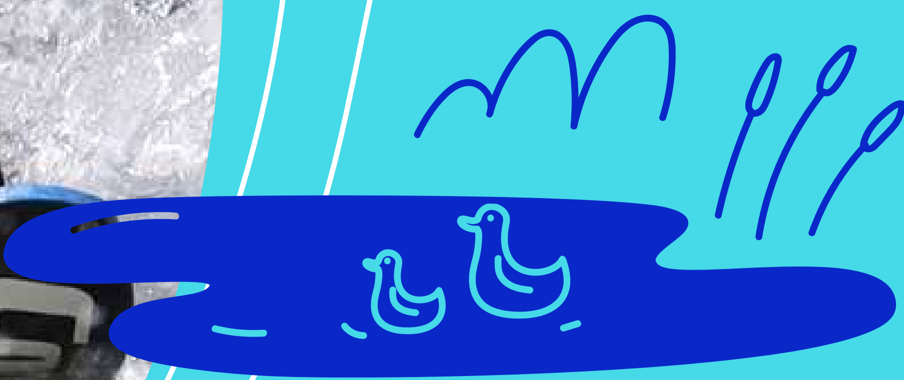
Financials



Independent Auditors' report to the members of Affinity Water Limited

Report on the audit of the financial statements

Opinion

In our opinion, Affinity Water Limited's financial statements:

- give a true and fair view of the state of the company's affairs as at 31 March 2023 and of its loss and cash flows for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, including FRS 101 "Reduced Disclosure Framework", and applicable law); and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the Annual Report and Financial Statements (the "Annual Report"), which comprise: the Statement of financial position as at 31 March 2023; the Income statement, the Statement of comprehensive income, the Statement of changes in equity and the Statement of cash flows for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We remained independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

Our audit approach

Context

The terms of the company's licence under the Water Industry Act 1991 require the company to report as if it had issued equity share capital listed on the London Stock Exchange and therefore the opinion below refers to the Listing Rules of the Financial Conduct Authority.

Our key audit matters for the year ended 31 March 2023 remain consistent with the year ended 31 March 2022, as set out in further detail below.

Overview

Audit scope

- The company has one finance function, with the audit being carried out by one team.
- In scoping our audit, with reference to our risk assessment, we identified and included all material financial statement line items within the scope of our audit procedures.

Key audit matters

- Accuracy of the measured income accrual
- Adequacy of loss allowance for trade receivables
- Assessment of cost capitalisation

Materiality

- Overall materiality: £3.0 million (2022: £3.8 million) based on approximately 3.5% of the earnings before interest, tax, depreciation and amortisation ('EBITDA') (2022: 3.5% of EBITDA).
- Performance materiality: £2.2 million (2022: £2.9 million).

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements.

Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

This is not a complete list of all risks identified by our audit.

The key audit matters below are consistent with last year.

Key audit matter	How our audit addressed the key audit matter
Accuracy of the measured income accrual	
Refer to page 156 (Audit, Risk and Assurance Committee Report), page 231 (accounting policies) and page 245 (note 12).	
A measured income accrual of £39.8 million (31 March 2022: £40.9 million) has been recognised relating to revenue from the provision of water services to metered household customers that had not been billed at the year end date.	The measured income accrual is a manual calculation prepared using data from the Hi-Affinity billing system. We understood the methodology and ensured that it had been applied consistently with previous years. We also tested the mechanics of the spreadsheet used to calculate the measured income accrual.
The determination of the measured income accrual impacts directly on both reported revenue and operating profit. The measured income accrual accounts for the timing difference between the last meter reading and the estimated consumption of water from that point to the year end and is calculated based on the average consumption over the past two years by small geographical groupings of customers.	In respect of the integrity of the data within Hi-Affinity, we tested the design and operating effectiveness of key controls within the revenue and receivables cycle, including the reconciliation of reports produced from the Hi-Affinity billing system and the revenue journals posted to the general ledger, and the quarterly review of tariff changes made in the Hi-Affinity billing system.
Given the range of factors underlying this estimate, there is a risk that the measured income accrual and associated revenue could be materially misstated.	We also validated the accuracy of the data within Hi-Affinity by agreeing a sample of meter readings to the system and tracing actual consumption to the bills raised. To assess the overall reasonableness of the accrual, we performed an independent roll forward of the accrual recognised at 31 March 2022 to calculate an expected accrual at 31 March 2023, reflecting the underlying changes in the number of metered customers, pricing tariffs, levels of water consumption and the timing of meter readings. In order to assess the ability of management to prepare appropriate estimates in respect of the measured income accrual, we evaluated the historical accuracy of the estimation process by comparing the bills raised through the year to the amount accrued at 31 March 2022. We also compared the billing subsequent to 31 March 2023 and extrapolated the difference identified against the remainder of the accrual. Based on the procedures performed, we did not identify any material misstatements. We also assessed the disclosures in respect of the measured income accrual and consider these to be appropriate.

Independent Auditors' report to the members of Affinity Water Limited continued

Key audit matter	How our audit addressed the key audit matter
Adequacy of loss allowance for trade receivables Refer to page 156 (Audit, Risk and Assurance Committee Report), page 231 (accounting policies), page 245 (note 12) and page 260 (note A4).	
The loss allowance for trade receivables of £37.0m (31 March 2022: £33.0m) was calculated by applying a range of different percentages to trade receivables based on their respective ageing, with higher percentages applied to those categories of trade receivables which are considered to be of greater risk.	We reviewed the methodology for calculating the underlying loss allowance for trade receivables and ensured it had been consistently applied with the prior year, with the exception of an incremental provision in respect of the impact of the cost of living on customers no longer being recognised. This is on the basis that this impact is reflected within the underlying collection rates used to calculate the provision.
Some customers have difficulty paying their bills or, in certain instances, choose not to pay them. As a result, given there are limited steps that a water company can take to recover debt from household customers, there is an ongoing risk of aged trade receivables not being collected, with this risk being heightened by the economic impact of the increased cost of living being experienced by customers.	We also understood and tested the mechanics of the spreadsheet used to calculate the initial loss allowance, the measurement basis (measured and unmeasured) and the methodology applied to calculate provision rates and agreed that they are consistent with the prior year. To ensure the appropriate classification of customers into sub-categories to apply the historical expected credit loss methodology, we selected a sample of trade receivables and tested that they have been allocated the appropriate provision rate based on ageing, customer type and measurement basis.
Given the quantum of trade receivables, and the range of assumptions used in preparing the loss allowance for trade receivables, there is a risk that this estimate could be materially misstated.	In addition, we compared the actual rates used in the calculation of the loss allowance to prior year rates and reviewed the level of bad debt write offs which occurred during the year ended 31 March 2023 to assess the ability of management to prepare appropriate estimates. We also challenged management on the appropriateness of their methodology, through the use of sensitivity analysis to assess the impact of calculating the provision and performed sensitivity analysis using average collection rates over a number of periods showing the provision is materially appropriate. Based on the procedures performed, we did not identify any material differences within the loss allowance for trade receivables. We also assessed the disclosures in respect of the loss allowance for trade receivables and consider these to be appropriate.

Key audit matter	How our audit addressed the key audit matter
Assessment of cost capitalisation	
Refer to page 156 (Audit, Risk and Assurance Committee Report), page 231 (accounting policies), page 241 (note 6) and page 260 (note A4).	We reviewed the process for allocating costs to capital projects to check that this allocation was made on an appropriate basis and is in line with the company's capitalisation policy.
The additions to assets under construction during the year amounted to £114.3m (year ended 31 March 2022: £136.0m). These additions arose as a result of the fact that the company capitalises expenditure with respect to its infrastructure assets where such expenditure enhances or increases the capacity of the network, or relates to material replacements of network components.	We also reviewed journals impacting property, plant and equipment with a credit to an unexpected income statement account. This test was performed to address the risk of non-capital expenditure being inappropriately capitalised.
The allocation of costs between capital and non-capital expenditure has a direct impact on profitability in any given year.	We also performed a review of capital projects within assets under construction, to understand the nature of the work being performed and the estimated completion dates of the projects. We then used this information to challenge, where appropriate, the accounting treatment of these projects as at 31 March 2023.
There is also a risk of completed assets not being appropriately transferred from assets under construction to the relevant asset categories.	We examined the process of capitalising staff time through the inspection of time sheet data and tested a sample of staff costs capitalised to ensure that the time capitalised related to valid capital projects.
Given the magnitude of capital expenditure, there is a risk that incorrect classification could give rise to a material misstatement.	We also tested a sample of additions to assets under construction during the year to corroborate the amount and appropriateness of these assets being capitalised.
	Overall, we consider the costs capitalised as at 31 March 2023 to be materially appropriate. We also assessed the disclosures in respect of the capitalisation of costs and consider these to be appropriate.

Independent Auditors' report to the members of Affinity Water Limited continued

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the company, the accounting processes and controls, and the industry in which it operates.

The company has one finance function, with the audit being carried out by one team.

In scoping our audit, with reference to our risk assessment, we identified and included all material financial statement line items within the scope of our audit procedures.

The impact of climate risk on our audit

Planning for, reacting to and assessing the impact of current and future changes in environmental factors, for example the volume and intensity of rainfall and periods of drought, is an inherent part of the company's day to day activities.

The majority of the company's carbon emissions are incurred in the treatment of water during the normal course of its operations, and the company continues to develop its assessment of climate change in terms of capital expenditure, the useful economic lives of assets currently in use (and those currently under construction) and impacts on cash flows.

In planning our audit, we considered the impact that the company has on the environment through its operations and the impact the environment, including the current and potential future impact of climate change, has on the company's business and its financial statements. We did not identify any additional risks of material misstatement in this respect.

As part of our audit, we made enquiries of management to understand the extent of the potential impact of climate change risks on the company's financial statements, including their assessment of critical accounting estimates and judgements, and the effect on our audit.

Whilst it is acknowledged that the physical and transition risks posed by climate change have the potential to impact the company over the medium to long-term, in particular given the commitment to achieve net zero carbon from operations by 2030, management has assessed that there is no quantitatively material impact arising from climate change on the judgements and estimates made in the financial statements for the year ended 31 March 2023.

We read the company's climate related disclosures in the other information within the Annual Report and considered consistency with the financial statements and our audit knowledge. We also made additional considerations throughout the performance of our audit to address areas which are commonly seen to be impacted by the risks associated with climate change, including the assumptions made as part of the assessment of the company to continue as a going concern, the long term viability of the company and the appropriateness of the useful economic lives of material non-current assets. We have not identified any material exceptions through the procedures performed.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Overall company materiality	£3.0 million (2022: £3.8 million).
How we determined it	Based on approximately 3.5% of the earnings before interest, tax, depreciation and amortisation ('EBITDA') (2022: based on approximately 3.5% of EBITDA)
Rationale for benchmark applied	We have used EBITDA as this is the measure that management focus on internally within their reporting. The use of EBITDA is also consistent with the prior year.

We use performance materiality to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds overall materiality. Specifically, we use performance materiality in determining the scope of our audit and the nature and extent of our testing of account balances, classes of transactions and disclosures, for example in determining sample sizes. Our performance materiality was 75% (2021: 75%) of overall materiality, amounting to £2.2 million (2022: £2.9 million) for the company financial statements.

In determining the performance materiality, we considered a number of factors - the history of misstatements, risk assessment and aggregation risk and the effectiveness of controls - and concluded that an amount at the upper end of our normal range was appropriate.

We agreed with those charged with governance that we would report to them misstatements identified during our audit above £0.15 million (2022: £0.2 million) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Conclusions relating to going concern

Our evaluation of the directors' assessment of the company's ability to continue to adopt the going concern basis of accounting included:

- testing the mathematical accuracy of the base case going concern model prepared by management and agreeing this to Board approved budgets;
- assessing the inputs and underlying assumptions of the base case model;
- assessed the accuracy of the cash flow forecast prepared in the prior year so as to obtain assurance of the ability of management to prepare accurate forecasts;
- assessing the downside scenario which has been used to sensitise the base case model, including consideration of the underlying assumptions;
- reviewing management's analysis of both liquidity and covenant compliance to ensure there is sufficient liquidity and no forecast covenant breaches during the going concern period; and
- assessing the extent of mitigating actions that could be taken by management, if necessary, to prevent a trigger or default event arising against the covenants in place.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the company's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

In auditing the financial statements, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

However, because not all future events or conditions can be predicted, this conclusion is not a guarantee as to the company's ability to continue as a going concern.

In relation to the directors' reporting on how they have applied the UK Corporate Governance Code, we have nothing material to add or draw attention to in relation to the directors' statement in the financial statements about whether the directors considered it appropriate to adopt the going concern basis of accounting.

Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report.

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information, which includes reporting based on the Task Force on Climate-related Financial Disclosures ('TCFD') recommendations. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic Report and Directors' Report, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on our work undertaken in the course of the audit, the Companies Act 2006 requires us also to report certain opinions and matters as described below.

Strategic Report and Directors' Report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Directors' Report for the year ended 31 March 2023 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

Independent Auditors' report to the members of Affinity Water Limited continued

In light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic Report and Directors' Report.

Corporate governance statement

ISAs (UK) require us to review the directors' statements in relation to going concern, longer-term viability and that part of the corporate governance statement relating to the company's compliance with the provisions of the UK Corporate Governance Code, which the Listing Rules of the Financial Conduct Authority specify for review by auditors of premium listed companies. Our additional responsibilities with respect to the corporate governance statement as other information are described in the Reporting on other information section of this report.

Based on the work undertaken as part of our audit, we have concluded that each of the following elements of the corporate governance statement is materially consistent with the financial statements and our knowledge obtained during the audit, and we have nothing material to add or draw attention to in relation to:

- The directors' confirmation that they have carried out a robust assessment of the emerging and principal risks;
- The disclosures in the Annual Report that describe those principal risks, what procedures are in place to identify emerging risks and an explanation of how these are being managed or mitigated;
- The directors' statement in the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and their identification of any material uncertainties to the company's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements;
- The directors' explanation as to their assessment of the company's prospects, the period this assessment covers and why the period is appropriate; and
- The directors' statement as to whether they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of its assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

Our review of the directors' statement regarding the longer-term viability of the company was substantially less in scope than an audit and only consisted of making inquiries and considering the directors' process supporting their statement; checking that the statement is in alignment with the relevant provisions of the UK Corporate Governance Code; and considering whether the statement is consistent with the financial statements and our knowledge and understanding of the company and its environment obtained in the course of the audit.

In addition, based on the work undertaken as part of our audit, we have concluded that each of the following elements of the corporate governance statement is materially consistent with the financial statements and our knowledge obtained during the audit:

- The directors' statement that they consider the Annual Report, taken as a whole, is fair, balanced and understandable, and provides the information necessary for the members to assess the company's position, performance, business model and strategy;
- The section of the Annual Report that describes the review of effectiveness of risk management and internal control systems; and
- The section of the Annual Report describing the work of the audit committee.

We have nothing to report in respect of our responsibility to report when the directors' statement relating to the company's compliance with the Code does not properly disclose a departure from a relevant provision of the Code specified under the Listing Rules for review by the auditors.

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the Statement of directors' responsibilities in respect of the financial statements, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud, is detailed below.

Based on our understanding of the company and industry, we identified that the principal risks of non-compliance with laws and regulations related to industry regulation, including the requirements of The Water Services Regulation Authority ('Ofwat'), the Water Industry Act 1991, health and safety regulation (including the requirements of The Health and Safety at Work etc Act 1974) and environmental regulation, and we considered the extent to which non-compliance might have a material effect on the financial statements. We also considered those laws and regulations that have a direct impact on the financial statements such as the Listing Rules, UK tax legislation, pensions legislation and the Companies Act 2006. We evaluated management's incentives and opportunities for fraudulent manipulation of the financial statements (including the risk of override of controls), and determined that the principal risks were related to posting inappropriate journal entries to increase revenue or reduce expenditure, in doing so increasing overall profitability, and management bias within accounting estimates, in particular the potential manipulation of the measured income accrual, loss allowance for trade receivables or the extent of costs capitalised. Audit procedures performed by the engagement team included:

- discussions with management, internal audit and the company's legal team, including inquiring of known or suspected instances of non-compliance with laws and regulation and fraud, and review of board minutes and internal audit reports;
- discussions with the General Counsel and Head of Ethics & Compliance to discuss both the litigation report and summary of whistleblowing matters arising;
- challenging assumptions made by management when preparing accounting estimates, in particular those that involve the assessment of future events, which are inherently uncertain – the key estimates determined in this respect are those relating to the measured income accrual and loss allowance for trade receivables; and
- identifying and testing journal entries posted, such as those with unusual account combinations, and incorporating an element of unpredictability into the audit procedures performed

There are inherent limitations in the audit procedures described above. We are less likely to become aware of instances of non-compliance with laws and regulations that are not closely related to events and transactions reflected in the financial statements. Also, the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion.

Our audit testing might include testing complete populations of certain transactions and balances, possibly using data auditing techniques. However, it typically involves selecting a limited number of items for testing, rather than testing complete populations. We will often seek to target particular items for testing based on their size or risk characteristics. In other cases, we will use audit sampling to enable us to draw a conclusion about the population from which the sample is selected.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report

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.

Other required reporting

Companies Act 2006 exception reporting

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not obtained all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the company, or returns adequate for our audit have not been received from branches not visited by us; or
- certain disclosures of directors' remuneration specified by law are not made; or
- the financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Other voluntary reporting

Directors' remuneration

The company voluntarily prepares a Remuneration Report in accordance with the provisions of the Companies Act 2006. The directors requested that we audit the part of the Remuneration Report specified by the Companies Act 2006 to be audited as if the company were a quoted company.

In our opinion, the part of the Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

Simon Bailey (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Watford

12 July 2023

Income statement

for the year ended 31 March 2023

(Registered Number 02546950)

	Note	2023 £000	2022 £000
Revenue	1	**323,343**	319,747
Cost of sales		**(282,452)**	(258,553)
Gross profit		**40,891**	61,194
Administrative expenses		**(37,650)**	(38,159)
Impairment losses on financial and contract assets	2.1	**(11,199)**	(7,444)
Other operating income	2.2	**21,929**	18,972
Operating profit	2	**13,971**	34,563
Finance income	4	**19,529**	16,043
Finance costs	4	**(169,693)**	(102,873)
Fair value gain/(loss) on inflation swaps	4	**50,122**	(31,295)
Net finance costs	4	**(100,042)**	(118,125)
Fair value (loss)/gain on energy swaps		**(26,638)**	27,988
Loss before tax		**(112,709)**	(55,574)
Income tax credit/(expense)	5	**11,764**	(41,331)
Loss for the financial year		**(100,945)**	(96,905)

All results of the company in the current year and prior year are from continuing operations.

The notes on pages 231 to 270 are an integral part of these financial statements.

Statement of comprehensive income

for the year ended 31 March 2023

(Registered Number 02546950)

	Note	2023 £000	2022 £000
Loss for the financial year		**(100,945)**	(96,905)
Other comprehensive (expense)/income for the year which will not be reclassified to profit or loss:			
Re-measurements of post-employment benefit assets	10	**(52,114)**	28,749
Deferred tax credit/(charge) on items that will not be reclassified	5	**13,029**	(7,187)
Other comprehensive (expense)/income for the year, net of tax		**(39,085)**	21,562
Total comprehensive expense for the year		**(140,030)**	(75,343)

The notes on pages 231 to 270 are an integral part of these financial statements.

Statement of financial position

as at 31 March 2023

(Registered Number 02546950)

	Note	2023 £000	2022 £000
Assets			
Non-current assets			
Property, plant and equipment	6	**1,658,058**	1,615,571
Right-of-use assets	7	**7,649**	9,440
Intangible assets	8	**42,611**	43,266
Investments	9	**100**	100
Retirement benefit surplus	10	**53,615**	104,247
Derivative financial instruments	11	**3,283**	7,342
		1,765,316	1,779,966
Current assets			
Inventories	13	**4,833**	4,348
Derivative financial instruments	11	**6,068**	20,646
Trade and other receivables	12	**102,566**	103,821
Short-term investments	9	**66,709**	70,179
Cash and cash equivalents	14	**78,783**	135,604
		258,959	334,598
Total assets		**2,024,275**	2,114,564
Equity and liabilities			
Equity			
Called up share capital	15	**30,506**	30,506
Share premium account	15	**1,400**	1,400
Capital contribution reserve	15	**30,150**	30,150
Accumulated losses		**(157,783)**	(17,753)
Total equity		**(95,727)**	44,303
Liabilities			
Non-current liabilities			
Trade and other payables	16	**262,074**	247,074
Borrowings	17	**1,331,716**	1,275,788
Lease liabilities	18	**4,785**	6,329
Derivative financial instruments	11	**121,719**	106,818
Deferred tax liabilities	19	**206,738**	231,530
Provisions for other liabilities and charges	20	**3,319**	3,107
		1,930,351	1,870,646
Current liabilities			
Trade and other payables	16	**176,889**	192,817
Lease liabilities	18	**3,053**	3,317
Derivative financial instruments	11	**2,128**	–
Provisions for other liabilities and charges	20	**4,100**	–
Current tax liabilities		**3,481**	3,481
		189,651	199,615
Total liabilities		**2,120,002**	2,070,261
Total equity and liabilities		**2,024,275**	2,114,564

The notes on pages 231 to 270 are an integral part of these financial statements. The statutory financial statements on pages 226 to 270 were approved by the Board of directors and were signed and authorised for issue on 12 July 2023 on its behalf by:

Keith Haslett
Chief Executive Officer

Martin Roughead
Chief Financial Officer

Statement of changes in equity

for the year ended 31 March 2023

(Registered Number 02546950)

	Note	Called up share capital £000	Share premium account £000	Capital contribution reserve £000	Retained earnings/ (accumulated losses) £000	Total equity £000
Balance as at 1 April 2021		30,506	1,400	30,150	57,590	119,646
Loss for the year		–	–	–	(96,905)	(96,905)
Other comprehensive income		–	–	–	21,562	21,562
Total comprehensive expense		–	–	–	(75,343)	(75,343)
Total transactions with owners recognised directly in equity		–	–	–	–	–
Balance as at 31 March 2022		30,506	1,400	30,150	(17,753)	44,303
Balance as at 1 April 2022		**30,506**	**1,400**	**30,150**	**(17,753)**	**44,303**
Loss for the year		**–**	**–**	**–**	**(100,945)**	**(100,945)**
Other comprehensive expense		**–**	**–**	**–**	**(39,085)**	**(39,085)**
Total comprehensive expense		–	–	–	(140,030)	(140,030)
Total transactions with owners recognised directly in equity		–	–	–	–	–
Balance as at 31 March 2023		**30,506**	**1,400**	**30,150**	**(157,783)**	(95,727)

The notes on pages 231 to 270 are an integral part of these financial statements.

Statement of cash flows

for the year ended 31 March 2023

(Registered Number 02546950)

	Note	2023 £000	2022 £000
Cash flows from operating activities			
Cash generated from operations	21.1	**98,088**	101,280
Interest paid		**(42,868)**	(41,807)
Tax received/(paid)		**–**	(130)
Net cash inflow from operating activities excluding capital contributions		**55,220**	59,343
Capital contributions		**9,637**	25,771
Net cash inflow from operating activities		**64,857**	85,114
Cash flows from investing activities			
Investment in short-term deposits		**3,470**	(55,046)
Purchases of property, plant and equipment		**(122,385)**	(131,288)
Proceeds from sale of property, plant and equipment		**535**	435
Purchases of intangible assets		**(5,299)**	(8,608)
Interest received		**19,680**	16,886
Net cash outflow from investing activities		**(103,999)**	(177,621)
Cash flows from financing activities			
Proceeds from loan from subsidiary undertaking		**–**	146,994
Principal elements of lease payments	18	**(3,475)**	(3,649)
Repayment of borrowings		**(14,204)**	–
Net cash (outflow)/inflow from financing activities		**(17,679)**	143,345
Net (decrease)/increase in cash and cash equivalents		**(56,821)**	50,838
Cash and cash equivalents at the beginning of the year		**135,604**	84,766
Cash and cash equivalents at end of year	14	**78,783**	135,604

The notes on pages 231 to 270 are an integral part of these financial statements.

Notes to the financial statements – accounting policies

Basis of preparation

These financial statements have been prepared under the historical cost convention, modified by revaluation of financial assets and financial liabilities held at fair value through profit and loss, and in accordance with the Companies Act 2006 and Financial Reporting Standard 101: 'Reduced disclosure framework' ('FRS 101') as issued by the Financial Reporting Council.

In preparing these financial statements, the company applies the recognition, measurement and disclosure requirements of International Financial Reporting Standards as adopted by the UK (UK-adopted international accounting standards), but makes amendments where necessary in order to comply with the Companies Act 2006 and to take advantage of FRS 101 disclosure exemptions.

On 31 December 2020, EU-adopted IFRS was brought into UK law and became UK-adopted international accounting standards, with future changes to IFRS being subject to endorsement by the UK Endorsement Board. In preparing these financial statements in accordance with FRS 101, the company financial statements transitioned to UK-adopted international accounting standards (as described above) on 1 January 2021. There is no impact on recognition, measurement or disclosure in the period reported as a result of this change.

Going concern

The directors consider it appropriate to adopt the going concern basis of accounting in preparing the financial statements as they believe that 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 and for a period of at least 12 months from the date of approval of these financial statements. This is based on assessment of the principal risks of the company and the other matters discussed in connection with the viability statement on pages 122 to 126, as well as consideration of the company's budgeted cash flows, short and long term forecasts and ability to generate future revenues, related assumptions and available debt facilities.

To assess the severe but plausible downside scenario, management have considered a base case scenario that reflects the current market conditions in the economy and have applied a series of severe downside assumptions. These include both increased costs from the financial impacts of operational events, including the impact of a severe cold weather event over the winter period, and an increase in bad debt representing approximately 20% of debt not currently subject to loss allowance provision. These severe but plausible downside scenarios are overlaid on our base case forecast which has taken into consideration the impact of inflation, interest rates, supply chain cost pressures, the energy price crisis and the cost of living crisis.

Both an ICR Trigger and Default Event would occur in a number of these severe but plausible downside scenarios detailed in the viability statement. However this is on the assumption that no mitigating actions would be taken. Management are confident that mitigation actions within their control could be implemented that would prevent a trigger or default event from occurring should one of these scenarios arise. Under an ICR Trigger Event, the company would be subject to certain constraints such as restrictions on dividends and restriction on debt buybacks. However, the directors are satisfied that an ICR Trigger Event would not fundamentally constrain the company's ability to carry out its business, particularly after considering the company's strong cash position meaning that the company has no further funding requirement in AMP7. Under an ICR Default Event, each finance party may declare all amounts outstanding under the applicable Finance Documents to be immediately due and payable.

The company continues to monitor and manage the risks associated with the ICR covenant through the forecasting and reporting process and continues to monitor potential mitigations, the most prominent of which are working capital management, operating expenditure reviews and debt buy backs.

The directors have also considered the ring fence structure in place and have obtained comfort that the existence of external borrowings outside of this structure, namely that within Affinity Water Holdco Finance Limited, does not impact the conclusions reached regarding the ability of the company to continue as a going concern. This is due to the fact that the company has no obligation to distribute funds through the holding company structure in order to meet such liabilities.

Details of the company's cash and short-term investment are included in the statement of financial position on page 228, and undrawn committed borrowing facilities are included in note 17. Due to the nature of the regulated water company's business, the directors consider it appropriate to place reliance on projected financials. There have been no events after the reporting period significantly affecting liquidity headroom.

Principal accounting policies

The principal accounting policies applied in the preparation of these financial statements are set out in note A3. These policies have been consistently applied to all the years presented, unless otherwise stated.

Adoption of new and revised standards

There are no amendments to accounting standards, or IFRIC interpretations that are effective for the year ended 31 March 2023 that have a material impact on the company's financial statements.

Notes to the financial statements – accounting policies continued

New standards, amendments and interpretations not yet adopted

There are no new standards and interpretations, which are not yet effective and have not been early adopted by the company, that will have a material effect on future years.

Disclosure exemptions

As permitted by FRS 101, the company has taken advantage of the following disclosure exemptions available under that standard in the preparation of these financial statements:

- Paragraph 38 of IAS 1: 'Presentation of financial statements' comparative information requirements in respect of:
  - paragraph 79(a)(iv) of IAS 1: 'Presentation of financial statements';
  - paragraph 73(e) of IAS 16: 'Property, plant and equipment'; and
  - paragraph 118(e) of IAS 38: 'Intangible assets' (reconciliations between the carrying amount at the beginning and end of the period)
- The following paragraphs of IAS 1: 'Presentation of financial statements':
  - 16 (statement of compliance with all IFRS); and
  - 38B-D (additional comparative information)
- Paragraphs 40A-D of IAS 1: 'Presentation of financial statements' in respect of prior year restatements
- Paragraph 17 of IAS 24: 'Related party disclosures' (key management compensation)
- The requirements in IAS 24: 'Related party disclosures' to disclose related party transactions entered into between two or more members of a group.
- Paragraphs 130(f)(ii), 130(f)(iii), 134(d) to 134(f) and 135(c) to 135(e) of IAS 36, 'Impairment of assets' (disclosures when the recoverable amount is fair value less costs of disposal, assumptions involved in estimating recoverable amounts of cash-generating units containing goodwill or intangible assets with indefinite useful lives, and management's approach to determining these amounts)

Critical accounting estimates

The preparation of financial statements in conformity with FRS 101 requires the use of certain critical accounting estimates. Estimates are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The company makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

Measured income accrual

The company records an accrual for measured consumption of water that has not yet been billed (refer to note 13). The accrual is estimated using a defined methodology based upon weighted average water consumption by tariff, which is calculated based upon historical information. Revenue for the year ended 31 March 2022 included a measured income accrual of £40,757,000. The value of billing recognised in the year ended 31 March 2023 for consumption in the prior year was £41,313,000.

This resulted in an increase of £556,000 in the current year's revenue due to the under-estimation of the prior year's revenue. This represented 0.17% of 2022/23 revenue.

Non-household wholesale revenue

The company has contracts with third parties operating in the non-household retail market for the supply of clean water (wholesale supply). The underlying performance obligation is the development and maintenance of the network, and ensuring its continued availability to such third party retailers on behalf of non-household consumers. Revenue is recognised at the point at which the company has a right to receive the revenue. For non-household retailers, the amount which the company has a right to receive, is determined by non-household consumption volume data provided by the market operator.

Loss allowance of trade receivables and contract assets

The company makes an estimate of the recoverable value of trade receivables and contract assets and records a loss allowance based on experience (refer to note A3). This provision is based on, amongst other things, a consideration of actual collection history. At each reporting date, the company takes into consideration any significant economic changes that may impact its credit loss model and future credit losses. The actual level of receivables collected may differ from the estimated levels of recovery, which could impact operating results positively or negatively. If the average of the 2021/22 and 2022/23 provision %'s were applied across each aged debt bracket, it would result in a reduction in the loss allowance for trade receivables and contract assets by £2,311,000 and corresponding increase in net assets. For comparison, if the average of the 2020/21 and 2021/22 provision %'s were applied across each aged debt bracket in the prior year, the equivalent sensitivity would have resulted in a £188,000 reduction in the loss allowance for trade receivables and contract assets and corresponding increase in net assets in the prior year.

Useful economic lives of property, plant and equipment

The annual depreciation charge for property, plant and equipment is sensitive to changes in the estimated useful economic lives and residual values of the assets. The useful economic lives and residual values are re-assessed annually. They are amended when necessary to reflect current estimates, based on management's judgement and experience, which include the knowledge and research of the company's dedicated asset management teams and the company's plans to achieve Net Zero carbon emissions by 2030. Refer to note 7 for the carrying amount of property, plant and equipment and note A3 for the useful economic lives for each class of assets.

Based on the current useful lives, the carrying amount of property, plant and equipment at 31 March 2023 is £1,658,058,000 (2022: £1,615,571,000). If the useful lives of the assets were 10% shorter, the carrying amount would instead be £1,215,568,000 (2022: £1,164,882,000) and if they were 10% longer, the carrying amount would be £1,823,352,000 (2022: £1,747,322,000).

Based on the current useful lives, the carrying amount of intangible assets, excluding goodwill, at 31 March 2023 is £27,650,000 (2022: £28,305,000). If the useful lives of the assets were 10% shorter, the carrying amount would instead be £25,004,000 (2022: £25,150,000) and if they were 10% longer, the carrying amount would be £30,297,000 (2022: £31,460,000).

The above estimates have been calculated using the average useful life for each class of asset and assumes that the assets in each category are midway through their useful life.

Defined benefit pension plan

The company has an obligation to pay pension benefits to certain employees. The cost of these benefits and the present value of the obligation depend on a number of factors, including life expectancy, inflation, salary increases, asset valuations and the discount rate on corporate bonds. Management estimates these factors in determining the net pension obligation in the statement of financial position. The assumptions (refer to note A5) reflect historical experience and current trends and may differ from actual results due to changing market and economic conditions and longer or shorter lives of participants. There are no restrictions to the realisability of the surplus relating to the defined benefit section of the pension plan; therefore, no adjustment has been made to the retirement benefit surplus recognised in accordance with International Financial Reporting Interpretations Committee 14: 'The limit on a defined benefit asset, minimum funding requirements and their interaction'. A sensitivity analysis has been performed based on changing different assumptions – see note A5 for the impact of changes in assumptions used.

Notes to the financial statements – accounting policies continued

Critical accounting judgements in applying the entity's accounting policies

The preparation of financial statements also requires management to exercise its judgement in the process of applying the company's accounting policies. The areas involving a higher degree of judgement or complexity are disclosed below.

Revenue recognition

IFRS 15 requires revenue to be recognised in line with the satisfaction of performance obligations identified within contracts between an entity and its customers, at an amount that reflects the transaction price allocated to each performance obligation. Particular challenges exist within the water industry as formal written contracts do not exist for most transactions with customers. Contracts are instead implied through statute and regulation. Judgement is, therefore, required in identifying the services contained within the contract and the customer with whom the contract is entered into, which in turn impacts on how the performance obligations are considered and, therefore, revenue recognised.

Refer to note 1 for the amount of revenue recognised in the income statement.

Grants and contributions

Grants and contributions (consisting of contributions for diversions and requisitioned mains/extensions, and infrastructure charges) are received in respect of property, plant and equipment. Judgement is required in identifying what the performance obligation is for each type of contribution, which in turn impacts on how revenue is recognised.

Contributions received in respect of diversions, requisitioned mains/extensions and infrastructure charges are recognised over a period of time. Contributions received in respect of connections charges are recognised immediately in the income statement. Refer to note A3 for further detail on our accounting policies in relation to these. Refer to note 1 for the amount of revenue recognised in the income statement.

Included within grants and contributions are contributions received relating to the HS2 rail programme, which crosses our supply area. These are shown within capital contributions in the statement of cash flows.

Cost capitalisation

The company capitalises expenditure on its infrastructure assets to property, plant and equipment where such expenditure enhances or increases the capacity of the network, or relates to material replacements of network components. Any expenditure classed as maintenance is expensed in the year it is incurred. Distinguishing between enhancement and maintenance expenditure is a subjective area, particularly when projects have both elements within them. The company is seeing increased enhancement and maintenance expenditure due to an increase in extreme weather events arising due to climate change. Refer to note 7 for the carrying amount of property, plant and equipment.

Climate change

The natural environment within which the company operates is constantly evolving due to the effects of climate change. This will influence how water is delivered by the company in the future.

The company is continually developing its assessment of the impact that climate change has on the assets and liabilities recognised and presented in its financial statements, such as the valuation of the property, plant and equipment, which could be impacted by either flooding or drought, or management's decision to replace assets as part of the company's Net Zero strategy. Management has considered the useful economic lives of assets impacted by climate change and environmental regulation and has considered whether any impairment has arose as a result of climate change. There has been no revaluation of assets or change in the assessment of assets' useful economic lives during 2022/23 as a result of this review.

The company established a Green Finance Framework during the year and issued its first green bond in October 2021 to finance projects which will adapt to and mitigate the effects of climate change. Updates on the proceeds and impact of the Green Funding can be found on our website at affinitywater.co.uk/corporate/investors/library.

Notes
to the financial statements

1. Revenue

1.1 Disaggregation of revenue from contracts with customers

	2023 £000	2022 £000
Timing of revenue recognition – at a point in time		
Unmeasured supplies	**95,859**	100,115
Measured supplies	**160,210**	155,232
Non-household wholesale revenue	**54,028**	51,111
Connection charges	**9,628**	7,989
	319,725	314,447
Timing of revenue recognition – over time		
Requisitioned mains/extensions	**556**	573
Diversions	**1,821**	3,382
Infrastructure charges	**1,178**	1,145
Other	**63**	200
	3,618	5,300
	323,343	319,747

All revenue is derived in the United Kingdom.

1.2 Assets and liabilities related to contracts with customers

The company has recognised the following assets and liabilities related to contracts with customers:

	2023 £000	2022 £000
Net trade receivables	**36,839**	33,480
Contract assets		
Unbilled accrual for metered customers – household customers	**39,516**	40,847
Unbilled accrual for metered customers – non-household customers	**3,928**	3,506
Contract liabilities		
Payments received in advance – household water supplies	**48,500**	46,746
Payments received in advance – non-household water supplies	**591**	–
Deferred income – water supplies	**76**	207
Deferred income – other	**506**	622
Deferred grants and contributions	**269,039**	252,772
Payments received in advance – grants and contributions	**15,104**	27,023

'Payments received in advance – grants and contributions' in the table above relate to contributions received from developers where the asset is still work in progress and not yet being depreciated. Once the asset is complete, the contribution is moved from 'payments received in advance – grants and contributions' to 'deferred grants and contributions' and amortised, to ensure the accounting treatment is consistent.

Significant changes in contract assets and liabilities

Up to 31 March 2023, the company had been reimbursed £157,631,000 (2022: £154,187,000) for its costs incurred in relation to the HS2 rail project, which will cross the Affinity Water supply area. This project is near completion and the company does not expect to incur significant costs for this in future periods. During the year, in line with the company's accounting policy for grants and contributions received in respect of property, plant and equipment, which include contributions received for diversions, £16,364,000 (2022: £98,478,000) relating to costs for assets that have been commissioned was reclassified from payments in advance – grants and contributions to deferred grants and contributions. At 31 March 2023, £1,348,000 (2022: £14,268,000) of payments received were included in payments in advance – grants and contributions.

Notes
to the financial statements continued

1. Revenue continued

Recognition of trade receivables, contract assets and contract liabilities

For metered customers, a receivable is recognised when the customer is billed for the usage. At this point, the consideration is unconditional because only the passage of time is required before the payment is due. Where the company has provided the service before payment is due, an accrual for the consumption of water that has not yet been billed is recognised in the income statement and the company discloses this as a contract asset in the statement of financial position (see table on the previous page). Where the company has not provided the service before payment is due, deferred income is recognised and the company discloses this as a contract liability in the statement of financial position (see table on the previous page).

For unmetered customers, the customer pays a fixed amount determined by the transaction prices set out in the company's charging scheme and tariff documents, irrespective of usage. If the payments received exceed the amount the company has the right to receive, the company recognises a payment received in advance and discloses this as a contract liability in the statement of financial position (see table on the previous page).

Where non-household retailers are billed monthly in advance for wholesale charges, as determined by billing/volume reports created by the market operator, the company recognises deferred income in relation to these accounts and presents this as a contract liability within trade and other payables. Where the company has not provided the service before payment is due, deferred income is recognised and the company discloses this as a contract liability in the statement of financial position (see table on the previous page).

Developers are billed for connection charges and contributions towards diversions and requisitioned mains/extensions in advance of work being performed by the company. The company recognises these payments as being received in advance and discloses them as contract liabilities in the statement of financial position (see table on the previous page).

Developers are billed for infrastructure charges once the connection has been completed; a trade receivable is immediately recognised at this point as the consideration is unconditional. These receivables are included in net trade receivables in the table on the previous page.

The company does not incur any costs to obtain or fulfil contracts that would be recognised as an asset under IFRS 15.

Revenue recognised in relation to contract liabilities

The following table sets out how much of the revenue recognised in the current reporting year relates to carried forward contract liabilities and how much relates to performance obligations that were satisfied in a prior year:

	2023 £000	2022 £000
Revenue recognised that was included in the contract liability balance at the beginning of the year		
Payments received in advance – household water supplies	**46,746**	41,217
Payments received in advance – non-household water supplies	**–**	2,948
Deferred income – water supplies	**207**	138
Deferred income – other	**1,091**	775
Deferred grants and contributions	**3,619**	5,300
Payments received in advance – grants and contributions	**11,924**	7,585
Revenue recognised from performance obligations satisfied in previous years		
Unbilled accrual for metered customers – household customers	**–**	–

Revenue expected to be derived from unsatisfied performance obligations

IFRS 15 requires the disclosure of the aggregate amount of revenue, which is expected to be derived from performance obligations, which are unsatisfied as at the end of the reporting year, i.e. the aggregate amount of future revenues from existing ongoing contracts.

The company has applied the practical expedient, set out in paragraph 121(a) of IFRS 15, not to disclose this amount in relation to water charges as the performance obligation is part of a contract that has an original expected duration of one year or less.

The unbilled accrual for measured income is a contract asset under IFRS 15. Historical information has proved to be an accurate indicator of current consumption and, therefore, the company deems it reasonable to conclude that the measured income accrual is materially correct.

At 31 March 2023, £269,039,000 (2022: £154,294,000) of grants and contributions is expected to be derived from performance obligations which were unsatisfied at the end of the reporting year.

2. Operating profit

2.1 Operating costs

The following items have been charged/(credited) to either cost of sales or administrative expenses in the income statement:

	2023 £000	2022 £000
Staff costs (note 3.1)	**55,549**	55,367
Energy costs	**41,096**	35,937
Profit on disposal of property, plant and equipment	**(535)**	(244)
Loss on disposal of infrastructure assets	**888**	728
Purchase of bulk water and water supplied under statutory entitlement	**11,723**	8,440
Water abstraction charges	**6,349**	4,201
Business rates	**15,547**	15,551
Chargeable services direct (income)/expenditure	**(57)**	72
Depreciation of infrastructure assets (note 6)	**17,033**	11,964
Depreciation of other property, plant and equipment (note 6)	**53,906**	48,487
Depreciation of right-of-use assets (note 7)	**3,458**	3,681
Amortisation of intangible assets (note 8)	**5,954**	11,125
Impairment of trade receivables and contract assets (note 12)	**11,199**	7,444
Research and development	**196**	133
Short-term lease rentals	**24**	37
Low-value lease rentals	**76**	129
Auditors' remuneration (note 2.3)	**550**	457
Cost of inventories used	**1,203**	1,334

2.2 Other operating income

	2023 £000	2022 £000
Timing of revenue recognition – at a point in time		
Commission and rentals	**21,929**	18,972

The majority of other income relates to commission earned by the company from billing and collecting charges in respect of sewerage and infrastructure within its area on behalf of Thames Water Utilities Limited and Anglian Water Services Limited (refer to note 23).

2.3 Auditors' remuneration

During the year, the company obtained the following services from its Auditor and its associates:

	2023 £000	2022 £000
Fees payable to the company's Auditor and its associates for the audit of the financial statements	**314**	248
Fees payable to the company's Auditor and its associates and subsidiaries for other services:		
Audit of the company's associates and subsidiaries	**99**	90
Audit-related assurance services		
– regulatory reporting	**64**	61
– Thames Water and Anglian Water annual returns	**8**	10
– audit related assurance service – other	**64**	47
Other non-audit services	**1**	1
Total Auditors' remuneration	**550**	457

Notes
to the financial statements continued

3. Employees

3.1 Employee benefit expense (including Executive directors)

	2023 £000	2022 £000
Wages and salaries	**64,638**	62,408
Social security costs	**7,160**	6,667
Other pension costs	**9,476**	8,399
Staff costs	**81,274**	77,474
Staff costs capitalised	**(25,725)**	(22,107)
Staff costs recognised in the income statement	**55,549**	55,367

3.2 Average number of people employed

The average monthly number of full-time equivalent persons (including Executive directors) employed by the company during the year was:

By activity	2023 Number	2022 Number
Operations	**875**	854
Customer service	**250**	257
Administration	**251**	262
	1,376	1,373

3.3 Directors' remuneration

Directors' emoluments were as follows:

	2023 £000	2022 £000
Aggregate emoluments	**1,113**	1,839

There was a change in the Chief Executive Officer ('CEO') of Affinity Water Limited during current and prior year. Pauline Walsh served as CEO until 17 September 2021. Stuart Ledger served as interim CEO from 18 September 2021 until 16 December 2022. Keith Haslett was appointed permanent CEO on 3 January 2023.

Aggregate amounts receivable under long-term incentive schemes were £110,000 (2022: £482,000), not included within aggregate emoluments above. In the current year, the total of £110,000 relates to Stuart Ledger. £67,000 of this total relates to the 2020/21 scheme for his period in office, which vested in the year ended 31 March 2023, with the balance of £43,000 relating to payments already accrued for the 2021/22 scheme for his period in office. An amount of £81,500 was paid in December 2022, with the balance due in July 2023

In the prior year, the total of £482,000 breaks down as follows. For Pauline Walsh, £230,000 related to the 2019/20 LTIP scheme vesting in the year ended 31 March 2022, with the remaining amount of £132,000 relating to accrued elements of the 2020/21 and 2021/22 LTIP schemes earned on a pro-rata basis for the period served in office. Both amounts were fully paid in July 2022. For Stuart Ledger, £120,000 related to the 2019/20 LTIP scheme vesting in the year ended 31 March 2022, a third of which was paid in July 2022 in accordance with the scheme rules, with the remainder to be honoured by his new employer.

Neither the company nor its immediate parent entities has any listed shares and so the directors have not been offered any share incentives. The Non-Executive directors who were appointed by Allianz Capital Partners on behalf of the Allianz group, DIF and InfraRed Capital Partners Limited on behalf of HICL Infrastructure plc did not receive any emoluments from the company, or any company within the Affinity Water group.

Highest paid director

The highest paid director's emoluments were as follows:

	2023 £000	2022 £000
Aggregate emoluments	**375**	933

Aggregate amounts receivable under long-term incentive schemes were £110,000 (2022: £362,000), not included within aggregate emoluments above. Of this, £67,000 relates to the 2020/21 scheme for the period in office, which vested in the year ended 31 March 2023, which vested in the year ended 31 March 2023, with the balance of £43,000 relating to payments already accrued for the 2021/22 scheme for the period in office. An amount of £81,500 was paid in December 2022, with the balance due in July 2023. The prior year total includes £230,000 related to the 2019/20 LTIP scheme, which vested in the year ended 31 March 2022, with the remaining amount of £132,000 relating to accrued elements of the 2020/21 and 2021/22 LTIP schemes earned on a pro-rata basis for the period served in office. The company made no contributions to a pension plan in respect of the highest paid director's qualifying services during the year (2022: £nil). The highest paid director did not hold any share options during the year.

Further information regarding directors' remuneration during the year can be found within the Remuneration Report on pages 180 to 201.

4. Finance income and costs

	2023 £000	2022 £000
Finance income:		
Bank interest income	3,462	192
Net interest receivable on RPI linked inflation swaps	6,745	7,434
Net interest receivable on CPI linked inflation swaps	6,483	6,929
Net income from post-employment benefits	2,839	1,488
	19,529	16,043
Finance costs:		
Interest payable on borrowings held at amortised cost from parent company	(160)	(160)
Interest payable on borrowings held at amortised cost from subsidiary undertakings	(37,522)	(37,411)
Accretion payable in respect of interest on loans from subsidiary undertakings	(72,096)	(35,047)
Accretion payable on financial instrument	(59,114)	(29,574)
Interest payable on lease liabilities	(266)	(313)
Other	(535)	(368)
	(169,693)	(102,873)
Fair value gain/(loss) on financial instruments:		
Fair value gain/(loss) on inflation swaps	50,122	(31,295)
	50,122	(31,295)
Net finance costs	(100,042)	(118,125)

5. Income tax credit/(expense)

5.1 Income tax credit/(expense) included in the income statement

	2023 £000	2022 £000
Current tax:		
– UK corporation tax on losses for the year	–	–
Total current tax	–	–
Deferred tax:		
– Origination and reversal of temporary differences	12,044	10,949
– Adjustment in respect of prior years	(4,083)	2,449
– Impact of change in tax rate	3,803	(54,729)
Total deferred tax	11,764	(41,331)
Income tax credit/(expense)	11,764	(41,331)

Tax credit assessed for the year is lower (2022: tax expense is higher) than the standard rate of corporation tax in the UK for the year ended 31 March 2023 of 19% (2022: 19%). The differences are explained below:

	2023 £000	2022 £000
Loss before tax	112,709	55,574
Tax calculated at the standard rate of tax in the UK of 19% (2022: 19%)	21,415	10,559
Tax effects of:		
– Adjustments in respect of prior years	(4,083)	2,449
– Expenses not deductible for tax purposes	(461)	390
– Unrelieved losses carried forward	(8,910)	–
– Impact of change in tax rate on deferred tax	3,803	(54,729)
Income tax credit/(expense)	11,764	(41,331)

Notes
to the financial statements continued

5. Income tax credit/(expense) continued

5.2 Income tax credit/(expense) included in the statement of comprehensive income

	2023 £000	2022 £000
Deferred tax:		
– Impact of change in tax rate on deferred tax	–	(1,725)
– Origination and reversal of temporary differences on retirement benefit surplus	13,029	(5,462)
	13,029	(7,187)

5.3 Factors that may affect future tax charges

In the Spring Budget 2021, the UK Government announced that from 1 April 2023 the corporation tax rate would increase to 25% (rather than remaining at 19%, as previously enacted). This new law was substantively enacted on 24 May 2021. Deferred taxes at the balance sheet date have been measured using these enacted tax rates and reflected in these financial statements.

5.4 Reconciliation of current and deferred tax charge

	2023 £000	2023 %	2022 £000	2022 %
Loss before tax	112,709		55,574	
Tax calculated at the standard rate of tax in the UK of 19% (2022: 19%)	21,415	19%	10,559	19%
Tax effect of:				
Depreciation in excess of capital allowances	(16,701)	(15%)	(10,752)	(19%)
Pension movements	371	0%	183	0%
Increase in provisions	65	0%	128	0%
Expenses not deductible for tax purposes	(42)	0%	(118)	0%
Unrelieved losses carried forward	(8,910)	(8%)	–	0%
Reported current tax charge and effective rate	(3,803)	(3%)	(–)	0%
Depreciation in excess of capital allowances	16,282	14%	11,260	20%
Increase in provisions	(64)	0%	(128)	0%
Pension movements	(371)	0%	(183)	0%
Impact of change in tax rate on deferred tax	3,803	3%	(54,729)	(99%)
Adjustments to tax charge in respect of prior years	(4,083)	(4%)	2,449	4%
Reported deferred tax charge and effective rate	15,567	14%	(41,331)	(74%)
Total tax charge and effective rate	11,764	11%	(41,331)	(74%)

Impact of change in tax rate

In the 2021 Spring Budget the Government announced that from 1 April 2023 the Corporation Tax rate will increase to 25%. The deferred tax liability at 31 March 2022 was recalculated at 25%, giving a deferred tax charge in the prior year of £54,729,000 shown in the table above. There was no subsequent charge in the year to 31 March 2023 as a result of this change in tax rate.

Depreciation in excess of capital allowances

The tax relief on our infrastructure assets is different from the depreciation of these assets in the accounts (although over the total life of the assets the two amounts will be equal). In 2022/23, the amount written off for tax purposes was lower than the depreciation in the accounts, resulting in a higher tax charge for the year.

Pension movements

Tax relief is given for the amount actually paid into the company's pension plan in the year, not the amount charged in the accounts. In 2022/23, the amount paid into the pension plan was higher than the amount charged in the accounts, resulting in a lower tax charge for the year.

Provisions movements

Some provisions charged in the accounts are not deductible until the amounts provided are actually paid. Taxable profits in 2022/23 have been reduced by payments made in respect of provisions charged in previous years.

Expenses not deductible for tax purposes

These will not reverse in future years, therefore, the increase in the tax charge is permanent. Permanent disallowable expenses include fines, business entertaining and certain legal fees.

Adjustment to tax charge in respect of prior years

The tax provision in the accounts is a best estimate at the time. The estimate is corrected when the tax returns are finalised and submitted to HMRC 12 months after the year-end. The correction made to the tax return for the year ended 31 March 2022 resulted in a lower tax charge, mainly as a result of claiming capital allowances.

6. Property, plant and equipment

	Land, buildings and operational structures £000	Potable water distribution mains £000	Raw water pipes £000	Fixed plant £000	Vehicles and mobile plant £000	Assets in course of construction £000	Total £000
Cost or deemed cost							
At 1 April 2022	310,251	1,018,342	22,761	897,391	91,629	159,469	**2,499,843**
Restatement of opening balance	(1,698)	(100,194)	–	103,530	(1,638)	–	**–**
Additions	–	–	–	–	–	114,315	**114,315**
Transfers	2,697	47,849	–	55,405	29,234	(135,185)	**–**
Disposals	–	(671)	(331)	–	–	–	**(1,002)**
At 31 March 2023	311,250	965,326	22,430	1,056,326	119,225	138,599	**2,613,156**
Accumulated depreciation							
At 1 April 2022	(105,864)	(91,769)	(2,639)	(641,672)	(42,328)	–	**(884,272)**
Restatement of opening balance	10	5,693	–	(6,464)	761	–	**–**
Charge for the year	(4,925)	(16,718)	(315)	(42,312)	(6,669)	–	**(70,939)**
Disposals	–	79	34	–	–	–	**113**
At 31 March 2023	(110,779)	(102,715)	(2,920)	(690,448)	(48,236)	–	**(955,098)**
Net book amount							
At 1 April 2022	204,387	926,573	20,122	255,719	49,301	159,469	**1,615,571**
Movement in year	(3,916)	(63,962)	(612)	110,159	21,688	(20,870)	**42,487**
At 31 March 2023	**200,471**	**862,611**	**19,510**	**365,878**	**70,989**	**138,599**	**1,658,058**

All land and buildings are held as freehold.

Assets were reclassified between land, buildings and operational structures, potable water distribution mains, fixed plant and vehicles and mobile plant in this statutory note, as shown in the line "Adjutsment to opening balance" within both cost and accumulated depreciation. This is a disclosure adjustment only with no impact on actual depreciation charged to date.

Notes
to the financial statements continued

7. Right-of-use assets

	Buildings £000	Vehicles £000	Total £000
Cost			
At 1 April 2022	9,079	10,084	**19,163**
Additions	–	1,685	**1,685**
Disposals	–	(680)	**(680)**
At 31 March 2023	9,079	11,089	**20,168**
Accumulated depreciation			
At 1 April 2022	(4,191)	(5,532)	**(9,723)**
Charge for the year	(1,396)	(2,062)	**(3,458)**
Disposals	–	662	**662**
At 31 March 2023	(5,587)	(6,932)	**(12,519)**
Net book amount			
At 1 April 2022	4,888	4,552	**9,440**
Movement in year	(1,396)	(395)	**(1,791)**
At 31 March 2023	**3,492**	**4,157**	**7,649**

Leasing arrangements

Lease income from operating leases where the group is a lessor is recognised in income on a straight-line basis over the lease term.

Lease payments for some contracts include CPI increases, but there are no other variable lease payments that depend on an index or rate.

Although the group is exposed to changes in the residual value at the end of the current leases, the group typically enters into new operating leases and therefore will not immediately realise any reduction in residual value at the end of these leases. Expectations about the future residual values are reflected in the fair value of the assets.

Minimum lease payments receivable on leases are as follows:

	2023 £000	2022 £000
Within 1 year	**650**	654
Between 1 and 2 years	**625**	643
Between 2 and 3 years	**463**	624
Between 3 and 4 years	**423**	463
Between 4 and 5 years	**412**	423
Later than 5 years	**1,080**	1,542
	3,653	4,349

Properties are held at cost in line with property, plant and equipment policy provided in note A3.

8. Intangible assets

	Goodwill £000	Software £000	Total £000
Cost			
At 1 April 2022	14,961	95,560	**110,521**
Additions	–	5,299	**5,299**
At 31 March 2023	14,961	100,859	**115,820**
Accumulated amortisation			
At 1 April 2022	–	(67,255)	**(67,255)**
Charge for the year	–	(5,954)	**(5,954)**
At 31 March 2023	–	(73,209)	**(73,209)**
Net book amount			
At 1 April 2022	14,961	28,305	**43,266**
Movement in year	–	(655)	**(655)**
At 31 March 2023	**14,961**	**27,650**	**42,611**

Goodwill includes £8,283,000 relating to the unification of the Affinity Water group's regulated businesses on 27 July 2012. The remaining balance of £6,678,000 relates to goodwill arising from the acquisition of the trade and assets of North Surrey Water Limited on 1 October 2000.

Affinity Water Limited is the only cash generating unit ('CGU') due to the fact it constitutes the smallest identifiable group of assets that generate cash inflows for the entity, by means of supplying drinking water to customers. The recoverable amount has been determined using the RCV of Affinity Water Limited at 31 March 2023. Management's assessment has determined that the headroom is such that no reasonable change in any key assumptions is expected to result in impairment of the goodwill recognised.

Included in the software category above is £14,419,000 (2022: £12,532,000) of capitalised intangible assets under construction, which is not amortised. £3,408,000 (2022: £7,366,000) of intangible projects under construction were completed in the year, and amortisation was charged as at the point in time that the software became fit for purpose and ready to use.

There were no individually material computer software development costs in the years ended 31 March 2023 or 31 March 2022.

9. Investments

	2023 £000	2022 £000
Non-current assets		
Investments in subsidiaries (refer to note A6)	**100**	100
Current assets		
Short-term deposits	**66,709**	70,179

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

10. Retirement benefit surplus

Defined benefit section

The net pension expense before taxation recognised in the income statement in respect of the defined benefit plan is:

	2023 £000	2022 £000
Total current service cost of the Affinity Water Pension Plan	**(3,236)**	(4,061)
Pension expense charged to operating profit	**(3,236)**	(4,061)
Net pension interest income credited to finance income (note 4)	**2,839**	1,488
Net pension expense charged before taxation	**(397)**	(2,573)

The opening and closing retirement benefit surpluses included in the statement of financial position are summarised as follows:

	2023 £000	2022 £000
At 1 April	**104,247**	74,532
Principal employer contributions	**1,879**	3,539
Net current service cost (per above)	**(3,236)**	(4,061)
Net interest income	**2,839**	1,488
Net re-measurement (loss)/gain	**(52,114)**	28,749
At 31 March	**53,615**	104,247

10. Retirement benefit surplus continued

Re-measurement gains and losses are recognised directly in the statement of comprehensive income and are summarised as follows:

	2023 £000	2022 £000
Re-measurement (losses)/gains on plan assets	**(159,088)**	8,249
Re-measurement gains on plan liabilities	**106,974**	20,500
	(52,114)	28,749

Further analysis and underlying valuation assumptions of the defined benefit plan are provided in note A5.

11. Derivative financial instruments

	2023 £000	2022 £000
Non-current assets:		
Fair value of energy swaps	**3,283**	7,342
Fair value of CPI linked inflation swap	**–**	–
Fair value of RPI linked inflation swaps	**–**	–
Current assets:		
Fair value of energy swaps	**6,068**	20,646
	9,351	27,988
Non-current liabilities:		
Fair value of RPI linked inflation swaps	**6,937**	24,224
Accretion on RPI linked inflation swaps	**55,062**	23,702
Fair value of CPI linked inflation swaps	**10,893**	43,729
Accretion on CPI linked inflation swaps	**42,953**	15,163
Fair value of energy swaps	**5,874**	–
Current liabilities:		
Fair value of energy swaps	**2,128**	–
	123,847	106,818

A series of power hedging swaps were entered into between May 2021 and January 2023 in order to hedge against wholesale energy prices.

The fair value of energy swaps have been derived from 'Level 2' fair value measurements: directly observable market inputs other than Level 1 inputs. The fair value of energy swaps is calculated by discounting expected future cashflows based on market expectations of energy prices in the future.

An RPI linked inflation swap with a nominal value of £135.0m, which is linked to the maturity of the Class A fixed rate £250.0m bond (maturity July 2026), was entered into in August 2018. A further RPI linked inflation swap with a nominal value of £75.0m, which is also linked to the maturity of the Class A fixed rate £250.0m bond (maturity July 2026), was entered into in October 2020, with an effective date of 1 August 2020.

A CPI linked inflation swap with a nominal value of £25.0m, which is linked to the maturity of the Class A fixed rate £250.0m bond (maturity March 2036), was entered into in March 2020. Further CPI linked inflation swaps with a total nominal value of £225.0m, which are also linked to the maturity of the Class A fixed rate £250.0m bond (maturity March 2036), were entered into between April 2020 and June 2020.

The fair value of RPI and CPI linked inflation swaps have been derived from 'Level 2' fair value measurements: directly observable market inputs other than Level 1 inputs. The fair value of RPI and CPI linked inflation swaps is calculated by discounting expected future cashflows based on market expectations of RPI and CPI. The discount rate used reflects the credit risk of the company, which is consistent with IFRS 13: 'Fair value measurement'.

12. Trade and other receivables

	2023 £000	2022 £000
Current:		
Trade receivables	**73,807**	66,517
Less: loss allowance for trade receivables	**(36,968)**	(33,037)
	36,839	33,480
Amounts owed by group undertakings	**40**	25
Interest receivable from external parties	**7,642**	7,786
Other receivables	**7,574**	7,964
Unbilled accrual for metered customers	**43,444**	44,353
Prepayments and accrued income	**7,027**	10,213
	102,566	103,821

Trade receivables that were fully provided for were sold in both the current year and prior year, resulting in a reduction to trade receivables of £4,397,000 (2022: £6,813,000) and a corresponding reduction in the loss allowance for trade receivables. The carrying amounts of trade and other receivables approximate to their fair value.

12.1 Loss allowance for trade receivables and contract assets

Trade receivables and contract assets do not carry interest and are stated net of a loss allowance, as follows:

	Trade receivables		Unbilled accrual for metered customers		Total	
	2023 £000	2022 £000	2023 £000	2022 £000	2023 £000	2022 £000
At 1 April	**33,037**	34,027	**101**	51	**33,138**	34,078
Provision for receivables impairment charged to income statement	**10,997**	7,394	**202**	50	**11,199**	7,444
Sale of trade receivables that were fully provided for	**(4,397)**	(6,813)	**–**	–	**(4,397)**	(6,813)
Receivables written off during the year as uncollectable	**(2,669)**	(1,571)	**–**	–	**(2,669)**	(1,571)
At 31 March	**36,968**	33,037	**303**	101	**37,271**	33,138

See note A4 for details of the nature and the calculation of the loss allowance.

In the current year, a charge of £11,199,000 to the income statement arose as a result of the ongoing cost of living crisis and a decline in cash collection rates seen in the year.

In the prior year, an additional charge of £1,413,000 to the income statement arose as a result of external economic factors which included the cost of living increases on our customers. This is included within the £7,444,000 total provision for receivables impairment debited to the income statement in the prior year. No additional charge has been included in the current year as this was reflected in an increase in base rates used in the calculation which sufficiently covered the provision.

12.2 Ageing analysis of trade receivables

The aged analysis of gross receivables at the reporting date is as follows:

	2023 £000	2022 £000
Aged less than one year	**27,155**	24,157
Aged between one year and two years	**23,682**	21,884
Aged greater than two years	**22,970**	20,476
	73,807	66,517

13. Inventories

	2023 £000	2022 £000
Raw materials and consumables	**4,833**	4,348

Inventories are stated after provisions for impairment of £364,000 (2022: £364,000).

Notes
to the financial statements continued

14. Cash and cash equivalents

	2023 £000	2022 £000
Cash at bank and in hand	**17,099**	34,479
Term deposits	**61,684**	101,125
	78,783	135,604

The carrying amounts of cash and cash equivalents approximate to their fair value.

15. Share capital, share premium and capital contribution reserve

Allotted and fully paid up	Number of shares (thousands)	Ordinary shares of £0.10 each £000	Share premium £000	Capital contribution reserve £000	Total £000
At 31 March 2022 and 31 March 2023	**305,058**	**30,506**	**1,400**	**30,150**	**62,056**

All shares rank pari passu in all respects.

16. Trade and other payables

	2023 £000	2022 £000
Non-current		
Amounts falling due after more than one year but less than five years		
Deferred grants and contributions	**28,137**	25,509
Amounts falling due after more than five years		
Deferred grants and contributions	**233,937**	221,565
	262,074	247,074
Current		
Amounts falling due within one year		
Trade payables	**15,453**	22,166
Amounts due to group undertakings	**679**	615
Interest payable to subsidiary companies	**14,409**	14,052
Commitment fees	**60**	63
Social security and other taxes	**1,848**	1,796
Other payables	**5,681**	5,391
Capital accruals	**13,519**	21,587
Deferred grants and contributions	**6,965**	5,698
Payments received in advance	**73,216**	81,980
Deferred income	**3,263**	843
Other accruals	**41,796**	38,626
	176,889	192,817
	438,963	439,891

The carrying amounts of trade and other payables approximate to their fair value.

Interest payable to subsidiary companies relates to accrued interest on bonds.

17. Borrowings

	2023 £000	2022 £000
Borrowings measured at amortised cost:		
Loan from Affinity Water Finance (2004) PLC financed by bond issue	**251,967**	252,498
Loan from Affinity Water Finance PLC financed by bond issue	**1,076,165**	1,019,706
Loan from intermediate parent company	**3,550**	3,550
3.5% irredeemable consolidated debenture stock	**–**	–
4% irredeemable consolidated debenture stock	**8**	8
4% irredeemable debenture stock	**1**	1
4.25% irredeemable debenture stock	**–**	–
5% irredeemable debenture stock	**24**	24
5.25% irredeemable debenture stock	**1**	1
	1,331,716	1,275,788

Loan from Affinity Water Finance (2004) PLC financed by bond issue

On 13 July 2004, the company's subsidiary Affinity Water Finance (2004) PLC issued a £200,000,000 bond at an interest rate of 5.875% and repayable in July 2026. On 16 July 2014, Affinity Water Finance (2004) PLC completed a tap issue of £50,000,000 on the same terms as the existing £200,000,000 bond.

The net proceeds of the bond and tap issue were lent to the company (Affinity Water Limited) on the same terms.

Loan from Affinity Water Finance PLC financed by bond issue

On 4 February 2013, the company's former subsidiary Affinity Water Programme Finance Limited issued £80,000,000 Class A Guaranteed Notes maturing in September 2022 with a coupon of 3.625%, £250,000,000 Class A Guaranteed Notes maturing in March 2036 with a coupon of 4.500%, £190,000,000 Class A Guaranteed RPI linked Notes maturing in June 2045 with a coupon of 1.548% and £95,000,000 Class B Guaranteed RPI linked Notes maturing in June 2033 with a coupon of 3.249%.

On 29 October 2015, Affinity Water Programme Finance Limited completed a tap issue of its 1.548% RPI linked Notes maturing in June 2045 of £40,000,000 on the same terms as the existing 2045 Notes.

On 19 February 2016, Affinity Water Programme Finance Limited issued £10,000,000 Class B Guaranteed RPI linked Notes maturing in June 2033 with a coupon rate of 1.024%.

On 22 August 2016, Affinity Water Programme Finance Limited exchanged £65,800,000 of its 3.625% Guaranteed Notes due 2022 for a new issue of 3.278% Guaranteed Notes due 2042. An additional £19,200,000 of 3.278% Guaranteed Notes due 2042 were issued at the same time.

On 22 November 2017, Affinity Water Programme Finance Limited issued £60,000,000 Class A Guaranteed Notes maturing in November 2033 with a coupon of 2.699% and £60,000,000 Class A Guaranteed CPI linked Notes maturing in November 2042 with a coupon of 0.230%.

On 22 January 2019, the assets and liabilities of Affinity Water Programme Finance Limited were transferred to the company's subsidiary Affinity Water Finance PLC.

On 20 October 2021, Affinity Water Finance PLC issued £130,000,000 Class A Guaranteed CPI linked Notes maturing in September 2038 with a coupon rate of 0.010%, a Green bond used to fund expenditure outlined in the company's Green Finance Framework.

The net proceeds of the bond issues and the tap issue were lent to the company on the same terms.

The £14,204,000 Class A Guaranteed Notes with coupon of 3.625% matured in September 2022. The company repaid this amount in full to Affinity Water Finance PLC in September 2022.

Notes
to the financial statements continued

17. Borrowings continued

Loan from intermediate parent company

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%.

Further details

The company has unconditionally and irrevocably guaranteed the due and punctual payment of all sums from time to time payable by Affinity Water Finance (2004) PLC and Affinity Water Finance PLC in respect of the bonds issued by these companies. These guarantees constitute direct, general and unconditional obligations of the company, which will at all times rank at least pari passu with all other present and future unsecured obligations. The bonds issued are also guaranteed by Affinity Water Holdings Limited, the company's immediate parent undertaking.

The fair value of the bonds on-lent from the financing subsidiaries at 31 March 2023 is £1,208,420,000 (2022: £1,560,813,000). The fair value of Class A bonds has been derived from 'level 1' fair value measurements: quoted prices (unadjusted) in active markets for identical liabilities. The fair value of Class B bonds has been derived from 'level 2' fair value measurements: directly observable market inputs other than Level 1 inputs. The fair value of Class B bonds is calculated by discounting expected future cashflows at a discount rate which is derived from the yield on comparable instruments which are observable in the market.

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. See additional details on our financial covenants included within the going concern statement in accounting policies.

18. Lease liabilities

	2023 £000	2022 £000
Non-current:		
Lease liabilities	**4,785**	6,329
Current:		
Lease liabilities	**3,053**	3,317

The following amounts in respect of leases are included within these financial statements:

	2023 £000	2022 £000
Depreciation charge of right-of-use assets (refer to note 7)	**3,458**	3,681
Interest expense on lease liabilities (refer to note 4)	**266**	313
Expense relating to short-term leases (refer to note 2.1)	**24**	37
Expense relating to leases of low-value assets (refer to note 2.1)	**76**	129
Principal elements of lease payments included within cash flows from financing activities	**3,475**	3,649
Interest payments included within cash flows from operating activities	**266**	313
Total cash outflow for leases in the statement of cash flows	**3,741**	3,962
Additions to right-of-use assets (refer to note 7)	**1,685**	3,660
Carrying amount of right-of-use assets (refer to note 7)	**7,649**	9,440

19. Deferred tax liabilities

19.1 Analysis of deferred tax assets and deferred tax liabilities

	2023 £000	2022 £000
Deferred tax assets:		
– Deferred tax asset to be recovered after more than 12 months	**(641)**	(585)
– Deferred tax asset to be recovered within 12 months	**(18)**	(38)
	(659)	(623)
Deferred tax liabilities:		
– Deferred tax liability to be settled after more than 12 months	**207,397**	232,153
	207,397	232,153
Deferred tax liabilities – net	**206,738**	231,530

The gross movement on the deferred tax account is as follows:

	£000
At 1 April 2021	183,011
Adjustment to prior year	(2,449)
Impact of change in tax rate	54,729
Credited to the income statement	(10,948)
Charged to other comprehensive income	7,187
At 31 March 2022	231,530
Adjustment to prior year	**4,083**
Impact of change in tax rate	**(3,803)**
Credited to the income statement	**(12,043)**
Credited to other comprehensive income	**(13,029)**
At 31 March 2023	**206,738**

The adjustment to prior year lines above are due to the tax provision in the accounts being a best estimate at the time. The estimate is corrected when the tax returns are finalised and submitted to HMRC 12 months after the year-end.

The movement in deferred tax assets and liabilities during the year is as follows:

19.2 Deferred tax liabilities

	Accelerated capital allowances £000	Retirement benefit obligations £000	Total £000
At 1 April 2021	169,451	14,160	183,611
Adjustment to prior year	(2,449)	–	(2,449)
Impact of change in tax rate	50,351	6,255	56,606
Credited to the income statement	(11,260)	183	(11,077)
Charged to other comprehensive income	–	5,462	5,462
At 31 March 2022	206,093	26,060	232,153
Adjustment to prior year	**4,184**	**–**	**4,184**
Credited to the income statement	**(16,282)**	**371**	**(15,911)**
Credited to other comprehensive income	**–**	**(13,029)**	**(13,029)**
At 31 March 2023	**193,995**	**13,402**	**207,397**

Notes
to the financial statements continued

19. Deferred tax liabilities continued

19.3 Deferred tax assets

	Provisions £000
At 1 April 2021	(600)
Impact of change in tax rate	(151)
Charged to the income statement	128
At 31 March 2022	(623)
Prior year adjustment	**(98)**
Charged to the income statement	**62**
At 31 March 2023	**(659)**

20. Provisions for other liabilities and charges

	Insurance £000	Reorganisation £000	Other £000	Tax £000	Total £000
At 1 April 2021	2,726	178	670	–	3,574
(Credited)/charged to the income statement	(105)	2,947	–	–	2,842
Utilised in the year	(184)	(3,125)	–	–	(3,309)
At 31 March 2022	2,437	–	670	–	3,107
Charged to the income statement	**464**	**–**	**–**	**4,100**	**4,564**
Utilised in the year	**(252)**	**–**	**–**	**–**	**(252)**
At 31 March 2023	**2,649**	**–**	**670**	**4,100**	**7,419**

Insurance

Provisions for insurance represent the amount of the company's liability in respect of individual claims. This is based upon data provided by loss adjusters to insurers and is calculated on settlement experience. The full balance of £2,649,000 is presented as a non-current liability in the statement of financial position.

Reorganisation

In the prior year, a provision in relation to a corporate reorganisation was charged and utilised in the income statement. A provision of £178,000 remaining from a previous reorganisation was also utilised in the prior year.

Tax provision

A tax provision of £4,100,000 (2022: £nil) has been charged to the income statement and included within administrative expenses. As at 31 March 2023, this is an estimate of an outstanding charge relating to a potential PAYE and NI claim.

Other provisions

Other provisions of £670,000 (2022: £670,000) relate to unfunded pension liabilities for a former Non-executive director, which it is expected will be utilised by January 2051, and, therefore, presented as a non-current liability in the statement of financial position.

21. Notes to the statement of cash flows

21.1 Cash generated from operations

	2023 £000	2022 £000
Loss before tax	**(112,709)**	(55,574)
Adjustments for:		
Depreciation of property, plant and equipment (note 6)	**70,939**	60,451
Depreciation of right-of-use assets (note 7)	**3,458**	3,681
Amortisation of grants and contributions	**(3,619)**	(5,300)
Amortisation of intangible assets (note 8)	**5,954**	11,125
Profit on disposal of property, plant and equipment	**(535)**	(244)
Loss on disposal of infrastructure assets	**888**	728
Post-employment benefits	**1,360**	522
Net finance costs (note 4)	**100,042**	118,125
Net loss / (gain) on energy swap	**26,638**	(27,988)
Changes in working capital		
– Inventories	**(485)**	(268)
– Trade and other receivables	**1,255**	(11,844)
– Trade and other payables		
– provision element	**4,312**	(467)
– other	**590**	8,333
Cash generated from operations	**98,088**	101,280

Changes in working capital – trade and other receivables of £1,255,000 in the year (2022: £(11,224,000)) primarily relates to a decrease in prepayments and accrued income partially offset by an increase in trade receivables, as shown in note 12.

Changes in working capital – trade and payables – other of £590,000 in the year (2022: £7,714,000) primarily relates to a reduction in trade payables and capital accruals, offset by an increase in current deferred grants and contributions, as shown in note 17.

21.2 Reconciliation of liabilities arising from financing activities

	At 1 April 2022 £000	Cash flow £000	Non-cash flows £000	At 31 March 2023 £000
Loan from Affinity Water Finance (2004) PLC financed by bond issue	**252,498**	**–**	**(531)**	**251,967**
Loan from Affinity Water Finance PLC financed by bond issue	**1,019,706**	**(14,204)**	**70,663**	**1,076,165**
Loan from intermediate parent company	**3,550**	**–**	**–**	**3,550**
Lease liabilities	**9,646**	**(3,741)**	**1,934**	**7,839**
Debenture stock	**34**	**–**	**–**	**34**
Total liabilities arising from financing activities	**1,285,434**	**(17,945)**	**72,066**	**1,339,555**

	At 1 April 2021 £000	Cash flow £000	Non-cash flows £000	At 31 March 2022 £000
Loan from Affinity Water Finance (2004) PLC financed by bond issue	252,999	–	(501)	252,498
Loan from Affinity Water Finance PLC financed by bond issue	838,496	146,994	34,216	1,019,706
Loan from intermediate parent company	3,550	–	–	3,550
Lease liabilities	9,683	(3,962)	3,925	9,646
Debenture stock	34	–	–	34
Total liabilities arising from financing activities	1,104,762	143,032	37,640	1,285,434

Non-cash flows relate to loan indexation and amortisation of bond issuance costs and net additions of leases.

Notes
to the financial statements continued

22. Commitments

22.1 Capital commitments

Capital expenditure contracted for at the end of the reporting year, but not yet incurred, is as follows:

	2023 £000	2022 £000
Property, plant and equipment	**28,481**	31,985
Intangible assets	**885**	2,069
	29,366	34,054

22.2 Commitments under leases

The company leases its vehicles and head office building under non-cancellable leases expiring within a maximum of five years. The leases have varying terms, clauses and renewal rights. The company also leased IT server space until 31 December 2021.

The company does not expect to extend any vehicles leases after their lease term has expired. The lease of the head office building will expire in September 2025. The company will assess closer to the expiry of the lease of the head office building whether another formal agreement will be entered in to.

From 1 April 2019, the company has applied IFRS 16 and recognised right-of-use assets for these leases, (except for short-term and low-value leases, which are not within the scope of IFRS 16), see note 18 for further information.

The future aggregate minimum lease payments for operating leases not within the scope of IFRS 16 are as follows:

	2023 £000	2022 £000
No later than one year	**59**	76
Later than one year and no later than five years	**39**	98
	98	174

23. 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 these financial statements in respect of uncollected sewerage and sewerage infrastructure charges at 31 March 2023 (2022: £nil) and the company incurs no bad debt risk in relation to this service.

24. Events after the reporting period

Martin Roughead was appointed to the board as Chief Financial Officer on 17 April 2023.

25. Ultimate parent company and controlling party

The immediate parent undertaking of the company is Affinity Water Holdings Limited, a company registered in England and Wales.

Affinity Water Holdings Limited is wholly owned by Daiwater Investment Limited, a company registered in England and Wales. Daiwater Investment Limited is the parent undertaking of the largest group to consolidate the statutory financial statements of the company. These financial statements are also consolidated in the financial statements of Affinity Water Holdco Finance Limited, the smallest group to consolidate the financial statements of the company.

Copies of the group financial statements of Daiwater Investment Limited and Affinity Water Holdco Finance Limited for the year ended 31 March 2023 may be obtained from the Company Secretary, Tamblin Way, Hatfield, Hertfordshire, AL10 9EZ.

The directors consider Daiwater Investment Limited as the ultimate holding and controlling company in the United Kingdom.

The directors consider the following entities to be the company's ultimate controllers, as they are in a position to exercise material influence over the company's policy and affairs:

- Allianz Infrastructure Holding I Pte. Limited
- DIF Management Holding BV
- DIF Management UK Limited
- HICL Infrastructure plc
- Sun Life Financial Inc.

Allianz Capital Partners is the Allianz Group's in-house investment manager for alternative equity investments. The investment focus is on infrastructure and renewables as well as private equity funds. Allianz Capital Partners' investment strategy is targeted to generate attractive, long-term and stable returns, while diversifying the overall investment portfolio for the Allianz Group insurance companies.

DIF is an independent and specialist fund management company, which invests in infrastructure assets that generate long-term stable cash flows, including public-private partnerships, regulated infrastructure assets and renewable energy projects in Europe, North America and Australia.

HICL Infrastructure plc is a long-term investor in infrastructure assets, which are predominantly operational and yielding steady returns. HICL Infrastructure plc has a portfolio of infrastructure investments, which are positioned at the lower end of the risk spectrum, in three target market segments: public-private partnerships, regulated assets and demand-based assets. The Investment Manager to HICL Infrastructure plc is InfraRed Capital Partners Limited, a leading international investment manager focused on infrastructure and renewable energy investments. On 1 July 2020, Sun Life Financial Inc acquired an 80% interest in the InfraRed business from InfraRed Capital Partners (Management) LLP and became an ultimate controller.

Notes to the financial statements – appendices

A1. General information

The company owns and manages the water assets and network in an area of approximately 4,500km2 split over three supply regions, comprising eight separate water resource zones, in the South East of England. The company is the sole supplier of drinking water in these areas.

The company is a private company limited by shares and is incorporated and domiciled in the United Kingdom. The address of its registered office is Tamblin Way, Hatfield, Hertfordshire, AL10 9EZ.

Refer to note 26 for details of the company's parent company and ultimate parent company.

A2. Segmental reporting

In the same way that financial information is reported on a quarterly basis to the Board, the company's chief operating decision maker, during the current and previous financial year on a combined basis, the company presents its results under a single segment for financial reporting purposes. Management do not consider climate change to have had an impact on reporting results under a single segment.

A3. Accounting policies

Consolidation

The company is a wholly owned subsidiary of its ultimate holding and controlling company, Daiwater Investment Limited, which is the parent undertaking of the largest group to consolidate the statutory financial statements. It is included in the consolidated financial statements of Daiwater Investment Limited, which will be made publicly available. Therefore the company is exempt by virtue of section 400 of the Companies Act 2006 from the requirement to prepare consolidated financial statements.

Property, plant and equipment

Property, plant and equipment are held at historical cost less accumulated depreciation and impairment charges.

Infrastructure assets comprise a network of mains and associated underground pipe-work. Infrastructure assets are held at deemed cost established through an event-driven valuation on transition to FRS 101 in 2015/16 and subsequent additions are recorded at historical cost less accumulated depreciation and impairment charges.

For accounting purposes, the network is segmented into components based on the material used to construct the pipe concerned. The estimated useful economic lives of infrastructure pipes are based on management's judgement and experience, which includes the knowledge and research of the company's dedicated asset management teams. Where management identifies that the actual useful economic life of an asset significantly differs from the estimate used to calculate its depreciation, the depreciation charge is adjusted prospectively.

Expenditure on infrastructure assets relating to increases in capacity, enhancements or material replacements of network components is capitalised where it can be reliably measured, and it is probable that incremental future economic benefits will flow to the company. The carrying amount of the replaced part is derecognised. Costs of day-to-day servicing of network components are recognised in the income statement as they arise.

Cost of other property, plant and equipment includes own work capitalised comprising the direct costs of materials, labour and applicable overheads. Property, plant and equipment are depreciated to their estimated residual values over their estimated useful lives using the straight-line method, with the exception of freehold land, which is not depreciated. Assets in the course of construction are not depreciated until commissioned.

The estimated useful lives of property, plant and equipment are:

Infrastructure assets	
Potable water distribution mains	50–150 years
Raw water pipes	50–150 years
Other property, plant and equipment	
Buildings	40–60 years
Operational structures	5–85 years
Fixed plant – short life	3–10 years
– other	10–30 years
Vehicles and mobile plant	3–15 years

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in operating profit.

The company is required to evaluate the carrying value of its property, plant and equipment for impairment whenever circumstances indicate, in management's judgement, that the carrying value of such assets may not be recoverable. An impairment review in such circumstances requires management to make subjective judgements concerning the future cash flows, growth rates and discount rates of the asset under review.

Intangible assets

Goodwill

Goodwill represents the excess of the fair value of purchase consideration over the fair value of the net assets acquired. Fair value adjustments based on provisional estimates are amended within one year of the acquisition, if required, with a corresponding adjustment to goodwill.

Goodwill is not amortised but is reviewed for impairment at least annually. Impairment reviews are also carried out if there is an indication that impairment may have occurred, or, where otherwise required, to ensure that intangible assets are not carried above their estimated recoverable amounts. Goodwill is allocated to the CGU that derives benefit from the goodwill for impairment testing purposes. Impairments are recognised immediately in the income statement.

Computer software development costs

Costs associated with maintaining computer software programmes are recognised as an expense as incurred. Development costs that are directly attributable to the design and testing of identifiable and unique software products controlled by the company are recognised as intangible assets only if they meet the criteria of IAS 38: 'Intangible Assets', in that it is a separable, identifiable asset and it has a future economic benefit. Other development expenditures that do not meet these criteria are recognised as an expense as incurred, including costs associated with cloud computing arrangements.

Computer software development costs recognised as assets are amortised on a straight-line basis over their estimated useful lives, which does not exceed five years. Amortisation charged on assets with finite lives is recognised in the income statement in operating costs.

Computer software development costs are reviewed for impairment where indicators of impairment exist. Impairments are recognised immediately in the income statement.

Grants and contributions

Grants and contributions received in respect of property, plant and equipment where the performance obligation is deemed to be satisfied over time (consisting of contributions for diversions and requisitioned mains/extensions, and infrastructure charges), are treated as deferred income and released to revenue over the useful economic life of the property, plant and equipment to which they relate once these assets have been commissioned.

The company may be contracted by developers in its statutory supply area to relocate a pipe, which is already in the ground; this is known as a diversion. The company may also be contracted by developers in its statutory supply area to provide a new water main or new sewer; this is known as a requisition/extension. Contributions received in respect of diversions and requisitioned mains/extensions are treated as deferred income and released to revenue over time as the company considers that the obligation to provide these services is highly interrelated with the ongoing obligation to provide water services; therefore, the performance obligation is considered to be satisfied over the period that the property, plant and equipment constructed are in service.

Infrastructure charges are charges levied on developers for network reinforcement, which is not site specific, i.e. to fund expenditure, which will contribute towards wider network reinforcement work away from the development site. Infrastructure charges are treated as deferred income and released to revenue over time as there is an implied ongoing performance obligation to improve and maintain the wider network in order to provide an ongoing supply of water services.

Grants and contributions received in respect of property, plant and equipment where the performance obligation is deemed to be satisfied at a point in time (comprising payments for connection charges) are recognised immediately in the income statement, once the performance obligation is fulfilled. Connection charges are billed to developers for the provision of a connection to an existing water main, laying a pipe to the boundary of customers' properties and connecting to their supply pipes. Connection charges are recognised in revenue in the income statement in the year that they became receivable; the performance obligation has been identified as the connection of a service pipe to the main. Once the connection is made, the performance obligation is fulfilled and the income recognised immediately in the income statement.

Each of these types of grants and contributions (contributions for diversions and requisitioned mains/extensions, infrastructure charges, and connection charges) is not a government grant within the scope of IAS 20: 'Accounting for government grants and disclosure of government assistance' as the contributions are received from developers. While there may not be a written contract with the customer, the legal duties of the company under the Water Industry Act 1991 would seem to constitute a legally enforceable contract based on the transaction prices set out in the company's charges scheme, tariff documents and invoices; accordingly these grants and contributions fall within the scope of IFRS 15.

Investments

Investment in subsidiaries are held at cost, less accumulated impairment losses.

Short-term investments are deposits that cannot be withdrawn prior to maturity and are held at cost.

Trade and other receivables

Trade and other receivables are recognised initially at transaction price. The company holds the trade receivables with the objective of collecting the contractual cash flows, and, therefore, the trade and other receivables are subsequently measured at amortised cost using the effective interest method, less expected credit losses.

Notes to the financial statements – appendices continued

A3. Accounting policies continued

Expected credit losses are based on historical recoverability and calculated by applying a range of different percentages to trade receivables of different ages. These percentages also vary between categories of trade receivables. Higher percentages are applied to those categories of trade receivable that are considered to be of greater risk and also to trade receivables of greater age. The historical recoverability of trade receivables is deemed a good estimate of future expected credit losses. At each reporting date, the company takes into consideration any significant economic changes that may impact its credit loss model and future credit losses, for example the increased cost of living and energy crisis currently impacting our customers. To estimate the impairment to its trade receivables from either of these factors, the company has assessed its debtors based on postcode driven customer demographics. The company has assessed what it believes to be the sensitivity of each demographic to the current and emerging effects of these factors on household finances and ability to maintain payments.

The company applies the IFRS 9 simplified approach for measuring expected credit losses, which uses a lifetime expected loss allowance for all trade receivables and contract assets. To measure expected credit losses, trade receivables and contract assets are grouped based on shared credit risk characteristics and overdue days. Contract assets relate to unbilled metered consumption and have substantially the same risk characteristics as trade receivables for the same types of contract. The company has, therefore, concluded that expected loss rates for trade receivables are a reasonable approximation for loss rates for contract assets.

Inventories

Inventories are valued at the lower of cost or net realisable value after allowance for obsolete and slow-moving items. In accordance with established practice in the water industry, no value has been placed upon the water in reservoirs, mains or in the course of treatment.

Cash and cash equivalents

Cash and cash equivalents include cash at bank and in hand, deposits held at call with banks and other short-term highly liquid investments with original maturities of 12 months or less. Term deposits with original maturities longer than three months can be redeemed early, subject to the interest income being forfeited or reduced to reimburse any cost incurred by the counterparty. These are classed as cash and cash equivalents if the deposit can be redeemed to meet short-term cash needs and there is no risk of a significant change in value as the result of an early withdrawal. Deposits that cannot be withdrawn prior to maturity are classed as short-term investments.

Current and deferred tax

The tax credit for the year (and expense in the prior year) comprises current and deferred tax. Tax is recognised in the income statement, except to the extent that it relates to items recognised in other comprehensive income or directly in shareholder's funds. In this case, the tax is also recognised in other comprehensive income or directly in shareholder's funds, respectively.

The current tax credit is based on taxable losses for the year. Taxable losses differs from net losses as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The company's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the date of the statement of financial position.

Deferred taxation is provided in full, using the liability method, on taxable temporary differences between the tax bases of assets and liabilities and their carrying amounts in the financial statements. A deferred tax asset is only recognised to the extent that it is probable that sufficient taxable profits will be available in the future to utilise it. Deferred taxation is measured on a non-discounted basis using the tax rates and laws that have been enacted or substantively enacted by the date of the statement of financial position and are expected to apply when the related deferred tax asset is realised, or the deferred tax liability is settled.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to taxes levied by the same taxation authority and the company intends to settle its current tax assets and liabilities on a net basis.

Trade and other payables

Payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method. Payments received in advance and measured and unmeasured deferred income are contract liabilities under IFRS 15 and relate to advance contributions received in respect of connection charges, diversions and requisitioned mains/extensions and customer payments in advance for measured and unmeasured supplies.

Borrowings

All loans are recognised initially at fair value plus directly attributable transaction costs. The carrying amount of the debt is increased by the amortisation of the finance and transaction costs determined using the effective interest rate in respect of the accounting period and reduced by any payments made in the year. The finance cost recognised in the income statement is allocated to accounting periods over the term of the debt using the effective interest method.

An exchange of debt with substantially different terms is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. At the point of refinancing, all costs relating to the previous debt are written off to the income statement in full.

Financial instruments

Financial instruments, such as derivatives, are initially recognised at fair value on the date the derivative contract is entered into and are subsequently re-measured at their fair value at each reporting year. Gains or losses arising on revaluation are recorded in the income statement in the year in which they arise and are shown within either fair value gain/(loss) on inflation swaps or fair value gain/(loss) on energy swaps on the face of the income statement. Interest received or incurred on these derivative financial instruments is shown within finance income and finance costs on the face of the income statement.

The fair value of derivative financial instruments includes a Debit Value Adjustment ('DVA'), which is calculated by discounting the potential future cashflows at a rate that reflects the credit risk of the company, consistent with IFRS 13: 'Fair value measurement'.

Provisions

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

Ofwat assesses companies' operational performance against agreed performance commitments. Certain performance commitments contain an ODI, which can carry a financial reward or penalty, or both, which will be recognised as a revenue adjustment in the next charging period. The company adjusts future tariffs to reflect such amounts and, therefore, the benefit or cost is linked to the provision of future services as well as future performance. Resultantly, the company does not recognise a provision for penalties or rewards in the financial year in which they are incurred or achieved as these amounts are not an asset or liability at the balance sheet date.

Revenue recognition

The company's core revenue stream is derived from the supply of clean water. The IFRS 15 definition of a contract is met since the UK Government has contracted with the company on behalf of customers by granting the company its water supply licence, where the underlying performance obligation is the development and maintenance of the network and ensuring its continued availability to customers. Under IFRS 15, revenue is measured at the transaction price and is recognised as the customer receives the benefit of the water supply through consuming the water:

- for metered customers, the amount which the company has a right to receive is variable, determined by the volume of water consumed; and
- for unmetered customers, the amount which the company has a right to receive is determined by the passage of time during which a customer occupies a property to which water is supplied by the company.

The company has contracts with third parties operating in the non-household retail market for the supply of clean water (wholesale supply). The underlying performance obligation is the development and maintenance of the network, and ensuring its continued availability to such third party retailers on behalf of non-household consumers. Revenue is recognised at the point in which the company has a right to receive the revenue. For non-household retailers, the amount which the company has a right to receive is determined by non-household consumption volume data provided by the market operator.

For metered household customers, a receivable is recognised when the customer is billed for the usage. At this point, the consideration is unconditional because only the passage of time is required before the payment is due. Where the company has provided the service before payment is due, an accrual for the consumption of water that has not yet been billed is recognised in the income statement offset by a contract receivable within assets. The accrual is estimated using a defined methodology based upon weighted average water consumption by tariff, which is calculated based upon historical information.

Unmetered customers pay a fixed amount determined by the transaction prices set out in the company's charging scheme and tariff documents. If the payments received exceed the amount the company has the right to receive (i.e. unearned income), the company recognises a payment received in advance and discloses this as a contract liability within trade and other payables.

Where non-household retailers are billed monthly in advance for wholesale charges, as determined by billing/volume reports created by the market operator, the company recognises deferred income in relation to these accounts and presents this as a contract liability within trade and other payables.

The recognition of revenue from grants and contributions billed to developers is detailed in the grants and contributions accounting policy.

Revenue is recognised if it is probable that it will be received, considering the customer's ability and intention to pay that amount of consideration when it is due.

A3. Accounting policies continued

The company is under a statutory obligation to maintain water services to domestic properties within the areas defined in its water supply licence. As a result, the company may provide water services to customers who are unlikely to pay for these services. The company does not recognise revenue where historical evidence indicates that the company will probably never be able to collect the revenue billed. The company is currently seeing higher levels of consumption due to increases in temperature, a risk associated with the ongoing effects of climate change and has taken this into consideration regarding the recognition of revenue.

The company does not expect to have any contracts where the period between the transfer of the promised goods or services to the customer and the payment terms exceeds one year. The company, therefore, does not adjust any of its transaction prices for the time value of money.

Other income

Other income includes all income derived from sources associated with the ordinary activities of the business, other than revenue derived from the regulatory activities of the business. Other income, including mast rentals and billing and collections services, involves readily identifiable contracts with customers with clearly defined performance obligations to which prices are allocated. Income is recognised as the contracts are completed and the performance obligations satisfied. It is stated net of value added taxes.

Interest income

Interest income is calculated by applying the effective interest rate to the gross carrying amount of a financial asset, except for financial assets that subsequently become credit-impaired. For credit-impaired financial assets, the effective interest rate is applied to the net carrying amount of the financial asset (after deduction of the loss allowance).

Leases

The company leases its head office building and most of its vehicles. Rental contracts for vehicles are typically for fixed periods of two to five years. The company has an option to extend its leases; however, no contracts are reasonably certain to be extended after their lease term has expired. The lease contract of the head office building has a remaining period of 2.5 years. Lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions. The company's lease agreements do not impose any covenants, but leased assets cannot be used as security for borrowing purposes.

The company also leased some physical IT server space that was accounted for under IFRS 16 up to 31 December 2020. The lease was subsequently renewed to 31 December 2021 and treated as a short-term operating lease until that date. All remaining IT server space has been provided through a hosting service, therefore, it is out of scope of IFRS 16 as there is not a physically distinct identifiable asset. Costs are recognised on a straight-line basis as an expense in profit or loss.

The company applies recognition exemptions to short-term leases and leases of low-value assets. Short-term leases are leases with a term of 12 months or less. Low-value assets comprise small items of office equipment and IT equipment, typically costing no more than £5,000. Costs are recognised on a straight-line basis as an expense in profit or loss.

Leases falling within the scope of IFRS 16 are recognised as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use by the company. Each lease payment is allocated between the liability and finance cost. The finance cost is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The right-of-use asset is depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis.

The company's accounting policy is for assets and liabilities arising from a lease to be initially measured on a present value basis. Lease liabilities include the net present value of one or more of the following lease payments:

- fixed payments (including in-substance fixed payments), less any lease incentives receivable; and
- payments of penalties for terminating the lease, if the lease term reflects the lessee exercising that option.

Right-of-use assets are measured at cost comprising one or more of the following:

- the amount of the initial measurement of lease liability;
- any lease payments made at or before the commencement date, less any lease incentives received;
- any initial direct costs; and
- restoration costs.

Lease payments may be discounted using the lessee's incremental borrowing rate if the interest rate implicit in the lease cannot be determined. The incremental borrowing rate is the rate that the lessee would have to pay to borrow the funds necessary to obtain an asset of similar value in a similar economic environment with similar terms and conditions. The company uses an independent third-party to determine the incremental borrowing rate for each class of lease. The weighted average lessee's incremental borrowing rate applied to the lease liabilities during the year was 2.37%, reflecting the current high interest rates in the market as a result of the ongoing high levels of inflation. The incremental borrowing rate is re-determined annually and applied to new leases for the subsequent year.

The company enters into agreements with employees to use vehicles that it leases from a third party as a company vehicle. These agreements are considered by the company to be part of the overall compensation package of an employee and, as such, the company has applied IAS 19 'Employee benefits' in accounting for these arrangements rather than considering the arrangements as subleases of vehicles to employees under IFRS 16.

The company does not use sale and leaseback transactions.

The Company as a lessor

The investment properties are leased to tenants under operating leases with rentals payable monthly. Lease income from operating leases where the group is a lessor is recognised in income on a straight-line basis over the lease term.

Lease payments for some contracts include CPI increases, but there are no other variable lease payments that depend on an index or rate.

Although the group is exposed to changes in the residual value at the end of the current leases, the group typically enters into new operating leases and therefore will not immediately realise any reduction in residual value at the end of these leases. Expectations about the future residual values are reflected in the fair value of the assets.

Grafham reservoir

Under the Great Ouse Water Act of 1961, the company has an entitlement to water from the Grafham reservoir owned and operated by Anglian Water Services Limited ('Anglian Water'). The company pays Anglian Water a charge for the supply of water, which covers its share of the overall costs of running Grafham reservoir. These costs are recognised as an expense within cost of sales in the income statement as incurred.

Dividend distributions

Dividend distributions to the company's shareholder are recognised as a liability in the company's financial statements in the year in which the dividends are approved.

Retirement benefits

The company operates a pension plan, the Affinity Water Pension Plan ('AWPP'), as the AWPP's Principal Employer, providing defined benefits based on final pensionable salary. The assets of the plan are held separately from those of the company.

Affinity Water Limited was the AWPP's Principal Employer up until 31 August 2020, with former group company Castle Water (Southern) Limited (formerly Affinity for Business (Retail) Limited) being a Participating Employer of the AWPP up until this date. Since this date, Affinity Water Limited has been the sole employer.

The cost of providing benefits under the defined benefit plan is determined using the projected unit method, which attributes entitlement to benefits to the current year (to determine current service cost) and to the current and prior years (to determine the present value of defined benefit obligations) and is based on actuarial advice. Past service costs are recognised immediately in the income statement. When a settlement or a curtailment occurs, the changes in the present value of the plan liabilities and the fair value of the plan assets reflect the gain or loss, which is recognised in the income statement. Losses are measured at the date that the employer becomes demonstrably committed to the transaction and gains when all parties whose consent is required are irrevocably committed to the transaction.

The retirement benefit surplus or deficit in the statement of financial position comprises the present value of the defined benefit obligation (using a discount rate based on high-quality corporate bonds), less any past service cost not yet recognised and less the fair value of plan assets out of which the obligations are to be settled directly. Fair value is based on market price information and in the case of quoted securities is the published bid price.

Re-measurement gains and losses arising from changes in actuarial assumptions are charged or credited to shareholder's funds in other comprehensive income in the year in which they arise.

The amount charged or credited to finance costs is a net interest amount calculated by applying the liability discount rate to the net defined benefit asset or liability.

Contributions to the defined contribution section of the plan are recognised within cost of sales and administrative expenses in the income statement in the year in which they become payable.

The company also has an obligation to pay pensions to former Non-Executive directors of predecessor companies. A provision in respect of the obligation is included within the net pension asset or liability.

Notes to the financial statements – appendices continued

A4. Financial instruments and risk management

Risk management

The company's financial instruments comprise borrowings, derivatives, debentures, cash and liquid resources, lease liabilities, and various items, such as trade receivables and trade payables that arise directly from operations. The main purpose of these financial instruments is to provide finance for the company's operations. The company finances its operations through a mixture of retained profits, borrowings from its subsidiary companies, borrowings from Affinity Water Capital Funds Limited, its intermediate parent, and debentures.

It is the company's policy, and has been throughout the year under review, that no trading in financial instruments shall be undertaken.

The main risks arising from the company's financial instruments are liquidity risk, credit risk, energy risk, interest rate risk and inflation risk. Treasury policies in relation to these risks are agreed in conjunction with the wider Affinity Water group.

The Board reviews and agrees policies for managing each of these risks (refer to our principal risks and uncertainties section beginning on page 108 for further information on management of these risks). These policies have remained unchanged during the year.

Day-to-day responsibility for operational compliance with the treasury policies rests with the treasurer. A treasury report is provided quarterly to the Board, which summarises treasury activities and includes details on the company's position in regard to debt and cash at the end of each quarter.

The company's treasury function does not act as a profit centre and does not undertake speculative transactions.

Liquidity risk

The objective of the company's liquidity risk management policy is to ensure that the company has banking arrangements and adequate, though not excessive, cash balances, revolving credit facilities and standby facilities to enable it at all times to have the level of funds available to it, which are necessary for the achievement of its business and service objectives.

Liquidity risk is primarily managed by maintaining a level of liquidity such that there are sufficient cash balances and committed loan facilities capable of immediate draw down to cover as a minimum the next 12 months' forecast cash requirement ensuring that over-reliance is not placed on any one counterparty, whether through cash holdings or available facilities.

Liquidity is actively monitored by the company's treasury function and reported to the Board on a quarterly basis through the treasury report.

At 31 March 2023, the company had £300,492,000 (2022: £360,783,000) of available liquidity, which comprised £145,492,000 (2022: £205,783,000) of cash and term deposits and £152,000,000 (2022: £155,000,000) of undrawn committed borrowing facilities.

The company has entered into RPI and CPI linked inflation swaps as detailed in the interest rate and inflation risk section of note A4. These transactions lead to a net interest receivable cashflow over the life of the swaps, offset by an accretion payment on maturity (2026 for the RPI swaps and either 2030 or 2036 for the CPI swaps). There is no liquidity risk prior to these dates as there is no requirement to pay collateral prior to maturity. On maturity, a final accretion payment will be made based on the mark to market valuation at that date, resulting in a total forecast cash payment of £209,145,000 (2022: £110,163,000), included in the maturity analysis table. The mark to market valuation is reviewed on a monthly basis and a forecast accretion payment is reviewed annually to ensure sufficient cash balances can be made available if required.

Undrawn borrowing facilities:

	2023 £000	2022 £000
Floating rate:		
– Expiring within one year	**52,000**	55,000
– Expiring in more than one year	**100,000**	100,000
	152,000	155,000

The facilities expiring within one year comprise two standby facilities with one counterparty (2022: one counterparty) in the event of a liquidity shortfall: a 364 day revolving Debt Service Reserve Facility of £27,000,000 (2022: £32,000,000), which is intended for the purpose of funding any debt service payments, and a 364 day revolving Operations and Maintenance Reserve Facility of £25,000,000 (2022: £23,000,000), which is intended for the purpose of funding operating and capital maintenance expenditure.

The facilities expiring in more than one year comprise two revolving credit facilities, £60,000,000 (2022: £60,000,000) provided by Barclays Bank PLC and £40,000,000 (2022: £40,000,000) provided by Lloyds Bank PLC. The facilities are intended for the purpose of financing capital expenditure and working capital requirements to the extent that additional funding is required and have a maturity date of July 2026 and July 2025 respectively. These facilities were renewed on 24 June 2020 and use SONIA as the reference rate and have sustainability performance measures included.

Maturity analysis

Additional risk may arise if large cash flows are concentrated within particular time periods. The maturity profile in the following table represents the forecast future contractual principal and interest cash flows in relation to the company's non-derivative financial liabilities (borrowings and lease liabilities) with agreed repayment periods on an undiscounted basis.

At 31 March 2023 Non-derivatives	1 year or less £000	1–2 years £000	2–3 years £000	3–4 years £000	4–5 years £000	More than 5 years £000	Total £000
Loans from subsidiaries	**39,751**	**39,980**	**40,225**	**290,468**	**26,030**	**1,325,377**	**1,761,831**
Loan from intermediate parent	**160**	**160**	**160**	**160**	**160**	**4,827**	**5,627**
Lease liabilities	**3,238**	**2,857**	**1,541**	**501**	**131**	**1**	**8,269**
Total non-derivatives	**43,149**	**42,997**	**41,926**	**291,129**	**26,321**	**1,330,205**	**1,775,727**

At 31 March 2022 Non-derivatives	1 year or less £000	1–2 years £000	2–3 years £000	3–4 years £000	4–5 years £000	More than 5 years £000	Total £000
Loans from subsidiaries	53,017	38,836	39,004	39,176	289,348	1,262,651	1,722,032
Loan from intermediate parent	160	160	160	160	160	4,987	5,787
Lease liabilities	3,545	2,849	2,469	1,161	170	1	10,195
Total non-derivatives	56,722	41,845	41,633	40,497	289,678	1,267,639	1,738,014

The maturity profile in the following table represents the forecast future net cash flows in relation to the company's derivatives estimated using the forward rates applicable at the year-end.

At 31 March 2023 Derivatives	1 year or less £000	1–2 years £000	2–3 years £000	3–4 years £000	4–5 years £000	More than 5 years £000	Total £000
RPI linked inflation swaps net payment/ (receivable)	**(6,427)**	**(6,249)**	**(6,067)**	**81,592**	**–**	**–**	**62,849**
CPI linked inflation swaps net payment/ (receivable)	**(6,486)**	**(6,390)**	**(6,293)**	**(6,194)**	**(3,037)**	**88,196**	**59,796**
Total derivatives	**(12,913)**	**(12,639)**	**(12,360)**	**75,398**	**(3,037)**	**88,196**	**122,645**

At 31 March 2022 Derivatives	1 year or less £000	1–2 years £000	2–3 years £000	3–4 years £000	4–5 years £000	More than 5 years £000	Total £000
RPI linked inflation swap net payment/ (receivable)	(7,233)	(7,131)	(7,026)	(6,920)	38,297	–	9,987
CPI linked inflation swap net payment/ (receivable)	(6,773)	(6,717)	(6,660)	(6,603)	(6,545)	24,484	(8,814)
Total derivatives	(14,006)	(13,848)	(13,686)	(13,523)	31,752	24,484	1,173

Covenant risk

The company's compliance with its lending covenants is a risk. Both an ICR Trigger and Default Event would occur in a number of severe but plausible downside scenarios detailed in the viability statement. However this is on the assumption that no mitigating actions would be taken. Management are confident that mitigation actions within their control could be implemented that would prevent a trigger or default event from occurring should one of these scenarios arise..

Under an ICR Trigger Event, the company would be subject to certain constraints such as restrictions on dividends and restriction on debt buybacks. However, the directors are satisfied that an ICR Trigger Event would not fundamentally constrain the company's ability to carry out its business, particularly after considering the company's strong cash position meaning that the company has no further funding requirement in AMP7.

Notes to the financial statements – appendices continued

A4. Financial instruments and risk management continued

The company continues to monitor and manage the risks associated with the ICR covenant through the forecasting and reporting process and has identified mitigations, the most prominent of which is working capital management. The company was not in breach of its financial covenants as at 31 March 2023 or up to the date of signing these financial statements.

Credit risk

Credit risk arises principally from trading (the supply of services to customers) and treasury activities (the depositing of cash).

The financial assets that are subject to the expected credit loss model are trade and other receivables, contract assets relating to the unbilled accrual for metered customers and cash and cash equivalents. While cash and cash equivalents are also subject to the impairment requirements of IFRS 9, the identified impairment loss is nil.

Contract assets and trade and other receivables

The company applies the IFRS 9 simplified approach for measuring expected credit losses, which uses a lifetime expected loss allowance for all trade receivables and contract assets. To measure expected credit losses, trade receivables and contract assets are grouped based on shared credit risk characteristics and overdue days. Contract assets relate to unbilled metered consumption and have substantially the same risk characteristics as trade receivables for the same types of contract. The company has, therefore, concluded that expected loss rates for trade receivables are a reasonable approximation for loss rates for contract assets.

The company manages its credit risk of trade and other receivables through effective management of customer relationships. Concentrations of credit risk with respect to trade receivables are limited due to the company's customer base consisting of a large number of unrelated households and non-household retailers. The Water Industry Act 1991 (as amended by the Water Industry Act 1999) prohibits the disconnection of a water supply and the limiting of supply with the intention of enforcing payment for certain premises, including domestic dwellings. However, allowance is made by Ofwat in revenue limits at each price review for a proportion of receivables deemed to be irrecoverable.

Expected credit losses for household receivables are based on historical recoverability and calculated by applying a range of different percentages to trade receivables of different ages. These percentages also vary between categories of trade receivables. Higher percentages are applied to those categories of trade receivables, which are considered to be of greater risk and also to trade receivables of greater age; these receivables have higher expected credit losses. The company's policy is to write-off closed and live accounts that fall under the following categories: bankruptcy, liquidation, debt relief orders, deceased accounts where there is no estate, failed legal action and receivable amounts from customers who have moved out of the property with no forwarding address or are no longer responsible for payment of a water bill; the company concludes that there is no reasonable expectation of recovery under these circumstances. The historical recoverability of trade receivables is deemed a good estimate of future expected credit losses. At each reporting date the company takes into consideration any significant economic changes that may impact its credit loss model and future credit losses, for example the increased cost of living currently impacting our customers and the current energy crisis.

Amounts are also written off on accounts where the company is still supplying the customer and where all reasonable internal and external debt collection activities have been undertaken. Under these circumstances, if the total receivable contains amounts over six years old, the amount over six years old or more is written off. The company's write-off policy on household receivables has remained unchanged and has been consistently applied in the current year compared with the previous year.

Since 1 April 2017, the company has supplied wholesale water to third party retailers operating in the non-household market. Retailers operating in the non-household market have been granted a licence by Ofwat, with the financial resources of the retailer assessed on licence application and monitored on a continual basis. The company uses this assurance and monitors the recoverability of these receivables by assessing cash collection rates since market opening to ensure any uncertain receivables are provided for. At each reporting date, the company takes into consideration any significant economic changes that may impact the recoverability of these debtors and future credit losses.

At each reporting date management takes into consideration any significant economic changes that may impact the model and future credit losses. Therefore, the directors of the company do not believe there is any further credit risk provision required in excess of the expected credit losses of trade receivables (see note 12).

The loss allowance as at 31 March 2023 and 31 March 2022 was determined as follows for both trade receivables and contract assets (unbilled accrual for metered customers):

At 31 March 2023	Current £000	Current £000	Less than 1 year £000	1–2 years £000	2–3 years £000	3–4 years £000	More than 4 years past due £000	Total £000
Expected loss rate – metered household receivables	0.76%	0.00%	7%	27%	45%	64%	100%	
Gross carrying amount – metered household receivables	–	–	19,930	4,706	2,530	1,579	2,202	30,947
Gross carrying amount – unbilled accrual for metered customers (household)	39,819	–	–	–	–	–	–	39,819
Gross carrying amount – unbilled accrual for metered customers (non-household)	–	3,927	–	–	–	–	–	3,927
Provision at expected loss rate	303	–	1,339	1,262	1,149	1,002	2,202	7,257
Amounts provided at 100%	–	–	1,970	4,075	2,973	2,214	2,923	14,155
Loss allowance	303	–	3,309	5,337	4,122	3,216	5,125	21,412

	Current £000	Less than 1 year £000	1–2 years £000	2–3 years £000	3–4 years £000	More than 4 years past due £000	Total £000
Expected loss rate – unmetered household receivables	0.00%	17%	37%	56%	68%	100%	
Gross carrying amount – unmetered household receivables	–	7,588	3,202	1,901	1,385	1,792	15,868
Provision at expected loss rate	–	1,253	1,194	1,066	945	1,792	6,250
Amounts provided at 100%	–	1,100	845	2,043	1,787	2,464	8,239
Loss allowance	–	2,353	2,039	3,109	2,732	4,256	14,489

	Less than 3 months £000	3–6 months £000	6–9 months £000	9–12 months £000	More than 12 months past due £000	Total £000
Expected loss rate – developer services	0.00%	30%	41%	21%	46%	
Gross carrying amount – developer services	1,102	220	223	804	2,250	4,599
Loss allowance	–	67	91	170	1,042	1,370
Total loss allowance						37,271

Notes to the financial statements – appendices continued

A4. Financial instruments and risk management continued

At 31 March 2022	Current £000	Current £000	Less than 1 year £000	1–2 years £000	2–3 years £000	3–4 years £000	More than 4 years past due £000	Total £000
Expected loss rate – metered household receivables	0.28%	0.00%	3%	10%	25%	49%	100%	
Gross carrying amount – metered household receivables	–	–	17,394	4,283	2,207	1,590	1,878	27,352
Gross carrying amount – unbilled accrual for metered customers (household)	40,948	–	–	–	–	–	–	40,948
Gross carrying amount – unbilled accrual for metered customers (non-household)	–	3,505	–	–	–	–	–	3,505
Provision at expected loss rate	101	–	448	448	545	781	1,878	4,201
Additional provision	–	–	2,177	–	–	–	–	2,177
Amounts provided at 100%	–	–	1,714	3,406	2,767	2,120	2,448	12,455
Loss allowance	101	–	4,339	3,854	3,312	2,901	4,326	18,833

	Current £000	Less than 1 year £000	1–2 years £000	2–3 years £000	3–4 years £000	More than 4 years past due £000	Total £000
Expected loss rate – unmetered household receivables	0.00%	3%	7%	17%	42%	100%	
Gross carrying amount – unmetered household receivables	–	6,452	2,859	1,686	1,070	1,554	13,622
Provision at expected loss rate	–	175	191	290	451	1,554	2,661
Additional provision	–	857	–	–	–	–	857
Amounts provided at 100%	–	333	2,559	2,377	1,854	2,405	9,527
Loss allowance	–	1,365	2,750	2,667	2,305	3,959	13,045

	Less than 3 months £000	3–6 months £000	6–9 months £000	9–12 months £000	More than 12 months past due £000	Total £000
Expected loss rate – developer services	0%	34%	38%	14%	86%	
Gross carrying amount – developer services	917	389	230	978	1,047	3,561
Loss allowance	–	131	88	140	901	1,260
Total loss allowance						33,138

A reconciliation between the opening and closing loss allowances for trade receivables and contract assets for the year ended 31 March 2023 is shown in note 13.

At 31 March 2023 and 31 March 2022, the maximum exposure to credit risk was represented by the carrying amount of each financial asset in the statement of financial position:

	2023 £000	2022 £000
Cash and term deposits (note 15)	**78,783**	135,604
Short-term deposits (note 10)	**66,709**	70,179
Trade and other receivables (excluding prepayments and amounts recoverable from the company's insurer)	**96,569**	97,967
	242,061	303,750

The company manages its risk from treasury activities by ensuring counterparties meet the minimum credit requirements approved by the Board, which include a maximum peak exposure limit and minimum credit rating. Credit exposure is monitored regularly by the company's treasury function and is reported quarterly to the Board through the treasury report.

The breakdown of cleared cash and cash equivalents and short-term deposits treated as investments exposed to credit risk at each of the credit ratings per Standard & Poor's at 31 March is:

	2023 £000	2022 £000
AAA	**61,683**	101,125
A-1+	**35,883**	35,048
A-1	**47,926**	67,212
A	**–**	–
	145,492	203,385

These are all short-term ratings.

Interest rate and inflation risk

The company seeks to manage its interest rate risk by maintaining its exposure within a Board approved range, primarily through using a mixture of fixed, inflation linked and floating rate borrowings. A series of RPI linked inflation swaps with a total nominal value of £210 million, linked to the maturity of the Class A fixed rate £250 million bond (July 2026), were entered into between August 2018 and October 2020. A series of CPI linked inflation swaps with a total nominal value of £250 million, linked to the maturity of the Class A fixed rate £250 million bond (March 2036), were entered into between March 2020 and June 2020.

These swaps will lead to net interest receivable cashflow over the life of the swaps, which is expected to increase the headroom against our covenant limits, offset by an accretion payment on maturity. Movements in RPI/CPI forward rates create fair value profits or losses, which will flow through the income statement and impact the company's retained earnings or accumulated losses.

The company earns an economic return on its RCV, comprising a real return through revenues and an inflation return as an uplift to its RCV. To the extent that nominal debt liabilities finance a proportion of the RCV, there is an asset liability mismatch, which potentially exposes the company to the risk of economic loss where actual inflation is lower than that implicitly locked in through nominal debt. The company's index-linked borrowings, which are linked to inflation, form a partial economic hedge of the company's regulatory assets, which are also linked to inflation.

Interest rate and inflation risks are reported quarterly to the Board through the Treasury Report.

The interest rate profile of the company's debt is as follows:

As at	Fixed rate debt £000	RPI linked debt £000	CPI linked debt £000	Total £000
31 March 2023	**656,843**	**438,474**	**236,399**	**1,331,716**
31 March 2022	671,752	387,649	216,387	1,275,788

Notes to the financial statements – appendices continued

A4. Financial instruments and risk management continued

Sensitivity analysis

Sensitivity analysis has not been performed on movements in interest rates as the company's fixed rate debts had no exposure to interest rates as at 31 March 2023. Given the large movements in inflation and the current high levels, the following table details the sensitivity of profit before taxation to changes in RPI and CPI on the company's index-linked borrowings, RPI linked inflation swap and CPI linked inflation swap. The analysis relates to the position at the reporting date and is not indicative of the years then ended, as these factors would have varied throughout the year.

Impact on profit before taxation	2023 £000	2022 £000
2%/1% increase in RPI	(4,389)	(3,872)
2%/1% decrease in RPI	4,391	3,872
2%/1% increase in CPI	(2,209)	(2,406)
2%/1% decrease in CPI	2,209	1,600

Impact on profit before taxation	2023 £000	2022 £000
1% increase in RPI	(4,389)	(3,872)
1% decrease in RPI	4,391	3,872
1% increase in CPI	(2,209)	(2,406)
1% decrease in CPI	2,209	1,600

Energy price risk

The company is allowed a fixed amount of revenue by the regulator, in real terms, to cover electricity costs for each five-year regulatory pricing period. To the extent that electricity prices remain floating over this period, this exposes the company to volatility in its operating cash flows. The company has mitigated this risk by fixing the price on a proportion of its anticipated electricity usage out to the end of AMP7 through entering into electricity swap contracts.

Currency risk

The company has no material net exposure to movements in currency rates.

Capital risk management

The gearing policy approved by the Board is a target measured as net debt (as defined in the company's WBS documentation, refer to table 1E of the company's regulatory Annual Performance Report) to RCV, of 80%. This allows sufficient headroom within the company's financial covenants, which are triggered at a level of more than 90%. The company's gearing on this basis was 73.4% at 31 March 2023 (73.0% at 31 March 2022).

Assuming no significant changes to existing credit rating agencies' methodologies or sector risk assessments, the company aims to maintain its existing credit ratings of A3 with Moody's, BBB+ with Standard & Poor's and BBB+ with Fitch for the Class A bonds issued by its financing subsidiaries. These ratings are used by the industry's economic regulator, Ofwat, to assess the company's ability to comply with its licence requirement to maintain an investment grade credit rating.

The company looks to manage its risk by monitoring and maintaining the relevant key financial ratios used by the credit rating agencies to determine the credit ratings given. Further detail on the precise measures and methodologies used to assess water companies' credit ratings can be found in the methodology papers published by the rating agencies. Gearing and credit ratings are reported quarterly to the Board through the treasury report.

A5. Retirement benefits

Defined benefit section

The company's pension plan providing benefits based on final pensionable salary is closed to new members (the two precursor plans closing in April 1996 and September 2004). The assets of the AWPP are held separately from those of the company. The plan's corporate trustee (the 'Trustee') is a subsidiary of Affinity Water Capital Funds Limited, an intermediate parent of the company.

The risks of the plan are as follows:

Asset volatility

The plan liabilities are calculated using a discount rate set with reference to high-quality corporate bond yields. If plan assets underperform this yield, this will create a deficit.

The assets of the plan include a proportion of equities, which are expected to outperform corporate bonds in the long term, while providing volatility and risk in the short term. As the plan has matured, the Trustee has commenced reducing the level of investment risk and will be investing more in assets that better match the liabilities of the plan and expected cash outflows based on the plan's maturity profile.

The company believes that due to the strength of its business and the long-term nature of the plan liabilities, a level of continuing equity investment is an appropriate element of the Trustee's long-term strategy to manage the plan efficiently.

Changes in bond yield

A decrease in corporate bond yields will increase plan liabilities, although this will be partially offset by an increase in the value of the plan's bond holdings.

Life expectancy

The majority of the plan's obligations are to provide benefits for the life of its members, so increases in life expectancy will result in an increase in the plan's liabilities.

Inflation risk

The pension obligations are linked to inflation, and higher inflation will lead to higher liabilities (although, in most cases, caps on the level of inflationary increases are in place to protect the plan against extreme inflation).

Investment strategy

Following a Trustee investment strategy review in 2018/19, and the focus towards a 'cashflow driven investment' strategy, the Trustee implemented the following changes to the plan's portfolio at that time:

- increased the level of interest rate and inflation hedging provided by the plan's assets from 90% to 92.5%, subsequently rebalanced to 90% in December 2021 and 91.5% in November 2022, with the Investment Guidelines allowing a range from 87.5% to 100%); and
- introduced a new segregated actively managed investment 'liability driven investment/cashflow driven investment' portfolio managed by Insight Investment Management Limited, which is expected to provide stable returns and regular income to meet the plan's outgoings.

The latest actuarial valuation of the AWPP, determined by an independent qualified actuary, was at 31 December 2020, which concluded that the pension plan was 96% funded on a self-sufficiency basis. This actuarial valuation was made on the 'attained age' funding method, based on the following assumptions:

RPI inflation:	measured by reference to the Bank of England gilt inflation curve
CPI inflation:	measured by reference to the RPI inflation curve described above less 1.0% per annum pre-2030 and less 0% per annum post-2030
Pre-retirement discount rate:	measured by reference to the Bank of England gilt yield curves plus 0.25% per annum
Post retirement discount rate:	measured by reference to the Bank of England gilt yield curves plus 0.25% per annum
Salary increases:	measured by reference to the CPI inflation curve described above plus 0.5% per annum
Deferred pension increases:	measured by reference to the CPI or RPI inflation curves described above with an appropriate adjustment for any caps and collars
Pension increases:	measured by reference to the CPI or RPI inflation curves described above with an appropriate adjustment for any caps and collars

Notes to the financial statements – appendices continued

A5. Retirement benefits continued

Defined benefit section – employer contributions

Based on the latest actuarial valuation at 31 December 2020, and to eliminate the funding shortfall identified, as well as funding the future cost of benefits being accrued within the plan, the company agreed to pay contributions of £1,250,000 prior to 31 July 2021, £1,600,000 prior to 31 December 2021, and £1,600,000 per annum commencing from 1 January 2022 onwards.

The contributions expected to be paid by the company into the AWPP for the year ending 31 March 2024 are, therefore, £1,600,000 (£1,600,000 in the year ended 31 March 2023, based on the former Schedule of Contributions and dependent on the outcome of the actuarial valuation as at 31 December 2020 being undertaken at the time).

The weighted average duration of the defined benefit obligation is 13.4 years (2022: 16.5 years).

Defined benefit section – financial and demographic assumptions

Adjustments to actuarial valuations have been made based on the following assumptions:

	2023	2022
Discount rate	**4.75% pa**	2.70% pa
Salary growth	**3.20% pa**	3.60% pa
RPI	**3.20% pa**	3.65% pa
CPI	**2.70% pa**	3.10% pa
Life expectancy for a male pensioner from age 65 (years)	**22**	22
Life expectancy for a female pensioner from age 65 (years)	**24**	24
Life expectancy from age 65 (years) for a male participant currently aged 45 (years)	**24**	24
Life expectancy from age 65 (years) for a female participant currently aged 45 (years)	**26**	26

Deferred pensions are revalued to retirement age in line with the CPI assumption of 2.70% per annum (2022: 3.10% per annum) unless otherwise prescribed by statutory requirements or the plan rules.

Defined benefit section – sensitivity analysis

The below sensitivity analyses are based on a change in an assumption, while holding all other assumptions constant. In practice, this is unlikely to occur, and changes in some of the assumptions may be correlated. When calculating the sensitivity of the defined benefit asset to significant actuarial assumptions, the same method (present value of the defined benefit asset calculated using the projected unit credit method at the end of the reporting year) has been applied as when calculating the pension asset recognised within the statement of financial position.

	Change in assumption	**Impact on defined benefit obligation**	**Defined benefit sensitivity analysis**	**Impact on defined benefit obligation**
2023				
Discount rate	**0.5% decrease**	**6.8% increase**	**0.5% increase**	**6.1% decrease**
Salary growth	**0.5% increase**	**0.6% increase**	**0.5% decrease**	**0.6% decrease**
Pension growth rate	**0.5% increase**	**5.7% increase**	**0.5% decrease**	**4.9% decrease**
Life expectancy	**1 year increase**	**4.0% increase**	**1 year decrease**	**4.0% decrease**
2022				
Discount rate	0.5% decrease	8.6% increase	0.5% increase	7.6% decrease
Salary growth	0.5% increase	0.8% increase	0.5% decrease	0.7% decrease
Pension growth rate	0.5% increase	6.8% increase	0.5% decrease	6.1% decrease
Life expectancy	1 year increase	4.0% increase	1 year decrease	4.0% decrease

Defined benefit section – net retirement benefit surplus

At 31 March, the fair values of the plan's assets recognised in the statement of financial position were as follows:

	Plan assets %	2023 £000	Plan assets %	2022 £000
Equity securities	**1%**	**2,535**	7%	37,244
Debt securities	**68%**	**266,030**	71%	391,678
Property	**0%**	**42**	0%	156
Infrastructure	**1%**	**2,692**	1%	3,388
Liability driven investments	**28%**	**108,353**	15%	80,555
Cash and cash equivalents	**2%**	**8,047**	6%	34,481
Total fair value of the plan's assets	**100%**	**387,699**	100%	547,502
Present value of defined benefit obligations		**(334,084)**		(443,255)
Net retirement benefit surplus		**53,615**		104,247

The total of assets that are quoted is £330,095,000 (2022: £441,737,000) and the total of assets that are unquoted is £57,604,000 (2022: £105,765,000).

Defined benefit section – fair value of plan assets

Movements in the fair value of the plan's assets were as follows:

	£000	£000
At 1 April 2022/1 April 2021	**547,502**	540,370
Benefits paid	**(17,337)**	(15,301)
Principal employer contributions	**1,879**	3,539
Contributions by plan participants	**170**	215
Interest income	**14,573**	10,430
Re-measurement (losses)/gains	**(159,088)**	8,249
At 31 March 2023/31 March 2022	**387,699**	547,502

Defined benefit section – present value of plan liabilities

Movements in the present value of the defined benefit liabilities are as follows:

	£000	£000
At 1 April 2022/1 April 2021	**(443,255)**	(465,838)
Benefits paid	**17,337**	15,301
Contributions by plan participants	**(170)**	(215)
Net current service cost	**(3,236)**	(4,061)
Past service cost	**–**	–
Interest expense	**(11,734)**	(8,942)
Re-measurement gains	**106,974**	20,500
At 31 March 2023/31 March 2022	**(334,084)**	(443,255)

Defined contribution section

At the same time that the defined benefit section became closed to new entrants, the company established a defined contribution section to provide pension benefits to qualifying employees.

The total pension charge for the defined contribution section of the AWPP for the year ended 31 March 2023 was £4,043,000 (2022: £3,677,000). There are no amounts prepaid or outstanding in respect of the defined contribution section at 31 March 2023 (2022: £nil).

Notes to the financial statements – appendices continued

A6. Subsidiaries

Name of company	Country of registration/ incorporation	Registered address	Nature of business	Type of holding	Proportion of voting rights and shares held
Affinity Water Finance (2004) PLC	United Kingdom	Tamblin Way, Hatfield, Hertfordshire AL10 9EZ	Financing company	Ordinary shares	100%
Affinity Water Finance PLC	United Kingdom	Tamblin Way, Hatfield, Hertfordshire AL10 9EZ	Financing company	Ordinary shares	100%
Three Valleys Water Limited	United Kingdom	Tamblin Way, Hatfield, Hertfordshire AL10 9EZ	Dormant company	Ordinary shares	100%
Tendring Hundred Water Services Limited	United Kingdom	Tamblin Way, Hatfield, Hertfordshire AL10 9EZ	Dormant company	Ordinary shares	100%
Folkestone and Dover Water Services Limited	United Kingdom	Tamblin Way, Hatfield, Hertfordshire AL10 9EZ	Dormant company	Ordinary shares	100%
White Cliffs Water Limited	United Kingdom	Tamblin Way, Hatfield, Hertfordshire AL10 9EZ	Dormant company	Ordinary shares	100%

The company has an investment of £50,000 in 100% of the £1 ordinary shares of a subsidiary company, Affinity Water Finance (2004) PLC. The principal activity of Affinity Water Finance (2004) PLC, incorporated in the United Kingdom, is to raise finance for the company. It made a profit of £1,000 for the year ended 31 March 2023 (2022: £1,000), relating to bond management fees charged to Affinity Water Limited.

The company also has an investment of £50,000 in 100% of the £1 ordinary shares of another subsidiary company, Affinity Water Finance PLC. The principal activity of Affinity Water Finance PLC, incorporated in the United Kingdom, is to raise finance for the company. It made a profit of £7,000 for the year ended 31 March 2023 (2022: £7,000), relating to bond management fees charged to Affinity Water Limited.

The four dormant subsidiaries listed above file accounts at Companies House.

A7. Related party transactions

Purchases of goods and services

			2023		2022	
Related party	**Nature of relationship**	**In respect of**	**Value £000**	**Balance £000**	Value £000	Balance £000
Allianz Global Corporate & Speciality	Common ownership	Insurance	**616**	**–**	1,701	(616)
Allianz Insurance	Common ownership	Insurance	**565**	**(26)**	539	(539)

Sales of goods and services

			2023		2022	
Related party	**Nature of relationship**	**In respect of**	**Value £000**	**Balance £000**	Value £000	Balance £000
Vistry Group plc	Shared director	Connection charges	**88**	**–**	4	–

See note 3.3 for disclosure of the directors' remuneration.

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