnight adjustments for the end of AMP5[1]				1,027,152
Gearing including midnight adjustments				76.73%

[1] Midnight adjustments are applied to the calculation of the opening RCV for AMP6 at 1 April 2015. These adjustments relate to the company's performance during AMP5 as well as the £4 million reward for achieving enhanced status for the company's PR14 Business Plan. The adjustments are set out in detail within the company's final determination.

REGULATORY FINANCIAL STATEMENTS CONTINUED

LICENCE CONDITION F – PARAGRAPH 7
OPERATING COST ANALYSIS
FOR THE 12 MONTHS ENDED 31 MARCH 2015 (WHOLESALE BUSINESS ONLY)

	Water resources £000	Raw water distribution £000	Water treatment £000	Treated water distribution £000	Water service total £000
Operating expenditure					
Power	-	2,948	12,891	3,155	18,994
Income treated as negative expenditure	-	-	-	-	-
Service charges	(1,295)	-	-	-	(1,295)
Bulk supply imports	-	-	3,390	-	3,390
Other operating expenditure	2,563	2,524	16,251	39,031	60,369
Local authority rates	1,987	336	2,912	10,376	15,611
Exceptional items	-	-	-	-	-
Total operating expenditure excluding third party services	**3,255**	**5,808**	**35,444**	**52,562**	**97,069**
Capital maintenance					
Infrastructure renewals charge	-	1,500	-	34,592	36,092
Current cost depreciation	17,404	614	19,070	11,960	49,048
Recharges to other business units	-	-	-	-	-
Recharges from other business units	-	-	-	-	-
Amortisation of deferred credit	(151)	(151)	(151)	-	(453)
Amortisation of intangible assets	-	-	-	-	-
Total capital maintenance excluding third party services	**17,253**	**1,963**	**18,919**	**46,552**	**84,687**
Third party services					
Operating expenditure	-	-	-	2,259	2,259
Infrastructure renewals charge	-	-	-	-	-
Current cost depreciation	-	-	-	-	-
Total operating costs	**20,508**	**7,771**	**54,363**	**101,373**	**184,015**

REGULATORY FINANCIAL STATEMENTS CONTINUED

LICENCE CONDITION F – PARAGRAPH 7
OPERATING COST ANALYSIS
FOR THE 12 MONTHS ENDED 31 MARCH 2015 (RETAIL BUSINESS ONLY)

	Household £000	Non-household £000	Retail services total £000
Operating expenditure			
Customer services	7,448	876	8,324
Debt management	137	39	176
Doubtful debts	8,851	1,140	9,991
Meter reading	3,245	357	3,602
Services to developers	-	-	-
Other operating expenditure	8,943	1,583	10,526
Local authority rates	507	26	533
Exceptional items	-	-	-
Total operating expenditure excluding third party services	**29,131**	**4,021**	**33,152**
Third party services operating expenditure	-	-	-
Total operating expenditure	**29,131**	**4,021**	**33,152**
Capital maintenance			
Current cost depreciation	2,962	181	3,143
Recharges to other business units	-	-	-
Recharges from other business units	-	-	-
Amortisation of deferred credits	-	-	-
Amortisation of intangible assets	-	-	-
Total capital maintenance	**2,962**	**181**	**3,143**
Total operating costs	**32,093**	**4,202**	**36,295**
Debt written off	**8,370**	**1,078**	**9,447**

Based on the company’s current systems it is not possible to exclude court and other debt recovery costs from debt written off amounts.

REGULATORY FINANCIAL STATEMENTS CONTINUED

NON-AUDITED SUPPLEMENTARY REGULATORY INFORMATION
NON FINANCIAL INFORMATION
FOR THE 12 MONTHS ENDED 31 MARCH 2015

		2015 Water	2014 Water
Number of properties			
Households billed		**1,340,077**	1,337,776
Non-households billed		**68,063**	70,125
Household voids		**42,380**	36,849
Non household voids		**10,351**	9,897
Properties served by new appointee in supply as at 1 April 2009		**2**	2
Per capita consumption (excluding supply pipe leakage) l/h/d			
Unmeasured household	- Central region	**165.37**	170.88
	- Southeast region	**172.38**	175.93
	- East region	**127.33**	157.78
Measured household	- Central region	**135.31**	135.40
	- Southeast region	**110.16**	121.20
	- East region	**111.89**	109.54
Volume (Ml/d)			
Bulk supply export		**25.93**	30.95
Bulk supply import		**14.36**	23.92
Distribution input		**895.76**	904.28

REGULATORY FINANCIAL STATEMENTS CONTINUED

NON-AUDITED SUPPLEMENTARY REGULATORY INFORMATION (CONTINUED)

Regulatory capital value

	2015 £000	2014 £000
Opening RCV for the year*	**1,006,466**	1,000,522
Capital expenditure	**48,609**	59,080
Infrastructure renewals expenditure	**46,939**	52,577
Infrastructure renewals charge	**(51,226)**	(50,583)
Grants and contributions	**(4,806)**	(4,281)
Depreciation	**(49,765)**	(50,924)
Out performance of regulatory assumptions (5 years in arrears)	**(9,009)**	(8,929)
Closing RCV carried forward	**987,208**	997,462
Average regulatory capital value	**995,157**	986,968

* prior year closing balance carried forward is adjusted for current year RPI

The table shows the RCV used in setting the price limits for the period. The differences from the actual capital expenditure, depreciation and other items will not affect price limits in the current period. Capital efficiencies and the effects of construction price inflation will be taken into account in the calculation for the next periodic review.

Transactions with associated companies

Company		Turnover of associate £000	Terms of supply	Value £000
Expenditure				
Affinity Water Shared Services Limited	Support services	8,543	Market tested	7,291
Affinity Water Capital Funds Limited**	Interest paid on loan	-	No market	160
Affinity Water Holdings Limited**	Dividends paid	-	No market	30,800
Veolia Environmental Services (UK) Limited	Waste water disposal	800,419	Market tested	254
Affinity Water Finance (2004) PLC**	Interest paid on loan	-	No market	13,634
Affinity Water Programme Finance Limited**	Interest paid on loan	-	No market	22,956
Income				
Affinity Water Shared Services Limited	Payroll services	8,543	Market tested	8,077
Veolia Water UK Limited	Transitional services and capability sharing agreement and other services	1,132	Market tested	178

* from latest publicly available financial statements.

** these companies do not have turnover.

REGULATORY FINANCIAL STATEMENTS CONTINUED

NON-AUDITED SUPPLEMENTARY REGULATORY INFORMATION (CONTINUED)

Transactions with associated companies (continued)

The company has applied a materiality threshold of £100,000 for disclosing transactions with individual related parties.

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, is £255,411,000 (2014: £197,036,000).

As part of the refinancing in February 2013, all existing loans and revolving facilities were replaced by the following four new bonds issued on 4 February 2013 by the company's 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 index-linked Notes maturing in June 2045 with a coupon of 1.548% and £95,000,000 Class B Guaranteed RPI index-linked Notes maturing in June 2033 with a coupon of 3.249%. The amount outstanding at year end, net of amortised debt issuance costs, is £576,081,000 (2014: £572,939,000). The proceeds of the above bond issues were lent to the company on the same terms.

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.

Dividend policy

The company's dividend policy is primarily based on maintaining a target level of gearing (net debt to RCV) of 80%. The amount of the dividend is dependent on the company's ability to generate cash flows and to achieve its regulatory outputs in the reported period. The policy distributes earnings equal to the amount necessary to maintain net debt to RCV at the targeted gearing ratio. This is consistent with the requirements of Condition F of the licence that dividends paid will not impair the ability of the appointee to finance the appointed business and under a system of incentive regulation, dividends would be expected to reward efficiency and the management of economic risk.

All profits arising from non-appointed business activities are paid out as dividends.

The directors have declared and paid ordinary dividends of £30,800,000 during the year ended 31 March 2015. This compares to £45,842,000 declared and paid in the year ended 31 March 2014.

No final dividend is proposed (2014: £nil).

REGULATORY FINANCIAL STATEMENTS CONTINUED

NON-AUDITED SUPPLEMENTARY REGULATORY INFORMATION (CONTINUED)

Accounting separation trial 2014/15

	Water resources £000	Raw water distribution £000	Water treatment £000	Treated water distribution £000
Operating expenditure	3,255	5,808	35,443	54,822
Infrastructure renewals charge	-	1,500	-	34,592
Current cost depreciation	17,404	614	19,070	11,960
Amortisation of deferred credit	(151)	(151)	(151)	-
Total operating costs	**20,508**	**7,771**	**54,362**	**101,374**

	Water resources		Raw water distribution		Water treatment	Treated water distribution	
	Abstraction licence £000	Raw water abstraction £000	Raw water transport £000	Raw water storage £000	£000	Trunk treated water distribution £000	Local treated water distribution £000
Operating expenditure	(1,231)	4,486	5,770	38	35,443	811	54,011
Infrastructure renewals charge	-	-	1,500	-	-	18,614	15,978
Current cost depreciation	-	17,404	-	614	19,070	6,436	5,524
Amortisation of deferred credit	-	(151)	(151)	-	(151)	-	-
Total operating costs	**(1,231)**	**21,739**	**7,119**	**652**	**54,362**	**25,861**	**75,513**
Volumes/drivers	Water abstracted	Water abstracted	Raw water mains	Raw water capacity	Water into supply	Water into supply	Water into supply
Unit costs	-4[1] (£/Ml)	65 (£/Ml)	36,064 (£/km)	597 (£/Ml)	166 (£/Ml)	79 (£/Ml)	230 (£/Ml)

The above data is derived from the accounting separation data on **pages 141 to 142** and the current cost depreciation data on **pages 135 to 136**.

Details behind the preparation of the accounting separation table above can be found on our stakeholder website: **stakeholder.affinitywater.co.uk**.

[1] The negative unit cost results from reimbursement of £3,840,000 Environmental Improvement Unit Charges ('EIUC') levied from 2008/09 to 2012/13 and £1,732,000 of credit notes received from the Environment Agency in respect of EIUC levied in 2013/14.

REGULATORY FINANCIAL STATEMENTS CONTINUED

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