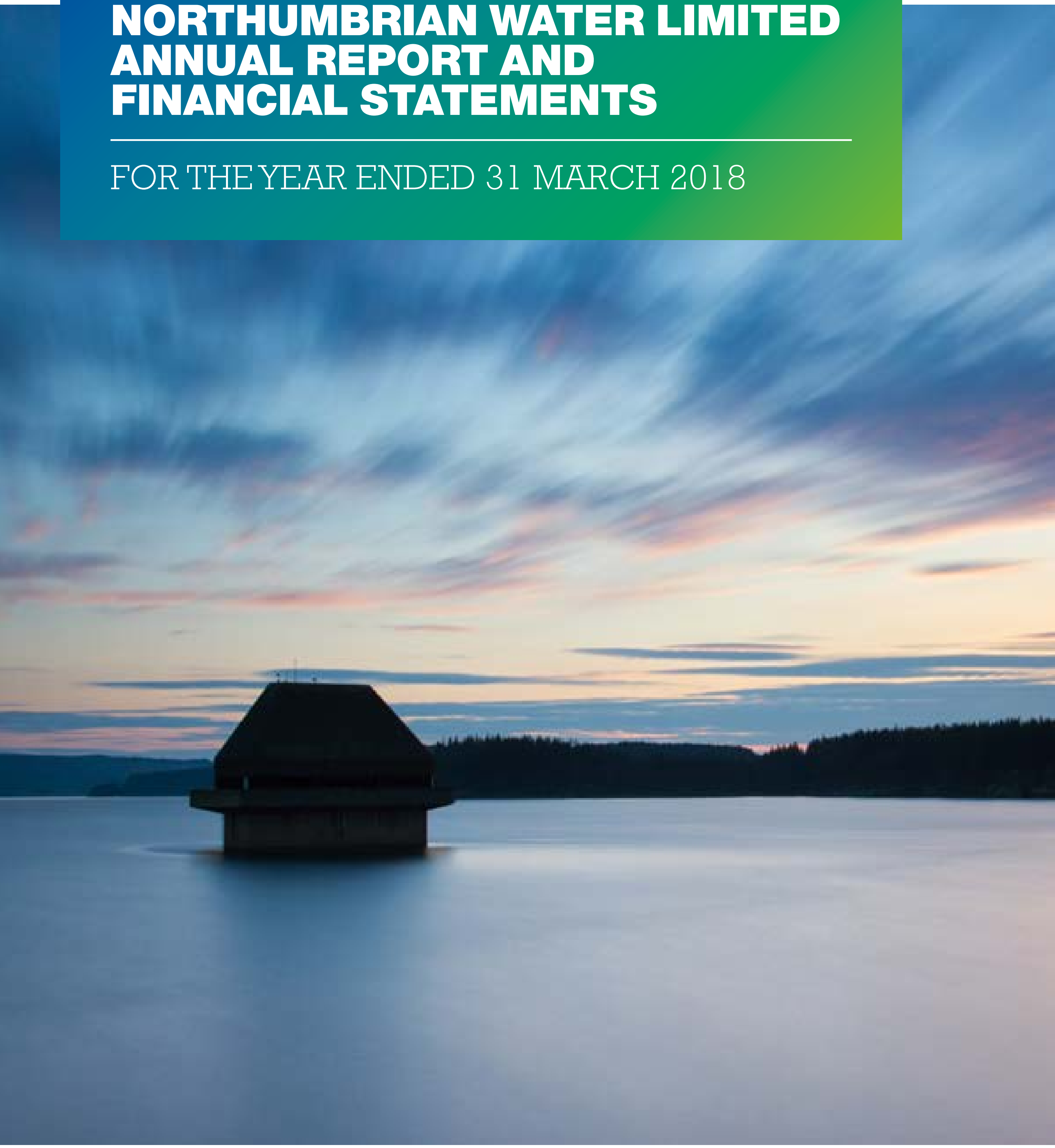
NORTHUMBRIAN WATER LIMITED ANNUAL REPORT AND FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 MARCH 2018



NORTHUMBRIAN WATER living water

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Registered company
no: 02366703

ANNUAL REPORT AND FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2018

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STRATEGIC REPORT

CHAIRMAN'S STATEMENT

I am pleased to introduce the Annual Report and Financial Statements of Northumbrian Water Limited for the year ended 31 March 2018.

A J Hunter

It is a privilege to be trusted to supply water to millions of customers in the United Kingdom, and to protect the environment by dealing responsibly with wastewater. The Board of Northumbrian Water Limited (NWL or the Company) never loses sight of this and the whole Company continually strives to deliver an unrivalled customer experience. This is an essential element of the Company's published vision to become the national leader in the provision of sustainable water and wastewater services and our Chief Executive Officer (CEO), Heidi Mottram, confirms in her report that we have made good progress across many of our key measures of success during 2017/18. Our good performance is reflected in the awards won by NWL in 2017/18; these include Utility Week's prestigious 'Utility of the Year' award, 'Water Company of the Year' and 'Customer Service Initiative of the Year' at the Water Industry Awards and the overall UK Excellence Award in the British Quality Foundation's large private sector category. This focus on performance has led to us having a high level of customer trust with year on year improvements on this measure.

As I reported last year, our progress is underpinned by our five strategic themes: Customer, Environment, Competitiveness, People and Communities. Our Strategic Report sets out our work and achievements within each of these themes. The Board reviews performance against a balanced scorecard of measures relating to the strategic themes at each meeting.

As Heidi explains in her report, we have continued to work collaboratively with our stakeholders to build on our solid foundations in these areas. The Company's open and honest approach to customers remains a key element of a corporate culture built on clear values: customer focused, creative, results driven, ethical and one team. We constantly remind ourselves of these values and sense-check all our business decisions against them. I firmly believe that this approach has helped us build a first class culture, with customer service at its heart. The strong public service ethos, which I referred to last year, is still very evident here at NWL.

I am also very pleased that our overall operational performance has remained excellent. We have again delivered low interruptions to supply, first class wastewater treatment compliance, good water quality, continued good progress in reducing sewer flooding, and bathing waters in the north east of England all meeting the required standard.

As part of our focus on the right culture, the wellbeing and safety of our employees is of paramount importance and a full Health and Safety (H&S) update is considered each time the Board convenes. This is a top priority for the Board, which reviews the H&S updates carefully and invests significant time with the Company's management to ensure that the H&S strategy is delivering good performance. The Company has developed a comprehensive 'safety culture' to increase awareness of risk and encourage employees to see safety as absolutely central to everything we do. Our new, company-wide campaign 'Everyone Home Safe Every Day' is reinforcing the safety message for all our people. We are rolling this out through small group briefings to all employees.

The Company's excellent customer service and operational performance are supported by the high corporate governance standards maintained by the Board. Full details of our corporate governance arrangements are set out in the report on pages 57 to 67.

In common with all water and sewerage companies, NWL needs to invest heavily in maintaining and, when necessary, replacing assets, equipment and facilities in order to ensure a reliable and high quality service. NWL also needs to pay a return to investors and lenders. Sound financial performance is therefore essential and I am pleased to confirm that the Company has retained its strong investment grade credit ratings and remains well within its financial Key Performance Indicator (KPI) targets, reported in the balanced scorecard on pages 15 to 16 under the Competitiveness theme. There are, however, real challenges ahead as we prepare for the next regulatory price review in 2019.

The transparency and financial resilience of the water sector, as a whole, has attracted a great deal of regulatory and political scrutiny and comment in recent months. As a company, we have been assessing and formally responding to the various consultations issued by the Water Services Regulation Authority (Ofwat). This has included supporting Ofwat on appropriately balanced changes that would clearly lead to enhanced outcomes for customers, while also taking steps to increase public awareness of how strongly NWL has delivered for customers over the past decade and how we continuously put customers at the heart of everything we do. NWL has maintained its simple, transparent, conventional funding structure with a prudent level of gearing. The Board has listened carefully to Ofwat's comments on dividends and financial resilience and is determined to maintain a fair balance between customers, investors and other stakeholders. The Company's strong investment grade credit ratings underpin this balance and the Board has taken direct action in 2017/18 to protect these.

Given our clear focus on customers and our ethical approach, we share Ofwat's stated desire to put customers' and society's interests at the heart of the business and we are keen to maintain an open and constructive dialogue on the subject of regulatory reform. We acknowledge the need to achieve an appropriate balance between necessary change and stability in outlook.

As Heidi confirms in her report, the Company's preparations for the opening of the non-household (NHH) retail market on 1 April 2017 were very thorough and NWL exited the market on that date, transferring its NHH customers to NWG Business Limited (NWGB), the NHH retail subsidiary of Northumbrian Water Group Limited (NWGL), or to alternative retailers chosen by the relevant customer. NWL continues to work very hard to ensure that it is an effective and efficient wholesaler of water and wastewater services to all retailers as customers, whilst continuing to provide first class services to its domestic customers.

The Board will continue to drive the performance of the Company forward to ensure we deliver even better services to our customers, both in 2018/19 and beyond.

Finally, I would again like to thank all our employees for their dedication and commitment this year. Our performance depends entirely on our people and their focus on exceeding the expectations of our customers.

Andrew J Hunter

CHIEF EXECUTIVE OFFICER'S REPORT

I am pleased to present our Annual Report and Financial Statements for the year ended 31 March 2018.

H Mottram

Our vision is to be the national leader in the provision of sustainable water and wastewater services, and I am delighted that we have made further progress towards this and remain at the forefront of performance in our industry.

It is important that we listen to our customers and we have made further progress this year promoting a culture of customer participation in the development of our strategies and plans. We see this as fundamental to ensure that we deliver continuously improving services to our customers and we have included a number of case studies in this report to demonstrate some of the innovative approaches we have taken to achieve this.

OUR PERFORMANCE

We put our customers at the heart of everything we do and aim to ensure that we deliver an unrivalled customer experience to all of our customers. Our levels of customer satisfaction remained extremely high this year and research by the Consumer Council for Water (CCWater) has shown that our levels of customer trust have increased even further this year.

Our customers have told us that a personal approach is really valued by them, so we have developed our customer service further through our Inclusivity Strategy which explains how we will provide extra support to those who need it and ensure that we treat all customers fairly and with respect.

At the start of the year we chose to exit the NHH retail market and transfer our NHH customers to another NWGL subsidiary. This transition went very well and the NHH market is now well-established providing choice for NHH customers. As a wholesaler, we have worked tirelessly through the year to provide excellent wholesale services to all of our NHH retailers. The NHH transition was the first phase of our programme to transform our customer care and billing systems. I am delighted that we have now also successfully transitioned all of our household customer data to our new billing system which will enable us to provide even better customer service than before.

We have continued to provide a resilient water supply maintaining our industry leading performance in lowest interruptions to supply along with 100% security of supply. I was very proud of the fantastic work our people did to keep the water flowing to our customers during the 'Beast from the East' in late February 2018, and that we were highlighted by Ofwat as one of the better performing companies over this period. We avoided any major incidents and, despite the significant increase in bursts caused by the freeze and subsequent thaw, we managed to keep our leakage levels broadly in line with our performance targets for the year. We continue to focus on driving leakage down sustainably using some exciting new technology and data science. We have also continued our award winning approach to water efficiency through our Every Drop Counts campaign and our engagement programme with school children.

The quality of the water we produce remains exceptionally high and we have made further progress in driving down instances of discolouration and taste and odour complaints from customers. We have continued to take an active catchment management approach to improving the quality of water in the environment, working with a number of partners to help us deliver more effectively together.

In our wastewater business I am pleased that we have seen further reductions in sewer flooding incidents, which is a testament to the number of innovative approaches we have adopted. These range from our award-winning Love Your Drain and Rainwise campaigns, through which we engage with customers about ways to prevent flooding occurring, to our partnership approach to sustainable urban drainage solutions (SUDS).

In the wider environment we are proud that all of the bathing waters in our north east operating region continue to meet the required standard and that the vast majority achieve the good or excellent standard. We continue to deliver excellent levels of wastewater treatment compliance and our transformative pollution management programme has helped us to reduce significantly the number of incidents over recent years.

One of the highlights of 2017/18 was our inaugural Innovation Festival where we hosted over 1,000 people over the week-long event with the aim of finding ways to address environmental and social issues that affect us all. It was great to see our employees engaging with our customers, other water companies and some world class partners who are leading in their fields. We are actively developing a number of the ideas to improve the lives of our customers and communities. Our second Festival is in full swing as we publish this report and has been even bigger and better.

We are also working with partners from across the utility sector to tackle the problem of future skills shortages through our NWG Academy, by engaging with schools and sponsoring research, particularly in the STEM (science, technology, engineering and maths) disciplines. We are also focusing on developing our people through a wide range of apprenticeships and it's exciting to see not only many younger people joining us through this route but also the number of our existing employees taking the opportunity to develop their skills and careers through an apprenticeship.

RECOGNITION

The successes above are a result of the hard work that our 3,000 employees put in every day and I was delighted that these efforts were recognised at a national level when we were named Utility of the Year at the Utility Week Awards, Water Company of the Year at the Water Industry Awards and also received the UK Excellence Award for best large private sector company from the British Quality Foundation. These awards recognised in particular our emphasis on customer service as well as our approach to innovation and sustainability.

On a personal level I was proud to be awarded a CBE for services to the water industry and business community in the Queen's Birthday Honours list, and named by Water and Wastewater International in their top 25 Global Water Leaders. I see this as recognition for the outstanding service we provide together every day and will accept on behalf of the whole fantastic NWL team.

LOOKING FORWARD

We are well advanced in our planning for the submission of our business plan to Ofwat for the 2020-25 price review period (PR19). We have been on a journey over recent years with our customers towards more and more active customer participation and co-creation. This deeper engagement with our customers has been fundamental to the development of our future plans. We will continue to set stretching targets in line with our national leader vision which will deliver further service benefits to our customers and the wider environment and communities in which we operate.

We are proud of our achievements to date, but we are never complacent and will continue to make further service improvements in 2018/19 and beyond. I hope you find our Annual Report and Financial Statements helpful and informative.

H Mottram

H Mottram CBE
CEO

*This **Annual Report and Financial Statements** is just one of a suite of documents we have published to provide our stakeholders with easily accessible information on our performance and governance. We have also published:*

***Annual Performance Report:** setting out how we have performed against the commitments we made in our business plan for 2015-20 and how we are continually striving to improve the services we deliver to our customers and our business Outcomes. There is also an accessible summary version.*

***Our Contribution Report:** presenting the social, environmental and economic impact we have on the communities we serve.*

***Data Assurance Summary:** explaining how we ensure that the information we report is accurate, clear and transparent and deliver against the commitments in Our Assurance Plan.*

All of these documents are available on our websites at www.nwl.co.uk and www.eswater.co.uk.

BUSINESS OVERVIEW

Our vision is to be the national leader in sustainable water and wastewater services.

We provide water and wastewater services to our customers in the north east of England, trading as Northumbrian Water (NW), and water services only to our customers in the south east of England, trading as Essex & Suffolk Water (ESW).

We employ over 3,000 people

2.7 MILLION

NW supplies water and wastewater services to 2.7 million people in the major population centres of Tyneside, Wearside and Teesside as well as the large rural areas of Northumberland and County Durham. We provide wastewater services only in Hartlepool.

1.5 MILLION IN ESSEX

0.3 MILLION IN SUFFOLK

ESW supplies water services to 1.5 million people in Essex and 0.3 million in Suffolk. Our Essex area is part rural and part urban and includes the main population centres of Chelmsford, Southend and the London Boroughs of Barking and Dagenham and Havering and Redbridge. Our Suffolk area is mainly rural with the largest towns being Great Yarmouth and Lowestoft.

We operate and maintain:

- 51 water treatment works;
- 305 water pumping stations;
- 324 water service reservoirs;
- 25,912km of water mains;
- 413 sewage treatment works;
- 945 sewage pumping stations; and
- 30,027km of sewers.

Every day we supply 1.1 billion litres of water

NWL is part of the Northumbrian Water Group (NWG or the Group). The ultimate parent undertaking of NWL is CK Hutchison Holdings Limited (CKHH), a company listed on the Hong Kong Stock Exchange. Further information about the structure and ownership of NWGL is provided on page 42 of this report.

OUR HIGHLIGHTS

UTILITY OF THE YEAR

Awarded at the Utility Week Awards 2017

MOST RELIABLE SUPPLY OF WATER

Industry leading performance on interruptions to supply

100% OF BATHING WATERS MEETING TIGHTER REGULATIONS

All designated bathing waters 'Sufficient' or better under the Bathing Water Regulations

REDUCED SEWER FLOODING

Continuing trend of reductions in repeat and internal sewer flooding incidents

100% OF SEWAGE SLUDGE CONVERTED TO RENEWABLE ENERGY

Benefitting customers and the environment

UK EXCELLENCE AWARD

British Quality Foundation UK Excellence Award in large private sector category

ROSPA GOLD MEDAL AWARD FOR 6TH CONSECUTIVE YEAR

Recognising Health and Safety performance and culture

INNOVATION FESTIVAL

Inaugural Innovation Festival held

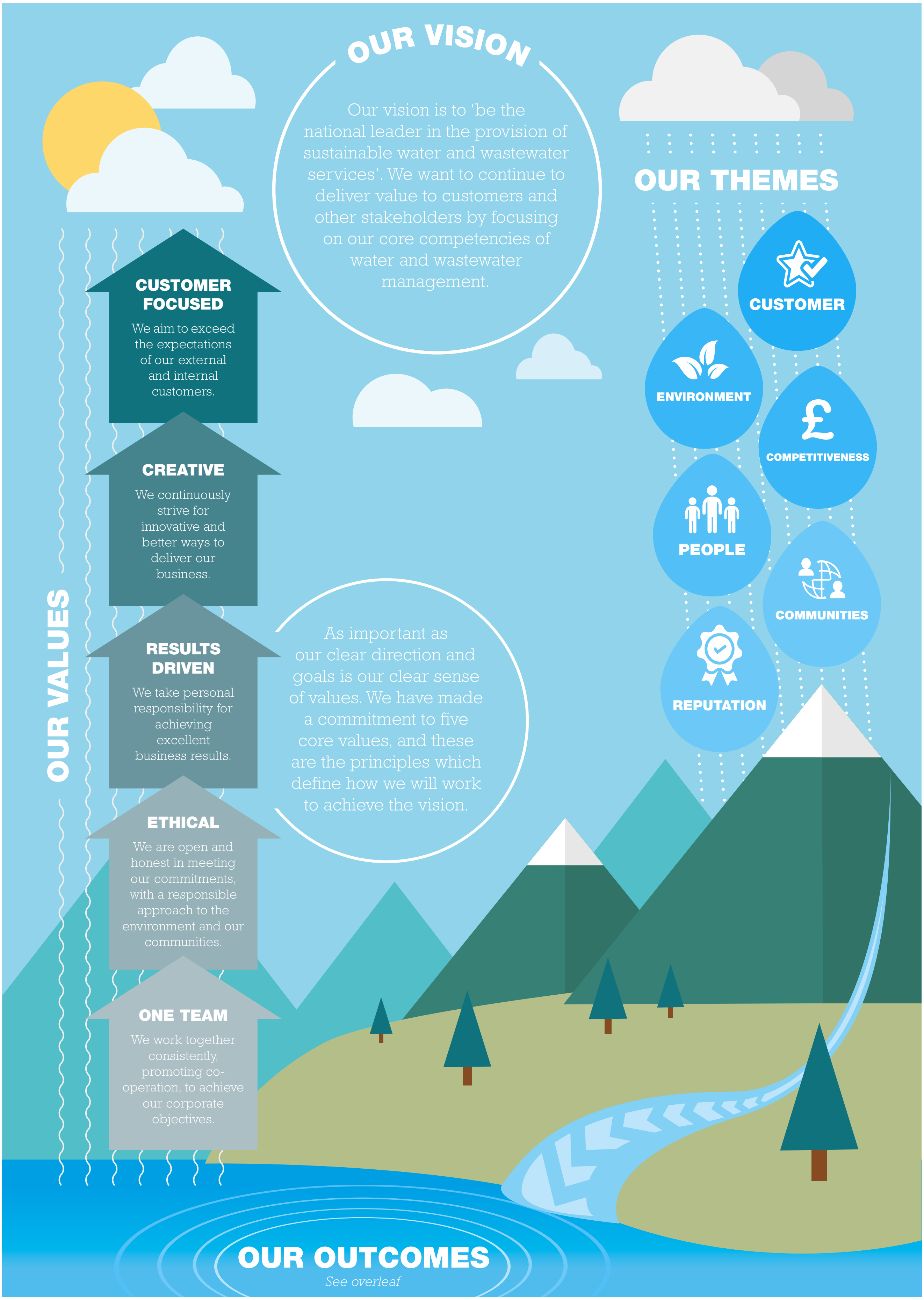
WATER COMPANY OF THE YEAR

Awarded at the Water Industry Awards 2018

TOP RATED GOVERNANCE AND ASSURANCE

Self-assured status in Ofwat's Company Monitoring Framework Assessment

BUSINESS MODEL



OUR OUTCOMES

THEME	OUTCOME
CUSTOMER	• We deliver water and sewerage services that meet the needs of current and future generations in a changing world. • We supply clean, clear drinking water that tastes good. • We provide a reliable and sufficient supply of water. • Our customers consider the services they receive to be value for money. • Our customers are well informed about the services they receive and the value of water. • We provide a sewerage service that deals effectively with sewage and heavy rainfall. • We provide excellent service and impress our customers.
ENVIRONMENT	• We help improve the quality of rivers and coastal waters for the benefit of people, the environment and wildlife. • We protect and enhance the environment in delivering our services, leading by example.
COMPETITIVENESS	• We are an efficient and innovative company. • Our finances are sound, stable and achieve a fair balance between customers and investors.
PEOPLE	• Our people are talented, committed and inspired to deliver great services to customers. • Our people act in line with our values. • We are seen as a great place to work. • Our workplaces are healthy and safe.
COMMUNITIES	• We are proud to contribute to the success of local communities. • We work in partnership towards common goals.
REPUTATION	• We are a company that customers trust.

OUR STAKEHOLDERS

We provide essential services to our customers and, as a licenced water and wastewater undertaker, we operate within a strict regulatory environment.

It is very important to us that we understand the needs of these and our many other stakeholders to ensure that we continue to provide a great service and deliver our business Outcomes. We engage proactively with all of our stakeholders in our continuing efforts to provide an unrivalled customer experience.

CUSTOMER VOICE

Over recent years we have progressed from customer consultation to a culture of deep customer participation, with customers co-creating our strategy and approach to customer service, levels of performance commitments and how investments are made. Customer participation has been fundamental to the development of our business plan strategy, helping us to understand what matters most to customers about the services we provide, which areas of the business they would most like to influence and the best ways for us to engage with them.

As a result we published our Customer Participation report: 'From customer consultation to a culture of customer participation'. Co-creation has become second nature for us, with customers shaping how investments are made and experiences are delivered. It was therefore a given to build on this when we started thinking about our 2020-25 business plan engagement and we have carried out design sprints, co-creation workshops and focus groups across all areas of the price review, having completely open conversations with customers about all areas of service.

Our Water Forums, one each for our NW and ESW customers, bring together a range of experts from various stakeholders to challenge the Company on behalf of our customers. They inform our approach to customer research and engagement on matters such as performance commitments and social tariffs research as well as challenging us to consider areas where performance and Outcomes for customers could be improved.

On a national and regional basis, customers' interests are represented by CCWater. We share and review customer literature with them before publication and engage on how we support vulnerable customers, as well as holding quarterly liaison meetings and attending regional public meetings.

GOVERNMENT AND REGULATORY CONTEXT

Ofwat regulates prices and levels of customer service. We engage on key issues such as market reform and future price controls as well as the need to demonstrate strong governance and the importance of maintaining the trust and confidence of our customers. This is achieved through our regular reporting, such as our Annual Performance Report (APR), responding to consultations, regular peer to peer contact and participating in the market place for ideas.

The Drinking Water Inspectorate (DWI) monitors drinking water quality and we engage at both an operational and strategic level to review performance and promote good practice, in addition to reviewing specific improvement schemes.

The Environment Agency (EA) covers environmental protection and we liaise on our environmental performance, discharge compliance and sewer flooding. In addition to regular performance reviews, we have worked collaboratively through catchment partnerships and providing strategic input to the 21st Century drainage programme.

OUR PEOPLE AND DELIVERY PARTNERS

We engage with our employees both through our Employee Relations Framework and via a range of communication channels, such as team briefings, director roadshows and regular internal communications. This covers a wide range of subjects from H&S and staff benefits to values and behaviours and diversity. Our approach is described in more detail in the Performance Review section, under the People heading on pages 31 to 36.

To meet the challenges of delivering our AMP6 (Asset Management Plan) capital investment programme as efficiently and effectively as possible, we implemented a new operating model with our supply chain, based around collaboration and co-operation. This involves joint framework governance groups, integrated programme delivery teams, joint recruitment campaigns and a joint framework for H&S, co-created with our partners.

CIVIL SOCIETY

We work closely with many non-government organisations and charities to deliver our corporate social responsibility commitments and build strong relationships with the communities we serve. Our activity in this area is explained in detail in Our Contribution Report, available on our websites, and is summarised on pages 37 to 38 under the Communities heading of our Performance Review.

We work with the media to help communicate messages to our customers through news releases, case studies and social media messaging. This covers a wide range of subjects such as the local impacts of capital investment schemes, environmental and community investment and corporate campaigns, such as Every Drop Counts and Love Your Drain.

INVESTORS

We are conscious of our duty to act in the best interests of our shareholder and we seek to achieve a fair balance between them and our customers and other stakeholders, including debt investors.

PERFORMANCE REVIEW

In order to measure delivery of the Company business plan and goals, we use a balanced scorecard of KPIs covering the full range of our strategic themes.

The top section of the Performance table on pages 15 to 16 shows our performance against the Outcomes, Measures of Success (MoS) and Performance Commitments (PCs) we agreed in the PR14 price review. The bottom section reports our performance against our internal targets under our Competitiveness, People and Communities Outcomes.

We are pleased that we have shown year on year improvement across the majority of our KPIs, achieving a high proportion of our performance targets and delivering industry leading performance in many areas, for example, water supply interruptions.

However, we aim to achieve all of our PCs and we are always disappointed when our performance doesn't meet our targets, albeit narrowly in some cases. In the table we identify those measures where we have achieved our target as (●), those where we were close to achieving and incur no penalty as (●) and other targets we have not achieved as (●).

In respect of lost time reportable accidents, whilst our performance remains good, we have not achieved the extremely stretching targets we set ourselves. H&S remains a top priority for the Board and we describe the work we continue to carry out in this area on page 36.

ACTUAL PERFORMANCE AGAINST THE KPI TARGETS AND FUTURE TARGETS

SCORECARD MEASURE	UNITS	2016/17 PERFORMANCE	PC	2017/18 PERFORMANCE	ACHIEVED	2018/19 PC
Customer						
We provide excellent service and impress our customers						
Ofwat Service Incentive Mechanism (SIM)	score (out of 100)	87.5	>=90	86.4		>=90
Independent overall customer satisfaction survey	score (out of 10)	8.5	>=8.2	8.7		>=8.2
Domestic customer satisfaction, net promoter score	score	46	>=32	44		>=32
Independent survey on keeping customers informed	%	94	>=94	94		>=94
Our customers consider the services they receive to be value for money						
NWL independent value for money survey	score (out of 10)	8.2	>=7.9	8.2		>=7.9
CCWater value for money survey – Water NW	%	84	>=83	78		>=83
CCWater value for money survey – Sewerage NW	%	84	>=84	78		>=84
CCWater value for money survey – Water ESW	%	67	>=73	71		>=73
We supply clean, clear drinking water that tastes good						
Overall drinking water compliance	%	99.936	100	99.938		100
Discoloured water complaints	no. of complaints	2,874	<=2,908	2,532		<=2,908
Satisfaction with taste and odour of tap water	no. of complaints	1,229	<=987	978		<=987
We provide a reliable and sufficient supply of water						
Leakage - NW	Ml/day	133.8	<=137	137.1		<=137
Leakage - ESW	Ml/day	68.1	<=66	66.2		<=66
Interruptions to water supply for more than 3 hours	average minutes/ property	02:26	<=05:56	05:23		<=05:29
Properties experiencing poor water pressure	no. of properties	199	<=216	186		<=216
Water mains bursts	no. of burst mains	4,273	<=4,586	4,214		<=4,586

table continued…

SCORECARD MEASURE	UNITS	2016/17 PERFORMANCE	PC	2017/18 PERFORMANCE	ACHIEVED	2018/19 PC
We provide a sewerage service that deals effectively with sewage and heavy rainfall						
Properties flooded externally	no. of properties	839	<=1,318	944		<=1,318
Properties flooded internally	no. of properties	119	<=186	96		<=186
Repeat sewer flooding	no. of properties	46	<=496	38		<=496
Properties flooded externally - transferred network (TDS)	no. of properties	2,730	<=2,931	2,726		<=2,931
Properties flooded internally (TDS)	no. of properties	215	<=228	199		<=228
Sewer collapses	number	55	<=58	46		<=58
Sewer collapses (TDS)	number	72	<=84	51		<=84
Environment						
We help improve the quality of rivers and coastal waters for the benefit of people, the environment and wildlife						
Pollution incidents (category 3)	number	102	<=115	58		<=115
Bathing water quality compliance	no. sufficient	34	>=32	34		>=34
Sewage treatment works discharge compliance	no. failing works	1	0	2		0
We protect and enhance the environment						
Greenhouse gas emissions	ktCO2e	188	<=172	164		<=161

SCORECARD MEASURE	UNITS	2016/17 PERFORMANCE	TARGET	2017/18 PERFORMANCE	ACHIEVED	2018/19 TARGET
Competitiveness						
Gearing: net debt to Regulatory Capital Value (RCV)	%	64.7	<=77.5	62.5		<=77.5
Interest cover	times	3.8	>=2.4	3.5		>=2.4
People						
Employee engagement – internal survey	%	74	>=79	80%		n/a
Employee engagement – external survey	score	n/a	n/a	n/a	n/a	2*
Lost time reportable accidents	number	9	<=3	9		3
Communities						
Business in the Community (BITC) Platinum Plus	y/n	retained	retain	n/a	n/a	retain

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CUSTOMER

SERVICE INCENTIVE MECHANISM

Ofwat's SIM measures our customers' experience of dealing with us and provides a good indication of how well we are serving those customers who have had a reason to contact us. Last year, in 2016/17, we were delighted to achieve joint first place in industry. In 2017/18 we have seen a slight dip in performance on the satisfaction survey, with our SIM score reducing from 87.57 to 86.4. This places us fourth in the industry.

"Our customers are well informed about the services they receive and the value of water"

We continue to embrace our Unrivalled Customer Experience Strategy and its core theme of 'Living Water Loving Customers', improving it further by refreshing it to make sure that our services are inclusive for all customers. Our customers are at the heart of everything that we do and we are determined to be the best service provider that our customers experience.

UNRIVALLED CUSTOMER EXPERIENCE

We want to make sure every single one of our customers receives an unrivalled experience whatever their particular circumstances or needs. Our customers have told us that a personal approach is incredibly valued by them; this is particularly true for customers who do need more help or support. It is in recognition of this that in the last year we have developed our approach further by publishing our Inclusivity Strategy to make sure that it is truly inclusive of all customer groups.

Our Inclusivity Strategy details our focus to provide extra support, financial and otherwise, for customers who need it and to remove the barriers that might get in the way of delivering exceptional service. Our aim is to treat all customers fairly and consistently, working alongside our partners to provide experiences that demonstrate respect and empathy always.

Every one of our employees has a role to play in this. If we are all sensitive to how others' needs might differ from our own, we will be better at creating and acting on opportunities to help our customers. Our Inclusivity Strategy shares our commitment to doing all that we can to enhance our customers' wellbeing and, in doing so, to improving their lives for the better.

Since the balance sheet date, we have also launched our new customer care and billing system for household customers. It enables a much more personalised service for our customers. This, coupled with our planned investment in our digital ambition, will transform our customer experiences and give our customers real choice of how and when they want to contact us; an essential part of enabling the delivery of our Unrivalled Customer Experience Strategy.

This will build on our existing innovative approaches to customer service, for example, our Utileyes initiative which won the Customer Service Initiative of the Year at the 2018 Water Industry Awards. Utileyes is an app which allows us to see exactly what our customers are looking at through their smart phone camera. If a customer calls us, this enables us to assess the problem straight away, saving the customer's time and allowing the problem to be resolved more quickly.

CUSTOMER PARTICIPATION

We are on a journey to involve our water and wastewater customers in the design and delivery of their future customer experience.

In previous years we started to take our interactions with customers further, moving from consulting and listening to something deeper and more meaningful. This shift developed in part from the benefits we saw when we co-created our Unrivalled Customer Experience Strategy in 2015. When Ofwat published its 'Tapped In' report, in 2017, it prompted us, along with our Water Forums, to take stock of where we had got to in our own approach and to use the 'FACE' (Futures, Action, Community, Experience) analysis to identify the steps we needed to take in order to place ourselves at the frontier when it comes to customer participation.

As a result we published our Customer Participation report: 'From customer consultation to a culture of customer participation'. Co-creation has become second nature for us, with customers shaping how investments are made and experiences delivered. It was therefore a given to build on this when we started thinking about our 2020-25 business plan engagement and we have carried out design sprints, co-creation workshops and focus groups across all areas of the price review, having completely open conversations with customers about:

- What matters most to them about the services we provide;
- Which areas of the business they would most like to influence; and
- The best ways for us to engage with them.

Customer participation is part of our DNA and looking ahead, we plan to make sure it reaches across all parts of our business.

CUSTOMER SATISFACTION AND VALUE FOR MONEY

Our aim is to deliver an unrivalled customer experience and, in addition to our industry leading SIM performance, we track various measures of customer satisfaction with the services we provide and the value for money of those services.

Our own customer satisfaction research is carried out quarterly by an independent company and we were delighted to achieve our best ever score of 8.7 in 2017. As an alternative indicator, we use Net Promoter Score to measure customer advocacy, the loyalty that exists between a company and its customers, and are proud to have maintained our strong positive score of +46, which ranks us alongside leading UK businesses.

> "Our customers consider the services they receive to be value for money"

Our customers tell us that it is important to keep them well informed and consistently over the last three years, 94% of our customers have told us that they were satisfied that they are supplied with all the information they need to feel informed about the services we provide.

Our customers have also told us that value for money is very important to them, and this is a key area where they would like to be involved in influencing our future plans. We use two surveys to help us assess whether our customers think we offer good value for money.

CCWater carries out research with customers about the value for money of services provided. The results showed levels of satisfaction above the industry average in our NW region for both water and sewerage services, but marginally below average levels in our ESW area where average bills are higher. However, we were disappointed that the results for the NW region were lower than the previous year and that we did not achieve our PC against these measures. We continue to strive to keep bills at affordable levels and describe our work to support customers in vulnerable circumstances below, including the launch of a new affordability tariff. We also commission independent surveys for which the value for money score has remained consistent over the last three years at 8.2 out of 10.

SUPPORTING CUSTOMERS IN VULNERABLE CIRCUMSTANCES

We have continued our focus on our support for customers who are in vulnerable circumstances and, as described above, we recently published our Inclusivity Strategy, which we developed in partnership with our customers.

> "We provide excellent service and impress our customers"

Through our strong partnership with the debt charity StepChange we continue to refer the most customers within the water industry, assisting our customers to receive holistic debt advice. With the benefit of our data sharing agreement with StepChange we know which of our customers are seeking debt advice so that we can provide them with the breathing space they need to work through their finances.

We also continue to signpost to other debt advice services and are working with local councils to promote our schemes. We are now providing nearly 4,300 customers with a reduced bill through our company-funded reduced tariff, and 1,900 customers are on our arrears write off scheme, and will see their arrears written off over a two year period.

We launched our customer-funded affordability tariff from 1 April 2018, providing a discount of up to 50% for low income households where their water bills represent more than 3% of net income. We promoted this tariff when we issued our annual unmeasured bills for 2018/19 and this generated a high level of interest with over 1,000 customers signed up by the end of March 2018.

We target promotion of our affordability and priority services to areas where we have the highest levels of customers in difficulty and use a range of approaches from leaflets and local radio campaigns to social media promotion. However, our own people are the best ambassadors and we have completed internal briefings for our contact centres and operational teams to increase understanding and provide easy routes of signposting.

COMMUNICATION IS KEY TO CUSTOMER SERVICE

Two-way communications with customers in our communities is central to our ambition to provide excellent service and impress our customers. Nothing beats meeting our customers face to face.

We regularly take to the road to canvass opinion, crowd-source ideas, provide practical advice and raise awareness of ways our customers can help protect our environment and save money.

We even have a vehicle designed for the purpose. Fondly known as Flo, our customer engagement vehicle is a regular feature of streets, busy car parks and residential areas across our regions – providing handy drop-in sessions for people on the go.

Recent dates in Flo's diary have included:

- A Have Your Say campaign day in Newcastle's shopping hotspot Northumberland Street where customers were encouraged to give their views on our existing and future services. Thoughts and ideas gathered from the session are now being used to shape our business plans and inform decision-making;
- Supporting our 'Make My Day' campaign in Chelmsford where, during National Customer Service Week in October 2017, we surprised customers and specially selected community groups with acts of kindness to make their day;
- A day collecting flood stories from residents in Barnard Castle as part of our efforts to use local knowledge to reduce flood risk in future;
- Carrying out customer research on our business outcomes for our PR19 business plan in Lowestoft and Great Yarmouth; and
- A Rainwise initiative event at a neighbourhood in Hartlepool providing residents with handy hints and tips to help reduce the risk of their homes being affected by flooding. Flo parked for the day near to our £2.4million project to upgrade a sewer network, to share ideas with residents on how they can do their bit to manage flooding by making small changes around their homes and gardens.

RELIABLE WATER SUPPLY

Delivering a reliable supply of water to customers is core to what we do and we have continued to deliver industry leading performance on interruptions to supply. This has been sustained in spite of adverse weather conditions, particularly at the start of 2018, causing a high level of mains bursts. We have also continued to reduce the small number of properties receiving poor water pressure.

We faced particularly difficult weather conditions across both our operating regions over the winter of 2017/18 which made leakage management very challenging. We worked hard throughout the year to keep on top of leakage and, in spite of many periods of adverse weather, we were on target to meet our PCs in both regions by the end of February. However, the further freeze and subsequent thaw caused by the 'Beast from the East' at the end of February 2018 pushed our annual average daily leakage level fractionally above our PC in each region, even though we were able to keep the water flowing to our customers and were highlighted as one of the better performing companies by Ofwat in their report "Out in the Cold - Water companies' response to the 'Beast from the East'".

From 2020, leakage performance will be measured on a three-year rolling average. This recognises that increasingly unpredictable weather patterns can make it very difficult to achieve annual leakage targets.

We are continuing to develop our approach to reducing leakage on a sustainable basis. We're using the insights from our advanced data analytics approach to develop a heat map technique to pinpoint where pipe repairs are needed most. We're also utilising satellite technology, drones, in-pipe robotics and even leak sniffer dogs to help find leaks.

LONGER TERM RESILIENCE

Building resilience to cope with the challenges of changes in future weather patterns is a key concern expressed by our customers, who want us to be best prepared for the future. The Security of Supply Index (SoSI) measures whether companies have sufficient water resources to meet demand at all times, including periods of high demand during warm, dry weather. Our SoSI score remains at 100% in both NW and ESW and in our draft Water Resource Management Plans, submitted in December 2017, we forecasted that our SoSI will remain at 100% for all of our water resource zones until at least 2060.

> "We supply clean, clear drinking water that tastes good"

In order to sustain this, we have continued our industry leading approach to water efficiency and have invited our customers to actively participate in helping us to design and implement solutions to our water resources challenge. Our award winning whole-town approach, Every Drop Counts, developed further with a greater focus on changing behaviour. In the summer of 2017 over 4,800 households in Stanley in County Durham and Witham in Essex signed up for a free water and energy saving visit.

We have also engaged with over 30,000 pupils in 200 schools on water efficiency over this year, through our new children's play, Super Splash Heroes. The play aims to demonstrate how people can make little changes that will have a big impact on the world around them and to inspire children to make a positive difference through the way they use water.

We continued to receive external recognition for our water efficiency work. We won the 2017 Water Industry Achievement Award for Water Resource Management Initiative of the Year. We were also shortlisted in The British Quality Foundation UK Excellence Awards 2018 for the Innovation in Sustainability and Society Award, both for Every Drop Counts. We have also been shortlisted in the Water Industry Achievement Awards 2018 for Water Resilience initiative of the year for Super Splash Heroes.

We have continued to install customer water meters during 2017/18, increasing meter coverage to 62% of all households and 94% of non-households in ESW, and to 37% of all households and 87% of non-households in NW.

WATER QUALITY

The water we supply must meet stringent quality standards, set by the DWI, to ensure that it is safe to drink and the quality is acceptable to customers in respect of taste, odour and colour. Our overall drinking water compliance remains extremely high at 99.938%, an improvement on the previous year. To put this in context, this represented only 45 failures from around 75,000 tests, importantly, with no risk to public health.

> "We provide a reliable and sufficient supply of water"

Whilst we would expect some variation in performance levels due to samples being taken on a random basis, we are committed to improving water quality even further. We plan to achieve this through catchment and abstraction management to take the best quality raw water for treatment. We are also investing in our treatment and network assets to improve water quality.

We are working to improve water quality performance over the longer term through our catchment management approach. We engage with a number of environmental partnerships to deliver catchment improvements in order to help us to improve the quality of rivers, reservoirs and groundwater from which we abstract water for our treatment processes, as well as helping to reduce the risk of flooding and improve biodiversity.

A good example of how we work together with likeminded organisations, including other water companies, to achieve shared objectives is the Pennine PeatLIFE project. This will restore large swathes of peatland in the North Pennines which will provide homes for wildlife, store carbon to help combat climate change and help filter clean water into our rivers.

CLEAN CLEAR WATER THAT TASTES GOOD

We have been working to reduce the number of discoloured water complaints in our NW area for more than ten years and our performance has improved significantly over this period. However, we recognise there is still more to do and we are continuing to invest in active network management approaches to reduce the accumulation of discolouration material and bring other service benefits, such as resilience to quality problems when burst pipes occur.

The drinking water we supply is of a very high quality but occasionally some of our customers become aware of changes to taste or odour. This can occur as a result of the use of chlorine to maintain good hygiene in our water supply network, a change in where a customer's water comes from, or how it is treated, or even issues with a customer's own plumbing. Following bespoke research to better understand the issue, we have developed plans across a number of areas to improve our customer experience. This includes new research into catchment and raw water quality, treatment works optimisation and network optimisation, as well as improved customer communication. The number of taste and odour contacts reduced significantly in 2017 compared to the prior year and is close to industry leading.

SEWER FLOODING

Sewer flooding is one of the worst service failures our customers can experience and reducing this remains one of our highest business priorities. As a result of our investment and customer engagement, we are very pleased to see a continued improvement in our sewer flooding performance with further reductions in the number of properties subject to repeat flooding and internal flooding incidents.

> "We provide a sewerage service that deals effectively with sewage and heavy rainfall"

As well as providing capital investment solutions where appropriate and responding quickly and efficiently to issues on our sewer network, our education campaign, 'Love Your Drain' has continued to grow. Spearheaded by the character Dwaine Pipe, we use the campaign to inform household customers about the causes of blockages and what can be disposed of down the toilet and sink, as well as working with businesses about the correct disposal of fats, oils and grease. Blockages have been reduced by up to 40% in some high risk areas as a result of the campaign.

We were delighted that Love Your Drain won the Marketing Campaign of the Year at the prestigious Chartered Institute of Marketing Marketing Excellence Awards as well as a number of other awards.

SUSTAINABLE URBAN DRAINAGE SOLUTIONS

As well as addressing immediate flooding issues, we are working in partnership to develop sustainable solutions to build resilience against flood risk. During the year, we continued to develop and improve our industry leading approach to partnership working. The innovative Northumbria Integrated Drainage Partnership that we formed with the EA and thirteen Lead Local Flood Authorities in our operating area, continues to strengthen with the creation of a ten year programme of potential flood risk reduction projects.

We continue to support the delivery of housing across the region, and work with local authorities, developers and land owners to develop drainage master plans to unlock strategic housing sites. One such example was the North Morpeth Strategic Sewer project which was developed with the local community and will enable future development plans in the town.

Another SUDS project at Killingworth and Longbenton in North Tyneside, saw the completion of its second phase during 2017/18. Delivered in partnership with North Tyneside Council and the EA, this has diverted surface water away from sewers and into natural storage areas and biodiverse flood plains, which have been designed to allow surface water from future housing development to be accommodated. In addition to reducing the property flooding risk, this reduced the risk of sewer overflows discharging during heavy rainfall and creates additional capacity at our sewage treatment works.

On a smaller scale, we have been trialling our Rainwise initiative to reduce customers' flood risk before they ever experience flooding. These projects, which are co-created with our customers, prioritise sustainable urban drainage and natural drainage systems wherever possible, and sustainability is a key message which is communicated to our customers via literature and customer events. The primary design focus has been on removal of surface water from the sewer network, followed by attenuation, diversion and storage of surface water in natural systems. Working in partnership with other agencies has yielded attractive projects which the communities view as assets, and by changing both landscapes and behaviours, we are building more resilient communities.

"We deliver water and sewerage services that meet the needs of current and future generations in a changing world"

INTELLIGENT ASSET MANAGEMENT

We adopt an integrated approach to managing our assets, which means finding the right balance between operational and long-term maintenance and investing in new assets at the right time, in the interests of current and future customers. We have company wide accreditation to ISO 55001 Asset Management, demonstrating that we follow best practice in the long term management of our assets.

Building on this approach, we are currently investing in a long term programme, named Intelligent Asset Management (iAM), which will deliver both improved systems and processes and enhanced data and analytics to improve how we manage our assets.

ASSET HEALTH

We use the concept of Asset Health to assess the effectiveness of our long-term stewardship of our assets, based on two baskets of measures, for water and wastewater. As asset health is about the long-term stewardship of our assets, we assess our performance on a three-year rolling average basis, 2017/18 being the first assessment point during our current 2015-20 price control period.

All bar one of our measures in each basket met or exceeded their PC in 2017/18. The two measures which failed narrowly to achieve their PC were overall drinking water compliance and sewage treatment works discharge compliance. In both cases we have a very high level of compliance, however, the PCs are set at zero failure rates. More detail on our asset health performance is available in our APR.

ENVIRONMENT

POLLUTION INCIDENTS

We manage and maintain a network of almost 30,000km of sewers across the NW region. When we have problems in our sewerage system, such as from blockages and mechanical breakdowns, untreated sewage can sometimes escape into watercourses and the sea causing environmental harm. On occasion, we experience problems with our water supply systems that can also result in environmental impacts.

We continue to focus our attention on reducing the risk of this happening but a relatively small number of these 'pollution incidents' occur. The number of serious incidents, categorised as category 1 or 2 by the EA, reduced to four in 2017. We are working hard with the EA, our operational teams and through our Pollution Best Practice Group, to make sure lessons are learnt and serious incidents are reduced further. Numbers of Category 3 incidents decreased markedly again from 102 in to 58 in 2017.

"We help to improve the quality of rivers and coastal waters for the benefit of people, the environment and wildlife"

Our transformative pollution management programme has contributed to the reduction in the number of incidents in recent years. This focused approach has looked at every incremental improvement that can be made in performance across all our assets. Activities have included water industry benchmarking, enhanced data analytics, community engagement, improved evidence collection and dynamic planned maintenance. In addition, we have continued our award winning Water Rangers scheme through which a team of dedicated volunteers monitor our waterways and report back incidents so we can respond swiftly.

BATHING WATER QUALITY COMPLIANCE

Our bathing waters in the NW region continue to be amongst the cleanest in the country. For the second year running, all 34 designated bathing waters in our region met the required standard of 'Sufficient' or better, with 25 classed as 'Excellent' and a further seven as 'Good'.

We are working in partnership with the EA, Scottish Environment Protection Agency and Northumberland County Council to further improve bathing water quality at Spittal beach, at Berwick-upon-Tweed, which was classed as 'Sufficient' standard for a second year. The EA has confirmed that further investment to improve bathing water quality at Spittal is no longer required. We are using catchment walks, communications to raise awareness and one-to-one engagement to encourage the adoption of best practice across the rural sector.

Since September 2017, we have been working in partnership with the EA and local authority to investigate the bathing water quality at Tynemouth Cullercoats in North Tyneside. The bathing water moved from 'Good' in 2016 to 'Sufficient' in 2017. This has included additional bacteriological sampling, DNA analysis and an extensive misconnections survey near the beach.

SEWAGE TREATMENT WORKS DISCHARGE COMPLIANCE

The EA sets strict standards for effluent discharged into rivers, estuaries and the sea. Our performance against these standards has been excellent for a number of years although this is becoming increasingly challenging as standards become even tighter, and we suffered two failures in 2017. Our aim remains zero failures to help improve the quality of rivers and coastal waters and to meet our objective to be a 4* company in the EA's Environmental Performance Assessment.

We are planning now to meet future new and tighter consent standards and to satisfy our obligations in working towards meeting 'Good' Water Framework Directive status in our rivers. We are making a significant investment in our sewage treatment works to reduce the amount of phosphorus being discharged and will continue our contribution to improving river water quality in North East England. A key aim is also to ensure our customers' money is spent on well justified schemes that will deliver real improvements to water quality and ecology.

ENVIRONMENTAL PARTNERSHIPS

We engage with more than 30 environmental partnerships to protect and enhance the environment in our NW and ESW operating areas. These include conservation partnerships to help manage our sites, rural partnerships to help deliver environmental improvements while protecting raw water, drainage partnerships to solve integrated flooding problems which are not ours alone, and catchment partnerships delivering improvements to the water environment.

> “We protect and enhance the environment in delivering our services, leading by example”

Over the last year, we have started to take a more strategic approach to working with all of our environmental partnerships, ensuring that we work effectively with other organisations to deliver shared environmental Outcomes which can benefit our customers. We ran a series of seven ‘Thinking Ahead’ workshops with our environmental partners and together developed a list of themes where we know we want to work together within partnerships to achieve shared objectives. We also explored expectations and opportunities to take more of a leading role in the water environment within our regions, which we will take forward within our 2020-25 business plan.

ENERGY EFFICIENCY

Our carbon management plan has the aim of reducing our greenhouse gas (GHG) emissions by 35% by 2020 against a 2008 baseline. We remain on track to achieve this target with emissions reducing by 11% compared to the previous year and down by 46% compared to the baseline, of which 31% is driven by our own efforts and 15% is the result of a lower emissions factor for grid electricity. This performance is explained in more detail on page 79 of the Governance Report.

We are continuing to progress the four pillars of our energy strategy: renewable generation, energy efficiency, smart energy and efficient procurement.

In respect of renewable energy, we remain the first and only wastewater company in the UK to use 100% of the sludge remaining after sewage treatment to produce renewable energy at two thermal hydrolysis advanced anaerobic digestion (AAD) plants. At one of these plants, we also clean and transform the biogas from the AAD process into biomethane for injection to the gas distribution network. We are continuing to explore other opportunities with partners and are seeking to develop solar arrays at nine sites in the next year, as well as exploring opportunities for industrial scale energy storage.

In terms of reducing energy usage, we are using a number of approaches, including site energy audits, data analytics, trigger management and investing in energy efficient assets, to drive down our underlying consumption, though we recognise that our overall usage of energy can be volatile depending upon levels of rainfall and pumping requirements.

We are also developing our smart energy approach using data analytics to manage our operations to reduce energy use during times of peak nationwide consumption. This helps to reduce demand on the grid, and also reduce our costs. We have recently awarded a new electricity supply contract to energy supplier Ørsted which will power all of our sites using renewable energy only for the next four years, at no additional cost premium. This makes it possible to anticipate becoming carbon neutral within the next decade.

BATHING WATERS A BEACON OF EXCELLENCE

Beaches in the North East of England are cited as beacons of excellence when it comes to bathing water. This Government recognition is a measure of our ongoing efforts to improve the quality of rivers and coastal waters for the benefit of people, the environment and wildlife.

32 of the region's 34 Bathing Waters were given either an 'excellent' or 'good' status, and every one of the North East's coastal sites passed the most recent water quality standards.

Compliance is based on the current and previous four years of sample data, taken by the EA between May and September each year to assess the bathing waters against the strict regulations.

Speaking on the day of the announcement, our Wastewater Director Richard Warneford said: "Our two decades of investment have yielded significant benefits, and we are confident that by maintaining focus upon the North East coastline we can continue to drive improvements and make the region's coast a beacon for excellent bathing water.

"Investment in improved storm water storage facilities throughout our network over the years and through our Rainwise initiative, where we remove surface water from our sewer network and divert it into the natural environment, will have contributed to these results.

"Back in 2000, only four North East bathing waters achieved the standards that were in place at the time, so today shows a massive improvement that we and all of our partners can be proud of. The environment is core to what we do and we are extremely proud of the investment and partnership working that we carry out to make our beaches a great place to visit."

COMPETITIVENESS

FINANCIAL PERFORMANCE

The financial performance of the Company is detailed in the financial performance and structure section later in this report.

INNOVATION

Innovation is crucial to how we will achieve our vision of becoming and remaining the national leader in the provision of sustainable water and wastewater services. We want to be recognised as a leader in innovation and in doing so we will demonstrate that the water sector can lead the UK in innovation.

"We are an efficient and innovative company"

Our approach is to be ambitious and dynamic, working with a diverse range of partners and deploying new tools and techniques to rapidly develop, prototype, test, refine and implement new solutions, some of which will be disruptive or ground breaking.

We focus on innovating with a purpose to achieve our priorities, whether it is to improve water quality, reduce sewer flooding, tackle pollution incidents or deliver an unrivalled customer experience. We have continued to develop our use of design sprints and data hacks, which along with creative problem solving, open innovation, horizon scanning, technology transfer and academic research are key elements of our innovation 'ecosystem'.

INNOVATION FESTIVAL

In July 2017 we ran our inaugural Innovation Festival, which was ground-breaking for the water industry in its scale and diversity of partnership and co-created innovation. The concept of the Festival was to run a large number of sprints and data hacks side-by-side, working alongside key sponsors. The case study on pages 28 to 29 describe this event in more detail, but some tangible outcomes are described below.

The idea of creating a 'moss tree' to filter air pollutants was first explored at our Innovation Festival and within eight months we have installed one in Newcastle city centre, the first of its kind in England. The 'tree' works by using moss cultures, which have the ability to filter certain pollutants, by binding them to the leaf surface and then integrating them permanently into their own biomass. This makes them ideal air purifiers. The moss is built into the treelike structure, which provides the water, largely harvested from the rain, and the shade the moss needs to survive, creating an intelligent combination of technology and nature. The 'tree' is now being studied by academics keen to understand the benefits of the plants' natural filtering abilities.

Teenagers and younger children worked with a range of STEM related innovation experts during the Festival, and one talented student took away a prestigious scholarship from the Festival after impressing us with her outstanding potential as an engineer. Jess Scott received an Arkwright Engineering Scholarship, sponsored by NWL, after success in a competition to design the teenager's bedroom of the future. Arkwright Engineering Scholarships are aimed at the most talented STEM students in UK schools and help to ensure that high potential young people retain an interest in engineering careers.

"Our finances are sound, stable and achieve a fair balance between customers and investors"

At the Festival we carried out a data hack to investigate the problem of leakage through the analysis of huge volumes of data from a wide variety of sources. We have built on the outputs of this exercise to develop new data driven techniques, including a heat map approach, which allow us to deploy our people much more effectively. Once fully developed we will be able to prioritise the most problematic areas in our networks, find more leaks faster and significantly reduce the volumes of water lost from our network.

INNOVATION FESTIVAL

When we launched our inaugural Innovation Festival in the summer of 2017 we knew we were embarking on a journey into the unknown.

We wanted to bring together a diverse group of people in the hope of generating some exciting ideas but we could not have predicted just how much collaboration and creativity we would spark.

More than 1,000 people from 140 organisations joined us at Newcastle Racecourse over the five-day event to consider ways to address a range of environmental and social problems that affect us all.

We focused our efforts on six design sprints that we hosted alongside six key sponsors

"Rain, Hail or Shine"

(how to reduce flooding) hosted by IBM. This considered the impact of flooding on people, properties and communities and considered novel ways to predict, prevent and minimise the impact of floods.

"Keep it Flowing"

(how to reduce leakage) hosted by Microsoft. We looked at the problem of leakage through a design sprint and a data hack. The design sprint looked at new ways of detecting and fixing leaks. The data hack hosted around 60 data scientists who looked at ten years' worth of leakage data and came up with some new insights into how we might reduce it.

"Preparing for the Future"

(how do we affordably upgrade our infrastructure for the 21st century) hosted by Reece Innovation. This looked at how the various entities that constitute our infrastructure might work together to increase capacity and deal with new challenges without having to replace everything.

"Tomorrow's World"

(what will living and working look like in 2030?) hosted by CGI. We considered the impact of rapid advances in technology and how it might change the way in which we work and live.

"How Green is your City"

(what can businesses do to improve the environment in the North East?) hosted by Ordnance Survey. This looked at ideas that use geographical data, technology and design thinking to help us to use and protect our environment.

"21st Century Reach"

(how can we optimise the mobile workforce for a complex network?) hosted by BT, the sprint considered the extremely complex problem of how to operate a network in an ever-changing environment. We considered the employee experience, health and safety, regulatory obligations, together with the environment impact and efficiency.

Hundreds of ideas were generated and streamlined to 18 that were presented to guests, industry regulators and partners among them, on the Festival's final day.

Ideas included new ways to work directly with, and support, people who live in areas of flood risk, greater use of mobile apps to help better identify the location of leaks when they are reported, shared infrastructure corridors to reduce roadworks, and special 'moss trees' that absorb pollution.

Aside from the main event, we hosted a number of activities aimed at increasing the awareness of STEM-based careers. We held a competition for older teenagers to design the teenager's bedroom of the future, one of the winners gaining a sponsorship from us for an Arkwright scholarship. We also hosted a STEM Fayre for younger school children facilitated by the Centre for Life in Newcastle. More than 250 children took part in these workshops.

Nigel Watson, our Director of Information Services, said: "The NWG Innovation Festival was certainly a first for the North East and we are really excited to now be getting stuck into developing these ideas and seeing just how far we can take them.

"There is huge potential to improve people's lives as a result of this festival and the ideas that came about, and we have created some amazing new relationships that will continue to thrive as we keep working together on these projects."

The whole event had the feel of a British Summer Festival that fostered wellbeing and encouraged creativity. We held yoga and fitness lessons, hosted mindfulness classes as well as cookery demonstrations and Indian head massages. In the evening, the participants were entertained by a comedy night, a band night, some inspirational talks and a pub quiz. The event took risks, was ambitious and resulted in ideas that will change the way we work.

The success of our first Festival convinced us to establish the event as an annual highlight. The 2018 event will take place around the date of publication of this Report and promises to be even bigger and more ambitious in the diversity of the problems it will solve and the participants it attracts.

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WORKING SMARTER

Working Smarter is our ongoing campaign which engages people across the Company to identify and exploit opportunities for realising capital and operational efficiencies and creating long-term sustainable benefits. We provide ongoing opportunities for all our people to get involved in innovation activities, recognising everyone's ability to learn and do new things. We encourage people and teams to share their ideas and experiences, both success stories and things we can learn from.

Design sprint and data hack methodologies have helped us to develop new solutions and deliver improvement across a wide range of topics, including developing our business plan strategy, reducing sewer flooding, the safety of our coastal sewage treatment works, engaging with schools and young people through our NWG Academy and improving our recruitment process.

Our employees are a great source of ideas and our IdeaBase portal has captured more than 580 ideas submitted by our people since its inception in October 2016. The ideas are refined and challenged before the most promising are progressed to either a sprint or other business process.

In 2017 we launched our first InvestQuest challenge, inviting employees to submit ideas which, for an investment of up to £250,000, could deliver significant business efficiencies. The ideas were filtered down to a list of five finalists, who then presented their idea to a 'Dragons' Den' style panel from our Executive Leadership Team (ELT), together with an external independent adjudicator. The finalists were all approved to proceed further and a second round of InvestQuest was launched in late 2017.

Whilst our employees are the bedrock of this strategy, we recognise that we frequently find we are at our best and most innovative when we combine our people and ideas with those from the outside world. We are fortunate to have some great partners around us in the form of universities, technology leaders and others who are pioneers in their respective industries. These arrangements give these organisations unique access to our business operations and the types of problems that we face. In return, they give us early sight of their latest thinking and product developments. In addition we continue to see the benefits of including our supply chain partners in our process for assessing and adopting new technology, which provides a route into our business for supplier-led innovations.

RESEARCH AND TECHNOLOGY

Alongside engaging our people, suppliers and customers in innovative thinking, we continue to invest in research and technology development, working with academic partners to deliver projects to help us achieve our current and future performance commitments. Notable successes this year include:

- The launch of the North East Water Hub (funded by the European Regional Development Fund) with our partners Durham University, the EA and Durham County Council. Through the Hub, we are seeking to raise awareness of water-related challenges and support regional businesses to develop new products and services to address them;
- Scaling up our operational use of flow cytometry, an innovative particle characterisation technique used for indicating water quality. At the same time we have invested in further research (funded by the Engineering and Physical Sciences Research Council) with Newcastle University's School of Engineering and Faculty of Medical Sciences to look at improving the technique and broadening its application;
- Completion of an Innovate UK-funded Knowledge Transfer Partnership with Durham University to re-use waste materials from mine-water, leading to further ongoing process development work with Durham and the Coal Authority; and
- Work with University of Northumbria on a proof-of-concept to show how Building Information Modelling can be used to produce a digital representation of our sewer network, ultimately enabling improved operation and maintenance of buried assets.

PEOPLE

GREAT PLACE TO WORK

Our ambition is for everyone to have a great experience at work and feel proud to work for NWL every day. In our most recent pulse survey 78% of our people would recommend working here and 77% of our people feel proud to work here. In 2017 we refreshed our approach to employee engagement and introduced our Great Place to Work (GPTW) programme focused on the four areas of My Voice, My Manager, Our Values and Our Shared Story.

We engage with our employees through our Employee Relations Framework and through a range of communication channels including director roadshows, structured Team Talk briefings every two months, our weekly H2info e-bulletin, and digital tools such as our intranet and Yammer. Our CEO, Heidi Mottram, introduced our GPTW programme at our 63 annual employee roadshows, where everyone had a chance to talk in their teams about what makes NWL a great place to work already, and what could improve, developing the strategy about how NWL becomes an even better place to work.

Our managers have worked with their teams to create local engagement action plans based on feedback from both the survey and roadshows. We have also introduced an 'Engagement Leads' forum where Senior Managers across the business can share best practice and a new company wide pulse survey as a more regular temperature check for our teams providing greater insights into the key drivers of engagement to inform local action plans and ensure we are focusing on improving the areas that really matter to our people.

We also worked with a new external survey provider in 2017 to refresh our survey strategy and approach and benchmark our performance against other utility organisations. Our annual 'Your Voice' survey is an opportunity for us to ask all of our people how they are feeling about various aspects of working at NWL. We had our highest ever response rate and engagement score this year with 83% of our people completing the survey and an employee engagement index of 80%, which is 6% higher than the average utilities sector engagement and better than our balanced scorecard target of 79%.

At the end of 2017, we were proud to be announced winners of the Best Innovation in Employee Engagement at the 2017 Engage Awards for our GPTW Programme, the UK's only customer and employee engagement awards programme.

We continue to be accredited as a Living Wage Employer with the Living Wage Foundation, which means that every employee in the Company earns at least the Living Wage, an hourly rate set independently and calculated according to the basic cost of living for the UK.

"Our people are talented, committed and inspired to deliver great services to customers"

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OUR VALUES AND BEHAVIOURS

Now in its seventh year, our employee awards scheme, known as ViVa (Vision and Values), saw more than 230 employees nominating their teams and colleagues to be recognised for living and breathing our company values and behaviours. The best individuals and teams from these nominations are invited to an annual award ceremony.

Our overall winner for 2017 was Peter Gill, Lead Process Technician from Bran Sands. Peter was chosen for his contribution to delivering sustained energy efficiencies by developing numerous approaches to optimise aeration treatment systems, which are very large power consumers. These approaches have now been applied to a number of aeration sites across the business with great success.

"Our people act in line with our values"

In 2017 we have worked with our people across the Company to identify the behaviours we all need to demonstrate to enable us to achieve our medium term goals and deliver our vision of being national leader. 'Our Behaviours' were developed for all employees, with additional expectations for people managers, and highlight how we would like to see everyone choose to behave. 'Our Behaviours' have been embedded into our recruitment and induction process, training, performance management and 360° feedback for all of our people managers.

NWG ACADEMY

The sector will need 221,000 new recruits by 2027, and we continue to work with the EU Skills Partnership, and the Workforce Renewal and Skills Strategy, to tackle future skills shortages to ensure we can continue to give customers the service they expect and deserve.

We are focusing our work in this area through our NWG Academy which we are developing to take a more strategic approach to attract and develop the skills, knowledge, talent and workforce we'll need for the short, medium and long-term, on a sustainable basis. We are looking ahead to inspire our future workforce about working in the water industry, both young people and those seeking a career change. We are finding ways to share learning more effectively in the business and have put in place development programmes to ensure the continued competence of our existing workforce as technology brings changes to the way we work.

We also play our part locally, working with partners and a range of other organisations to deliver apprenticeships and other routes into the sector. We work in schools, with around 8,000 young people each year, to educate them about water and also to enthuse them about our industry, so they see the varied and exciting careers available within the utilities sector.

Apprenticeships are a key area of focus of the Academy and at present there are 61 young people completing apprenticeships in the business, earning and gaining valuable work experience as they work towards a range of qualifications, including Water Regulations, Water Engineering, Digital and Technology Solutions, Project Management, Customer Service and Business Administration. We also have other employees studying for apprenticeships as an opportunity to enhance their careers.

Another strand of activity is working with students and academics at some of the UK's leading universities to help us develop new innovation and knowledge that will help us to keep at the forefront of our industry. Over the last two decades, we have built a network that includes universities across our operating regions and other leading institutions. Much of our collaborative work is funded by the Engineering and Physical Sciences Research Council and the Natural Environment Research Council, and we currently sponsor around 30 students through their postgraduate research. The findings that come back have enhanced our understanding of areas including water and wastewater treatment processes whilst offering the students the opportunity to approach a piece of research that has requirements of both an academic and an industrial nature.

"We are seen as a great place to work"

We recognise the importance of effective leadership to empower our people to take ownership and responsibility for delivering an unrivalled experience for our customers. In June 2017 we initiated our Extraordinary Leaders Programme, a leadership development programme focused on leaders being their best selves, teams working to their best abilities and the organisation working to achieve its best results. This enhanced focus on leadership skills and emotional intelligence has contributed to an improvement in the way our people feel about their relationship with their leaders and the organisation, through our 'Your Voice' survey results.

EMPLOYEES EXPAND THEIR SKILLS THROUGH APPRENTICESHIPS

More than 200 of our existing employees are furthering their careers by signing up to apprenticeship programmes. This expansion of their skills is a prime example of how our people act in line with our values.

Once considered an option solely for people under 25, apprenticeships are increasingly used for people of all ages looking to expand their skills or retrain. We are giving people, including some who already have decades of workplace experience, a chance to continue their professional development by using apprenticeship programmes that allow them to continue working alongside their studies.

Training Contracts Manager Tracey Greener said: "Apprenticeships are industry recognised learning programmes. They are for people of all ages, and not just those starting out on a career. They are a fantastic opportunity to expand or update knowledge relating to an existing career, or for someone looking to retrain."

Paul Walker, an area manager in Customer Field Services, has been working for more than 20 years, but is now studying towards a Chartered Management Degree Apprenticeship with Teesside University while continuing in his role at NWL.

He said: "I'm passionate about professional development. I think it's crucial in your personal and business life, and the next natural progression for me was a degree, so the opportunity to achieve that through the apprenticeship route, where I work and study at the same time, is fantastic.

Production Operator Aron Potter is working towards a Level 3 Diploma in Water Engineering - Water Supply as a route into a career change within NWL.

He said: "Taking on an apprenticeship programme has been a fantastic way to get into what is effectively my second career with Northumbrian Water. The tutors come into our sites to see us and I've been moving around different parts of the business."

DIVERSITY AND EQUAL OPPORTUNITIES

We recognise the value and importance of diversity and inclusion in our workforce. Our aim is to support all of our people to be the best that they can be in an environment that values and capitalises on everyone's contribution, not only focusing on those elements of diversity that are protected by law.

GENDER DIVERSITY AT 31 MARCH 2018

	Female	Male
Board	2	10
ELT	4	6
Full company	1,025	2,082

In common with many engineering and operating businesses, and in line with what is typically seen in the water industry, our business is currently predominantly male. We are committed to improving our gender balance through our continued focus on encouraging more women to join our team and to develop their careers in the water industry.

We are working actively in partnership with other organisations to promote and encourage greater diversity and inclusion. We continue to lead on the WISE (Women in Science and Engineering's) North East regional hub which aims to improve gender balance and promote diversity in science and engineering. We are also actively involved in a North East Diversity and Inclusion Network and with the Energy and Utility Skills Partnership Diversity and Inclusion Forum to work collaboratively across the sector to have a greater impact on addressing diversity and inclusion challenges.

Our Equal Opportunity Policy seeks to ensure that all our current employees and potential employees are treated with respect. We welcome job applications from all parts of the community and it is our intention that all job applicants and employees are treated equally, regardless of their age, ability, marital or partnership status, race, religion or belief, gender or sexual orientation.

We welcome employment applications from people with disabilities and, where existing employees develop disabilities, they are supported to remain in employment, wherever practicable, by providing appropriate adjustments to their roles and/or effective redeployments. Occupational health physicians assist this process with professional medical advice.

GENDER PAY GAP REPORT

We are committed to the principle of equality of opportunity and equal treatment for all of our employees. We set out below our Gender Pay Gap figures as at April 2018 using the company data and the parameters set out by legislation. The data represents 3,096 employees who work in various roles across a national footprint and demonstrates a positive picture of pay equality in the Company.

Gender pay reporting provides a better understanding of organisational performance for gender pay. We have taken, and continue to take, a proactive approach to ensuring that we improve diversity across our organisation. We celebrate inclusivity, recognising that working with a diverse range of colleagues makes for better decision-making, strong and well-rounded teams and a more interesting place to work. We proudly celebrate our strong female leaders throughout the business, who are great role models for both men and women.

GENDER PAY DATA

NAME	%
Mean gender pay gap	12.0
Median gender pay gap	17.6
Mean gender bonus gap	36.2
Median gender bonus gap	0.0
Proportion of females paid a bonus	19.8
Proportion of males paid a bonus	22.0

PAY QUARTILES BY GENDER

QUARTILE BANDS	DESCRIPTION	FEMALE	MALE	TOTAL
Band A	All employees whose standard hourly rate places them at or below the lower quartile	419 (54.1%)	355 (45.9%)	774
Band B	All employees whose standard hourly rate places them at or below median but above the lower quartile	227 (29.3%)	547 (70.7%)	774
Band C	All employees whose standard hourly rate places them above median but at or below the upper quartile	162 (20.9%)	612 (79.1%)	774
Band D	All employees whose standard hourly rate places them above the upper quartile	204 (26.4%)	570 (73.6%)	774
Total		**1,012**	**2,084**	**3,096**

We have worked with our Directors, senior leaders and our people over several years to promote equality, diversity and inclusion, resulting in a number of positive activities, including:

- promoting inclusion and diversity from the top of the organisation, from our female CEO and ELT;
- training our managers to raise awareness of unconscious bias and supporting our employee ambassadors to promote our principles, which creates an environment of fairness and equality;
- undertaking job evaluation in line with a globally recognised framework and reviewing pay grades to ensure a fair structure;
- signing up to the WISE 10-steps programme and developing the WISE hub for the North East;
- operating a recruitment process which values transparency, diversity and equality by actively encouraging females to apply for roles, challenging search agencies for gender-balanced shortlists and defining job roles fully so they are more attractive to women; and
- conducting pay and benefits benchmarking exercises and salary reviews to ensure we are in line with market trends and conducting equal pay reporting.

We are confident that our gender pay gap does not stem from paying men and women differently for the same or equivalent work; rather it is the result of differences in the roles held by men and women within the organisation and the different market salaries that these roles attract.

We believe our results are positive when compared to others who have published their figures but we recognise there is opportunity to improve and we are committed to promoting inclusivity, attracting, developing and retaining diverse talent and paying everyone fairly based on job role and performance.

HEALTH AND SAFETY

It is our aspiration and ethical responsibility to make sure that everyone goes home safe every day, which extends to our employees, supply chain partners and customers. During 2017 our performance plateaued despite the introduction of new innovative health and safety initiatives. However we are confident that changes we have made will lead to sustainable long term improvements. We are certified under OHSAS 18001 Occupational Health and Safety Systems and received a gold medal award from the Royal Society for the Prevention of Accidents (RoSPA) for the sixth consecutive year. The RoSPA Gold Award recognises organisations which have achieved a high level of performance and demonstrated well developed occupational H&S management systems and culture.

We are passionate about maintaining a healthy and safe workplace, and we are working hard to improve this even further. Our 'Everyone Home Safe Every Day' strategy reminds employees about the importance of getting the job done safely and about taking personal responsibility. We are creating a great safety culture and over the last year we have had over 500 people, including our Leadership team, attend an 'Everyone Home Safe Every Day' workshop focusing on safety leadership, engagement and providing simple practical tools. We have introduced weekly everyone home safe learning calls, a 'Spot It' system to encourage reporting of H&S issues and concerns and deliver key safety messages to everyone through our bi-monthly Team Talk. This commitment to developing and maintaining this strong behavioural safety culture is clearly demonstrated by our ELT who regularly meet employees in their workplace environments to discuss health and safety.

"Our workplaces are healthy and safe"

We operate a fleet of around 900 vehicles to deliver our services and we take seriously the health and safety of our drivers and others on the road. We have therefore invested in a new telematics system to keep our people safe on the roads. This is aimed at encouraging improved driving styles and records data mileage, speed and driver behaviour which can be used to make improvements to driving styles. Employees from across the business have been involved with rolling out the system and developing a clear policy to inform all drivers how their data will be used and who will be able to access it.

WELLBEING

We are committed to providing an environment where people can maintain good physical and mental health and make informed lifestyle choices. We have continued our 'Live Well, Work Well, Be Well' wellbeing programme, encouraging our employees to maintain healthy lifestyles, by delivering an annual calendar of health promotion campaigns, supported by a network of Wellbeing Champions across the business. This has included four wellbeing challenges, an opportunity for individuals and teams to improve in areas including physical exercise, weight management and resilience over a four week period, employee health checks, yoga and mindfulness classes and wellbeing weeks with interactive activities.

We have continued our focus on mental health and supporting our people to build personal resilience with 1,900 of our people attending one or more of our courses. Our 'Building Personal Resilience' workshops are available to everybody in the organisation.

At the end of 2017 we were awarded 'Continuing Excellence' in the North East Better Health at Work Awards, a partnership project between the local authorities, National Health Service and Trades Union Congress, for our ongoing commitment to support the health and wellbeing of our employees.

COMMUNITIES

Serving a diverse and large variety of communities across equally diverse geographical areas, we know the positive impact we can have on our communities and the role we can play to help facilitate their success.

We are dedicated to building strong relationships with the communities we serve and we ensure that corporate responsibility is embedded in the business.

EMPLOYEE VOLUNTEERING

We are proud that our people give their time and resources to the causes that are important to our communities. 'Just an Hour' is our highly successful employee volunteering programme. We know our communities can benefit from the wealth of knowledge, skills and expertise our employees have to give and each of our employees is given the opportunity to take a minimum of 15 working hours a year to support community initiatives.

"We are proud to contribute to the success of local communities"

The programme is designed to have an impact on education, the environment and the general wellbeing of the community and is something our employees tell us they take enjoyment from. More than half of our workforce is actively engaged in the programme. In 2017, 52% of our people volunteered their time, giving support to 565 organisations.

WATER RANGERS

We started our award winning Water Rangers scheme in 2014. Volunteers monitor public access routes next to watercourses across the North East that are prone to pollution. In 2017 we expanded the Water Rangers scheme and 1,914 patrols were completed. Nine incidents reported by our volunteer Water Rangers were referred to the EA.

BRANCH OUT

Our Branch Out grant fund helps to deliver projects that benefit the natural environment and their local communities. A healthy natural environment is essential for us today and to make sure we can continue to supply top quality drinking water and safely remove wastewater in the future. We supported 16 Branch Out projects in 2017 providing £60,000 in funding which helped our partners bring in additional funds in excess of £350,000 to put towards Branch Out projects in our local communities.

PARTNERSHIPS

Our Partnerships Strategy gives us clear direction to make sure we are focusing our efforts on the things our customers have told us are important to them. We look beyond our annual finance and performance reporting and also report on our influence and impact in the wider economy, the environment and society in Our Contribution report, which is available on our websites.

We work with partners across sectors at a range of levels, from making sure we provide effective grassroots support to a large number of organisations in our community, to a small number of larger strategic flagship partners co-delivering with us in line with our vision and values.

"We work in partnership towards common goals"

We are at our best and most innovative when we combine our people and ideas with those from the outside world. Accordingly, we have built strong relationships with organisations and individuals to support our innovation initiatives. These innovation partnerships, with organisations such as IBM and O2, have given us early sight of latest thinking and product developments, as well as new working relationships following the Innovation Festival.

We have a long history of delivering research projects with Durham University and have recently established the NE Water Hub, which includes the EA and Durham County Council. We also have a long-established collaboration with Newcastle University, and have recently formed a strategic partnership that will enable us to apply the world-leading research carried out with Newcastle to benefit our customers and communities.

COMMUNITY PARTNERSHIPS

Our contribution in 2017/18 will be detailed in Our Contribution report, but some of the highlights are shown below.

- 4,388 customers receiving support and advice to help manage debt in 2016.
- £601,000 financial contribution to environmental, community and charitable non-governmental organisations.
- 1,145 organisations supported.
- 52% of our people volunteered to support community projects, giving 15,781 hours.
- over 8,200 young people supported through our employability activity.
- 294 'Refill Stations'.
- 14,000 people given access to clean water and sanitation through our fundraising for WaterAid.
- over 560,000 visitors to our historical and ecological sites.
- 1,914 patrols by 62 water ranger volunteers completed to help protect our rivers.

REFILL

A new and key partnership for us that started in 2017 is our partnership with City to Sea to bring Refill to the North East and Essex & Suffolk. Refill aims to reduce single use plastic water bottle pollution and promote a healthy lifestyle in towns and cities across the UK, by improving access to free drinking water, on the go.

Refill works by promoting free tap-water refill points ('Refill Stations') in cafes, shops, businesses and transport hubs. As such we are presently asking businesses to agree to be added to the free 'Refill' app as a 'Refill Station', and display a small Refill window sticker to alert passers-by that they're welcome to come and fill up their water bottle for free.

Refill's core appeal varies across different groups and communities within our towns and cities. People's main motivations range from wanting to be healthy, through to reducing ugly litter, to saving our oceans and the life within them for future generations. Refill can bring people from diverse backgrounds together and also aims to boost the local economy and bring more environmental awareness to local businesses. In the last year we achieved mass media coverage for the campaign and we will continue to develop the partnership throughout 2018.

NORTHUMBRIAN WATER living water

REPUTATION

TRUST

In 2017 we were delighted to achieve self-assurance through Ofwat's company monitoring framework assessment, which is the highest level of assurance we could receive. We have worked hard to give Ofwat and our customers a high level of trust and confidence in our governance and assurance arrangements, which ensure that the information we publish is accurate, clear and transparent. Our Final Assurance Plan is published in full on our websites each year and we also published our Assurance Summary, describing how we have carried out this Assurance Plan over the course of the year.

Each year CCWater asks customers for their views about the services they receive from their water and sewerage company. We were pleased that our scores for trust increased in both our NW and ESW operating regions, continuing an upward trend over the past seven years.

"We are a company that customers can trust"

Our assurance framework builds upon our integrated management system. We have company-wide accreditation to: ISO 9001 Quality Management; ISO 14001 Environmental Management; OHSAS 18001 Occupational Health & Safety Management; and ISO 55001 Asset Management. In addition our sampling and laboratory analysis are accredited to ISO 17025 and we are working towards achieving company-wide accreditation to ISO 22301 Business Continuity Management.

RECOGNITION

We have gained recognition for our approach to delivering unrivalled customer service through being recognised by a number of awards in the year. We were named Utility of the Year at the prestigious Utility Week Awards in recognition of our consistent leadership and performance, including our approach to innovation and sustainability (see case study on page 41). In addition we were awarded Water Company of the Year at the Water Industry Awards 2018.

We were also delighted to be presented with the overall UK Excellence Award 2018 for large private sector company at the British Quality Foundation UK Excellence Awards. The British Quality Foundation is the premier organisation representing excellence and performance improvement in the UK and the awards recognise organisations which have demonstrated excellence in all areas of operation. This award was recognition for the innovative approach and progressive solutions we employ right across our organisation.

At an individual level, our CEO, Heidi Mottram, was named as a global industry leader by Water and Wastewater International (WWi), celebrating her as a stalwart of ethical and innovative trading practices. Now in its fourth year, the WWi Top 25 Global Water Leaders initiative continues to grow in popularity as a barometer of the industry's thought leaders. The focus of this year's initiative was on active leaders who are driving companies forward into the digital water age with a focus on innovation.

Their nomination commended Heidi for 'Helping the utility to develop a policy of using local suppliers to support the local economy, as well as introducing a very forward-thinking flood policy'. The WWi particularly highlighted our Innovation Festival as reason for praise.

In June 2018, after the balance sheet date, Heidi was awarded a CBE for services to the water industry and business community in the Queen's Birthday Honours list. Upon receiving the award, Heidi said "Though I'm really proud to receive this award, it's really great recognition for the outstanding service we provide together every day. I'll be accepting it on behalf of all of the fantastic team who make NWL such a brilliant place to work."

WE ARE UTILITY OF THE YEAR

The efforts of our employees to put customer trust at the heart of everything they do was recognised on a national level when we were named Utility of the Year.

The top prize at the prestigious Utility Week Awards is awarded annually to the company that has been successful in all aspects of the utility business, and rewards exceptional performance compared with other companies across the sector.

The judges were impressed by our "all round, consistent out-performance", and described us as "a recognised leader in its sector, a champion for its community and an outstanding example of a utility operating at the top of its game." Our approach to innovation and sustainability were also key to winning the top award and ultimately earning our customers' trust and delivering satisfaction.

Speaking after receiving the award, our CEO Heidi Mottram said: "Winning Utility of the Year is a fantastic achievement and emphasises our leading level of performance across the entire utilities sector.

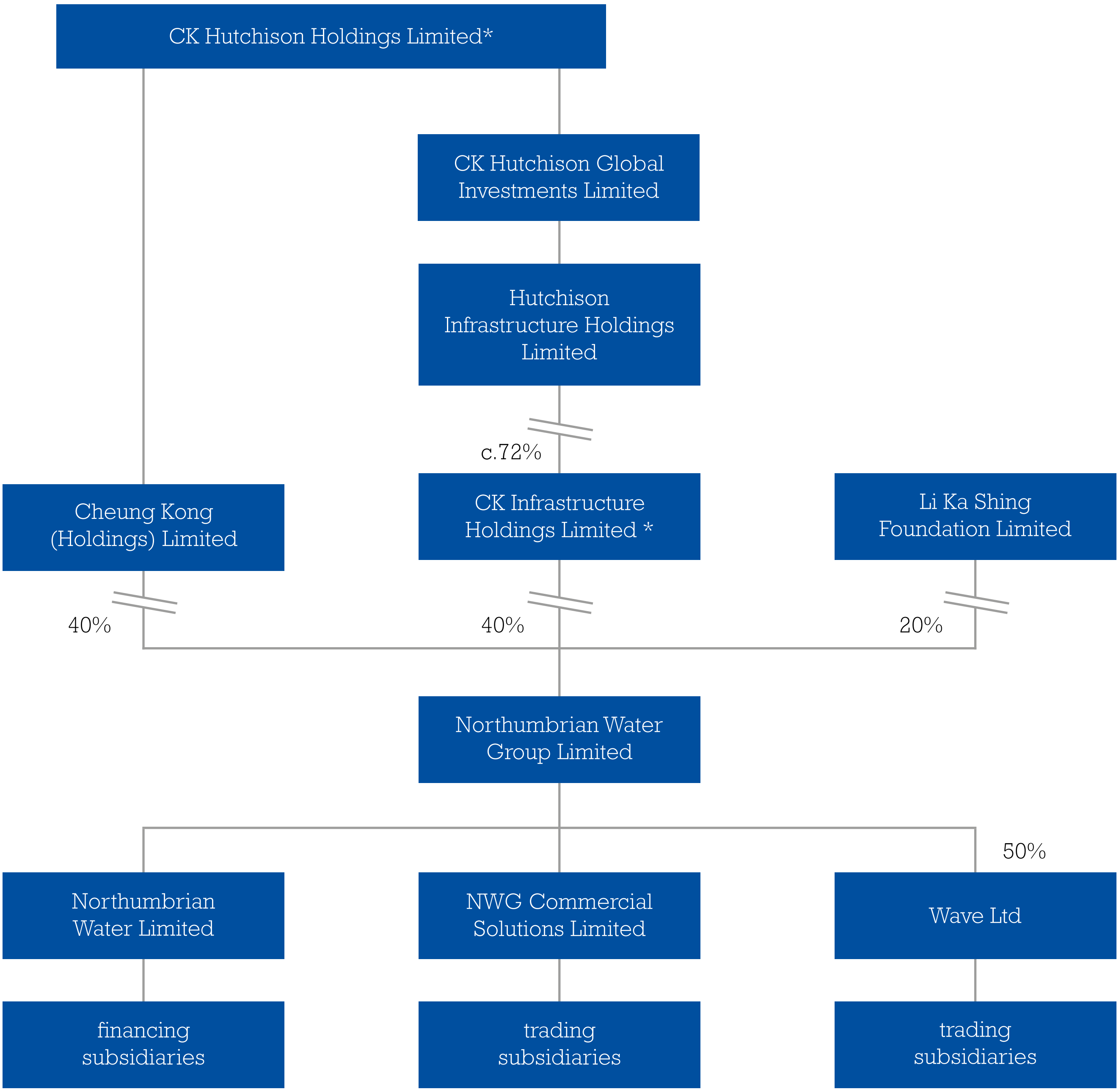
"We work very hard to put our customers at the heart of everything we do, and recognition like this spurs us on to continue to maintain and improve on the levels of service we have been able to achieve. This award is also testament to the hard work of all our 3,000 people, who help make NWL the great company that it is."

FINANCIAL PERFORMANCE AND STRUCTURE

GROUP STRUCTURE

NWL is a wholly owned subsidiary of NWGL. NWGL has one other direct subsidiary, NWG Commercial Solutions Limited, which acts as a holding company for other non-regulated trading companies. NWGL also owns 50% of a joint venture company, Wave Ltd., which carries out NHH retail activities in England and Scotland.

In the Directors' opinion, CKHH is the ultimate parent undertaking and controlling party of NWGL and, therefore, NWL. The chart below shows the structure of the Northumbrian Water Group up to CKHH. The chart shows the principal intermediate holding companies, which are wholly owned unless otherwise shown.



* Companies listed on the Hong Kong Stock Exchange

FINANCIAL PERFORMANCE

The financial KPIs we report in our balanced scorecard on page 16 reflect the financial covenants underpinning our committed bank facilities, which are reported to each Board meeting. These KPIs remained better than the target for the year.

The Company's income statement, statement of comprehensive income, balance sheet and statement of changes in equity are set out on pages 84 to 87. The Financial Statements have been prepared on an historical cost basis in accordance with Financial Reporting Standard FRS 101, reflecting International Financial Reporting Standard (IFRS) with reduced disclosures. The key accounting policies are summarised in note 1 to the Financial Statements on pages 88 to 93 and have been applied consistently to current and preceding period information.

Revenue was £834.6m for the year ended 31 March 2018 (31 March 2017: £821.6m). This reflects an increase in wholesale charges, set in line with the revenue allowance from the Final Determination (FD) of price controls for 2015-20, which increased by a 'K factor' of 0.4% plus RPI inflation of 2.2%, less the loss of NHH retail revenue, as a consequence of NWL exiting the NHH retail market, which contributed £8.9m revenue in the prior year.

Operating costs, including capital maintenance costs, for the year ended 31 March 2018 were £495.7m (31 March 2017: £464.7m). The prior year costs included an exceptional credit of £10.7m relating to the settlement of an outstanding appeal on business rates, explained in more detail in note 3. Underlying costs, excluding the exceptional item, have increased by £20.3m (4.3%) in the year. This primarily reflects significant step change increases in our water cumulo rating valuation (£11.3m) and a change to the structure of abstraction charges in our NW region (£6.9m), along with increased energy costs, mostly through increased environmental levies (£3.2m). Other upward cost pressures, through inflation and capital investment, have been mitigated by cost efficiencies delivered under our Working Smarter programme.

Underlying operating profit for the year ended 31 March 2018 was £338.9m (31 March 2017: £346.2m excluding exceptional item), a slight reduction compared to the previous year as result of the operating cost pressures explained above.

Net interest payable was £133.7m in the year ended 31 March 2018 (31 March 2017: £136.6m). The reduction of £2.9m relates to lower interest payable on loans as a result of old debt at historically high rates being replaced by new debt issued at lower market rates and favourable mark to market movements on the fair value of financial instruments, less increased index-linked debt accretion from higher inflation rates and new issuance. Profit on ordinary activities before taxation for the year ended 31 March 2018 was £205.2m (31 March 2017: £220.3m).

The current tax charge for the year ended 31 March 2018 was £32.7m (31 March 2017: £38.3m). The decrease in the charge mainly reflects the fall in profit before tax as well as the reduction in the main rate of corporation tax from 20% to 19%. Deferred tax for the year ended 31 March 2018 was a charge of £6.7m (31 March 2017: credit of £19.3m). The prior year credit reflected the restatement of deferred tax liabilities due to a reduction in future corporation tax rates enacted in that year. Further details of the net tax charge are provided in note 7 to the Financial Statements. Profit for the year ended 31 March 2018 was £165.8m (31 March 2017: £201.3m).

Total dividends paid in the year ended 31 March 2018 were £125.4m (31 March 2017: £212.5m), including a special dividend of £18.9m in respect of both the profit on the sale of NWL's NHH business to NWGB, a related party, and the enduring working capital benefit which NWL gained as a consequence of this transaction. The Directors recommended payment of a final ordinary dividend of £65m (31 March 2017: £nil), which was approved and paid after the balance sheet date.

In previous years, the Company has typically paid two interim dividends and no final dividend in each financial year. In 2018 the Directors have decided that the second interim dividend payment will be replaced with a final dividend to be paid after the Directors have reviewed the financial position of the Company at the balance sheet date.

When declaring the final dividend for the year ended 31 March 2018, the Directors considered the future impact of Ofwat's final methodology for the 2019 price review on the Company's medium term financial plan, in particular a lower rate of return and the projected reduction in RCV from April 2020, whereby the Company will share with customers the benefits of cost efficiencies in the current price control period. As a result, the Directors have deemed it prudent to reduce the level of dividend payments for both the year ended 31 March 2018 and the remainder of the current price control period in order to continue to meet the Company's overarching financial objective of retaining investment grade credit ratings. The dividend policy is explained in note 8 to the Financial Statements.

CAPITAL INVESTMENT

Total fixed asset additions in the year ended 31 March 2018 were £260.7m (31 March 2017: £225.2m); £230.7m net of capital contributions (31 March 2017: £190.6m). Around £175m of this investment related to the maintenance of our asset base to ensure the continued provision of sustainable water and wastewater services in the areas we serve. In addition we have continued to enhance our asset base, in particular to reduce the risk of sewer flooding, to improve water and wastewater treatment compliance and to support new development activity in our areas of operation.

Significant investments in the year included the completion of work to address sewage spills at Whitburn, in line with our regulatory PC, and continued activity on the upgrade of Horsley water treatment works, which serves Newcastle. Our programme to transform our billing and customer contact systems for household customers and for interacting with the NHH retail market in our capacity as a wholesaler, progressed well with NHH billing in place from the start of the year and household billing transition completed in May 2018. We have also proceeded to the implementation stage of our iAM programme, which aims to transform our management of our asset base in support of many of our business outcomes.

CAPITAL STRUCTURE AND LIQUIDITY

The Company's long term debt structure remained largely unchanged with 64% fixed at an average rate of 4.45%, 35% index-linked at an average real rate of 1.36% and 1% on a variable rate basis, after allowing for hedging instruments. The blended average nominal rate for the Company for the year ended 31 March 2018 was 4.64% (31 March 2017: 4.52%). The increase was due to higher indexation on index-linked debt, partially offset by the refinancing of fixed rate debt, which matured during the year, at lower rates.

In September 2015, the European Investment Bank (EIB) approved a new £250m loan facility, to support our AMP6 capital plan. An initial £150m tranche was drawn in October 2015. The remaining £100m tranche was drawn in June 2017 at a fixed rate of 1.881%, swapped to index-linked at a favourable real rate of 1.1025%.

In October 2017, through our finance subsidiary Northumbrian Water Finance plc (NWF), we issued £300m Guaranteed Eurobonds, with an annual coupon of 2.375%, maturing October 2027. NWL guaranteed the issue and received the issue proceeds by way of an inter-company loan. The proceeds were partially used to repay the £180m bond which matured in October 2017.

We have a committed five year bank facility in place to maintain general liquidity, with a total value of £350m maturing in 2019. This was undrawn at 31 March 2018.

Gearing reduced from 64.7% to 62.5%, remaining well within target. The reduction was a consequence of net debt increasing by only 0.7% whilst RCV grew by 4.2%. Interest cover fell slightly from 3.8 to 3.5, but also remained comfortably better than target.

The Company retains strong investment grade credit ratings of BBB+ (stable outlook) from Standard & Poor's (S&P) and Baa1 (negative outlook) from Moody's. The difference in outlook reflects Moody's view on the gearing level of our parent company, NWGL, whilst recognising the strength of the regulatory ring-fence. We report on our financial resilience in our viability statement on page 80.

TREASURY POLICIES

The Board is responsible for the financing strategy of the Company which is determined within treasury policies set by NWGL. The treasury policies set out how the risks associated with treasury activities are managed, which are summarised below. On occasion, derivatives are used as part of this process, but the treasury policy prohibits their use for speculation.

Funding risk

The level of capital expenditure which NWL is obliged to incur is such that we cannot be wholly cash financed by internally generated sources. As a result, we must rely upon raising additional finance on a regular basis, to be principally used to fund the long term assets required by the regulated business. In order to raise this finance efficiently, the Board's aim is to retain our investment grade credit ratings at BBB+ and Baa1. A reduction in the credit rating would likely restrict future sources of funding, increase the associated cost of new borrowing and prompt discussions with the EIB about the existing facilities in place.

Liquidity risk

The Company's policy is to have available standby committed bank borrowing facilities with a value of no less than £50m and with a bank agreement availability period of no less than three months. At 31 March 2018, NWL had £350m (31 March 2017: £350m) of undrawn bank facilities, provided by a group of five key relationship banks, which mature in 2019.

Interest rate risk

The Company finances its operations through a mixture of retained profits and borrowings. It borrows at both fixed and variable rates of interest and, on occasion, uses derivatives to generate the desired interest profile and to manage its exposure to interest rate fluctuations. The Company's policy is to keep a minimum 50% of its borrowings at fixed rates of interest. At 31 March 2018, 64% (31 March 2017: 65%) of the borrowings of the Company were at fixed rates of interest. Index-linked borrowings are treated as variable rate debt.

Credit risk

The Company invests surplus cash with banks on a short term basis. The treasury policy specifies which counterparties the Company can invest with and sets a limit for the maximum exposure to each counterparty. These limits take account of published credit ratings. There is no material customer credit risk as no individual customer accounts for a significant proportion of income or debt. Note 1(o) of the Financial Statements sets out the Company's bad debt policy.

Foreign currency risk

The Company's policy is that any foreign currency exposure in excess of £100,000 sterling equivalent of a transactional nature, or £3m sterling equivalent of a translation nature, should be covered as soon as they are identified. At 31 March 2018, the Company had forward foreign exchange contracts of £7m (31 March 2017: £6.8m) for the purpose of hedging the foreign currency risk of committed future purchases.

Market price risk

The Company's exposure to market price risk principally comprises interest rate exposure. The Company's policy is to accept a degree of interest rate risk. On the basis of the Company's analysis, it is estimated that a 1% rise in interest rates would not have a significant effect.

RISK REPORT

RISK MANAGEMENT FRAMEWORK

The Board sets the tone for risk management within the Company, supported by the Risk & Compliance Sub-committee, and determines the appropriate risk appetite. The Board's view of acceptable risk is based on a balanced view of all of the risks in the operating environment and it aims to ensure an appropriate balance between risk aversion and opportunities. The Board's approach to monitoring, managing and mitigating risk, and the work undertaken by the Risk & Compliance Sub-committee during the year, is set out in the Governance Report.

The ELT implements policies on risk management and internal control, ensuring that risks are appropriately controlled, managed and reported and that remedial action is taken as appropriate. The Company's approach to risk management is set out in our Risk Management Framework, which has been endorsed by the Risk & Compliance Sub-committee, and is managed through a corporate risk model.

The Risk Management Framework sets out our process for identifying, analysing and evaluating risk across the business. Risk champions within each area of the business co-ordinate the identification and assessment of risks for their area of responsibility and record these in a departmental risk register. Risk champions meet on a quarterly basis to share learning and ensure consistency of approach.

Each risk is assessed against defined likelihood and consequence criteria on both an unmanaged and managed basis, producing a risk score. The management controls and responsibilities are documented and the effectiveness of the control assessed. An assurance map details the external and internal assurance provided over the controls. We also set a target risk and, where this is below the current managed risk score, set out an action plan to achieve the desired risk reduction.

Those risks in the departmental risk registers with a managed risk score above a defined threshold are classed as 'significant risks' and are reported in the Corporate Risk Register. This is reviewed monthly by the ELT and at each meeting of the Risk & Compliance Sub-committee.

We define strategic risks as those which are foreseeable, but not with sufficient clarity to be assessed within the corporate risk model. These are captured in a Strategic Risk Register and a sub-group of the Board reviews these strategic risks annually, most recently in November 2017.

PRINCIPAL RISKS AND UNCERTAINTIES

The Risk & Compliance Sub-committee, on behalf of the Board, carried out a robust assessment of the principal risks facing the Company, including those that would threaten its business model, future performance, solvency or liquidity, taking account of both the highest rated risks on our Corporate Risk Register and the Strategic Risk Register identified by the Sub-committee.

The principal business risks facing the Company, and our approach to mitigating these risks, are set out in the table below. The risks are not set out in order of priority. The table also shows how these risks relate to our business Outcomes and any changes in the level of risk compared to last year. These principal risks have also been considered in our assessment of financial resilience, as set out in our viability statement on page 80.

OPERATIONAL RISKS

DESCRIPTION OF RISK	MITIGATION	CHANGE FROM PRIOR YEAR
Customer trust and confidence Our customers are at the heart of everything we do and failure to deliver a consistently unrivalled customer experience or negative media coverage resulting in a poor public perception of our reputation could damage our customers' trust and confidence in our business. *We provide excellent service and impress our customers* *Our customers consider the services they receive to be value for money* *We are a company that customers can trust*	Our unrivalled customer experience strategy was co-created with our customers so that we could understand what was really important to them. We continue to involve customers through active participation in a number of critical pieces of work that are shaping future service and experience. We also continue to improve our support for customers in vulnerable circumstances and engage with them regularly to understand their needs. Our people are supported to deliver an unrivalled customer experience through ongoing investment in their skills including through our cultural change programme, Our Way. We have invested in significant improvements in our customer facing systems and we are now looking at how to make sure digital experience is also unrivalled.	No change (continuous improvement).
Health & safety The nature of our operational and construction workplaces means that there is a significant inherent risk to the health and safety of our staff and supply chain of which we are acutely conscious. *Our workplaces are healthy and safe*	The health and safety of our staff, contractors and members of the public is our highest priority. We are proud of our record of maintaining a healthy and safe workplace, but not complacent, and we are working hard to improve this further. Health and safety matters are given a high priority at all meetings of our ELT and Board. Long term planning and targets set to drive continuous improvement. This is underpinned by our focus on improving behavioural safety and creating a great safety culture. Our health and safety management system defines clear arrangements and responsibilities for implementation and management throughout the Company, and this is externally audited as part of our OHSAS 18001 certification.	No change (continuous improvement).
Water service failure A problem in our water system could cause either a major loss of supply or for unfit water to be supplied. This could have many potential causes, including the failure of a strategic water main or treatment works, loss of power supply or contamination of a service reservoir. *We provide a reliable and sufficient supply of water* *We supply clean, clear drinking water that tastes good*	We operate a risk-based prioritisation process for the maintenance and replacement of our assets. We are ISO 55001 (Asset Management) certified on a company-wide basis, demonstrating that we follow best practice in the long term management of our assets. We monitor the effectiveness of our asset management through a number of asset health measures. We have well developed business continuity plans in place for managing incidents, down to a site specific level. These are regularly tested. We restrict access to our treated water network through authorisation and physical security measures.	No change.

DESCRIPTION OF RISK	MITIGATION	CHANGE FROM PRIOR YEAR
Wastewater service failure A problem in our wastewater system could cause either significant environmental pollution or flooding of customer properties. This could have many potential causes, including insufficient network capacity to cope with severe weather events, misconnected properties and the consequences of sewer blockages or collapses. *We provide a sewerage service that deals effectively with sewage and heavy rainfall*	We continue to invest heavily in preventing pollution and sewer flooding, which share many of the same root causes. We have developed a pollution management programme with multiple workstreams, to tackle these root causes. A key part of this involves engaging with our customers and local communities through initiatives such as ‘Love Your Drain’ and Water Rangers, inspections to identify misconnections, and working with partners to deliver SUDS. We are also investing significantly in proactive maintenance and cleaning of the network, real time monitoring and analysis to enable early intervention, flooding mitigation and, where appropriate, investment to increase network capacity.	No change.
Cyber security Key business systems could be lost as a result of a malicious attack or failure of cyber security. Sensitive data could be released in breach of the Data Protection Act, General Data Protection Regulation (GDPR) or Environmental Information Regulations (EIR). New obligations being brought into force under the Networks & Information Systems (NIS) Directive. *We are a company that customers can trust*	Our Information Security policy sets out our commitment to the continuous improvement of information security controls and culture throughout the business. This is delivered through software and hardware access controls, additional levels of security for web-facing systems and clear policies and procedures and user awareness, supported by briefings and training. We have implemented a resilient infrastructure which includes full back-up and recovery, and also fail-over to other hardware in the event of a local failure. Data is protected through access controls, laptop encryption and awareness briefings. A ten point data protection action plan has been developed to further mitigate the risks This activity is supported by a dedicated team covering security, data protection and EIR.	Increased potential penalties under GDPR and NIS Directive.

DESCRIPTION OF RISK	MITIGATION	CHANGE FROM PRIOR YEAR
Effect of climate change In the short term, climate change may cause more volatile weather conditions which could impact on customer service through disrupting water supply or causing sewer flooding. Over the longer term, climate change could impact on water resources resilience and the integrity of our assets. *We provide a reliable and sufficient supply of water* *We provide a sewerage service that deals effectively with sewage and heavy rainfall*	Our approach to mitigating short term risks of service failures on our water and wastewater businesses are set out in the risks above. We consider the longer term impacts of climate change in our long term planning, such as our Water Resource Management Plan, and identify long term solutions to future potential resilience issues well in advance.	New principal risk.

FINANCIAL RISKS

DESCRIPTION OF RISK	MITIGATION	CHANGE FROM PRIOR YEAR
Regulatory and political changes Changes to the Licence or regulatory methodology could impact adversely on the balance of risk and return or reduce investor confidence in the stability and predictability of the regulatory framework. A change in government could introduce significant changes in policy, impacting upon the Company. *Our finances are sound, stable and achieve a fair balance between customers and investors*	Externally driven, but we actively engage with Ofwat through responding to formal consultations, regular direct dialogue, contributing to the 'market for ideas' and through other forums such as Water UK.	Increased political volatility.
Funding and liquidity risk A key funding risk would be an inability to access future funding at acceptable rates due to market uncertainty or in the event of a credit rating downgrade. Also, the loss of EIB as a source of low cost funding, due to Brexit, would increase borrowing costs. Liquidity risk could arise due to breaching financial covenants on standby borrowing facilities. *Our finances are sound, stable and achieve a fair balance between customers and investors*	The Board has approved treasury policies which set out how we manage treasury risks (see page 45). Our five year plans identify future borrowing requirements and we plan our financing strategy accordingly over this time horizon. This is supported by £350m of standby committed borrowing facilities, which were undrawn at 31 March 2018, and we maintain substantial headroom in the financial covenants for these facilities. We are committed to maintaining our investment grade credit ratings and manage our financial plans accordingly. Our viability statement on page 80 reports on the financial resilience of our plan over a seven year time horizon.	Risk remains heightened due to uncertainty in financial markets as a result of the UK's process to exit the EU.

DESCRIPTION OF RISK	MITIGATION	CHANGE FROM PRIOR YEAR
Financial performance A failure to deliver our financial plans could impact on expected shareholder returns. This could result from significant adverse movements on costs, interest or tax or a failure to deliver efficiency commitments. A sustained period of low RPI could depress RCV, increasing gearing. An increase in defined benefit pension liabilities could require additional contributions to be paid into the pension scheme. An adverse outcome of the PR19 price review, compared to current plans, could result in lower than expected revenues. *Our finances are sound, stable and achieve a fair balance between customers and investors*	We are implementing a range of efficiency actions for both operating and capital expenditure under our Working Smarter programme and progress is reported monthly to ELT. We have fixed commodity prices for electricity and fuel to March 2020 and maintain more than 50% of our borrowings on fixed rates, providing certainty. We have an agreed schedule of contributions from our most recent actuarial valuation of our defined benefit pension scheme. Our employer covenant remains strong, reflecting the long term nature of our business and 25 year rolling term of our Operating Licence. Our viability statement on page 80 reports on the financial resilience of our plan over a seven year time horizon.	No change.

NEW RISKS

As part of their assessment of principal risks, and taking account of the findings of the Financial Reporting Council Lab report on Risk and Viability Reporting, the Risk & Compliance Sub-committee decided that the potential impact of climate change should be added to the principal risks.

INCREASING RISKS

The introduction of GDPR and the NIS Directive after the balance sheet date potentially exposes the Company to greater levels of penalties for relevant data breaches.

There has been an increased level of political debate in respect of the water sector during the year, as well as a number of regulatory consultations, introducing a greater degree of uncertainty on the future of the sector.

REDUCING RISKS

As part of their assessment of principal risks, the Risk & Compliance Sub-committee decided to remove increased competition as a principal risk. This reflected the Company's assessment that the introduction of upstream competition does not pose a significant risk whilst the potential introduction of household competition has not progressed.

The risk related to loss of integrity of our billing data during transition to a new billing system for household customers has been removed as this transition took place successfully after the balance sheet date.

By order of the Board

H Mottram, CEO
13 July 2018

GOVERNANCE REPORT

CHAIRMAN'S INTRODUCTION

This report explains our robust corporate governance, which the Board believes is essential to protect the interests of all our stakeholders.

NWL remains fully committed to the consistent delivery of outstanding customer service. Whilst operational excellence is central to delivery of that service, the entire business must be underpinned by robust governance. This is, perhaps, more important than ever, given the increasing focus on board leadership, public trust, transparency and resilience.

The starting point for the Board is the UK Corporate Governance Code (UK CGC), to which we have close regard, as required by the Company's Instrument of Appointment (the Licence).

The main focus of the UK CGC is the relationship between a company and its shareholders. Listed companies generally have a high number of shareholders, some of whom may not be fully familiar with the risks facing those companies and management's approach to those risks. The UK CGC provides very valuable protection to shareholders in such companies. NWL, by contrast, is a private company with a single controlling shareholder. As such it is in a very different position from the companies for which the UK CGC was designed. NWL seeks to comply with both the principles and spirit of the UK CGC where appropriate and the Board has a continuous and detailed involvement in NWL's overall business.

The Company also has in place a further governance code (the NWL Code), developed in discussion with Ofwat in response to its Board leadership, transparency and governance principles (the Ofwat Principles). The NWL Code states NWL's intention that the Board will comprise four Independent Non-Executive Directors (INEDs) (rather than the three required by the Licence), four shareholder-appointed Non-Executive Directors (NEDs), excluding me as Chairman, and three Executive Directors. As a private company with a single ultimate controlling shareholder, we believe it to be consistent with good corporate governance for there to be significant shareholder representation on the Board, including the Chairmanship. The shareholder-appointed NEDs (excluding me as Chairman) are not a majority on the Board and are no greater than the number of INEDs. However they play an extremely significant role in the functioning of the Company, and are a valuable resource both to the Company and its Board. They are instrumental in all aspects of the Board, and play a leading role on the various Board Committees. Our four INEDs are highly experienced, capable and independent-minded people who bring a diverse range of talents to the Board, as well as a determination to champion customers' interests, environmental matters, and maintain first class governance. Working with the other NEDs, they are very effective in scrutinising the performance of management in meeting agreed goals and objectives and monitoring the reporting of performance. We believe our current arrangements, with strong INED input, ensure that there is sufficient independent challenge and judgement on the Board.

It is important to note, however, that the Board continues to function as an integrated whole and that each Director understands his or her individual responsibility to act in the best interests of the Company, as well as the importance of the service provided to our customers and our environmental responsibilities. All Directors play a full part in Board meetings and shape the Company's strategy, as well as ensuring that customers' interests are central to investment and operational decisions. The composition of the Board ensures a sound balance of experience, knowledge and independence and that decision making is not dominated by any single group.

Paul Rew, our Senior INED, confirms in his report (on pages 54 to 55) that the INEDs are fully involved in all the main aspects of NWL's governance and, throughout the year, were invited to and participated in all the Board meetings of our holding company, NWGL (except in relation to NHH retail business). We recognise that some of our INEDs have served for longer than is recommended by the UK CGC. We have explained the reasons for this elsewhere in this document, but we review the composition of the Board on an ongoing basis.

We recognise the critical role of our INEDS to the business, for example in the submission of the PR19 Business Plan. After the Business Plan has been submitted we will ensure that the composition of the Board remains appropriate and that customers' best interests are taken fully into account.

In practice, the Company complies with the Ofwat Principles and with the UK CGC's principles (and more detailed provisions) with very few exceptions. The Corporate Governance Report (on pages 57 to 67) describes and explains those minor aspects of the Ofwat Principles and the UK CGC which we have chosen not to fully adopt given our ownership structure.

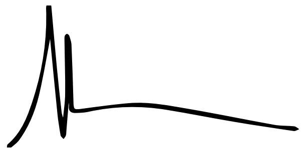
The Board, supported by the Risk & Compliance Sub-committee, has ultimate responsibility for risk management and determines risk appetite. The Risk & Compliance Sub-committee receives regular updates on the top-rated business risks and priorities for assurance and conducts 'deep-dives' into key areas of risk. On the Board's behalf, the Risk & Compliance Sub-committee has conducted a robust assessment of the principal risks facing the Company. These risks, and how they are managed, are described on page 46 of the Strategic Report. Risks have also been robustly stress-tested in our viability statement assessment which, in turn, has fully considered all detailed guidance recently provided by Ofwat.

A sub-group of the Board conducts a separate annual strategic risk review exercise. In November 2017 the sub-group invited Andrew Haines, Chief Executive of the Civil Aviation Authority, to participate in the process. Andrew drew on his significant experience in aviation and rail to bring many very helpful insights on risk to the exercise.

As our stakeholders will be aware, individuals and companies across the world are increasingly exposed to the threat of cyber-attack and theft of personal data. I would like to assure our customers and other stakeholders that we are very conscious of these risks and, whilst no systems can guarantee absolute security, we continue to challenge ourselves to ensure we take sensible and robust steps to protect the data we hold. We have also developed a detailed action plan to ensure that the Company was well prepared for the GDPR which came into force in May 2018.

The Board is fully aware of, and has discussed, the proposed changes to the UK CGC and to other corporate governance provisions and disclosure requirements. We are preparing for the changes, and I am happy to report that many of the proposals are entirely consistent with the Company's existing purpose, culture and approach.

Finally, I am pleased to confirm that our recent Board evaluation exercise delivered very positive feedback on how the Board operates. We engaged Professor Giovanna Michelon to facilitate the exercise and her report concludes that the Board is working well, with particular reference to the positive, constructive tone of its discussions and the quality of the work done at Committee level. These findings are entirely consistent with my own view of how well the Board works, on behalf of all the Company's stakeholders.



Andrew J Hunter
Chairman

SENIOR INDEPENDENT NON-EXECUTIVE DIRECTOR'S REPORT

As Senior Independent Non-Executive Director I am pleased to be able to describe the role of NWL's INEDs, and how the Board Committees and Sub-committees support NWL's high standards of corporate governance.

Paul Rew

I can fully endorse the Chairman's explanation of the key role which the INEDs continue to play in NWL's governance, assurance and decision making. I chair the Audit Committee, the Assurance Sub-committee, the Risk & Compliance Sub-committee and the Board PR19 Sub-group, which I explain below. Fellow INEDs sit on all these Committees, Sub-committees and the PR19 Sub-group, as well as on the Remuneration and Nomination Committees.

We are therefore fully involved in all the main aspects of NWL's governance and the Board is satisfied that this enables it to ensure that sound governance is maintained. The UK CGC suggests that all Audit Committee members should be INEDs, whilst NWL's Audit Committee comprises three INEDs and one shareholder-appointed NED. The Board believes that this balance is appropriate, given that NWL is a private company with a single ultimate controlling shareholder. The INEDs on the Audit Committee have a wide range of skills and experience and the shareholder-appointed NED brings great expertise and an additional appreciation of best practice. The Committees work as a unified team to ensure that strong governance is maintained. The three members of the Risk & Compliance and Assurance Sub-committees are all INEDs.

The INEDs recognise the increasing need for careful and thorough assurance of many of the key projects being undertaken by NWL, to ensure compliance, efficiency and excellent Outcomes for customers. As I have reported in previous years, in order to sharpen the focus on assurance, the Audit Committee formed an Assurance Sub-committee which closely reviewed, in the last calendar year, NWL's preparations for the opening of the NHH retail market and, this year, NWL's major transformation project to implement a new customer care and billing system.

Given the critical importance of PR19 to our customers, the Board has formed a PR19 Sub-group to provide integrated support to the Board in driving forward and assuring preparation of NWL's PR19 Business Plan.

All INEDs sit on the PR19 Sub-group, as do NWL's three Executive Directors and two shareholder-appointed NEDs. The Sub-group has met eight times during 2017/18 and is scheduled to meet at least monthly until the Business Plan is submitted. I describe the work of the Sub-group in a little more detail below, but I can assure our customers that their interests are given very high priority in its discussions. To this end, my fellow INED Margaret Fay, who has deep roots in the north east and is passionate about customer service, has volunteered to co-ordinate the efforts of the whole Board to champion and promote customers' interests throughout the PR19 process and to ensure that customers' views are reflected fully and accurately in the Business Plan.

Most decisions relating to NWL are made by the NWL Board alone and the only decisions referred to the NWGL Board are certain large contract awards, capital project approvals, substantial funding arrangements and the re-appointment of certain Directors. During the last year, the NWGL Board has endorsed all the recommendations of the NWL Board.

The INEDs have carefully followed the recent regulatory and political discussions regarding the transparency, legitimacy and resilience of the water sector. We understand the concerns raised by some towards the highly-leveraged structures in the sector, but support the Chairman's view that NWL is not in this category. The Board recognises the stability our simple capital structure brings, and the need to maintain our investment grade credit ratings, which underpin our financial resilience. Nonetheless, there is an ongoing need to review distributions and maintain a sound, balanced approach. The INEDs have therefore been fully involved in the Board's decision to significantly reduce dividends paid in

2017/18 (as shown in our Strategic Report and in the notes to the financial statements) and planned to be paid over the remainder of the current Asset Management Plan period and into PR19

Although the INEDs are not members of the NWGL Board, we have been present at its Board meetings this year, which has continued to encourage a cohesive approach at both Boards and given us full transparency. Naturally, we have not received papers relating to the NHH retail market or been present when that has been under discussion.

I would like to emphasise that, in addition to our extensive work on assurance and our participation in formal meetings, the INEDs have had very broad and continuous involvement in NWL's overall business. We have attended several customer feedback sessions to help guide the Company in preparing for PR19, as well as meetings with NWL's Water Forums (Customer Challenge Groups). We have again all taken part in extensive sessions with management on business risk and customer service. We have also met from time to time without management or the other directors being present (with and without the Company's auditors) and attended seminars arranged by Ofwat and other events relating to the water sector.

I confirm that the INEDs are all satisfied that the balance of experience and expertise on the Board of NWL, its Committees, Sub-committees and the PR19 Sub-group ensures that robust compliance and good governance are achieved and that the interests of all the Company's stakeholders, and especially customers, are protected.

Paul Rew

P Rew
Senior Independent Non-Executive Director

INED ENGAGEMENT WITH CUSTOMERS

Our INEDs are always keen to actively engage with our customers through attending customer events, stakeholder workshops and our Innovation Festival.

One of the ways in which we have formalised our Board engagement has been through board members championing particular interests and perspectives, such as environmental matters and customer service.

Dr Simon Lyster takes a particular interest in environmental matters and chaired our regional 'Thinking ahead' workshops in 2017, which brought together stakeholders and partners to consider catchment management. He has also attended several PR19 customer workshops across our regions and enjoyed talking directly with customers about their experiences of our services and hearing how they wanted to shape our plans. Reflecting on his experience of this Dr Lyster said; "I think in terms of the organisations I'm involved in Northumbrian Water's attitude to customer participation is at the leading edge … listening to customers and what they think we should do is absolutely crucial."

Margaret Fay is passionate about customer service and has been particularly active in attending customer research and engagement events throughout the PR19 process. She has promoted customer interests throughout the process, taking the lead on behalf of the Board to ensure that customers' views are represented fully in the Business Plan. Ms Fay said; "Our engagement with customers has been very thorough and effective. I am confident that we understand customers' needs and expectations and that the collaborative effort we have all invested means the business plan will really deliver for customers".

CORPORATE GOVERNANCE

The composition of the Board is as follows:

A J Hunter (Non-Executive Chairman) joined the Board in October 2011, having been appointed by CK Infrastructure Holdings Limited (CKI), which is listed on the Hong Kong Stock Exchange and is a substantial shareholder in the Group. Mr Hunter is Deputy Managing Director of CKI and is an Executive Director of Power Assets Holdings Limited, a listed company. He has been an Executive Director of CKI since December 2006 and Deputy Managing Director since May 2010. Mr Hunter acted as the Chief Operating Officer of CKI from December 2006 to May 2010. Prior to his appointment to the board of Power Assets Holdings Limited in 1999, Mr Hunter was Finance Director of the Hutchison Property Group. He holds a Master of Arts degree, a Master's degree in Business Administration and is a member of the Institute of Chartered Accountants of Scotland and of the Hong Kong Institute of Certified Public Accountants. Mr Hunter chairs the Remuneration Committee and Nomination Committee.

Key strengths: Leadership, strategic overview, finance and infrastructure.

P Rew (Senior Independent Non-Executive Director) joined the Board in 2010. Mr Rew is a Chartered Accountant and was a partner in PricewaterhouseCoopers LLP (PwC) from 1987 until 2010, where he was lead partner for a diverse range of FTSE 100 clients and for PwC's UK energy, utilities and mining sector practice. Mr Rew is a Non-Executive Director of the Care Quality Commission and chairs their Audit Committee. He was formerly a Non-Executive Director of the Met Office and, until July 2018, of DEFRA. He chairs the PR19 Board Sub-group, Audit Committee, Assurance Sub-committee and Risk & Compliance Sub-committee, and is also a member of the Remuneration Committee and Nomination Committee.

Key strengths: Finance, risk and corporate governance.

H Mottram (CEO) joined the Board in 2010, when she was appointed as CEO of NWL and NWGL. Prior to her current position, Ms Mottram held a number of senior management roles, including Managing Director of Northern Rail Limited, Commercial Director of Arriva Trains and Operations Director of Midland Mainline, as well as various senior positions in Great North Eastern Railway. Ms Mottram is a Non-Executive Director of Eurostar International Limited, Vice-Chair of the North East Local Enterprise Partnership, a member of the CBI Board and Vice-Chair of Newcastle University Council. Ms Mottram was named Rail Business Manager of the Year in 2009 for being an ''inspirational leader''. She was awarded an OBE in 2010 for services to the rail industry and a CBE in 2018 for services to the water industry and business community. Ms Mottram is also the Prince of Wales' Ambassador for Business in the north east of England.

Key strengths: Leadership, corporate overview, infrastructure and customer service.

C I Johns (Finance Director) joined the Board in 2013, having served as Finance Director of Northern Gas Networks Limited (NGN), which is also part of the Cheung Kong Group, since 2005. Before joining NGN, Mr Johns, who is a Chartered Accountant, held senior financial management positions in the financial services sector, in both Yorkshire and London. Mr Johns' previous positions include being Head of Finance and Accounting within the UK lending operations of Provident Financial plc, and a senior management role in the Financial Reporting and Control Group of Morgan Stanley.

Key strengths: Finance and infrastructure.


A C Jones

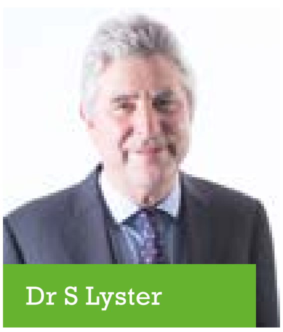
A C Jones (Assets and Assurance Director) joined the NWL Board in 2004. An economist by background, Mr Jones holds an MBA with distinction from Warwick and has extensive experience in dealing with government and regulatory bodies. Mr Jones is a Chartered Environmentalist and worked as a government economist and economic consultant before joining the water industry. He has held non-executive positions at a number of water industry organisations and is currently Chair of Landlord Tenant Access Portal Limited and Deputy Chair of a locally based enterprise development business.

Key strengths: Economic regulation and corporate planning.


M Fay

M Fay (Independent Non-Executive Director) joined the Board in 2010. Ms Fay was Managing Director of Tyne Tees Television until December 2003 when she became Chair of One North East, a position she held until August 2010, and was Deputy Chair of The Sage Gateshead until March 2018. Ms Fay is Deputy Chair of Governors of the University of Sunderland and Chair of South Tyneside Council's Economic Regeneration Board. She was awarded a CBE in 2010 for services to regional development and is a Deputy Lieutenant for Tyne and Wear. Ms Fay is a member of the PR19 Board Sub-group, Remuneration Committee and Nomination Committee.

Key strengths: Corporate overview and customer service.


Dr S Lyster

Dr S Lyster (Independent Non-Executive Director) joined the Board in 2006. A lawyer by training, Dr Lyster qualified in both the UK and the USA and is the author of the leading legal textbook on international wildlife law. Dr Lyster was Chief Executive of LEAD International from 2005 to 2011. Before joining LEAD, he was Director General of The Wildlife Trusts and previously worked for World Wildlife Fund for nine years, where he was responsible for its global policy work on international conventions. He is Chairman of Conservation International-UK, a Trustee of Kilverstone Wildlife Conservation Trust and the Rural Community Council of Essex, and a Council member of World Land Trust. In July 2014, Dr Lyster was appointed to the Board of Natural England and he is a Deputy Lieutenant for the County of Essex. Dr Lyster is a member of the PR19 Board Sub-group, Audit Committee, Remuneration Committee, Nomination Committee, and the Assurance Sub-committee and Risk & Compliance Sub-committee.

Key strengths: Conservation, the environment and law.


M A B Nègre

M A B Nègre (Independent Non-Executive Director) joined the Board in 2006. Mr Nègre was, between April 2000 and April 2001, the CEO of the former Northumbrian Water Group plc and the chief corporate representative of its parent company, Suez, in the UK. Mr Nègre was a founding Director of NWGL when it acquired the Group from Suez SA in 2003 and listed it on the London Stock Exchange (LSE). He currently chairs Ecofin Vista Hedge Fund and Ecofin Global Renewable and Infrastructure Fund and is a Non-Executive Director of LSE-listed Investment Trust EGL plc. Mr Nègre sits on the supervisory board of Messieurs Hottinger & Cie. He is a member of the PR19 Board Sub-group, Audit Committee, Assurance Sub-committee and Risk & Compliance Sub-committee.

Key strengths: Strategy, utilities and infrastructure.


F R Frame

F R Frame (Non-Executive Director) joined the Board in November 2011, having been appointed by Li Ka Shing Foundation Limited (LKSF), a company limited by guarantee and a charity, which is a substantial shareholder in the Group. A lawyer by profession, Mr Frame served as Deputy Chairman of The Hongkong and Shanghai Banking Corporation; as Chairman of South China Morning Post Limited and The Wallem Group Limited; and as a Director of The Weir Group plc, Swire Pacific Limited, The British Bank of the Middle East, Edinburgh Dragon Trust plc and Baxter International Inc. He holds the degrees of Master of Arts and Bachelor of Laws.

Key strengths: Corporate overview and law.

H L Kam (Non-Executive Director) joined the Board in October 2011, having been appointed by Cheung Kong (Holdings) Limited (CKH), a wholly-owned subsidiary of CK Hutchison Holdings Limited of which he is the Deputy Managing Director. Mr Kam is also Group Managing Director of CKI, a position he has held since its incorporation in May 1996. He is the Deputy Managing Director of CK Asset Holdings Ltd., President and Chief Executive Officer of CK Life Sciences Int'l. (Holdings) Inc., as well as Chairman of Hui Xian Asset Management Limited, which manages Hui Xian Real Estate Investment Trust, a listed real estate investment trust. Mr Kam holds a Bachelor of Science degree in Engineering and a Master's degree in Business Administration.

Key strengths: Leadership, strategic overview, finance and infrastructure.

L S Chan (Non-Executive Director) joined the Board in 2016, having been appointed by CKH, and has been an Executive Director of CKI since January 2011 and Chief Financial Officer of CKI since January 2006. Mr Chan joined Hutchison Whampoa Limited, which is a substantial shareholder of CKI, in January 1992 and has been with the Cheung Kong Group since May 1994. Mr Chan is a fellow of the Hong Kong Institute of Certified Public Accountants, a fellow of the Association of Chartered Certified Accountants and also a member of the Institute of Certified Management Accountants (Australia). He is a member of the PR19 Board Sub-group and Audit Committee.

Key strengths: Finance, infrastructure and corporate overview.

D N Macrae (Non-Executive Director) joined the Board in October 2011, having been appointed by CKI, where he holds the position of Head of International Business. Mr Macrae has over 20 years' experience in the infrastructure investment field and holds a Bachelor's and a Master's degree in Philosophy, Politics & Economics. He is a member of the PR19 Board Sub-group, Remuneration Committee and Nomination Committee.

Key strengths: Finance, infrastructure and corporate overview.

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ATTENDANCE AT BOARD MEETINGS

The Board met six times during the year, which it considered sufficient to enable it to discharge its duties effectively, and will meet out of the agreed cycle for any other matters for time-critical matters or significant matters that arise as necessary.

Attendance at the five scheduled meetings during the year was as follows:

NAME	ATTENDANCE
A J Hunter	5
P Rew	5
H Mottram	5
C I Johns	5
A C Jones	5
M Fay	5
Dr S Lyster	5
M A B Nègre	4
F R Frame	5
H L Kam	2
D N Macrae	5
L S Chan	5

One short, additional Board meeting was held and was attended by P Rew, Dr S Lyster, M Fay, D Macrae, L S Chan, F R Frame, H Mottram, C I Johns and A C Jones.

COMPLIANCE WITH CORPORATE GOVERNANCE OBLIGATIONS

The Boards of the Company and its holding company, NWGL, are committed to high standards of corporate governance. The Company's Licence contains provisions to ensure that the Company's governance is sound and that its Directors, acting as such, act independently of parent companies. The Licence requires the Company to have particular regard to the UK CGC. Good governance is further underpinned by the Ofwat Principles and the bespoke Governance Code, the NWL Code, which the Board put in place in March 2014, following discussion with Ofwat in response to the Ofwat Principles. The NWL Code is reviewed each year to ensure it is still appropriate.

The arrangements and functioning of the Board, its Committees and Sub-committees adhere to the Licence obligations and follow the NWL Code, the Ofwat Principles and the UK CGC, subject to the exceptions explained below. The Board believes that, as a private company with a single ultimate shareholder, it is consistent with good corporate governance for there to be significant shareholder representation on the Board, including the Chairmanship. The Board considers that the balance which has been achieved ensures good governance and takes account of the interests of shareholders, customers and other stakeholders. There are four INEDs, four shareholder-appointed NEDs (excluding the Chairman) and three Executive Directors. The composition of the Board does not comply with the UK CGC's guidance that at least half the Board, excluding the Chairman, should be INEDs or with the Ofwat Principle that INEDs should be the largest single group on the Board. However, the Board is satisfied with the mitigation put in place to ensure that good governance is achieved. This includes the appointment of four INEDs, rather than the three required by the Licence. These arrangements, with strong INED input, ensure that there is sufficient indepenent challenge and judgement on the Board. Although not technically independent, a fifth NED, F R Frame, is not and never has been an employee of the shareholders and brings an additional strong and experienced voice to the Board. F R Frame, a lawyer by profession, was appointed by the LKSF.

LKSF indirectly owns twenty per cent of the shares in NWL. LKSF is a charitable foundation which seeks to inspire societal improvement through supporting education and healthcare initiatives. Since its establishment in 1980, LKSF has invested over HK$20 billion on education, medical services and research initiatives in 27 countries and regions.

The Chairman comments (in his introduction to the Governance Report on page 52) on the balance of the Board, which functions as an integrated whole, and the quality and contribution of the INEDs. As the Chairman mentions in his introduction, the INEDs work with the other NEDs to scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance. The NEDs carefully review regular, detailed reports which compare all aspects of the Company's performance with agreed targets and hold management to account. The INEDs bring an independent approach to this scrutiny and the breadth of their experience and their strong understanding of the operations of the business supports their effective involvement in board decisions.

The Chairman ensures that the Board works in a collegiate way, in the best interests of the Company, and that each Director has an equal voice. All members of the Board are content that the balance of the Board is appropriate, in the context of a private company with a single ultimate controlling shareholder, and that it has supported and delivered good governance. The directors have all been able to allocate sufficient time to the Company to discharge their responsibilities effectively.

The Licence requires the Company to obtain undertakings from its ultimate controllers to underpin the Licence and to require the Company's Board to include 'not less than three independent Non-Executive Directors, who shall be persons of standing with relevant experience' and who have collective knowledge of, and connections with, the Company's areas of supply and customers. Throughout the year, the Company had four INEDs, P Rew, Dr S Lyster and M Fay (who were the three INEDs for the purposes of the Licence) and M A B Nègre. Their biographical details are set out on pages 57 to 58 above. They were appointed on the recommendation of the Nomination Committee of Northumbrian Water Group plc, when it was independently listed. The Board has rigorously reviewed the re-appointment of the INEDs and determined that they are independent for the purposes of the UK CGC, notwithstanding that they have served on the Board for more than six years. Further detail is given on page 66.

The INEDs have attended and participated in discussions at all NWGL Board meetings (except in relation to the NHH retail market), at meetings of the Audit and Remuneration Committees and of the Risk & Compliance and Assurance Sub-committees of the Audit Committee (whose members are P Rew (Chairman), Dr S Lyster and M A B Nègre), and the PR19 Board Sub-group. These bodies are formally constituted at the NWL level, but the Audit Committee and Risk & Compliance Sub-committee meet jointly with the corresponding NWGL Committee where this is practicable. The INEDs have therefore played a full part in relevant strategic decisions both at the NWL and NWGL Boards. All Directors' views have been given full consideration and due weight in all proceedings of the Board and Committees, Sub-committees and Sub-group.

There is a clear division of responsibilities between the Chairman and CEO. This has been set out in writing and agreed by the Board, in line with the UK CGC.

The Board considers that it complies substantially with the relevant provisions of the UK CGC, except as explained on pages 66 to 67. Compliance with the NWL Code is reported on page 67.

BOARD RESPONSIBILITIES AND PROCESSES

The Board sets, implements and supports the Company's vision, values, standards and strategy and ensures compliance with Group policies and legal and regulatory obligations. Within the Group framework, NWL operates as a standalone company and its strategy is determined solely by the NWL Board. During the year, the only decisions referred to the NWGL Board were certain large contract awards, capital project approvals and substantial funding arrangements. The NWGL Board has also been asked to endorse decisions taken at the NWL Board to extend the appointments of directors as required. In all the instances referred to above, the NWGL Board has accepted the recommendations of the NWL Board.

The Board has ultimate responsibility for risk management and determines the appropriate risk appetite. The Board's view of acceptable risk is based on a balanced view of all of the risks in the operating environment and it aims to ensure an appropriate balance between risk aversion and opportunities. The Board monitors the management of fundamental risks and approves major decisions affecting the Company's risk profile. The Board is supported in this by the Risk & Compliance Sub-committee, from which it receives regular and detailed reports.

The Board requires management to identify and assess the impact of risks to the business using a corporate risk model. In addition, during the year, a sub-group of the Board carried out a review of strategic risks, being potentially high impact risks which are foreseeable but with a high degree of uncertainty.

The Board receives detailed reports from the Executive Directors in advance of Board meetings, covering each aspect of the Company's activities.

The Chairman leads the Board and ensures that all items on the Board agendas are discussed openly and that all Directors have an opportunity to express their views. He encourages constructive challenge, so that ideas and proposals are tested and explored fully. This enables the Board to provide entrepreneurial leadership, as required by the UK CGC, within the framework of the controls described in this document. The Board recognises that customers' interests are best served when the Company is flexible and innovative, so the Executive team is always encouraged to think laterally and consider a range of solutions for each issue.

The Company has adopted terms of reference which set out the matters reserved to the Board for approval and matters which are, or can be, delegated to the Committees, Sub-committees and management. These are published on the Company's website. The Board makes key strategic decisions and approves the annual and medium term business plans. It also approves regulatory submissions and very significant investments or expenditure which is not in the normal course of business. Investments which form part of projects within approved business plans are authorised by committees below Board level. Although this formal framework is very effective, the ELT takes great care to ensure that matters which relate to the quality of the Company's services to customers, leakage, water quality and environmental performance are discussed fully by the Board.

The Company has also adopted financial approval rules which set out the authorisation processes and financial limits to be applied to financial transactions within the Company. The terms of reference and financial approval rules are reviewed regularly by the Board. The Standing or Executive Committees can take decisions not delegated to specific committees between Board meetings. All Directors receive notice of Standing Committee meetings and may participate if they wish. Decisions taken by the Standing or Executive Committees are reported at the next Board meeting. The Company's Board meets at least five times each year.

The Company has put in place Directors' and Officers' insurance cover for the benefit of all directors of the Company. In addition, NWGL entered into a Deed of Indemnity on 21 March 2017 to provide directors of NWGL and its subsidiaries further protection against potential liability.

BOARD ACTIVITIES IN 2017/18

During the year, the Board received regular detailed updates from the Executive Directors on each aspect of the Company's work. There are also regular reports on each Board agenda on customer service, operational performance, health and safety, management of key business risks, the investment programme and regulatory matters. There is a strong focus on the Company's success in delivering its key Outcomes, as explained in the Strategic Report. The Chairman of the Audit Committee, Risk & Compliance Sub-committee and Assurance Sub-committee reports fully to the Board on their work. In addition, the following significant matters were considered by the Board, as a matter of sound governance:

- the Annual Report and Financial Statements;
- the annual business plan;
- data security;
- the General Data Protection Regulation;
- decisions on tariffs;
- approval of several significant capital projects;
- review of performance commitment targets and related investment priorities; and
- preparations for PR19 and approval of publication of certain preliminary items.

Several members of the Board attended the Company's Innovation Festival, held in July 2017, and participated in various design sprints. More details of the Festival are given in the case study on pages 28 to 29. Members of the Board were also involved in PR19 customer research sessions (see page 56 and the Chair and Vice-Chair of the Water Forums (NWL's customer challenge groups) have attended Board meetings.

The Board also reviewed the results of the annual employee engagement survey and was pleased to note the 12% increase in participation and that the Company had achieved its highest ever engagement index score of 80, putting the Company at the top of the utilities benchmark group. The Board also meets and discusses issues with the Company's employees whenever possible. The Board met the teams of employees leading the Company's work in water efficiency, leakage prevention, conservation and customer engagement for a comprehensive discussion of the innovative methods being used and progress being made.

BOARD PERFORMANCE EVALUATION

During 2017/18 the Company arranged a formal externally-facilitated review of the Board's performance. This was conducted by Professor Giovanna Michelon, a professor of accounting, who has particular expertise in corporate governance and has no prior connection to the Company. P Rew is an advisory board member of the business school at which Professor Michelon is employed, but played no part in the decision to select her to provide this service.

The evaluation process involved directors completing a tailored questionnaire and submitting it directly to Professor Michelon, who interviewed several directors before submitting her initial findings ahead of the Board meeting on 17 April 2018, followed by a written report.

The findings were generally very positive. Professor Michelon concluded that the Board is working in a solid way, exhibiting a high level of trust and a positive environment where everyone feels comfortable giving their opinions and contributing to the debate. The Chairman's leadership style was described as "empowering" and the risk management process led by the Board was felt to be very detailed and thorough. The Board will give further thought to Professor Michelon's suggestions relating to:

- refining the Board's approach to prioritising the business at meetings;
- succession planning; and
- creating further opportunities for direct engagement between stakeholders and the Board.

The structure of the various committees was changed in 2017, so the main committees operate at the NWL level. The next review of the performance of the committees will therefore be conducted later in 2018. The last review of the effectiveness of the committees was conducted in March 2017 and reported to the Board in August 2017.

AUTHORISATION OF DIRECTORS' CONFLICTS OF INTEREST

Directors have a statutory duty, under s175 of the Companies Act 2006, to avoid a situation in which they have, or could have, a conflict of interest with the Company's interests. However, there is no breach of this duty if the Board has authorised the matter in question. The Articles permit Directors (other than the Director having the interest in question) to authorise any situation giving rise to a known or potential conflict. A register of the interests which have been authorised is maintained by the Company Secretary and is available at every Board meeting.

BOARD COMMITTEES AND SUB-COMMITTEES

During the year, the Board had Audit and Remuneration Committees and a Risk & Compliance Sub-committee to assist it in the performance of its duties. The Board sets the terms of reference of the Committees and Sub-committees and receives regular reports from their chairmen at Board meetings. Reports from the Audit and Remuneration Committees and the Risk & Compliance Sub-committee are set out below.

BOARD PR19 SUB-GROUP

Given the critical importance of PR19 to our customers, the Board has formed a dedicated PR19 Sub-group to provide integrated support to both the Board and management in driving forward and assuring preparation of NWL's PR19 Business Plan.

All INEDs sit on the PR19 Sub-group, as do NWL's three Executive Directors and two shareholder-appointed NEDs. The Sub-group has met five times during 2017/18 and is scheduled to meet at least monthly until the Business Plan is submitted.

The Sub-group has discussed detailed reports from the Company's PR19 team, covering each aspect of the preparation of the Business Plan for PR19. This has included:

- customer engagement and participation;
- affordability and inclusivity;
- our goals and ambitions;
- the drive for upper quartile efficiency;
- the Water Industry National Environment Programme;
- the enhancement programme and resilience;
- establishing MoS, PCs and Outcome Delivery Incentives (ODIs);
- the progress of the Business Plan against programme milestones; and
- assurance of the Business Plan.

The PR19 Sub-group is working closely with the Company's executive management and relevant senior managers below that level, as well as external assurance providers. In addition, INEDs are regularly attending meetings of NWL's Water Forums and customer participation workshops, to ensure they have a first-hand understanding of customers' needs, priorities and concerns ahead of the price review.

AUDIT COMMITTEE REPORT

Introduction by the Chairman of the Committee, Paul Rew

The role of the Audit Committee is to assist both Executive and Non-Executive Directors of Group companies to discharge their individual and collective responsibilities in relation to:

- ensuring the financial and accounting systems of each Group company are providing accurate and up-to-date information on its current position;
- ensuring the Group's published financial statements represent a true and fair reflection of this position;
- ensuring the integrity of the Company's regulatory reporting systems and the accuracy of its regulatory reports; and
- assessing the integrity of internal financial controls.

The Committee also maintains oversight of internal and external auditors. I have worked with the members of the Committee and with management to produce an action plan for the Committee, setting out the business to be addressed at each meeting. This plan is dynamic and is updated throughout the year. The members of the Committee are updated regularly on developments in financial reporting requirements and on any changes in NWL's regulatory environment.

Members of the Audit Committee

The members of the Audit Committee are P Rew (Chairman), Dr S Lyster, M A B Nègre and L S Chan.

The CEO, Finance Director, Assets and Assurance Director, Internal Audit Manager and the external auditor normally attend the Committee's meetings by invitation and Martin Parker is Secretary to the Committee. Other senior managers and advisers are invited to attend as appropriate.

The work of the Audit Committee

During the year, and up to the date of approval of these financial statements, the Audit Committee assisted both Executive and Non-Executive Directors to discharge their individual and collective responsibilities. Its work included the following:

- reviewing the draft Financial Statements and APR, considering reports from the external auditor setting out the audit approach and plan, significant audit risks and conclusions on the Group's internal controls and risk management;

- considering the key areas of judgement in the Financial Statements, reviewing reports from management, and ensuring these are consistent with those set out in note 1(q) to the Financial Statements on page 92;
- reviewing the appropriateness of accounting policies, and evidence supporting the going concern basis for the Financial Statements and recommending approval of the Financial Statements to the Board;
- reviewing and commenting on the APR, including the underlying assurance, reviewing evidence to support the Condition F6A.2A certificate (statement of sufficiency of financial resources) and long term Viability Statement and recommending their approval to the Board;
- confirming the objectivity and independence of the external auditor, noting that Deloitte LLP were appointed in 2012 with Anthony Matthews, the current audit partner, first signing the 2016 Annual Report, and in so doing reviewing the representations made in the audit report on these subjects;
- reviewing and monitoring the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements;
- approving the external auditor's fees for both audit and non-audit services, by reference to the agreed policy;
- monitoring the effectiveness of the internal audit function;
- approving the internal audit work programme for the year and reviewing progress against the programme;
- approving arrangements for monitoring compliance with the Company's procedures designed to prevent bribery, having regard to the Bribery Act 2010 and the updated code of conduct 'Our Way at NWG', including receiving reports on any whistleblowing allegations;
- reviewing the risk and control framework and reporting. In the course of this review the Committee emphasised the importance of reputation, delighting customers and perceptions of NWL as an ethical and legitimate provider of an essential service;
- reviewing the progress of NWL's new customer care and billing project, including detailed assessment of readiness against agreed "go/no-go" criteria;
- management of tax compliance matters and other tax issues, including Base Erosion and Profit Shifting (BEPS) and replacing NWL's Advance Thin Capitalisation Agreement with HMRC; and
- in-camera meeting with auditors without management present.

The Audit Committee Chairman reports formally to the NWL Board following each Audit Committee meeting and its minutes are circulated to both Boards.

Attendance at the four Audit Committee meetings during the year was as follows:

NAME	ATTENDANCE
P Rew	3
Dr S Lyster	4
M A B Nègre	4
L S Chan	4

Given the increasing need for careful and thorough assurance of a number of NWL's key projects, to ensure compliance, efficiency and excellent customer Outcomes, the Audit Committee has an Assurance Sub-committee whose three members are all INEDs. Although the Sub-committee has a broad remit, its work during the year focused on:

- NWL's major transformation project to implement a new billing system to enable NWL to work with Market Operator Services Limited after market opening and to manage household customer billing and contact;
- the assurance plan for March 2018 reporting; and
- assurance of 2018/19 charges.

The Sub-committee met once with Executive Directors, senior management and independent assurance providers during the year and all the members were present and ad hoc updates were made throughout the year on progress on the implementation of the new customer care and billing system, particularly around major milestones.

Paul Rew

P Rew
Chairman of the Audit Committee

RISK & COMPLIANCE SUB-COMMITTEE REPORT

Introduction by the Chairman of the Sub-committee, Paul Rew

The role of the Sub-committee is to assist both Executive and Non-Executive Directors to discharge their individual and collective responsibilities in relation to assessing the scope and effectiveness of the Group's risk management systems and the integrity of its internal financial controls.

Members of the Risk & Compliance Sub-committee

The members of the Risk & Compliance Sub-committee are P Rew (Chairman), Dr S Lyster and M A B Nègre.

The work of the Risk & Compliance Sub-committee

The ELT implements policies on risk management and internal control and ensures that risks are appropriately identified and managed within the business. This approach is set out in a Risk Management Framework, which has been endorsed by the Risk & Compliance Sub-committee. The ELT reviews the approach to risk management in detail every year and reviews the significant risks every month. Any significant issues are reported by the CEO to the Board. Senior management implements policies on risk management and internal control.

The Risk & Compliance Sub-committee, on behalf of the Board, has performed a robust assessment of the principal risks facing the Company, including those that would threaten its business model, future performance, solvency or liquidity. These principal risks, and how they are managed, are described on page 46 to 50 in the Strategic Report.

The internal control framework supports the risk management process, ensuring that risks are appropriately managed, that controls are effective and that appropriate remedial action is taken where identified. Risks are mapped against the providers of assurance, whether this be management, internal or external assurance. The Board is supported by the Audit Committee in monitoring the effectiveness of the internal control framework with primary assurance being provided by the Internal Audit team.

The Risk & Compliance Sub-committee, on behalf of the Board, has carried out an annual review of the effectiveness of the Company's risk management and internal control systems. This review confirmed that the Company has strong systems of internal control and robust processes in place to enable it to identify, evaluate and manage the risks it faces and to ensure that its obligations are met. These systems and processes are embedded in the organisation and are reviewed regularly by the Board, its Committees and Sub-committees. The annual review confirmed that the risk management and internal control systems have operated effectively through the year and that there have been no significant failings or weaknesses.

During the year, and up to the date of approval of these financial statements, the work of the Risk & Compliance Sub-committee included the following:

- reviewing reports at each meeting on the top rated managed risks and priorities for assurance (being those risks with the biggest reduction between the business (gross) and managed (net) risk scores), representing key control areas for the Company;
- reviewing high impact, low likelihood risks which have a rare to unlikely likelihood of occurrence but a potentially catastrophic level of impact;
- reviewing the management of specific areas of risk in relation to the introduction of the new customer care and billing system and other matters including H&S and business continuity arrangements;
- advising the Board on risk appetite and exposure and reviewing risk assessment processes as well as keeping the effectiveness of the risk and internal control management systems under review;
- monitoring compliance with covenants and treasury risks; and
- reviewing management of customer debt.

Attendance at the three scheduled Risk & Compliance Sub-committee meetings during the year was as follows:

NAME	ATTENDANCE
P Rew	3
Dr S Lyster	3
M A B Nègre	3

The Sub-committee holds a special meeting with other members of the Board each year to conduct a separate strategic risk review exercise. In November 2017, Andrew Haines, Chief Executive of the Civil Aviation Authority, was invited to participate in the exercise. He drew on his significant experience in aviation and rail to bring many very helpful insights on risk to the process.

The Board is able to monitor the impact of environmental, social and governance matters on the Company's business, to assess the impact of significant risks on the business and to evaluate methods of managing these risks through reports it receives from the Audit Committee and the Risk & Compliance Sub-committee.

Paul Rew

P Rew
Chairman of the Risk & Compliance Sub-committee

COMPLIANCE WITH THE UK CORPORATE GOVERNANCE CODE

The Board considers that it complies substantially with the relevant provisions of the UK CGC where they are appropriate for a privately owned company, except as explained below. The Board also explains below how NWL has complied with certain provisions, where we believe this will be helpful.

Code Provisions

A.3.1: The Chairman was appointed by the Group's shareholders which is considered to be appropriate, given that NWL is a private company with a single ultimate controlling shareholder. As per the Ofwat Principles, there is a Senior INED, P Rew, who is available to liaise with Ofwat in respect of any regulatory matter.

A.4.2: The Chairman has informal discussions with the Non-Executive Directors (both individually and collectively) as the need arises, though it has not been felt necessary to hold formal meetings with them without the executives present. The Non-Executive Directors have not formally appraised the performance during the year of the Chairman, but such an appraisal will be conducted in following up the Board performance review.

B.1.1: The Board has determined that the following Directors are independent for the purposes of the UK CGC, notwithstanding that they have served on the Board for more than nine years:

- M A B Nègre (appointed in 2006). Mr Nègre has no prior connections with the Group's shareholders. He is a very experienced director, and brings to the Board an excellent understanding of the business coupled with sound commercial judgment. The Board is satisfied that he continues to demonstrate a fully independent approach and to contribute a constructive and challenging perspective to Board discussions.
- Dr S Lyster (appointed in 2006). Dr Lyster has no prior connections with the Group or its shareholders. He is a very experienced director, with particular expertise in wildlife, conservation and environmental matters, which are central to the Company's work. He lives in the Company's ESW supply area. The Board is satisfied that Dr Lyster continues to demonstrate a fully independent approach and to offer valuable constructive challenge.

B.1.2: The Board comprises a Chairman and four further Non-Executive Directors appointed by the Group's shareholders, four INEDs and three Executive Directors (including the CEO). As explained in the Chairman's Statement, Senior INED's Report and Corporate Governance obligations section on page 60, the Board considers that this is an appropriate balance in the context of a private company with a single ultimate controlling shareholder.

B.2.3: The Board has rigorously reviewed the re-appointment of the INEDs, all of whom have served for more than six years. Details of the contribution of M A B Nègre and Dr S Lyster are given in the comments on provision B.1.1 above and the contributions of M Fay and P Rew are described below:

- M Fay (appointed in 2010). Mrs Fay has no prior connections with the Group or its shareholders and brings to the Board very valuable knowledge of, and a strong connection with, NWL's customers in North East England, a passion for and deep understanding of customer service and a rigorous approach to corporate governance. The Board is satisfied that Mrs Fay continues to demonstrate a fully independent approach and to offer constructive challenge.
- P Rew (appointed in 2010). Mr Rew has no prior connections with the Group or its shareholders. He brings expertise in finance, risk, corporate governance and compliance and has very significant experience as an audit committee chairman in substantial and complex organisations. The Board is satisfied that Mr Rew continues to demonstrate a fully independent approach and to offer constructive challenge.

As the Chairman mentions in his introduction to this Report, on page 52, the Board reviews the composition of the Board on an ongoing basis.

B.2.1, B.2.2 and B.2.4: The Board introduced a Nomination Committee in 2017 and it met, informally, to discuss succession planning for the INEDs. The Company has confirmed (in its governance document) that any new INEDs and Executive Directors will be appointed on an objective basis and by means of a formal, rigorous and transparent procedure, in which all Non-Executive Directors will participate. Moreover, the Board has agreed to ensure that the recruitment process for INEDs is such that a diverse range of candidates is encouraged to apply.

The CEO has kept the Board informed of the extensive work being done within the Company in relation to diversity. These will form key strands of the work of the Committee during 2018/19.

B.4: INEDs receive induction on joining the Board and continually update their knowledge of and familiarity with the Company. The Chairman does not formally review with each Director their training and development needs. For Executive Directors this is managed by the CEO and INEDs keep up to date with developments in the sector via briefings and updates at Board meetings and external seminars and meetings.

B.6: The Company has conducted an externally-facilitated review of the Board's performance and the findings will be reviewed at the Board meeting in July

2018. The feedback from the review was extremely positive and no material concerns were raised. The performance of Executive Directors is appraised by the CEO and all Executive Directors participate in NWL's extensive 360° feedback system. An internal review of the performance of the Committees was conducted in 2017 and the next review will be conducted during 2018/19.

The Board rigorously reviews the contributions of any directors whose appointments are extended beyond a term of six years.

B.7: Annual re-election by shareholders is not considered to be appropriate in the case of a privately owned company.

C.3.1: The Audit Committee comprises three INEDs and one shareholder-appointed NED. This is considered to be appropriate in the context of a private company with a single ultimate controlling shareholder. The Committee ensures that high standards of governance and good practice are maintained.

D.1: The Company's policy on remuneration and the detailed remuneration disclosures are set out in the Remuneration Committee Report on pages 68 to 78.

D.2.1: The Remuneration Committee is chaired by A J Hunter, the shareholder-appointed Chairman of the Board. Although this is not compliant with the Ofwat Principles, it is considered to be appropriate in the context of a private company with a single ultimate controlling shareholder. In this ownership model the shareholders are not exposed to the risk of the Committee agreeing to unduly generous remuneration packages for executive directors. The other members of the Committee are P Rew, M Fay and Dr S Lyster (all INEDs) and D N Macrae (shareholder-appointed NED), meaning that there is a majority of INEDs in accordance with the Ofwat Principles.

E.1: The Chairman was appointed by CK Infrastructure Holdings Ltd, which is a significant, indirect shareholder in NWL. He is therefore well placed to convey to the Board the shareholders' views, where this is appropriate. The Non-Executive Directors regularly meet representatives of the ultimate controlling shareholder and therefore have every opportunity to understand their views.

E.2: As a private company with a single ultimate controlling shareholder, the Company does not consider it necessary to hold annual general meetings.

Proposed revisions to the UK CGC and other corporate governance provisions

As the Chairman mentions in his introduction to this Report (on page 52), the Board is fully aware of the proposed changes to the UK CGC and other corporate governance provisions and disclosure requirements and is making appropriate preparations. Many of the proposals are consistent with the Company's existing purpose, culture and approach and the Company therefore aspires to be able to report a high level of compliance.

NORTHUMBRIAN WATER LIMITED BOARD GOVERNANCE CODE

In March 2014, following discussions with Ofwat, the Board put in place a bespoke Governance Code (the NWL Code), which is available on the NWL website. The Company follows the NWL Code and, accordingly, commenced performance evaluations in 2015. As disclosed above, an externally-facilitated review of the performance of the Board was conducted during the year.

CODE OF CONDUCT

The Group has a code of conduct, 'Our Way at NWG', covering its relationships with customers, employees, suppliers, local communities, shareholders, other investors and regulators. This document provides clear guidance to employees in relation to personal conduct, conflicts of interest and a number of other matters. As part of the annual staff appraisal system, all employees are required to confirm that they have seen the code of conduct.

REMUNERATION COMMITTEE REPORT

The following report has been produced in accordance with section 35A of the Water Industry Act 1991. It also has regard to the requirements of the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 in respect of directors' remuneration reporting for quoted companies, albeit in the context of a company which is not a listed public limited company.

ANNUAL STATEMENT

The work of the Remuneration Committee comprises the adoption of principles and standards in relation to executive remuneration and benefits, as well as agreeing individual remuneration packages. All decisions regarding Directors' remuneration are taken by the Remuneration Committee, other than where stated.

Members of the Remuneration Committee

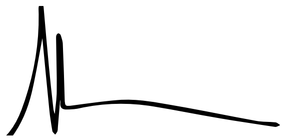
The members of the Remuneration Committee during the year were A J Hunter (Chairman), P Rew, M Fay, Dr S Lyster and D N Macrae. H Mottram attends Committee meetings but does not participate in discussions relating to her own remuneration. S Salter, the Group HR Director, provides advice to the Committee from time to time. There is a majority of INEDs in accordance with the Ofwat Principles.

Please see the explanation in respect of the chairmanship of the Remuneration Committee provided on page 67, in commenting on compliance with Provision D.2.1 of the UK GCG.

The work of the Remuneration Committee

The Remuneration Committee met once during the year on 23 January 2018. All members attended the meeting. No substantial changes were made to the directors' remuneration policy, or individual Directors' remuneration, during the year. Set out below is a brief summary of the work of the Committee:

- reviewing Executive pay and Non-Executive Directors' fees, taking account of market data, and agreed annual pay awards to take effect from 1 January 2018;
- considering an assurance report from the Internal Audit Manager on performance against targets reflected in incentive recommendations for the 2017 Short Term Incentive Plan (STIP) and Long Term Incentive Plan (LTIP);
- agreeing STIP payments for the 2017 calendar year;
- agreeing the level at which the LTIP award in respect of the 2017 calendar year would vest;
- setting performance targets for the STIP for Executive Directors and senior managers for the 2018 calendar year; and
- setting performance targets for the LTIP scheme for the award in respect of the 2018 calendar year.



A J Hunter
Chairman of the Remuneration Committee

DIRECTORS' REMUNERATION POLICY

The policy of the Remuneration Committee is to pay no more than necessary to attract and retain good quality directors, and to ensure that policy is aligned with market practice. For Executive Directors the reward policy is designed to achieve a balance between attraction, reward for performance and retention, and salaries are based on relevant market benchmarks, which are reviewed typically every three years. For Non-Executive Directors, fees paid reflect market practice for similar sized companies, and may be enhanced for roles leading Board Committees.

Executive Directors

The remuneration of the Executive Directors comprises:

- basic salary;
- benefits in kind;
- a performance related STIP;
- annual LTIP awards; and
- pension benefits.

In addition to reviewing each constituent element, the Remuneration Committee reviews the remuneration packages as a whole to ensure that they remain appropriate in terms of structure and quantum. In 2012 the Remuneration Committee restructured the remuneration of the Executive Directors, with advice from Hay Group, independent external reward consultants. This resulted in a reduction in the value of performance related STIP and LTIP awards, offset by an adjustment to basic pay. The Remuneration Committee is satisfied that this balance between fixed and performance related remuneration remains appropriate.

A significant proportion of renumeration is linked to Company performance through the short-term and long-term incentive plans, with 50% of the CEO's maximum renumeration being linked to performance and around 40% for the other Executive Directors, as illustrated on page 72.

The remuneration policy is designed to incentivise performance across all the full range of the Company's strategic themes and not to over-emphasise short-term financial gains. The following table describes the policy in more detail, explaining the purpose of each component, how the policy operates and, for the variable elements of remuneration, the maximum amount payable and how performance is assessed.

PURPOSE	OPERATION	PERFORMANCE ASSESSMENT	MAXIMUM PAYABLE
Basic salary			
Basic salaries are set at a level to attract and retain Directors with the leadership capabilities to deliver the Company's vision of being the national leader in the provision of sustainable water and wastewater services and to reflect the external market.	Basic salary is reviewed annually based on individual contributions, periodic benchmarking to the external market and with regard to the expected pay award for other groups of employees.	The basic salaries payable to Directors of NWL are not directly linked to specific standards of performance in connection with the carrying out of functions of a 'relevant undertaker'. There is no variable performance related element.	Fixed annual amount determined annually by the Remuneration Committee.
Benefits in kind			
Other employment benefits provided in accordance with the Company's policy on provision of benefits to all staff.	Benefits provided to the Executive Directors comprise car and fuel allowances, healthcare and professional subscriptions.	There is no variable performance related element.	Fixed annual amount set in accordance with the Company's policies on provision of benefits to all staff.
STIP			
The purpose of the STIP is to focus on delivering key business performance targets in the year. The performance targets are firmly linked to NWL's strategic themes (customer, environment, competitiveness, people and communities) as reported in the balanced scorecard. Stretching targets are set which are aligned to the Company's vision of being the national leader in the provision of sustainable water and wastewater services.	The STIP is assessed on a calendar year basis. Awards are paid in cash with no deferral, other than for specific reasons, such as a performance metric not being finalised at the point of award. A clawback applies in the event that results on which the STIP is paid are subsequently found to be inaccurate or there has been relevant misconduct on the part of the employee.	The STIP is structured with three elements, determined by the Remuneration Committee: • up to 50% payable on financial targets; • up to 40% payable on balanced scorecard targets; and • up to 10% payable on performance against personal targets. The Chairman retains the right to award an additional discretionary bonus to the CEO, taking account of overall performance.	The maximum STIP payable, as a percentage of basic salary, is 70% for the CEO and 50% for the other Executive Directors.

table continued...

PURPOSE	OPERATION	PERFORMANCE ASSESSMENT	MAXIMUM PAYABLE
LTIP			
The purpose of the LTIP is to focus on key business metrics, engender a longer term view, encourage a one team approach, remain competitive in the executive market and encourage the retention of our key people.	The LTIP is a cash based award, with deferred payment. Vesting of the LTIP is based on performance in the first calendar year after award. Payment is deferred until the completion of four years from the start of the performance period.	The LTIP is payable on financial performance only, with 50% related to delivery of expected distributions to Group shareholders in line with the Board approved plan and 50% related to achievement of the Group profit after tax target. For each element, there will be no vesting if less than 97.5% of the target value is achieved, increasing on a sliding scale to 50% vesting if 100% of the target is achieved and 100% vesting if 105% of the target is achieved.	The maximum LTIP payable, as a percentage of basic salary, is 50% for the CEO and 30% for the other Executive Directors.
Pension			
Pension benefits are provided at a level to reflect market expectations.	The Company operates the Northumbrian Water Pension Scheme (NWPS or the Scheme) which has defined benefit and defined contribution sections. The defined benefit section closed to new entrants on 31 December 2007. More details of the NWPS are provided in note 22 of the Financial Statements.	There is no variable performance related element.	H Mottram left the NWPS in 2016 and receives additional salary payments in lieu of pension contributions. C I Johns participates in the defined contribution section of the NWPS, making an employee contribution of 8% of basic salary (under a salary sacrifice arrangement) and receiving an employer contribution of 15% of salary, up to the annual pension contribution taxation limit, and additional salary payments in lieu of pension contributions. A C Jones participates in a defined benefit section, making an employee contribution of 8% of pensionable salary (under a salary sacrifice arrangement) and receiving an employer contribution equivalent to 22.1% of pensionable salary. Benefits are calculated on a career average revalued earnings basis with future accrual at 1/45th of salary per annum.

ILLUSTRATION OF REMUNERATION POLICY

The graphs below show for each Executive Director, for the proportion of their remuneration borne by the Company:

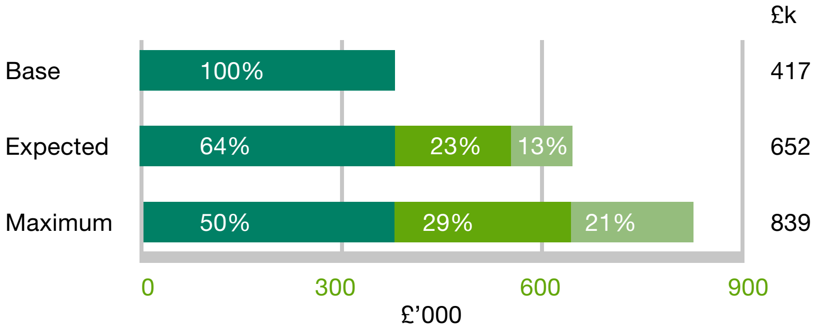
- the base level of remuneration, which is not dependent upon performance and comprises basic salary, benefits in kind and pension;
- the expected level of remuneration, reflecting a typical level of performance against targets for the STIP and LTIP; and
- the maximum level of remuneration, if all STIP and LTIP performance targets were fully achieved.

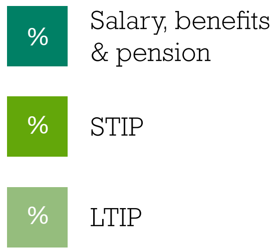
For H Mottram, 50% of maximum renumeration is linked to Company performance through STIP and LTIP. For C I Johns and A C Johns, the equivalent proportions are 40% and 39% respectively.

For the purposes of the graph, the expected level of performance for the STIP has been assumed to achieve 60% of the maximum potential value and the LTIP has been assumed to achieve 50% of the maximum value, though awards are dependent upon actual performance.

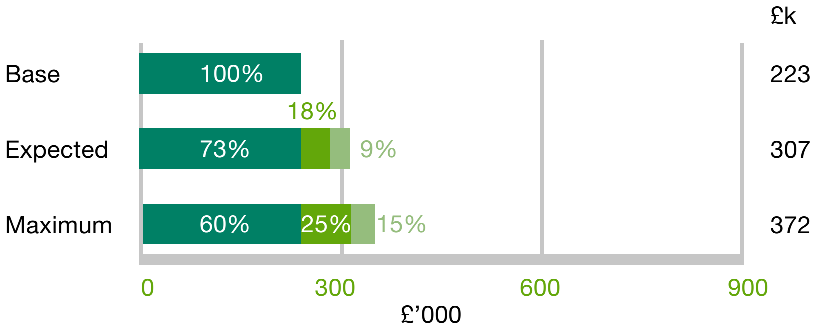
Information on actual awards for the STIP and LTIP in respect of 2017 is provided on page 76.

H MOTTRAM

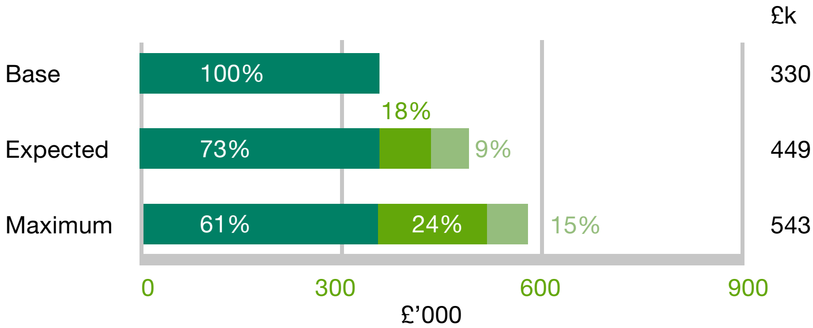




C I JOHNS



A C JONES



NON-EXECUTIVE DIRECTORS

FEES	OTHER COMPONENTS OF REMUNERATION	REMUNERATION ELSEWHERE IN THE GROUP
The Company's policy is that the Independent Non-Executive Directors receive fees for their duties. The level of fees is set by reference to the market. An additional fee is paid to the Chair of the Audit Committee to reflect the additional responsibilities and time commitment involved.	The Non-Executive Directors do not receive benefits in kind and do not participate in the STIP, LTIP or pension schemes operated by the Company.	The INEDs do not receive any other remuneration from the Company, the Group or its shareholders. In respect of the Non-Executive Directors appointed by the Group's shareholders, F R Frame receives the same base fee for performing his duties as a Director of both the Company and NWGL. This fee is shared with NWL paying a 30% proportion and NWGL paying the remaining 70%. The other Non-Executive Directors receive no remuneration from the Company.

SERVICE CONTRACTS

The service contracts of Executive Directors have a notice period of 12 months from either side, with the exception of A C Jones, who has a long-standing contractual arrangement requiring only 6 months notice from the employee and 12 months from the Company.

The contracts do not contain any specific provisions related to payment for loss of office. Any such payments would be at the discretion of the Remuneration Committee and would take account of the contractual notice period and any STIP payments considered to have been earned. LTIP awards will typically lapse, although the Remuneration Committee may approve payment of outstanding LTIP awards if a Director is considered to be a 'good leaver', for example upon retirement.

INEDs and F R Frame are engaged on a contract for services with a notice period of 6 months from either side. No payment is made for loss of office other than accrued fees.

The other Non-Executive Directors do not have service contracts with the Company, and receive no payment from the Company.

APPROACH TO REMUNERATION ON RECRUITMENT

Newly appointed Directors are remunerated in accordance with the policy set out in this report.

CONSIDERATION OF SHAREHOLDER VIEWS

The Remuneration Committee comprises two shareholder-appointed Directors and three INEDs. In the context of a private company with a single ultimate controlling shareholder, this ensures that the views of the shareholder are taken into account when setting executive remuneration, whilst also maintaining a strong independent presence on the Committee.

CONSIDERATION OF EMPLOYMENT CONDITIONS ELSEWHERE IN THE COMPANY

The Remuneration Committee reviews Directors' pay on an annual basis, taking account of market trend information and pay awards for the wider workforce in the Company. Whilst Directors' remuneration is not specifically consulted on with employees, in general, annual pay awards for Directors reflect the target pay awards for the workforce, which are subject to consultation under the Company's Employee Relations Framework. The incentive pay arrangements for executives are not mirrored elsewhere, but are considered to be relatively modest in comparison with market comparisons.

Directors' remuneration packages are benchmarked against market data on a periodic basis, typically every three years, with support from external advisers. The salary benchmarking is reviewed annually for senior managers and every three years for the wider workforce.

DIRECTORS' REMUNERATION IN 2017/18 (AUDITED)

The table below shows the total remuneration paid by the Company to Directors during the year, along with comparative information for the previous year. The table has been produced in accordance with the requirements of Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013.

	SALARIES AND FEES £'000		BENEFITS IN KIND £'000		STIP £'000		LTIP £'000		PENSION £'000		TOTAL REMUNERATION £'000	
	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017
H Mottram	358	350	10	9	217	210	43	126	39	39	667	734
C I Johns	183	180	10	9	76	67	14	40	25	25	308	321
A C Jones	270	264	22	16	109	95	20	57	30	75	451	507
M Fay	46	45		-		-		-		-	46	45
F R Frame	14	14		-		-		-		-	14	14
Dr S Lyster	46	45		-		-		-		-	46	45
M A B Nègre	46	45		-		-		-		-	46	45
P Rew	61	60		-		-		-		-	61	60
	1,024	**1,003**	**42**	**34**	**402**	**372**	**77**	**223**	**94**	**139**	**1,639**	**1,771**

The table shows only the proportion of remuneration borne by the Company. For two of the Directors, H Mottram and C I Johns, NWL pays 70% of their remuneration and NWGL pays the remaining 30%. For F R Frame, NWL pays 30% of his remuneration and NWGL pays the remaining 70%. For the other Directors reported in the table, NWL pays 100% of their remuneration.

H Mottram and C I Johns receive salary payments in lieu of employer pension contributions. These payments are reported under the pension heading in the table.

BASIC SALARY

Basic salary is set by reference to market data and trends.

For the calendar year 2017, senior executives were awarded an annual increase in their basic salaries of 2%, which was the same as the level awarded to most employees.

For the calendar year 2018, senior executives were awarded an annual increase in their basic salaries of 2.4%. This was the same as the level awarded to other senior managers.

BENEFITS

Taxable benefits provided to the Executive Directors comprise car and fuel allowance, healthcare and professional subscriptions. The values are not significant in the context of overall remuneration.

STIP

The STIP for the 2017 calendar year was structured by the Committee in accordance with the policy outlined above, as follows:

- up to 50% payable on balanced scorecard financial targets;
- up to 40% payable on balanced scorecard non-financial targets; and
- up to 10% payable on performance against personal targets.

The balanced scorecard measures and targets, and performance against the targets in the year, are shown in the table below. These targets are internal measures set at stretching levels so as to drive year on year performance improvements on a path to deliver our 'national leader' vision. This means that they are often more stretching than the regulatory PCs reported in the Performance Review section on pages 15 to 16.

SCORECARD MEASURE	TARGET	PERFORMANCE	ACHIEVED	% OF TOTAL AWARDED	% OF TOTAL STIP POTENTIAL
Customer					
Customer satisfaction					
- SIM qualitative score[1]	>=4.7	4.55	no	3[1]	3
- SIM quantitative score	<=80	79.8	yes	1	1
Water supply interruptions >3 hours (average minutes per property)	<=3:55	2:26	yes	4	4
Mean zonal compliance	>=99.97	99.94	no	-	4
Repeat sewer flooding (properties)	<=71	46	yes	4	4
Environment					
Leakage (Mld)					
- NW	<=130	134	no	-	2
- ESW	<=60	68	no	-	2
Pollution incidents category 1 & 2	<=1	4	no	-	4
Seweage treatment works failing consent	0	0	yes	4	4
Competitiveness					
Group Earnings Before Tax (EBIT)	budget	achieved	yes	25	25
Group cash available for distribution	budget	achieved	yes	25	25
People					
Employee engagement score	>=79%	80%	yes	4	4
Lost time reportable accidents (no.)	<=3	9	no	-	4
Communities					
BITC Platinum Plus/ Ethisphere[2]	retain	retained	yes	4	4
Total STIP related to balanced scorecard				**74**	**90**

[1] The SIM measure was revised to reflect the most recent completed year at the time of the Remuneration Committee meeting, in this case the 2016/17 year. Although the stretch target for qualitative SIM was not achieved, NWL finished joint first in the industry, therefore the Committee exercised its discretion and deemed the target to have been achieved.

[2] As the BITC Corporate Social Reponsibility Index was not run in 2017, remaining on the Ethisphere list of most ethical companies in 2017 was substituted as a comparable measure.

In respect of the 10% of STIP related to personal targets, the individual targets were as follows:

- H Mottram had targets including delivering expected financial performance, retention of existing credit ratings, delivery of outstanding customer service, a wider set of KPIs relating to a balanced scorecard of targets and leadership and delivery of the Company's Business Plan;
- C I Johns had targets including delivering expected financial performance, retention of existing credit ratings, working with HMRC to finalise open years' tax computations and assessing and responding to the impacts of changes in tax legislation; and
- A C Jones had targets including delivering an integrated asset planning and delivery operating model, directing the iAM programme, overseeing the development and implementation of a behavioural safety culture programme and leading our PR19 Business Plan approach and Board engagement.

A number of these targets related to NWL's performance as a relevant undertaker. In assessing overall performance, the Committee takes into account the Company's position in Ofwat reports.

For the CEO, in addition to the STIP calculation explained above, a further discretionary award was made by the Committee to reflect the Board's continued satisfaction with the CEO's performance. This remained within the limit of the overall potential maximum STIP award.

The total STIP awards for 2017 were as follows:

	STIP awarded (out of 100%)	MAXIMUM STIP (% OF BASIC SALARY)	STIP AWARDED (% OF BASIC SALARY)
H Mottram	90.3%	70%	63.2%
C I Johns	84.0%	50%	42.0%
A C Jones	84.0%	50%	42.0%

LTIP

A cash LTIP was awarded by the Committee in 2017, structured in accordance with the policy outlined above, as follows:

- up to 50% payable on achievement of the Group profit after tax target; and
- up to 50% payable on delivery of expected distributions to Group shareholders.

The scheme related to the period January 2017 to December 2020. Performance targets were assessed in the first year of the scheme with payment deferred until early 2021, after the end of the four year scheme period.

The Committee assessed the performance against the scheme criteria in January 2018. In respect of Group profit performance zero vested and for Group distributions 25% of the 50% available vested.

The Committee therefore approved that the 2017 LTIP should vest at 25%. This is not dependent upon any future performance conditions being met.

The total LTIP awards for 2017 were as follows:

	LTIP awarded (out of 100%)	MAXIMUM LTIP (% OF BASIC SALARY)	LTIP AWARDED (% OF BASIC SALARY)
H Mottram	25%	50%	12.5%
C I Johns	25%	30%	7.5%
A C Jones	25%	30%	7.5%

PENSION

Pension arrangements operated in accordance with the policy outlined on page 71.

A C Jones is a member of the defined benefit section of the NWPS, therefore the pension value shown in the table on page 74 has been calculated in accordance with the 2013 Regulations and represents the estimated increase in the capital value of his pension in the year.

PERCENTAGE CHANGE IN CEO REMUNERATION

The table below shows the change in remuneration for 2017/18 compared to 2016/17 for the CEO and for other employees. In order to make a meaningful comparison, other employees includes only those who have been employed for the full two year period and excludes senior management whose remuneration is set by the Remuneration Committee. STIP has been compared to the annual bonus paid to the senior management cohort.

	CHANGE IN CEO REMUNERATION	CHANGE IN OTHER EMPLOYEES' REMUNERATION
Salaries and fees	2.3%	3.6%
Benefits in kind	4.2%	11.2%
STIP / annual bonus	3.3%	(6.4%)

RATIO OF CEO PAY TO THE AVERAGE PAY OF OTHER EMPLOYEES

Government is seeking to introduce legislation to require listed companies to publish the ratio of CEO pay to the average pay of other employees. In his letter to the Chair of Ofwat on 18 April 2018, the Secretary of State for Environment, Food and Rural Affairs requested that he would like to see all water companies publish this information voluntarily.

As the legislation has not yet been enacted and guidance is still being developed, we have chosen this year to report a simplified calculation. The table below shows total CEO remuneration for 2017/18, as published in the table on page 74, compared to the average pay for other employees published in note 5 to the Financial Statements on page 95, excluding the CEO.

	CEO REMUNERATION	AVERAGE REMUNERATION FOR OTHER EMPLOYEES	RATIO
Remuneration (£000)	667	45	14.9

CEO REMUNERATION OVER TIME

Since the current remuneration policy was put in place in 2012, the basic salary of the CEO has increased by the same, or less than, the average pay award for the majority of employees each year, which has been targeted to ensure we keep pace with the general cost of living. Over the same period, the maximum potential bonus available under the STIP and LTIP has remained a constant proportion of salary and the actual bonuses awarded have increased year on year by less than 2%.

RELATIVE IMPORTANCE OF SPEND ON PAY

The table below shows total staff costs and dividends paid for the current and prior years, and the year on year change.

	2018	2017	CHANGE
Staff costs (note 5)	137.2	134.0	2.4%
Dividends (note 8)	125.4	212.5	-41.0%

IMPLEMENTATION OF REMUNERATION POLICY IN 2018/19

There have been no changes made by the Committee to the remuneration policy to be implemented in 2018/19.

STIP

The balanced scorecard targets for 2018/19 are shown in the table below. These are internal measures set at stretching levels so as to drive year on year performance improvements on a path to deliver our ‘national leader’ vision. This means that they are often more stretching than the regulatory PCs reported in the Performance Review section on pages 15 to 16.

SCORECARD MEASURE	TARGET	%OF TOTAL STIP POTENTIAL
Customer		
Customer satisfaction[1]		
- SIM qualitative score	>=4.65	3
- SIM quantitative score	<=85	1
Water supply interruptions >3 hours (average minutes per property)[1]	<=3.50	4
Mean zonal compliance	>=99.97	4
Repeat sewer flooding (properties)	<=71	4
Environment		
Leakage (Mld)[1]		
- NW	<=133	2
- ESW	<=60	2
Pollution incidents category 1 & 2	<=1	4
Sewage treatment works failing consent	0	4
Competitiveness		
Group EBIT	budget	25
Group cash available for distribution	budget	25
People		
Employee engagement score (Sunday Times Best Companies)	2*	4
Lost time reportable accidents (no.)[1]	<=3	4
Communities		
BITC Platinum Plus	retain	4
Personal targets		10

[1] Where stretching targets are set which are designed to achieve industry leading performance, the Remuneration Committee has agreed that if the target score is not achieved but actual performance is at an industry leading level and has shown an improvement on prior year performance, the target will be deemed to have been achieved.

Personal targets for 2018 have been set as follows:

- H Mottram has targets including delivering expected financial performance, retention of existing credit ratings, delivery of outstanding customer service and KPIs across the balanced scorecard and leadership of the Company's PR19 Business Plan, maximising the opportunity to gain exceptional status.

  The balanced scorecard measures our performance across the full range of our strategic themes, focusing particularly on the areas that customers have told us are important to them. The targets have been set at stretching levels so as to drive year on year performance improvements on a path to achieve our 'national leader' vision and deliver improved services to our customers;
- C I Johns has targets including delivering expected financial performance, retention of existing credit ratings, working with HMRC to finalise open years' tax computations and ensuring the PR19 Business Plan is financeable; and
- A C Jones has targets including leading our PR19 Business Plan production, ensuring it is fully supported and endorsed by the Board and maximises the opportunity to gain exceptional status, overseeing re-accreditation to ISO 9001, ISO 14001, ISO 55001 and OHSAS 18001 and achieving first time accreditation to ISO 22301, and achieving improved management of business information across the H&S, Scientific Services and Business Continuity teams.

DIRECTORS' REPORT

DIRECTORS

The Directors who served during the year, and to the date of signing, are listed on pages 57 to 59 of the Governance Report.

DISCLOSURES PROVIDED IN THE STRATEGIC REPORT

Future developments which may impact on the Company are described in the CEO's Report.

Our approach to innovation is described in the Performance Review section of our Strategic Report under the Competitiveness heading and the costs of research and development are disclosed in note 3 of the Financial Statements.

Our policies in respect of the employment of disabled persons and employee involvement are set out in the Performance Review section of our Strategic Report under Diversity and Equal opportunities on page 34.

Information on results and dividends is contained in the Financial Performance Review and Structure section of the Strategic Report. Our policies in relation to the use of financial instruments and treasury operations are set out in the same section under the 'Treasury policies' heading.

POLITICAL DONATIONS

NWL does not support any political party and we do not, directly or through any subsidiary, make what are commonly regarded as donations to any political party or other political organisation. However, the wide definition of donations in the Political Parties, Elections and Referendums Act 2000 covers activities which form part of the necessary relationship between the Company and political parties and political organisations. These activities include attending party conferences, as these provide the best opportunity to meet a range of stakeholders, both national and local, to explain our activities, as well as local meetings with MPs, MEPs and their agents. During the year, no external costs were associated with these activities, however, Company representatives attended the party conferences of the Labour and Conservative parties.

GREENHOUSE GAS EMISSIONS

Our carbon management plan has the aim of reducing our GHG emissions by 35% by 2020 against a 2008 baseline. We have almost achieved this target, having reduced emissions through our own efforts by 31% compared to the baseline, with a further 15% reduction resulting from a lower emissions factor for grid electricity. The protocol that we use for measuring our emissions is based on the Carbon Accounting Workbook developed and updated annually by the Water Research Council, on behalf of the water industry, and published by UK Water Industry Research. This is founded on international and DEFRA protocols but includes additions that are specific to the water industry.

Our total net operational GHG emissions for the year ended 31 March 2018 reduced to 163.5 ktonnes CO2e (31 March 2017: 187.7 ktonnes CO2e), reflecting a marginal increase in energy usage together with a 14% reduction in the emissions factor applied for grid electricity. Low rainfall and elevated demand in the year meant that we needed to carry out more transfers of water resources and utilise more energy intensive water treatment works. This increase in energy usage in our water operations was largely offset by a reduction in our wastewater operations.

In addition to absolute emissions we also monitor the emissions intensity of our operations using three measures, one relating to the water service and two for wastewater. All three measures have shown a significant decrease over the past year though, as described above, these measures can be volatile depending upon levels of rainfall and pumping requirements.

ANNUAL OPERATIONAL GHG INTENSITY RATIO	2017/18	2016/17
Emissions/Ml of water	193	227
Emissions/Ml of sewage treated (flow to full treatment)	205	252
Emissions/Ml of sewage treated (water distribution input)	390	452

Figures in kgCO_2e/Ml

DIRECTORS' INDEMNIFICATION

The Company has maintained Directors' and Officers' ('D&O') insurance cover throughout the year to 31 March 2018. For the period 1 April 2017 to 31 December 2017 this cover was through D&O insurance placed by NWGL. For the period 1 January 2018 to 31 March 2018, and up to the date of the signing of this Directors' Report, cover has been provided under group-wide D&O insurance placed by CKHH, the Company's ultimate parent company and controlling shareholder.

On 21 March 2017 NWGL entered into a deed of indemnity to grant the Directors of NWGL and its subsidiaries further protection against liability to third parties, subject to the conditions set out in the Companies Act 2006, and this remains in place.

DIRECTORS' STATEMENT

As required under s418 of the Companies Act 2006, so far as each current Director is aware, there is no relevant audit information of which the Company's auditor is unaware and each Director has taken all the steps that he or she ought to have taken as a Director in order to make himself or herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

AUDITOR

Pursuant to s487 of the Companies Act 2006, Deloitte LLP is deemed to be re-appointed as the Company's auditor for the ensuing year.

FINANCIAL STATEMENTS PREPARATION AND GOING CONCERN

The Directors confirm that, in their opinion, the Company has sufficient financial resources and facilities available to enable it to carry out its activities for at least the next 12 months. Accordingly, they continue to adopt the going concern basis in preparing the annual report and financial statements. In arriving at their decision, the Directors have taken into account:

- the financial strength of the Company at the balance sheet date and financial performance, which is in line with expectations and reviewed at each Board meeting, most recently in April 2018;
- the key financial ratios over the next 12 month planning horizon, as reflected in strong investment grade credit ratings;
- the fact that the Company has in place £350m of five year committed bank facilities as back up liquidity (maturing in 2019), which was undrawn at 31 March 2018; and
- the Company's formal governance and risk management arrangements which are monitored by the Audit Committee, Risk & Compliance Sub-committee and Board.

VIABILITY STATEMENT

The Directors believe that the Company is well placed to manage its business risks and expect that the business can continue to operate effectively over the long term and, specifically, meet its financial obligations over the seven years to March 2025. In arriving at their opinion, the Directors have taken into account:

- the Licence which is in place on a rolling 25 year basis;
- the certainty on wholesale and household retail price controls to March 2020 provided by the 2014 FD by Ofwat, following its acceptance by the Board;
- the financial strength of the Company at the balance sheet date and the fact that the Company has a £350m five year committed bank facility as back up liquidity (maturing in 2019), which was undrawn at 31 March 2018;
- the Company's draft business plan for the next price control period from 2020-25;
- the key financial ratios over the planning horizon of the Company's medium term plan (MTP) to March 2025 as reflected in investment grade credit ratings;
- the Board's flexible dividend policy; and
- the principal risks and uncertainties facing the Company and the mitigating controls, as described on pages 47 to 50, which are monitored by the Audit Committee, Risk & Compliance Sub-committee and Board.

The Directors have chosen a period of seven years to March 2025 to assess the viability of the Company to align with the business planning process for the regulatory price review period to March 2025, for which the Board is also assessing its financial resilience. Whilst the Directors do not believe that it is possible to robustly test financial resilience beyond March 2025 at this point, they are not aware of any reason to indicate that the business will not continue to operate effectively and remain financially resilient beyond the seven year period.

The MTP has been stress tested under a number of plausible and severe adverse scenarios. The scenarios were selected by the Board after considering the principal risk and uncertainties facing the Company, as set out on pages 47 to 50 of the Strategic Report, and the key economic and financial variables which could impact on the MTP. The combined impact of multiple scenarios has also been tested.

The stress tests were assessed in the context of NWL's overarching financial objective of retaining its investment grade credit ratings of BBB+ (Standard & Poor's) and Baa1 (Moody's). Whilst the viability statement relates specifically to NWL, both rating agencies take account of NWGL metrics in their methodologies, therefore, the impact on both NWL and NWGL financial plans have been considered.

The scenarios tested were:

- lower RPI and CPIH inflation, leading to reduced allowed revenue and RCV and therefore gearing;
- increased future borrowing rates for new and refinanced debt, increasing interest charges and reducing interest cover metrics;
- increased current tax payments resulting either from increased tax rates or transition to new IFRS accounting standards, causing increased net debt and gearing;
- higher operating and capital investment costs, as a result of not achieving the levels of outperformance targeted in the MTP, causing increased net debt and gearing;
- increased defined benefit pension scheme deficit, leading to increased company pension contributions and higher gearing under rating agency methodologies;
- impact of a major incident crystallising one of the principal risks identified on pages 47 to 50, causing a significant cash outflow and increased net debt and gearing;
- impact of a significant regulatory penalty for failing to deliver acceptable performance levels in contravention of our Licence;
- prolonged closure of the credit markets in response to uncertainty caused by Brexit, resulting in an inability to raise finance; and
- adverse outcome of PR19 compared to MTP assumptions, through a lower cost and revenue allowance or reduced ODI performance, increasing gearing through either higher net debt or lower RCV.

A number of combined scenarios were also tested. These were determined by considering which scenarios were most likely to occur in combination. The combined scenarios tested were:

- all plausible scenarios occurring;
- combined impact of severe scenarios for higher operating and capital investment costs; and
- combined impact of severe adverse PR19 scenarios.

To the extent that any of these scenarios, in isolation or combination, would place retention of the Company's credit rating at risk, the Directors are confident that this could be mitigated by a combination of efficient delivery of our outcomes and performance commitments in the remainder of the current price control period and in the period 2020-25, targeting RORE outperformance in the next price control period by delivering exceptional levels of service and performance for our customers, and by application of the Board's flexible dividend policy.

The Board engaged Deloitte LLP to provide third party assurance, in the form of agreed upon procedures performed on the calculations and stress testing of the plan, to provide independent assurance on the impact of the stress testing scenarios on the MTP.

FAIR, BALANCED AND UNDERSTANDABLE

The Directors consider that the annual report and financial statements, taken as a whole, is fair, balanced and understandable and provides the information necessary for stakeholders to assess the Company's performance, business model and strategy. In reaching this conclusion, the Board has taken advice from the Audit Committee which has considered the process by which the Annual Report and Financial Statements has been produced as well as reviewing and commenting on the report.

DIRECTORS' RESPONSIBILITIES STATEMENT

The Directors are responsible for preparing the annual report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare the financial statements in accordance with UK Generally Accepted Accounting Practice (UK Accounting Standards and applicable law), including FRS 101 Reduced Disclosure Framework. Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period.

In preparing these financial statements, the Directors are required to:

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

The Directors are responsible for keeping proper accounting records which are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

By order of the Board

M Parker,
Company Secretary,
13 July 2018

Registered office
Northumbria House, Abbey Road, Pity Me, Durham, DH1 5FJ

Registered in England and Wales
Registered no: 02366703

FINANCIAL STATEMENTS

INCOME STATEMENT

FOR THE YEAR ENDED 31 MARCH 2018

	NOTE	2018 £'m	2017 £'m
Continuing operations			
Revenue	2	834.6	821.6
Operating costs (including exceptional operating items)	3	(495.7)	(464.7)
Operating profit		**338.9**	**356.9**
Finance costs	6	(133.7)	(136.6)
Profit before taxation		**205.2**	**220.3**
Taxation	7(a)	(39.4)	(19.0)
Profit for the year attributable to the shareholder of the Company		**165.8**	**201.3**

STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31 MARCH 2018

	NOTE	2018 £'m	2017 £'m
Profit for the year		165.8	201.3
Items that will not be reclassified subsequently to profit and loss:			
Actuarial gains / (losses)	22	55.0	(71.7)
Deferred tax related to actuarial (gains) / losses	7(b)	(10.1)	10.9
Items that may be reclassified subsequently to profit and loss:			
Profit on cash flow hedges taken to equity		11.7	4.2
Deferred tax on items charged to equity that may be reclassified	7(b)	(2.3)	(1.0)
Other comprehensive income / (loss)		**54.3**	**(57.6)**
Total comprehensive income for the year attributable to the shareholder of the Company		**220.1**	**143.7**

BALANCE SHEET

AT 31 MARCH 2018 (REGISTERED NUMBER 02366703)

	NOTE	2018 £'m	2017 £'m
Non-current assets			
Property, plant and equipment	9	4,385.9	4,260.5
Financial investments	10	160.9	160.9
		4,546.8	**4,421.4**
Current assets			
Inventories	11	3.0	2.8
Trade and other receivables	12	160.6	161.0
Asset held for resale	13	-	42.4
Short term cash deposits		92.0	-
Cash and cash equivalents		2.2	-
		257.8	**206.2**
Total assets		**4,804.6**	**4,627.6**
Current liabilities			
Trade and other payables	14	(169.1)	(170.2)
Borrowings	15	(35.7)	(268.1)
Obligations under finance leases	16(a)	(3.0)	(56.2)
Provisions	17	(0.2)	(0.2)
		(208.0)	**(494.7)**
Non-current liabilities			
Borrowings	15	(2,774.4)	(2,378.8)
Obligations under finance leases	16(a)	(56.5)	(53.0)
Provisions	17	(1.1)	(1.2)
Deferred tax liabilities	7(d)	(394.6)	(375.5)
Pension liability	22	(94.3)	(153.1)
Hedging instruments	19	(32.8)	(39.6)
Other payables		(0.6)	(0.2)
Grants and deferred income	18	(549.4)	(533.3)
		(3,903.7)	**(3,534.7)**
Total liabilities		**(4,111.7)**	**(4,029.4)**
Net assets		**692.9**	**598.2**

Capital and Reserves			
Share capital	20	122.7	122.7
Cash flow hedge reserve		(11.6)	(21.0)
Profit and loss account		581.8	496.5
Equity attributable to the shareholder of the Company		**692.9**	**598.2**

Approved by the Board of Directors on 13 July 2018 and signed on their behalf by: **H Mottram**

H Mottram

STRATEGIC REPORT GOVERNANCE REPORT STATUTORY FINANCIAL STATEMENTS

STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 MARCH 2018

	NOTE	SHARE CAPITAL £'m	CASH FLOW HEDGE RESERVE £'m	RETAINED EARNINGS £'m	TOTAL EQUITY £'m
At 1 April 2016		**122.7**	**(24.2)**	**568.5**	**667.0**
Profit for the year		-	-	201.3	201.3
Other comprehensive income and expense		-	3.2	(60.8)	(57.6)
Total comprehensive income and expense for the year		**-**	**3.2**	**140.5**	**143.7**
Dividends	8	-	-	(212.5)	(212.5)
At 31 March 2017		**122.7**	**(21.0)**	**496.5**	**598.2**
Profit for the year		-	-	165.8	165.8
Other comprehensive income and expense		-	9.4	44.9	54.3
Total comprehensive income and expense for the year		**-**	**9.4**	**210.7**	**220.1**
Dividends	8	-	-	(125.4)	(125.4)
At 31 March 2018		**122.7**	**(11.6)**	**581.8**	**692.9**

Other comprehensive income and expense taken to the cash flow hedge reserve arises from the cumulative amount of gains or losses on hedging instruments, and associated deferred tax, taken directly to equity under the hedge accounting provisions of IAS 39.

Other comprehensive income and expense taken to retained earnings arises from actuarial revaluations, and associated deferred tax, on the Company's defined benefit pension scheme taken directly to equity.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 MARCH 2018

1. ACCOUNTING POLICIES

NWL is incorporated in the UK under the Companies Act. The Company is a private Company limited by shares and is registered in England and Wales. The address of the Company's registered office is shown on page 82. The nature of the Company's operations and its principal activities are set out in the Strategic Report on page 8.

These Financial Statements are presented in sterling and all values are rounded to the nearest one hundred thousand pounds (£0.1m) except where otherwise indicated.

These Financial Statements are separate financial statements. The Company is exempt from the preparation and delivery of consolidated financial statements, because it is included in the Group Financial Statements of NWGL (see note 24).

(A) BASIS OF ACCOUNTING

These Financial Statements have been prepared in accordance with FRS 101, incorporating the Amendments to FRS 101 issued by the Financial Reporting Council (FRC) in July 2015 and the amendments to Company law made by The Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015.

As permitted by FRS 101, the Company has taken advantage of the disclosure exemptions available under that standard in relation to financial instruments, presentation of a cash flow statement, standards not yet effective and related party transactions.

The Financial Statements have been prepared under the historical cost convention, with the exception of financial instruments held at fair value through profit and loss.

The Financial Statements have been prepared on a going concern basis, having considered the principal risks and uncertainties, which assumes that the Company will have adequate funding to meet its liabilities as they fall due in the foreseeable future. As at 31 March 2018, the Company had net current assets of £49.8m (2017: net current liabilities of £288.5m). The Directors have reviewed cash flow requirements and are confident that they will be able to meet these from funds available, including the undrawn committed bank facilities of £350m (2017: £350m). Accordingly, the Directors believe it is appropriate to prepare the financial statements on a going concern basis.

(B) REVENUE

Revenue, which excludes Value Added Tax, represents the income receivable in the ordinary course of business for services provided within the UK. All water and sewerage charges billed to customers are recognised pro-rata over the period to which they relate. For consumption by measured customers which has not yet been billed, an accrual is estimated.

(C) CASH FLOW STATEMENT

As permitted by FRS 101, the Company has taken advantage of the disclosure exemption available under that standard in relation to presentation of a cash flow statement.

(D) PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment, including assets in the course of construction, comprise infrastructure assets (being mains and sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls) and other assets (including properties, vehicles and above ground plant and equipment).

Purchased property, plant and equipment are included at cost less accumulated depreciation and any provision for impairment. Cost comprises the aggregate amount incurred and the fair value of any other consideration given to acquire the asset and includes costs directly attributable to making the asset capable of operating as intended.

Where assets are constructed by a developer and adopted by NWL at no cost to the company, the assets are recognised in the balance sheet at their fair value on the date of the transfer and an equivalent value is recognised in deferred income, in accordance with IFRIC 18 Transfers of Assets from Customers. The fair value is based on the average cost to the Company of constructing an equivalent asset.

1. ACCOUNTING POLICIES (continued)

Freehold land is not depreciated. Other assets are depreciated evenly over their estimated economic lives, which are principally as follows:

Freehold buildings	30-60 years
Operational structures, plant and machinery	4-92 years
Infrastructure assets (see below)	4-200 years
Fixtures, fittings, tools and equipment	4-10 years

The carrying values of property, plant and equipment are reviewed for impairment if events or changes in circumstances indicate the carrying value may not be recoverable and are written down immediately to their recoverable amount. Useful lives and residual values are reviewed annually and, where adjustments are required, these are made prospectively.

Assets in the course of construction are not depreciated until commissioned.

Infrastructure assets

Infrastructure assets comprise a network of systems being mains and sewers, reservoirs, dams and sea outfalls.

Expenditure on infrastructure assets which enhances the asset base is treated as fixed asset additions while maintenance expenditure which does not enhance the asset base is charged as an operating cost.

Infrastructure assets are depreciated evenly to their estimated residual values over their estimated economic lives, which are principally as follows:

Dams and impounding reservoirs	150 years
Water mains	100 years
Sea outfalls	60 years
Sewers	200 years
Dedicated pipelines	4-20 years

(E) FINANCIAL INVESTMENTS

Financial investments are stated at their purchase cost, less provision for diminution in value (note 10).

(F) GRANTS AND CONTRIBUTIONS

Grants are recognised at their fair value where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with. Revenue grants are credited to the income statement in the period to which they relate. Capital grants and contributions relating to property, plant and equipment are treated as deferred income and amortised to the income statement over the expected useful economic lives of the related assets.

Deferred income relating to assets adopted from developers, recognised in accordance with IFRIC 18, is amortised to the income statement over the expected useful economic lives of the related assets.

(G) HIRE PURCHASE AND LEASING

Where assets are financed by leasing arrangements which transfer substantially all the risks and rewards of ownership to the Company, the assets are treated as if they had been purchased at their fair value or, if lower, at the present value of the minimum lease payments. Rentals or leasing payments are treated as comprising a capital element and finance charges, the capital element reducing the outstanding liability and the finance charges being charged to the income statement over the period of the leasing contract at a constant rate on the reducing outstanding liability.

Rentals under operating leases (where the lessor retains a significant proportion of the risks and rewards of ownership) are expensed in the income statement on a straight line basis over the lease term.

(H) INVENTORIES

Inventories are stated at cost less any provision necessary to recognise damage and obsolescence.

(I) PENSION COSTS

The Company is the principal employer of the NWPS, which has both a defined benefit section and a defined contribution section.

The cost of providing benefits under the defined benefit section of the Scheme is determined using the projected unit credit method, which attributes entitlement to benefits to the current period (to determine current service cost) and to the current and prior periods (to determine the present value of defined benefit obligation) and is based on actuarial advice. Past service costs are recognised in the income statement on a straight line basis over the vesting period or immediately if the benefits have vested. When a settlement (eliminating all obligations for benefits already accrued) or a curtailment (reducing future obligations as a result of a material reduction in the scheme membership or a reduction in future entitlement) occurs, the obligation and related plan assets are re-measured using current actuarial assumptions and the resultant gain or loss recognised in the income statement during the period in which the settlement or curtailment occurs. Net interest is calculated by applying the discount rate to the net defined asset or liability.

The service cost is disclosed in manpower costs and the net interest expense is disclosed within finance costs.

1. ACCOUNTING POLICIES (continued)

Actuarial gains and losses on experience adjustments and changes in actuarial assumptions are recognised in full in the period in which they occur in the statement of comprehensive income.

The costs of the defined contribution section are charged to the income statement in the period they arise.

(J) TAXATION

Current tax

Current tax liabilities are measured at the amount expected to be paid to the taxation authorities. The tax rates and tax laws used to compute the amounts are those that are enacted or substantively enacted by the balance sheet date.

Deferred tax

Deferred tax is provided using the liability method on temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognised for all taxable temporary differences except:

- where the deferred tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in subsidiaries where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets are recognised for all deductible temporary differences and unused tax losses to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and unused tax losses can be utilised except:

- where the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Unrecognised deferred tax assets are reassessed at each balance sheet date and are recognised to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted, or substantively enacted, at the balance sheet date.

Deferred tax is recognised in the income statement, except when it relates to items that are recognised in other comprehensive income or directly in equity, in which case the deferred tax is also recognised in other comprehensive income or directly in equity.

(K) FOREIGN CURRENCY

All transactions denominated in foreign currencies are translated into sterling at the actual rates of exchange ruling at the date of transaction. Foreign currency balances are translated into sterling at the rates of exchange ruling at the balance sheet date. Exchange gains or losses are recognised in the profit and loss account in the period incurred.

(L) RESEARCH AND DEVELOPMENT

Research and development expenditure is charged to the income statement in the period in which it is incurred.

(M) DERIVATIVE FINANCIAL INSTRUMENTS

The Company utilises interest and inflation rate swaps, gilt locks and forward exchange contracts as derivative financial instruments.

A derivative instrument is considered to be used for hedging purposes when it alters the risk profile of an underlying exposure of the Company in line with the Group's risk management policies. Derivative financial instruments are stated at their fair value.

Hedge accounting is employed in respect of those derivative financial instruments fulfilling the requirements for hedge accounting as prescribed under IAS 39. In summary, these criteria relate to initial designation and documentation of the hedge relationship, prospective testing of the relationship to demonstrate the expectation that the hedge will be highly effective throughout its life and subsequent retrospective testing of the hedge to verify effectiveness.

1. ACCOUNTING POLICIES (continued)

Under IFRS 13, derivative financial instruments are measured at fair value, which is considered to be the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction reflecting the credit risk of the counterparties in the principal (or most advantageous) market under market conditions as at the balance sheet date.

The fair value of forward exchange contracts is calculated by reference to current forward exchange rates for contracts with similar maturity profiles. The fair value of interest rate swaps and inflation swaps are determined by reference to market values for similar instruments.

Hedging transactions undertaken by the Company are classified as either fair value hedges when they hedge the exposure to changes in the fair value of a recognised asset or liability, or cash flow hedges where they hedge exposure to variability in currency cash flows that is either attributable to a particular risk associated with a recognised asset or liability or a forecast transaction.

In relation to fair value hedges which meet the conditions for hedge accounting, any gain or loss from re-measuring the hedging instrument at fair value is recognised immediately in the income statement.

In relation to cash flow hedges to hedge firm currency commitments which meet the conditions for hedge accounting, the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised directly in the cash flow hedge reserve and the ineffective portion is recognised in the income statement.

When the hedged firm commitment results in the recognition of a non-financial asset or a non-financial liability then, at the time the asset or liability is recognised, the associated gains or losses that had previously been recognised in the cash flow hedge reserve are included in the initial measurement of the acquisition cost or other carrying amount of the asset or liability. For all other cash flow hedges, the gains or losses that are recognised in the cash flow hedge reserve are transferred to the income statement in the same periods in which the hedged firm commitment affects the income statement.

For derivatives that do not qualify for hedge accounting, any gains or losses arising from changes in fair value are taken directly to the income statement.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. At that point in time, any cumulative gain or loss on the hedging instrument recognised in the cash flow hedge reserve is kept in the cash flow hedge reserve until the forecast transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in the cash flow hedge reserve is transferred to the income statement.

(N) INTEREST BEARING LOANS AND BORROWINGS

All loans and borrowings are initially stated at the amount of the net proceeds, being fair value of the consideration received net of issue costs associated with the borrowing. Finance costs (including issue costs) are taken to the income statement over the term of the debt at a constant rate on the balance sheet carrying amount. The carrying amount is increased by the finance charges amortised and reduced by payments made in respect of the accounting period. The carrying amount of index linked borrowings increases annually in line with the relevant RPI, with the accretion being charged to the income statement as finance costs payable. Other borrowing costs are recognised as an expense when incurred.

Realised gains and losses that occur from the early termination of loans and borrowings are taken to the income statement in that period.

Net debt is the sum of all loans and borrowings less cash and cash equivalents, short term cash deposits, financial investments and loans receivable.

(O) BAD DEBT PROVISIONING

The bad debt provision is calculated by applying a range of percentages to debt of different ages. These percentages also vary between different categories of debt. Higher percentages are applied to those categories of debt which are considered to be of greater risk and also to debt of greater age.

(P) BORROWING COSTS

Borrowing costs are generally expensed as incurred. Borrowing costs that are directly attributable to the acquisition or construction of an asset that necessarily takes a substantial time to prepare for its intended use are capitalised while the asset is being constructed as part of the cost of that asset.

Capitalisation ceases when the asset is substantially ready for its intended use or sale. If active development is interrupted for an extended period, capitalisation is suspended. When construction occurs piecemeal, and use of each part ceases upon substantial completion of that part, a weighted average cost of borrowings is used.

The Company capitalises borrowing costs for all eligible assets when construction commenced on or after 1 April 2009 and continues to expense borrowing costs relating to construction projects that commenced prior to that date.

1. ACCOUNTING POLICIES (continued)

(Q) SIGNIFICANT ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

In the process of applying the accounting policies, the Company is required to make certain judgements, estimates and assumptions that it believes are reasonable based on the information available. Actual results may have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

The significant accounting judgements were:

- the estimation of income for measured water and sewerage services supplied but not billed at the end of the financial period. Consumption by measured domestic customers is billed in arrears on quarterly or six-monthly cycles. Revenue is estimated and accrued using a defined methodology based upon historical usage and the relevant tariff per customer. Consumption by non-household properties is billed to the relevant retailer under the terms of the Wholesale Contract and may be either in advance or in arrears. Revenue billed in arrears is estimated by reference to wholesale market settlement reports, adjusted for any additional information obtained after a settlement report has been run;
- the estimation of uncertain tax provisions, which are assessed on advice from independent tax advisers and the status of ongoing discussions with the relevant tax authorities; and
- the asset lives assigned to property, plant and equipment, details of which can be found in note 1(d) above.

The significant accounting estimates were:

- those assumptions used in arriving at the defined benefit pension scheme assets and liabilities under IAS 19. These key assumptions and their possible impact are disclosed in note 22; and
- the bad debt provision, which is calculated by applying a range of percentages to debt of different ages, as described on note 1(o) above. These percentages also vary between different categories of debt. Higher percentages are applied to those categories of debt which are considered to be of greater risk and also to debt of greater age. The value of the bad debt provision is sensitive to the specific percentages applied.

(R) ACCOUNTING STANDARDS

At the balance sheet date, the following significant new accounting standards were in issue but not yet effective:

- IFRS 9 – Financial Instruments (effective for periods beginning on or after 1 January 2018);
- IFRS 15 – Revenue from Contracts with Customers (effective for periods beginning on or after 1 January 2018); and
- IFRS 16 – Leases (effective for periods beginning on or after 1 January 2019).

IFRS 9 – Financial Instruments

This standard relates to the measurement and disclosure of financial instruments. The Company does not anticipate that the adoption of IFRS 9 will have a material impact on the financial statements in the period of initial application.

IFRS 15 – Revenue from Contracts with Customers

This standard relates to the recognition of revenue from customers. The Company has assessed the impact of IFRS 15 in respect of the two material revenue streams, being revenue from the provision of water and wastewater services to customers and revenue received in respect of contributions to capital investment, particularly from developers.

The Company does not anticipate that there will be any change to the timing of recognition of revenue for water and wastewater services upon the adoption of IFRS 15.

In respect of contributions to capital investment, this revenue is currently recognised as deferred income in the balance sheet and amortised to the income statement over the useful life of the associated assets (see note 18). Under IFRS 15 the revenue must be recognised in line with the satisfaction of the performance obligations to the customer.

For contributions related to the connection of new properties to the Company's networks, comprising infrastructure charges, new connection charges, requisitioned mains and sewers and adopted assets, the Company considers that these activities form a combined performance obligation that is not distinct from the ongoing provision of water and wastewater services through the new connection. On this basis, it is anticipated that these contributions will continue to be recognised as deferred income and amortised to the income statement over the expected useful life of the connection.

For other contributions to capital investment, most significantly mains and sewer diversions, the Company considers that the performance obligation is satisfied upon completion of the investment, which will typically be the point at which the associated asset is brought into use.

1. ACCOUNTING POLICIES (continued)

On this basis, it is anticipated that these contributions will be recognised in full in the income statement upon satisfaction of the performance obligation.

IFRS 15 will be applied retrospectively with the cumulative effect recognised at the date of initial application. Deferred income related to contributions for activities which will be recognised in full in the income statement in future, will be transferred from deferred income to reserves, along with the associated deferred tax. The estimated cumulative impact on transition, 1 April 2018, is a credit to reserves of £70.9 million with an associated deferred tax impact of £12.0 million.

IFRS 16 – Leases

This standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. The primary impact will be to reclassify most leases currently classified as operating leases, as disclosed in note 16(b), as finance leases. This will result in the recognition of a material non-current asset and a broadly equivalent finance lease obligation on the balance sheet.

Work is ongoing to ensure that all contractual arrangements falling within scope of the standard are correctly identified. The Company does not anticipate that the adoption of IFRS 16 will have a material impact on the reported profit in the period of initial application.

2. SEGMENTAL INFORMATION

The Directors consider that the Company has one class of business, the provision of water and sewerage services. All revenue is generated from within the United Kingdom.

3. OPERATING COSTS

	2018 £'m	2017 £'m
Materials and consumables	18.4	17.5
Manpower costs (note 5)	137.2	134.0
Own work capitalised	(38.1)	(36.2)
Costs of research and development	0.7	0.9
Operating lease payments	2.5	1.5
Bad debt charge	9.7	10.9
Inventories recognised as an expense	2.6	2.6
Other operating costs	238.1	220.0
Depreciation of property, plant and equipment	135.2	130.5
Amortisation of capital grants	(6.3)	(5.7)
Profit on disposal of property, plant and equipment	(4.3)	(0.6)
Total operating costs prior to exceptional items	**495.7**	**475.4**
Exceptional business rates credit	-	(10.7)
Total	**495.7**	**464.7**

3. OPERATING COSTS (continued)

The prior period included an exceptional credit of £10.7m in settlement of an appeal against the rateable value for water business rates, as published on the 2005 Central List by the Valuation Office Agency. This amount was received in June 2017, along with interest of £0.5m.

Auditor's remuneration in respect of the statutory audit of the Financial Statements amounted to £146k (2017: £131k), including fees for a subsidiary, NWF, of £7k (2017: £5k). Fees of £68k (2017: £54k) were incurred in respect of the APR, including the audit of the Regulatory Accounting Statements, and agreed upon procedures in respect of additional regulatory information, the statement of sufficiency of financial resources and facilities, financial resilience stress testing and financial flows statement.

Fees of £128k (2017: £163k) were incurred for non-audit services comprising assurance work in respect of: the implementation of a new customer billing system; a bond issue; PR19 submissions and other assurance to third parties.

4. DIRECTORS' EMOLUMENTS

(a) Directors' remuneration

The remuneration of the Directors of the Company was as follows:

	2018 £'000	2017 £'000
Emoluments (including benefits in kind)	1,639	1,771

For those Directors holding office with both NWL and NWGL, or contributing significantly to the day to day operations of NWGL, costs are apportioned between the companies to reflect the level of activity carried out for each company. This note reflects only the proportion of costs charged to NWL.

One of the Directors at 31 March 2018 was a member of a defined benefit section of the Scheme where the Company makes contributions towards the cost (2017: 1).

One of the Directors at 31 March 2018 was a member of a defined contribution section of the Scheme where the Company makes contributions towards the cost (2017: 1).

The Directors' remuneration policy and a detailed report showing total remuneration for each Director, for the year to 31 March 2018, are set out in the Remuneration Committee Report on page 68 to 78 of the Governance Report.

(b) Highest paid Director

The amounts for remuneration shown in note 4(a) include the following in respect of the highest paid Director:

	2018 £'000	2017 £'000
Emoluments (including benefits in kind)	667	734

The highest paid Director left the defined contribution section of the NWPS at the beginning of the year ended 31 March 2017, therefore no payments were made to the Scheme in either the current or prior year.

5. EMPLOYEE INFORMATION

The total employment costs of all employees (including Directors) were as follows:

	2018 £'m	2017 £'m
Gross costs charged to the profit and loss account:		
Wages and salaries	78.1	78.3
Social security costs	8.4	8.4
Other pensions costs	17.7	16.8
	104.2	**103.5**
Costs recharged to other Group companies:		
Wages and salaries	2.2	3.0
	2.2	**3.0**
Net costs charged to the profit and loss account:		
Wages and salaries	75.9	75.3
Social security costs	8.4	8.4
Other pensions costs	17.7	16.8
	102.0	**100.5**
Costs charged to capital schemes:		
Wages and salaries	26.4	25.9
Social security costs	2.9	2.7
Other pensions costs	5.9	4.9
	35.2	**33.5**
Total employee costs	**137.2**	**134.0**

The average monthly number of employees during the year was made up as follows:

	2018	2017
Water and waste water services	1,472	1,470
Customer services and meter reading	565	612
Other regulated activities	915	938
Non regulated activities	100	108
	3,052	**3,128**

6. NET FINANCE COSTS

	2018 £'m	2017 £'m
Finance costs payable:		
Bank overdrafts and loans	15.4	14.5
Receivable in respect of derivatives	(2.4)	(2.0)
Payable to subsidiary Group company	83.4	95.7
Payable to other Group company	0.1	0.2
Amortisation of discount, fees, loan issue costs and other financing items	1.8	1.7
Accretion on index linked bonds	33.5	15.7
Interest cost on pension plan obligations	3.6	2.8
Obligations under finance leases	2.7	4.1
	138.1	**132.7**
Less amounts capitalised on qualifying assets	(6.5)	(5.2)
	131.6	**127.5**
Fair value losses on derivative financial instruments	4.9	12.5
Total finance costs payable	**136.5**	**140.0**
Finance income receivable:		
Bank deposits	(0.5)	(0.8)
Receivable from Group companies	(2.3)	(2.6)
Total finance costs receivable	**(2.8)**	**(3.4)**
Net finance costs payable	**133.7**	**136.6**

7. TAXATION

(a) Tax on profit on ordinary activities:

	2018 £'m	2017 £'m
Current tax:		
UK current income tax charge at 19% (2017: 20%)	17.1	14.1
Adjustments in respect of prior periods	9.2	0.1
Payable in respect of group relief for the year	16.0	24.7
Adjustments in respect of prior period group relief	(9.6)	(0.6)
Total current tax	**32.7**	**38.3**
Deferred tax:		
Origination and reversal of temporary differences in the year at 17% (2017: 17%)	4.9	4.5
Impact of reduction in rate of UK corporation tax	-	(24.2)
Adjustments in respect of prior periods	1.8	0.4
Total deferred tax	**6.7**	**(19.3)**
Tax charge in the income statement	**39.4**	**19.0**

The rate of UK corporation tax for the current year was 19%. Finance Act 2016 provides that this will be reduced to 17% with effect from 1 April 2020. Deferred tax has been provided wholly at 17% as amounts that are expected to reverse at the higher rate are insignificant.

Tax losses have been provisionally claimed as group relief from other group companies in the current year, for which payment is being made at the full rate of tax.

Prior year adjustments mainly reflect the withdrawal of tax losses previously claimed as consortium relief from related parties that were paid for at less than the full rate of tax.

(b) Tax relating to items charged outside the income statement:

	2018 £'m	2017 £'m
Deferred tax:		
Actuarial gains / (losses) on pension scheme	9.4	(12.2)
Impact of reduction in rate of UK corporation tax	-	1.4
Adjustment for items expected to reverse at 19%	0.7	(0.1)
Financial instruments	2.0	0.7
Impact of reduction in rate of UK corporation tax	-	0.3
Adjustment for items expected to reverse at 19%	0.3	-
Tax charge / (credit) in the statement of comprehensive income	**12.4**	**(9.9)**

7. TAXATION (continued)

(c) Reconciliation of the tax charge:

	2018 £'m	2017 £'m
Profit on ordinary activities before tax	**205.2**	**220.3**
Profit on ordinary activities multiplied by standard rate of corporation tax of 19% (2017: 20%)	39.0	44.1
Effects of:		
Expenses not deductible for tax purposes	0.4	0.4
Non-taxable income and other tax reliefs	(1.9)	(1.4)
Depreciation in respect of non-qualifying items	1.1	1.0
Adjustment to prior year consortium relief paid for at less than the full rate	2.2	(0.5)
Impact on deferred tax of change in current tax rate	-	(24.2)
Deferred tax movement not at current tax rate for the year	(0.5)	(0.8)
Adjustments in respect of prior periods	(0.9)	0.4
Transfer pricing adjustments	(0.8)	(0.9)
Transfer pricing balancing payments	0.8	0.9
Total tax charge	**39.4**	**19.0**

The change to consortium relief is referred to in note 7(a) above. Non-taxable income relates to amortisation of capital sums and profit on the sale of the Company's NHH business to NWGB.

The effective rate of tax for the year was 19.2% (2017: 8.6%). The increase of 10.6% is mainly due to there being no restatement of deferred tax as no further changes in the UK corporation tax rate have been enacted), increased prior year charges, offset by the reduction in the current rate of tax to 19% (2017: 20%).

(d) Deferred tax:

	ACCELERATED TAX DEPRECIATION £'m	DEFERRED INCOME £'m	RETIREMENT BENEFIT OBLIGATIONS £'m	FAIR VALUE HEDGING INSTRUMENTS £'m	BUSINESS COMBINATIONS £'m	OTHER £'m	TOTAL £'m
At 1 April 2016	**473.3**	**(54.0)**	**(20.3)**	**(6.0)**	**6.1**	**5.6**	**404.7**
Charge/(credit) in the income statement	(18.5)	(0.7)	1.9	(2.1)	(0.5)	0.6	(19.3)
Charge/(credit) in other comprehensive income	-	-	(10.9)	1.0	-	-	(9.9)
At 31 March 2017	**454.8**	**(54.7)**	**(29.3)**	**(7.1)**	**5.6**	**6.2**	**375.5**
Charge/(credit) in the income statement	7.4	(2.6)	1.9	(0.7)	(0.2)	0.9	6.7
Charge/(credit) in other comprehensive income	-	-	10.1	2.3	-	-	12.4
At 31 March 2018	**462.2**	**(57.3)**	**(17.3)**	**(5.5)**	**5.4**	**7.1**	**394.6**

7. TAXATION (continued)

(e) Factors that may affect future tax charges:

The future change in the tax rate is referred to in note 7(a) above.

The Company expects to continue to incur high levels of capital expenditure during the remainder of the 2015-20 regulatory review period which, under current tax legislation, should result in claims for tax reliefs in excess of depreciation.

New rules were introduced with effect from 1 April 2017 (to implement the OECD's Base Erosion and Profit Shifting Action 4) to determine the amount of interest that companies can deduct for UK corporation tax purposes. Although the Company's financial statements contain significant amounts of finance costs, it is expected the new rules will continue to have no impact on its tax position.

8. DIVIDENDS

	2018 £'m	2017 £'m
Equity:		
Dividends paid:		
Special dividend paid for the year ended 31 March 2018 of 15.41p (year ended 31 March 2017: nil) per share on an aggregated basis	18.9	-
Interim dividend paid for the year ended 31 March 2018 of 86.83p (year ended 31 March 2017: 86.42p) per share on an aggregated basis	106.5	106.0
Interim dividend paid for the year ended 31 March 2018 of nil (year ended 31 March 2017: 86.83p) per share on an aggregated basis	-	106.5
Total dividends paid in the year	**125.4**	**212.5**
Dividends proposed:		
Special dividend proposed for the year ended 31 March 2018 of 15.41p (year ended 31 March 2017: nil) per share on an aggregated basis	-	18.9
Final dividend proposed for the year ended 31 March 2018 of 53.00p (year ended 31 March 2017: nil) per share on an aggregated basis	65.0	-
Total dividends proposed	**65.0**	**18.9**

A special dividend of £18.9m proposed in the year ended 31 March 2017 was paid in the year. This related to both the profit on the sale of NWL's non-household retail business to NWGB, and the enduring working capital benefit which NWL gained as a consequence of this transaction.

In previous years the Company has typically paid two interim dividends in each financial year, in October and March. In 2018, the Directors have decided that the second interim dividend payment will be replaced with a final dividend to be paid in April, after the Directors have reviewed the financial position of the Company at the balance sheet date.

A final dividend of £65m for the year ended 31 March 2018 (2017: nil) was approved by the Board and paid after the balance sheet date.

The Directors have a policy which takes into account the principle of incentive based price cap regulation, including operating, investment and financing performance. When declaring the final dividend for the year ended 31 March 2018, the Directors considered the impact of Ofwat's final methodology for the 2019 price review on the Company's medium term financial plan, in particular a lower rate of return and a projected reduction in RCV from April 2020. As a result, the Directors have decided to reduce the level of dividend payments both in respect of the current year and the remainder of the current price control period in order to continue to meet the Company's overarching financial objective of retaining investment grade credit ratings.

The level of dividend has been declared by reference to:

- the Company's ability to finance its functions;
- the Company's cumulative financial performance and past outperformance; and
- maintaining the Company's stable investment grade credit ratings.

The Directors have also had regard to:

- the Company's operational performance and the level of service provided to its customers; and
- the Company's compliance with the repair plan agreed with the trustees in respect of the NWPS, as submitted to the Pensions Regulator.

9. PROPERTY, PLANT AND EQUIPMENT

	FREEHOLD LAND AND BUILDINGS £'m	INFRASTRUCTURE ASSETS £'m	OPERATIONAL STRUCTURES, PLANT AND MACHINERY £'m	FIXTURES, FITTINGS, TOOLS AND EQUIPMENT £'m	ASSETS IN THE COURSE OF CONSTRUCTION £'m	TOTAL £'m
Cost:						
At 1 April 2017	149.5	2,690.8	2,871.1	281.3	132.0	6,124.7
Additions	-	10.9	0.2	-	249.6	260.7
Schemes commissioned	4.9	80.4	74.0	8.4	(167.7)	-
Disposals	-	(0.9)	(3.7)	(1.1)	-	(5.7)
At 31 March 2018	**154.4**	**2,781.2**	**2,941.6**	**288.6**	**213.9**	**6,379.7**
Depreciation:						
At 1 April 2017	56.5	355.6	1,245.3	206.8	-	1,864.2
Charge for the year	3.3	27.0	87.7	17.2	-	135.2
Disposals	-	(0.9)	(3.5)	(1.2)	-	(5.6)
At 31 March 2018	**59.8**	**381.7**	**1,329.5**	**222.8**	**-**	**1,993.8**
Carrying value:						
At 31 March 2018	94.6	2,399.5	1,612.1	65.8	213.9	4,385.9
At 31 March 2017	93.0	2,335.2	1,625.8	74.5	132.0	4,260.5
Leased assets included above:						
Carrying value:						
At 31 March 2018	-	44.3	10.7	-	-	55.0
At 31 March 2017	-	44.8	16.8	-	-	61.6

Operational structures, plant and machinery include an element of land dedicated to those assets. It is not possible to separately identify the value of all land assets.

Cumulative borrowing costs capitalised in the cost of property, plant and equipment amount to £41.6m (2017: £35.2m). The capitalisation rate used to determine the amount of borrowing costs eligible for capitalisation was 4.58% (2017: 5.0%).

10. FINANCIAL INVESTMENTS

	LOANS TO GROUP COMPANIES £'m
At 1 April 2017 and 31 March 2018	160.9

(a) Loans to Group Companies

In May 2004, the Company made a loan of £159.0m to Northumbrian Services Limited, maturing in January 2034. Following a restructuring of the NWGL group, this loan was reassigned to NWGL in March 2016 at a variable interest rate of LIBOR plus 1% calculated on twice yearly payment dates.

In May 2004, the Company made a loan of £1.5m to Bakethin Holdings Limited, maturing in January 2034. The interest on the loan is capitalised and at 31 March 2018 the balance was £1.9m (2017: £1.9m).

(b) Subsidiaries

The Company's interests in subsidiaries at 31 March 2018 were as follows:

NAME OF UNDERTAKING	COUNTRY OF INCORPORATION OR REGISTRATION AND OPERATION	DESCRIPTION OF SHARES HELD	PROPORTION OF NOMINAL VALUE OF ISSUED SHARES HELD BY COMPANY (%)	BUSINESS ACTIVITY
Northumbrian Water Finance plc	England and Wales	Ordinary shares of £1	100	Holding of finance instruments
Reiver Finance Limited	England and Wales	Ordinary shares of £1	100	Special purpose financing vehicle
Reiver Holdings Limited	England and Wales	Ordinary shares of £1	100	Holding company

The registered office of all subsidiaries listed above is Northumbria House, Abbey Road, Pity Me, Durham DH1 5FJ.

The Company also has two quasi-subsidiary special purpose entities, Bakethin Holdings Limited, which is wholly owned by Bakethin Charitable Trust, and Bakethin Finance plc, which is a wholly owned subsidiary of Bakethin Holdings Limited. The principal activity of Bakethin Finance plc is as a special purpose financing vehicle.

The registered office of the two quasi-subsidiaries is c/o Wilmington Trust SP Services (London) Limited, Third Floor, 1 King's Arms Yard, London, United Kingdom, EC2R 7AF.

11. INVENTORIES

	2018 £'m	2017 £'m
Raw materials and consumables	3.0	2.8

12. TRADE AND OTHER RECEIVABLES

	2018 £'m	2017 £'m
Trade receivables	152.2	157.8
Doubtful debt provision	(80.0)	(85.0)
Amounts owed by other group companies	2.6	4.4
Other receivables	7.4	29.1
Prepayments and accrued income	78.4	54.7
	160.6	**161.0**

13. ASSETS HELD FOR RESALE

NWL exited the NHH retail market at 1 April 2017 and transferred the associated NHH retail business to an acquiring licenced retailer, NWGB, a subsidiary of NWGL at that date.

As part of this transfer the following assets and liabilities were reclassified from their original Balance Sheet heading to Assets held for resale as at 31 March 2017:

	£'m
Property, plant and equipment	3.7
Trade debtors	22.7
Doubtful debt provision	(1.1)
Prepayments and accrued income	17.1
Total assets held for resale as at 31 March 2017	**42.4**

14. TRADE AND OTHER PAYABLES

	2018 £'m	2017 £'m
Trade payables	15.9	29.5
Amounts owed to other group companies	12.2	11.1
Amounts owed to related parties	-	0.6
Taxation and social security	3.8	3.7
Income tax payable	11.6	3.0
Other payables	30.1	24.2
Accruals and deferred income	95.5	98.1
	169.1	**170.2**

15. LOANS AND BORROWINGS

	2018 £'m	2017 £'m
Current:		
Bank overdrafts	-	1.2
Current instalments due on external borrowings	35.7	45.3
Current instalments due on internal borrowings	-	221.6
	35.7	**268.1**
Non-current:		
Non-current instalments due on external borrowings	557.7	480.8
Non-current instalments due on internal borrowings	2,216.7	1,898.0
	2,774.4	**2,378.8**

(a) External borrowings:

Loans wholly repayable within five years amount to £77.4m (2017: £102.0m).

Loans not wholly repayable within five years amount to £516.0m (2017: £424.1m) and bear interest rates in the range 1.47% to 5.35%.

The fair value gain on the Company's outstanding interest rate swaps in the year to 31 March 2018 was £2.6m (2017: loss of £14.5m) in relation to interest rate swaps with a notional principal of £350.0m (2017: £250.0m).

(b) Internal borrowings:

NWF issued £200m and £150m Guaranteed Eurobonds in February 1998 and September 2001 respectively, maturing February 2023, with an annual coupon of 6.875%. The issues were guaranteed by the Company who received the issue proceeds by way of inter-company loans of £194.2m and £163.2m respectively. Finance costs allocated during the year amounted to £0.2m (2017: £0.2m). Amortisation of loan issue receipts during the year amounted to £0.3m (2017: £0.3m).

NWF issued £250m and £100m Guaranteed Eurobonds in December 2002 and December 2004, maturing April 2033 with an annual coupon of 5.625%. Both issues were guaranteed by the Company who received the issue proceeds by way of inter-company loans of £246.6m and £100.8m respectively. Finance costs allocated during the year amounted to £0.2m (2017: £0.2m).

NWF issued £150m Guaranteed Index Linked Eurobonds in September 2005, maturing July 2036, with a real coupon of 2.033%. The issue was guaranteed by the Company who received the issue proceeds by way of an inter-company loan of £150.0m. Indexation accretion during the year amounted to £7.5m (2017: £3.8m). Finance costs allocated during the year amounted to £0.2m (2017: £0.2m)

NWF issued £60m Guaranteed Index Linked Eurobonds in January 2006, maturing January 2041, with a real coupon of 1.6274%. The issue was guaranteed by the Company who received the issue proceeds by way of an inter-company loan of £60.0m. Indexation accretion during the year amounted to £3.0m (2017: £1.5m).

NWF issued two £100m Guaranteed Index Linked Eurobonds in June 2006 with real coupons of 1.7118% and 1.7484% and with maturities of 2049 and 2053 respectively. Both issues were guaranteed by the Company who received the issue proceeds by way of two inter-company loans of £100.0m. Indexation accretion during the year amounted to £9.8m (2017: £5.0m).

NWF issued £360m Guaranteed Eurobonds in January 2012, maturing January 2042, with an annual coupon of 5.125%. The issue was guaranteed by the Company who received the issue proceeds by way of an inter-company loan of £338.8m. Finance costs allocated during the year amounted to £0.7m (2017: £0.7m).

NWF issued £300m Guaranteed Eurobonds in October 2016, maturing October 2026, with an annual coupon of 1.625%. The issue was guaranteed by the Company who received the issue proceeds by way of an inter-company loan of £297.6m. Finance costs allocated during the year amounted to £0.2m (2017: £0.1m).

NWF issued £300m Guaranteed Eurobonds in October 2017, maturing October 2027, with an annual coupon of 2.375%. The issue was guaranteed by the Company who received the issue proceeds by way of an inter-company loan of £297.6m. Finance costs allocated during the year amounted to £0.5m (2017: £nil).

16. OBLIGATIONS UNDER HIRE PURCHASE CONTRACTS AND FINANCE LEASES

(a) Obligations under hire purchase contracts and finance leases are as follows:

The Company uses finance leases and hire purchase contracts to acquire plant and machinery and motor vehicles. There are no contingent rents, escalation clauses or material renewal or purchase options. The leases impose no restrictions in respect of dividends or raising additional debt. The obligations are as follows:

	2018 £'m	2017 £'m
Future minimum lease payments due:		
Within one year	5.5	56.2
In the second to fifth years inclusive	17.7	16.2
After five years	74.0	75.9
	97.2	**148.3**
Less:		
Finance charge allocated to future periods	(37.7)	(39.1)
Present value of minimum lease payments	**59.5**	**109.2**
Present value of minimum lease payments:		
Within one year	3.0	56.2
In the second to fifth years inclusive	9.2	7.7
After five years	47.3	45.3
	59.5	**109.2**
Disclosed as due:		
Current liability	3.0	56.2
Non current liability	56.5	53.0
	59.5	**109.2**

(b) Lease commitments:

The Company has entered into non-cancellable operating leases in respect of land and buildings, plant, machinery and motor vehicles.

Land and building rent reviews are triggered by the lessor and typically take place every three to five years, at which point there may be an increase in rental payments. There are no purchase options or escalation clauses in respect of these leases and the terms of renewal are governed by Landlord and Tenant legislation. There are no restrictions imposed by these lease arrangements.

There are no contingent rents, escalation clauses or material renewal or purchase options in the terms of the plant, machinery and motor vehicle leases. The leases impose no restrictions in respect of dividends or raising additional debt.

The future minimum rentals payable under non-cancellable operating leases are as follows:

	2018 £'m	2017 £'m
Not later than one year	1.5	1.2
After one year but not more than five years	4.9	4.2
After five years	39.8	34.5
	46.2	**39.9**

17. PROVISIONS

	£'m
Pension provision for former employees:	
At 1 April 2017	1.4
Utilised during the year	(0.1)
At 31 March 2018	**1.3**
Analysed as:	
Current	0.2
Non-current	1.1
	1.3

The provision mainly represents outstanding pension liabilities for pensions that have been awarded on a discretionary basis, mainly to former employees of water companies which have since merged with the Company. These pension liabilities have been calculated by an independent actuary, using the same actuarial assumptions as applied to the defined benefit pension scheme, and are expected to be paid over the remaining lives, which is approximately five years.

In the ordinary course of business, the Company is sometimes subject to claims and potential litigation, whether from regulatory bodies, individuals or particular groups, related to one off matters. The Directors consider that, where it is possible to be estimated, a reasonable and appropriate position has been taken in reflecting such items in these financial statements in note 14 and the note above.

It is not currently possible to estimate the financial effect and likely timing of any associated outflow of some matters, given that some are in early stages of discussion, the limited likelihood of the claims against the Company being successful, or the potential range of possible outcomes, and accordingly no provision has been made in the Financial Statements. No reasonably possible financial outcome that would be significant to the Financial Statements has been identified in relation to these remaining matters at the date of the issue of these Financial Statements.

18. GRANTS AND DEFERRED INCOME

	CAPITAL GRANTS AND CONTRIBUTIONS £'m	PROCEEDS FROM KIELDER SECURITISATION £'m	TOTAL £'m
At 1 April 2017	**412.5**	**120.8**	**533.3**
Additions	30.0	-	30.0
Amortised during the year	(6.8)	(7.1)	(13.9)
At 31 March 2018	**435.7**	**113.7**	**549.4**

The Kielder securitisation involved the assignment of the right to the future income stream associated with the Kielder operating contract until 2034 to Reiver Finance Limited, a subsidiary company, in return for consideration of £212.1m. This capital sum is amortised to the income statement of the Company over the life of the assignment.

19. FINANCIAL INSTRUMENTS

	2018 £'m	2017 £'m
Financial liabilities that are designated and effective as hedging instruments carried at fair value:		
Interest rate swaps	10.0	17.6
Power forward contracts	3.9	8.7
Foreign exchange contracts	0.2	(0.5)
Financial (assets) / liabilities carried at fair value through profit and loss:		
Interest rate swaps	18.8	13.7
Power forward contracts	(0.1)	0.1
	32.8	**39.6**

At 31 March 2018, the Company held the following interest rate swaps, designated as hedges of future interest cash flows, used to convert variable rate interest payments to a fixed rate basis:

NOTIONAL AMOUNT	START DATE	TERMINATION DATE	FIXED RATE
£100.0m	15 September 2008	15 March 2022	4.79%
£150.0m	15 October 2015	15 October 2025	2.36%

At 31 March 2018, the Company held the following interest rate swaps, designated as hedges of future interest cash flows, used to convert fixed rate interest payments to an index linked rate basis:

NOTIONAL AMOUNT	START DATE	TERMINATION DATE	INDEX LINKED RATE
£150.0m	15 October 2015	15 October 2025	(0.42%)
£100.0m	22 June 2017	22 June 2027	(1.10%)

At 31 March 2018, the Company held the following forward power contracts, designated as hedges of expected future purchases:

NOTIONAL AMOUNT	START DATE	TERMINATION DATE	PRICE PER MWH £
166,896 MWH	1 April 2018	30 September 2018	50.7
165,984 MWH	1 October 2018	31 March 2019	56.2
166,896 MWH	1 April 2019	30 September 2019	52.2
166,896 MWH	1 October 2019	31 March 2020	56.8

At 31 March 2018, the Company held the following fuel hedge, designated as a hedge of expected future purchases:

NOTIONAL AMOUNT	START DATE	TERMINATION DATE	PRICE PER LITRE £
3,000,000 litres	1 April 2018	31 March 2019	0.3435
3,000,000 litres	1 April 2019	31 March 2020	0.3562

19. FINANCIAL INSTRUMENTS (continued)

At 31 March 2018, the Company held the following forward exchange contracts, designated as hedges of expected future purchases for which the Company has firm commitments. The forward currency contracts are being used to hedge the foreign currency risk of the firm commitments. The terms of these contracts are as follows:

CURRENCY BOUGHT	MATURITY	EXCHANGE RATE	TRANSACTION VALUE £'m
USD 1,245,000	4 April 2018	1.4492	0.9
USD 1,112,000	31 May 2018	1.2500	0.9
USD 1,245,000	4 April 2019	1.4550	0.9
USD 1,112,000	31 May 2019	1.2645	0.9
USD 1,245,000	13 March 2020	1.4600	0.8
USD 1,240,404	30 April 2018	1.3852	0.9
USD 1,240,404	30 April 2019	1.4069	0.9
USD 1,240,404	30 April 2020	1.4293	0.8
			7.0

At 31 March 2017, the Company held the following forward exchange contracts, designated as hedges of expected future purchases for which the Company has firm commitments. The forward currency contracts are being used to hedge the foreign currency risk of the firm commitments. The terms of these contracts are as follows:

CURRENCY BOUGHT	MATURITY	EXCHANGE RATE	TRANSACTION VALUE £'m
USD 1,245,000	4 April 2017	1.4454	0.9
USD 978,630	13 April 2017	1.5072	0.6
USD 91,000	28 April 2017	1.2365	0.1
USD 1,112,000	31 May 2017	1.2375	0.9
USD 1,245,000	4 April 2018	1.4492	0.9
USD 1,112,000	31 May 2018	1.2500	0.9
USD 1,245,000	4 April 2019	1.4550	0.8
USD 1,112,000	31 May 2019	1.2645	0.9
USD 1,245,000	13 March 2020	1.4600	0.8
			6.8

20. SHARE CAPITAL

	2018 £'m	2017 £'m
Authorised:		
122,650,000 Ordinary Shares of £1 each (31 March 2017: 122,650,000)	122.7	122.7
Allotted, called-up and fully paid:		
122,650,000 Ordinary Shares of £1 each (31 March 2017: 122,650,000)	122.7	122.7

NWL is a company limited by shares.

21. FINANCIAL COMMITMENTS

(a) Capital commitments:

	2018 £'m	2017 £'m
Contractual commitments for the acquisition of property, plant and equipment	130.2	134.6

In addition to these commitments, the Company has longer term expenditure plans, including investment to deliver business outcomes, maintain the health of the asset base and provide for new demand and growth in the regulated part of the business.

(b) Foreign currency commitments

At 31 March 2018 the Company held forward foreign exchange contracts of £7.0m (2017: £6.8m) for the purpose of hedging the foreign currency risk of committed future purchases.

22. PENSIONS

NWL participates in the Group defined benefit pension scheme, NWPS, providing benefits to 1,244 active members at 31 March 2018 (2017: 1,340). The assets of the NWPS are held separately from those of the Group in independently administered funds.

The most recent actuarial valuation of the NWPS was at 31 December 2016. At that date, the value of assets amounted to £954.6m and the liabilities were £1,242.2m, resulting in a deficit of £290.6m and a funding level of 76.7%.

Under the revised schedule of contributions the future service contribution rate, jointly payable by members and the employers, remained at 29.4% of pensionable salaries until 31 December 2017. With effect from 1 January 2018, the employers' contribution was set at £12.3m per annum, increasing annually by RPI. Employee contribution rates remained at between 6% and 8% of pensionable salary, dependent upon which section of the Scheme the employee is a member of. The Company operates a salary sacrifice scheme under which members can elect for the Company to pay employee contributions on their behalf in place of salary. The Company will continue to pay the employer NI savings resulting from the salary sacrifice arrangement as additional employer contributions to the Scheme.

In addition, the employers continue to make deficit reduction payments of £11m per annum, with effect from 1 April 2015, increasing annually by RPI. Deficit reduction payments will increase by £2.6m per annum with effect from 1 April 2021. The deficit reduction payments have been set with the objective of removing the deficit by 31 March 2031, which has been our long-term aim.

Employers' contributions (including associated company contributions) of £25.8m were paid in the year to 31 March 2018, of which £11.4m related to deficit reduction. For the year to 31 March 2019 employers contributions are projected to be £27.6m, including £11.7m in respect of deficit reduction.

Two new activities to manage Scheme liabilities are being implemented in 2018. A pension increase exchange exercise is being carried out and transfer values are being included in members' retirement data with the Scheme offering to meet the cost of one round of financial advice. The potential impact of these activities has not been recognised in the 31 March 2018 valuation but is expected to be realised in the year to 31 March 2019.

The Scheme also has a defined contribution section which had 1,945 active members at 31 March 2018 (2017: 1,779). Members can choose to contribute either 3%, 4% or 5% of salary, with employers contributing at either 6%, 7% or 8% depending on the member contribution rate. The contributions paid to the defined contribution section by the Company in the year totalled £5.3m (2017: £5.1m).

The additional disclosures regarding the defined benefit scheme as required under FRS 101 and the relevant impact on the financial statements are set out below. A qualified actuary, using revised assumptions that are consistent with the requirements of FRS 101 has updated the actuarial valuation described above as at 31 March 2018. Investments have been valued, for this purpose, at fair value.

22. PENSIONS (continued)

FRS 101 ACTUARIAL ASSUMPTIONS:	2018	2017
Discount rate	2.65%	2.55%
Pay increases[1]	3.0%	3.1%
Price inflation (RPI)	3.0%	3.1%
Price inflation (CPI)	1.9%	2.1%
Pension increases linked to RPI	3.0%	3.1%
Pension increases linked to CPI	1.9%	2.1%
Mortality assumptions[2]		
- Life expectancy for a member aged 65 - female (years)	24.2	24.1
- Life expectancy for a member aged 65 - male (years)	22.5	22.0

1. including promotional salary scale
2. scheme specific bespoke 'Vitacurves' which reflect the characteristics of the Scheme membership

The fair value of the assets in the NWPS and the present value of the liabilities in the Scheme are shown below:

	2018 £'m	2017 £'m
Equities	274.1	296.8
Corporate bonds	57.1	244.0
Government bonds	354.9	131.3
Property related funds	95.3	108.6
Cash	111.3	12.7
Other	96.6	186.0
Total fair value of assets	**989.3**	**979.4**
Present value of liabilities	**(1,083.6)**	**(1,132.5)**
Deficit	**(94.3)**	**(153.1)**

The amounts recognised in the income statement and in the statement of comprehensive income are analysed as follows:

RECOGNISED IN THE INCOME STATEMENT:	2018 £'m	2017 £'m
Current service cost	16.0	13.4
Administration cost	2.2	1.5
Past service cost	0.1	1.7
Recognised in operating costs in arriving at operating profit	**18.3**	**16.6**

22. PENSIONS (continued)

RECOGNISED IN THE INCOME STATEMENT:	2018 £'m	2017 £'m
Net interest cost on plan obligations	3.6	2.8
Recognised in finance costs	**3.6**	**2.8**

RECOGNISED IN THE STATEMENT OF COMPREHENSIVE INCOME:	2018 £'m	2017 £'m
Changes in demographic assumptions	(6.5)	49.3
Changes in financial assumptions	49.0	(223.5)
Return on assets (excluding amounts included in finance costs)	19.3	94.6
Other actuarial (losses) / gains	(6.9)	7.7
Net actuarial gains / (losses)	**54.9**	**(71.9)**
Contributions made by associated company	0.1	0.2
Net actuarial gains / (losses)	**55.0**	**(71.7)**

Changes in the present value of the defined pension obligations are analysed as follows:

	2018 £'m	2017 £'m
At start of period	**1,132.5**	**960.1**
Current service cost	16.0	13.4
Administration cost	2.2	1.5
Past service cost	0.1	1.7
Interest cost	28.1	33.4
Contributions by plan participants	0.1	0.1
Benefits paid	(59.8)	(44.2)
Remeasurement:		
Changes in demographic assumptions	6.5	(49.3)
Changes in financial assumptions	(49.0)	223.5
Other actuarial gains and losses	6.9	(7.7)
At end of period	**1,083.6**	**1,132.5**

22. PENSIONS (continued)

Changes in the fair value of plan assets are analysed as follows:

	2018 £'m	2017 £'m
At start of period	**979.4**	**870.2**
Interest income on scheme assets	24.5	30.6
Contributions by employers (including associated company)	25.8	28.1
Contributions by plan participants	0.1	0.1
Benefits paid	(59.8)	(44.2)
Return on assets (excluding amounts included in finance costs)	19.3	94.6
At end of period	**989.3**	**979.4**

Nature of benefits, regulatory framework and other entity's responsibilities for governance of the Scheme

The Scheme is a registered defined benefit scheme subject to the UK regulatory framework for pensions, including the scheme specific funding requirements. The Scheme is operated under trust and as such, the Trustee of the Scheme is responsible for operating the Scheme and they have a statutory responsibility to act in accordance with the Scheme's Trust Deed and Rules, in the best interest of the beneficiaries of the Scheme, and UK legislation (including Trust law). The Trustee has the power to set the contributions that are paid to the Scheme.

Risks to which the Scheme exposes the Company

The nature of the Scheme exposes the Company to the risk of paying unanticipated additional contributions to the Scheme in times of adverse experience. The most financially significant risks are likely to be:

- members living for longer than expected;
- higher than expected actual inflation and salary increase experience;
- lower than expected investment returns; and
- the risk that movements in the value of the Scheme's liabilities are not met by corresponding movements in the value of the Scheme's assets.

Asset-liability matching strategies used by the Scheme or the Company

The Scheme does not currently use any asset-liability matching strategies. The Trustee's current investment strategy, having consulted with the Company, is to invest the majority of the Scheme's assets in a mix of equities and corporate and government bonds, in order to strike a balance between:

- maximising the returns on the Scheme's assets; and
- minimising the risks associated with lower than expected returns on the Scheme's assets.

The Trustee is required to regularly review their investment strategy in light of the revised term and nature of the Scheme's liabilities. During the year, the Trustee chose to de-risk part of their equity allocation.

22. PENSIONS (continued)

Sensitivity to key assumptions

The costs of a pension arrangement require estimates regarding future experience. The financial assumptions used for FRS 101 reporting are the responsibility of the Directors of the Company. These assumptions reflect market conditions at the balance sheet date. Changes in market conditions which result in changes in the net discount rate (essentially the difference between the discount rate and the assumed rates of increases of salaries, deferred pension revaluation or pensions in payment), can have a significant effect on the value of the liabilities reported.

There has been no change in the methodology used to assess the impact of changes in assumptions. Approximate adjustments were made to the defined benefit obligations reflecting the mean term of the liability.

Impact of changes in assumptions compared with actuarial assumption for the NWPS:

Actuarial value of liabilities on 31 March 2018:

	£'m
0.25% reduction in in discount rate	1,134.2
1 year increase in life expectancy	1,116.1
0.25% increase in inflation	1,131.0

Maturity profile of the defined benefit obligation for the year ended 31 March 2018:

	NUMBER OF MEMBERS	LIABILITY SPLIT (%)	DURATION (YEARS)
Active members	1,244	35	25
Deferred members	1,145	15	23
Pensioners	3,196	50	13

23. RELATED PARTY DISCLOSURES

The Company is a wholly owned subsidiary of NWGL, whose publicly available consolidated financial statements include the Company. Accordingly, the Company is exempt under the terms of FRS101 from disclosing transactions with other members of the Group headed by NWGL.

Transactions with related parties outside of the NWGL group comprised purchases of £12.1m (2017: £11.0m), sales of £110.0m (2017: £0.2m), and a net repayment for prior year consortium tax relief of £8.9m (2017: payment of £3.8m). As at 31 March 2018 £10.7m (2017: £0.9m) is owed from these companies in respect of sales or rebates, and £0.1m (2017: £0.8m) is owed to these companies in respect of purchases.

The Company acquires vehicles from Vehicle Lease and Service Limited, an associated company, on a finance lease basis. During the year, new finance leases of £4.8m (2017: £3.9m) were entered into and capital repayments of £3.6m (2017: £3.5m) were made. The year end finance lease creditor was £10.7m (2017: £9.4m).

At 31 March 2018, nil (2017: £0.6m) is owed in respect of tax losses surrendered by Hutchison 3G UK Holdings Limited (note 14).

The companies with which NWL had transactions during the year, included in the above balances, were as follows:

- Anglian Water Business (National) Limited;
- CKI;
- Gascorp Limited;
- NGN;
- Hutchison 3G UK Holdings Limited;
- Hutchison 3G UK Limited;
- NWGB; and
- Vehicle Lease and Service Limited.

24. ULTIMATE PARENT UNDERTAKING AND CONTROLLING PARTY

In the Directors' opinion, the Company's ultimate parent undertaking and controlling party is CKHH, a company listed on the Hong Kong Stock Exchange. This is the parent undertaking of the largest group of undertakings for which group financial statements are drawn up and of which the reporting company is a member. Copies of CKHH's group financial statements, which include the Company, are available from www.ckh.com.hk/en/ir/annual.php. CKHH's registered office is PO Box 309, Ugland House, Grand Cayman, KY1-1104, Cayman Islands and is incorporated in the Cayman Islands with limited liability.

The parent undertaking of the smallest group of undertakings for which group financial statements are drawn up, and of which the reporting company is a member, is NWGL, which is incorporated in England and Wales. Copies of NWGL's group financial statements will be available in due course from Northumbria House, Abbey Road, Pity Me, Durham DH1 5FJ.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF NORTHUMBRIAN WATER LIMITED

REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS

OPINION

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 March 2018 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice including FRS101 'Reduced Disclosure Framework'; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements of NWL which comprise:

- the income statement;
- the statement of comprehensive income;
- the balance sheet;
- the statement of changes in equity; and
- the related notes 1 to 24.

The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards, including FRS101 'Reduced Disclosure Framework' (United Kingdom Generally Accepted Accounting Practice).

BASIS FOR OPINION

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the Financial Statements section of our report.

We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

SUMMARY OF OUR AUDIT APPROACH

KEY AUDIT MATTERS	The key audit matters that we identified in the current year were: • Classification of capital expenditure and operating expenditure; • Provision for bad and doubtful debts; • Revenue recognition (valuation of unbilled revenue accrual); and • Revenue recognition (adjustments to industry data from Market Operator Services Limited (MOSL)).
MATERIALITY	The materiality that we used in the current year was £10.5m which was determined on the basis of 5% of profit before tax, adjusted to take account of derivative valuation movements charged to the income statement in the year.
SCOPING	Audit work to the respond to the risks of material misstatement was performed directly by the audit engagement team.

CONCLUSIONS RELATING TO GOING CONCERN, PRINCIPAL RISKS AND VIABILITY STATEMENT

GOING CONCERN	We have reviewed the 'Directors' statement in note 1 of 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 from the date of approval of the Financial Statements.	We confirm that we have nothing material to report, add or draw attention to in respect of these matters.
PRINCIPAL RISKS AND VIABILITY STATEMENT	Based solely on reading the Directors' statements and considering whether they were consistent with the knowledge we obtained in the course of the audit, including the knowledge obtained in the evaluation of the Directors' assessment of the Company's ability to continue as a going concern, we are required to state whether we have anything material to add or draw attention to in relation to: • the disclosures within the Strategic Report that describe the principal risks and explain how they are being managed or mitigated; • the Directors' confirmation on page 46 that they have carried out a robust assessment of the principal risks facing the Company, including those that would threaten its business model, future performance, solvency or liquidity; or • the Directors' explanation on page 80 as to how they have assessed the prospects of the Company, over what period they have done so and why they consider that period to be appropriate, and their 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 their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.	We confirm that we have nothing material to report, add or draw attention to in respect of these matters.

We also report on whether the Directors' statement relating to the prospects of the Company as set out in Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit.

KEY AUDIT MATTERS

Key audit matters are those matters that, in our professional judgement, were of most significance in our 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) that we identified. These matters included 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 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.

CLASSIFICATION OF CAPITAL EXPENDITURE AND OPERATING EXPENDITURE	
Key audit matter description	The water industry is capital intensive and pipeline assets require regular maintenance and upgrades. There is an inherent risk in the industry that costs included in property, plant and equipment are not capital in nature and/or are not in line with the capitalisation criteria of IAS 16. Capital expenditure for the year ended 31 March 2018 was £256m, together with significant spend on maintenance costs. The classification of expenditure on capital assets also includes the allocation of certain overhead costs to property, plant and equipment reflecting the use of the Company's own teams and resources to complete capital work which requires the application of judgement. The capitalised labour costs were £37m for the year ended 31 March 2018 (2017: £36m). Further details are included within the Strategic Report on page 44 and also note 9 to the Financial Statements.
How the scope of our audit responded to the key audit matter	• We evaluated the design and implementation of management's key controls over the processing of accounting entries associated with capital and operating expenditure; • We have reviewed the appropriateness of the Company's capitalisation policies and its approach to determining which costs should be capitalised and which expensed; • We compared the actual capitalised expenditure incurred in the period with regulatory targets and made enquiries of management to understand any under/ over spend; • We performed substantive testing on both capitalised and expensed amounts to assess whether these are classified in accordance with the Company's policies and IAS 16; • We continued to challenge management's assumptions by comparing amounts capitalised by department in the current and prior years and we have understood the reasons behind levels of capitalisation; and • We tested a sample of capitalised overheads by agreeing to timesheets and project plans to ensure capitalisation was appropriate.
Key observations	The results of our procedures were satisfactory. We concluded that the valuation and classification of capital expenditure and operating expenditure are appropriately stated.

PROVISION FOR BAD AND DOUBTFUL DEBTS	
Key audit matter description	As noted in the critical accounting judgements and key sources of estimation uncertainty in note 1(q) on page 92, the value of the bad debt provision is calculated by applying a range of percentages to debt of different ages with higher percentages applied to different categories of debt depending on an assessment of the level of risk of default. There is a significant customer base, and regulations do not allow NWL to interrupt water supply to domestic customers. The valuation of the bad debt provision is sensitive to the specific percentages applied which are judgemental. At 31 March 2018 the gross debtors balance was £149m (2017: £158m) and the bad debt provision was £80m (2017: £85m).

table continued...

How the scope of our audit responded to the key audit matter	• We evaluated the design and implementation of management's key controls over the calculation of the bad debt provision; • We have compared the assumptions made by management in calculating the provision to evidence provided from historical collection data; • We tested the accuracy and completeness of the aged debtor balance and the ageing categories applied; • We have assessed the reasonableness of any judgements made in respect of likely future events through discussion of any known events with management and assessment of associated provision; • We audited a sample of credit notes raised to determine whether any were as a result of an event known but not appropriately provided for; • We performed sensitivity analysis on the provision to assess the impact of changes in the cash collection rate; and • We reviewed the receivables ageing report to help assess whether overdue debtors are appropriately provided for.
Key observations	The results of our procedures were satisfactory. We have concluded that management's judgements are appropriate and that the provision for bad and doubtful debts was appropriately stated.

REVENUE RECOGNITION (VALUATION OF UNBILLED REVENUE ACCRUAL)	
Key audit matter description	The nature and scale of NWL's business is such that it is not possible to read all water meters at year end. An estimate is therefore made of the unbilled revenue at the year end. At 31 March 2018 this measured income accrual was £66m (2017: £60m). Management estimates the amount of water and sewerage services that have been supplied to customers and not billed at year end, based on historic water consumption and default consumption rates. The revenue attributable to this unbilled revenue at year end is accrued. The accrual is both material and judgemental and is therefore considered to be a key audit matter. Further details are included in note 1(q) to the Financial Statements.
How the scope of our audit responded to the key audit matter	• We evaluated the design and implementation of management's key controls over the unbilled revenue accrual; • We audited the operating effectiveness of controls over the revenue process to assess the integrity of reported turnover; • We performed substantive testing of the accrued revenue calculation and made an assessment of the appropriateness of accounting estimates made by management; • We reviewed the accrued revenue balance for indications of recoverability risk by tracing a sample to subsequent bill and cash payment; and • We considered historic accuracy by performing retrospective testing on the March 2017 balance.
Key observations	The results of our procedures were satisfactory. We concluded that the valuation of unbiled revenue accrual is appropriate and concurred with management on judgements adopted.

table continued...

REVENUE RECOGNITION (ADJUSTMENTS TO INDUSTRY DATA FROM MOSL)

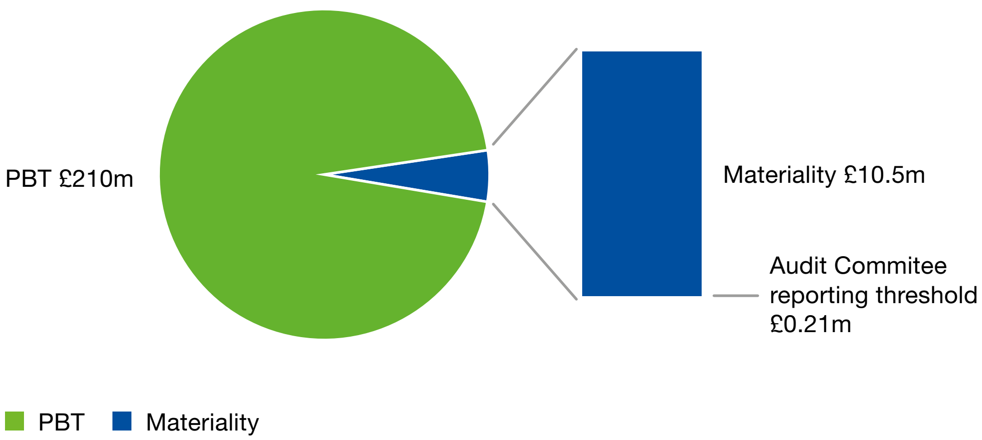
Key audit matter description	Following the opening of the non-household market to competition in England from 1 April 2017, NWL receives retail market data from MOSL on which invoices to the retailers are based. There are a number of manual adjustments to be made for errors identified in these industry data feeds which are regularly corrected over time. Management therefore estimates the amount of water that has been supplied to retail customers and compares this to the data they are receiving, based on historic water consumption and default consumption rates. The value of these adjustments is currently circa. £3m. The revenue recognised is material, and the adjustments made highly judgemental. Management have developed new controls and processes to deal with this new revenue input, and this is therefore considered to be a key audit matter. Further details are included within the Chief Executive Officer's report on page 6 and in note 1b to the Financial Statements.
How the scope of our audit responded to the key audit matter	• We evaluated the design and implementation of management's key controls over the adjustments to the industry data from MOSL; • We generated an independent expectation of the retail revenue for the year; • We have performed substantive testing on a sample of the retail revenue recognised and made an assessment of the appropriateness of accounting estimates made by management; and • We audited and understood significant adjustments to the data received externally, and assessed to supporting evidence available from MOSL.
Key observations	The results of our procedures were satisfactory. We concluded that the adjustments made to industry data are appropriate and we concurred with management on judgements adopted.

OUR APPLICATION OF MATERIALITY

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

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

MATERIALITY	£10.5m
BASIS FOR DETERMINING MATERIALITY	5% of adjusted pre-tax profit. This was adjusted to take account of derivative valuation movements charged to the income statement in the year. This has been excluded due to the level of volatility of such derivative valuation movements, in order to provide a consistent basis year on year.
RATIONALE FOR THE BENCHMARK APPLIED	Pre-tax profit was selected as the appropriate measure on which to calculate materiality as it is considered an area of focus for the users of the accounts.



We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £210,000, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the Financial Statements.

AN OVERVIEW OF THE SCOPE OF OUR AUDIT

NWL operates as a regulated water and wastewater business operating in the UK. Reflecting the nature of this audit and the UK base and business model of the Company no significant scoping decisions were required.

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

Audit work to respond to the risks of material misstatement was performed directly by the audit engagement team.

OTHER INFORMATION

The Directors are responsible for the other information. The other information comprises the information included in the Annual Report and Financial Statements, other than the Financial Statements and our Auditor's Report thereon.

Our opinion on the Financial Statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

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 such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in 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.

In this context, matters that we are specifically required to report to you as uncorrected material misstatements of the other information include where we conclude that:

- **Fair, balanced and understandable** – the statement given by the directors that they consider the Annual Report and Financial Statements taken as a whole is fair, balanced and understandable and provides the information necessary for the shareholder to assess the Company's position and performance, business model and strategy, is materially inconsistent with our knowledge obtained in the audit; or
- **Audit Committee reporting** – the section describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.
- **Directors' statement of compliance with the UK Corporate Governance Code** – the parts of the directors' statement relating to the Company's compliance with the UK Corporate Governance Code containing provisions that for premium listed entities are specified for review by the auditor in accordance with Listing Rule 9.8.10R(2) do not properly disclose a departure from a relevant provision of the UK Corporate Governance Code.

We have nothing to report in respect of these matters.

RESPONSIBILITIES OF DIRECTORS

As explained more fully in the Directors' Responsibilities Statement, the Directors are responsible for the preparation of the Financial Statements and for being satisfied that they give a true and fair view, and for such internal control as the Directors 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.

AUDITOR'S 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 Auditor's 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.

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 Auditor's Report.

USE OF OUR REPORT

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

OPINIONS ON OTHER MATTERS PRESCRIBED BY THE COMPANIES ACT 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic Report and the Directors' Report for the financial year for which the Financial Statements are prepared is consistent with the Financial Statements; and
- the Strategic Report and the Directors' Report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the Company and its environment obtained in the course of the audit, we have not identified any material misstatements in the Strategic Report or the Directors' Report.

MATTERS ON WHICH WE ARE REQUIRED TO REPORT BY EXCEPTION

Adequacy of explanations received and accounting records

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

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Company Financial Statements are not in agreement with the accounting records and returns.

We have nothing to report in respect of these matters.

Directors' remuneration

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of Directors' remuneration have not been made.

We have nothing to report in respect of these matters.

Anthony Matthews

Anthony Matthews FCA (Senior statutory auditor)

for and on behalf of Deloitte LLP
Statutory Auditor
Newcastle Upon Tyne
United Kingdom
13 July 2018

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www.nwl.co.uk | www.eswater.co.uk | www.welivewater.co.uk