Severn Trent Water Limited

Report and financial statements
for the year ended 31 March 2016

Company number 2366686

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Strategic report
At a glance

About Us
One of the largest of the 10 regulated water and sewerage companies in England and Wales. We provide high quality services to more than 4.3 million households and businesses in the Midlands and mid-Wales.

Where we operate
Our region stretches across the heart of the UK, from the Bristol Channel to the Humber, and from mid-Wales to the East Midlands.

Key Facts

Turnover **£1,550.2** (2015: £1,581.2m) **4.3m** Households and businesses serviced	Profit* **£518.7m** (2015: £536.6m*) *** Before interest, tax and exceptional items** **1.8bn** Litres of drinking water supplied each day
1.4bn Litres of waste water collected per day.	**5,236** Employees (as at 31 March 2016)

What we do
Serving our customers and communities
We are committed to putting customers at the heart of all we do. Our customers will always come first in our thinking and planning as we deliver our day-to-day business, working together tirelessly to serve our communities.

Building a lasting water legacy
We are dedicated to ensuring a sustainable future for water and our environment. By recognising the growing challenges and pressures on resources; by investing in smarter, more efficient ways to supply the network and by adopting greener, renewable energy to support our operations, we demonstrate a commitment beyond serving the needs of today to securing a legacy for generations to come.

Earning the trust of all
We are committed to earning the trust of everyone we serve. We will do this by transforming our service today, driving operational improvements and shaping the future of our industry for tomorrow, for the mutual benefit of our customers, communities, investors and employees.

Strategic report
Chief Executive’s review

Transforming Customer Services

This has been a promising year at Severn Trent as we embrace the new regulatory environment. However, there remains much to do to ensure that we are consistently delivering great service for our customers each and every day to achieve our vision of being the most trusted water company by 2020.

Embracing change

I firmly believe that if you embrace change in a regulated business such as ours you will be a winner. I also firmly believe that if you start with the customer and deliver a better service for them, you will drive improvements throughout the business and be rewarded for doing so. The new regulatory emphasis that rewards companies for doing the right thing for customers, improving services and being more efficient fits exactly with our strategic framework. Our framework outlines five areas of embedding customers at the heart of all we do: driving operational excellence and continued innovation; investing responsibly for sustainable growth; changing the market for the better; and creating an awesome place to work. Focus on these actions will, we believe, enable us to become the most trusted water company by 2020.

We planned and prepared well for these changes. For example, we sought to embed the principle of performance commitments and Outcome Delivery Incentives (‘ODIs’) across the business ahead of implementation, enabling us to assess what needed to be done to deliver operational improvements and ultimately improved services for customers.

This approach has enabled us to deliver some significant milestones this year and make some great strides in operational improvements. For example, we have reduced the number of sites with coliform failures by 62% and incidents of internal sewer flooding by 31%. These improvements have been achieved through a number of initiatives, such as pre-emptive work on known problem areas or by working with customers to reduce materials that cause blockages, such as fats being disposed of down drains. By being proactive in managing our network we can prevent problems occurring in the first place, which improves services for customers as well as enabling us to operate more cost-effectively and be rewarded for doing so. This type of thinking has seen us exceed our initial expectations and earn a reward of £23.2 million under the ODI mechanism this year.

That said, we still have much to do to improve the quality of our service for our customers.

We had two significant unsatisfactory incidents during the year. In February, a burst water main in Nottingham saw more than 7,000 customers without water for over 12 hours. In March, an incident at our Castle Donington reservoir affected 3,700 customers on the Derbyshire and Leicestershire border, the majority of which were able to use their water supply within 24 hours. These incidents show that there remains much work to be done to consistently deliver the high quality levels of service that our customers rightly deserve.

Our aim is to lead our sector in how we manage energy. We aim to generate more renewables, use less energy from the grid and pay the lowest prices where we are not generating our own. Over the last 12 months we have generated an extra 44GWh compared to 2014/15, which is an increase of 17%. We now generate an equivalent of 33% of our consumption.

Making the business better for customers requires us to look at all parts of our business. With a new management team in place we have been able to review our cost structures including how and where we spend our money. This has not only enabled us to lock in our £372 million (at 2012/13 prices) efficiency target set by Ofwat, but also to map out an additional £260 million of efficiencies, at nominal prices, that we can deliver over the course of the AMP. About half of this we will re-invest back into the business to improve water quality, security and service to vulnerable customers.. These changes will not only make the business better, but cost less to run for customers and easier to manage for our colleagues. We want to be leaders in our industry and these improvements will serve us well on the journey towards maintaining our position at the frontier of efficiency of waste water and help us move closer to our ambition of upper quartile efficiency in water when compared to other UK water and waste water companies.

Strategic report
Chief Executive's review

Our regulator has started to further utilise markets in some downstream activities with the introduction of non-household retail competition in England. We think the best way to win in this market is to offer customers a cost-effective, service driven operation at scale and we have created a joint venture with United Utilities to achieve this. Water Plus, the new operation is based in Stoke-on-Trent and will combine the complementary skills of both companies in customer service, billing and debt management systems to deliver an outstanding customer service to non-household customers. I am very excited by the opportunity this innovative approach will bring for customers and shareholders alike.
All of this activity has been done against a backdrop of further reductions in customer bills with the average combined water and waste water bill for our customers being £329 p.a, once again the lowest in Britain. Our customers pay less than £1 a day for all their clean and waste water services. Of course water is an essential commodity and we must do all we can to ensure that vulnerable customers have access to all that we can offer. So I am delighted that our Big Difference Scheme has doubled the number of vulnerable customers we have helped this year. If everyone pays their fair share, then all customers get a better deal, so I am pleased to see that we have also further reduced bad debts again this year.

Continuing our strong track record of delivery from last year, we have achieved sector leading environmental performance again, having been awarded a provisional Environment Agency 4* rating in their Environmental Performance Assessment, demonstrating that we continue to respect our environment and are viewed as industry leading when benchmarked against our peers.

Engaged workforce
None of this intense activity would have been possible without the hard work and dedication of all of my colleagues across the business. I could not be more proud of the way they have risen to the challenges, embraced change and delivered a better service for our customers. I thank them all wholeheartedly.

I firmly believe that helping our colleagues to do their job more easily and effectively will not only make their lives better, but also improve the service we deliver to our customers. So I am pleased that, despite some tough choices, we instigated a number of initiatives to simplify processes and management structures. By doing this, we have empowered our colleagues to take the right action for our customers. Deploying digital tools, such as smartphones and tablets, as well as introducing apps, helps speed up processes and reduce costs. For example, a new app enables our teams out in the field to photograph, map, spec and log work that needs doing in a fraction of the time taken previously and improves scheduling and deployment of resources. We have also introduced new ways for our customers to interact with us, such as webchat with 100,000 chats this year already. Improving the management of, and access to, supplies and assets means that our teams can more easily get hold of the materials they need to complete jobs in a more timely manner. These are just a few of a number of changes we have introduced that are helping our colleagues do a better job for customers and there are many more that we will introduce in the years ahead.

Our colleagues' health and safety (H&S) is an ongoing priority and on H&S measures we have seen operational improvements with a reduction of 20% in accidents this year.

Alongside all this, we have aligned bonus structures across the business, with everyone rewarded for delivering the same three key metrics – profit, customer service and operational performance, and health and safety. This means that everyone is incentivised to work towards common goals, ensuring greater cohesion of objectives.

Delivering returns
I am delighted that all of our hard work is delivering for our investors. We measure ourselves against four key measures of potential outperformance, three of which I have discussed above: ODIs, Totex and Renewables. James Bowling, our Chief Financial Officer, discusses the fourth, Financing, in more detail in the Financial Review, and through his careful stewardship I am pleased to see that we are on track to deliver outperformance on this, too.

Strategic report
Chief Executive's review

ODIs, Totex and Financing are key enablers for us to deliver outperformance on our allowed return on regulated equity (RoRE). This year we have achieved 8.4% RoRE. We see this as an important measure of the quality of our earnings as it reflects not only regulatory requirements, but in our case, the significant improvements in underlying services provided to customers as measured by ODIs. This approach, we believe, holds us in good stead to deliver for all of our stakeholders in the years ahead.

Case study:
Our 'Thinking Out Loud' initiative gives a voice to employees across all business areas, enabling them to share their awesome ideas and to make a difference in company decisions.

Case study:
Severn Trent has achieved a sector-leading environmental performance again, having been awarded a provisional Environment Agency 4* rating for environmental performance.

Looking forward
This has been a year with some significant achievements for Severn Trent. However there remains much to do. We will continue to prioritise water quality. We want to deliver the best quality possible to our customers. This will require us to remain obsessive about the provision of wholesome water and deliver continuous improvements.

We will continue to embrace regulatory change. We are well placed for the forthcoming changes to the non-household retail market and are engaging with Ofwat about further opening up of competition in parts of our value chain, in particular in relation to sludge trading.

We have one of our largest ever asset-creation programmes underway for this AMP, which includes the Birmingham Resilience project, a major scheme that will secure the future supply of water to Birmingham for many years to come. Alongside this we will continue to invest in maintaining and upgrading our network as well as delivering our renewables programme. In fact, this is one of our largest investment periods in our history which will see us invest £3 billion, delivering one of the biggest increases in asset values across the sector.

These ambitious plans of course require us to continue to invest in our colleagues. We will invest further in digital technology for our teams to help make their jobs easier and more efficient. Our apprenticeship and graduate schemes will increase in size this year, which alongside our technical training schemes will ensure Severn Trent is equipped to serve the needs of our customers for the next generation and beyond. Customers remain firmly at the heart of everything we do with a focus on doing the right thing for them each and every day. I am extremely privileged to be a part of this great company, to work with such a fantastic team of people and to ensure the sustainability of such an important service for customers.

Our long-term strategy is to transform customer services today, drive growth, and shape our industry for tomorrow, for the mutual benefit of our customers, communities and investors.

Liv Garfield
Chief Executive

How we are achieving our strategy

Our purpose is to serve our communities and build a lasting water legacy. It is our vision by 2020 to be the most trusted water company: delivering an outstanding customer experience, the best value service and environmental leadership. How we plan to achieve this strategy is set out below.

Embed customers at the heart of all we do

What do we mean by this?

We'll improve the way in which customers engage with us through improved insight and understanding of what's important to them.

Our progress in 2015/16

- → Expanded digital channels and apps – launched webchat and Facebook, launched Track My Job and In My Street apps
- → Improved operational performance
- → Resolved longstanding legacy issues and improved case management
- → Simplified customer experience by reducing contact numbers and simplifying our automated telephony

Areas of focus for 2016/17

- → Refresh online experience for customers
- → Expand personalised service and vulnerable customer offering
- → Improve customer contact centre effectiveness through cross-skilling our agents
- → Expand proactive customer communications

Drive operational excellence and continuous innovation

What do we mean by this?

We'll build a smart water and waste water network and relentlessly look at ways to improve operational performance and customer service levels.

Our progress in 2015/16

- → We have made positive steps in our energy efficiency, investing in our first Thermal Hydrolysis Plant during the year
- → We have embedded communities of practice to bring together experts from across the Company and empower them to drive improvement
- → We have aligned performance reporting to focus on what our customers value (ODIs)

Areas of focus for 2016/17

- → We will continue to work on our energy profile, both usage and generation
- → We will continue to focus on improving information to drive better customer outcomes

Investing responsibly for sustainable growth

What do we mean by this?

We'll develop an effective strategy which optimises our regulated asset base, whilst creating new growth opportunities for the future.

Our progress in 2015/16

- → We have started our Proactive Asset Management programme focused on investing at the right time and cost to maintain and enhance the long term health of our assets
- → We continue to investigate new technology and process innovation which brings improved customer delivery at reduced cost

Areas of focus for 2016/17

- → Careful management of our investment programme to deliver high value projects on cost and on time
- → Selected investments in new technology to enhance customer delivery or reduce costs

Change the market for the better

What do we mean by this?

We'll embrace market opening in England and explore opportunities for growth in new water markets worldwide.

Our progress in 2015/16

- → We have laid the foundations for the retail market opening in our structures, creating a market facing unit and commercial pricing and delivery model
- → We have begun developing the right operating model to prepare for potential sludge market opening

Areas of focus for 2016/17

- → Readiness for shadow operation of the retail market, followed by successful market opening in full
- → Continued work on sludge market opening structures and models

Creating an awesome place to work

What do we mean by this?

We'll create a culture of empowerment and accountability with a focus on skills, talent and career development.

Our progress in 2015/16

- → 150 of our Team Managers completed our new Awesome Leaders Programme designed to help them engage and empower their teams to drive high performance
- → We have redesigned our annual opinion survey – QUEST – to provide better data to managers about engagement levels in their teams to focus their action planning

Areas of focus for 2016/17

- → A further 300 Team Managers will have completed the Awesome Leaders Programme by the end of July 2016
- → We will double our intake of graduates and apprentices in 2016 to build our talent pipelines for the future

Strategic report
Our Strategy

Strategy in action: Embed Customers at the heart of all we do:
Enhancing customer experience through digital channels has been a key priority for us this year and we've added real value for our customers, particularly through our new webchat facility. As an example, we recently assisted a customer whose husband had passed away and needed a change of name processed on their account. The webchat service made this easy to do and avoided her having to talk about the loss of her husband on the telephone. The changes were made in minutes and the ease of service shows how we're expanding our channels to continuously put customers at the heart of all we do. We are excited to help as many customers as we can in ways they find the most convenient for them.

Strategy in action: Drive operational excellence and continuous innovation
We have begun an exciting programme of investment in renewable energy technology, aiming to generate 50% of the electricity we use from renewable energy by 2020. A component of this plan is building solar photovoltaic arrays on unused land at our water and waste water treatment works.One of the largest of these is at Barnhurst Treatment Works in Wolverhampton, where a 2.8MW array of 11,000 solar panels has been built to provide electricity for the equipment we use. This covers an area equivalent to four football pitches, generating enough electricity to power the equivalent of around 800 homes!

Strategy in action: Investing responsibly for sustainable growth
The Water Framework Directive is driving the need for phosphorus removal from sewage to very low levels. As current UK technologies are unlikely to be capable of achieving this, we have invested in a ground-breaking trial at our Packington Sewage Treatment Works to investigate potential alternatives, including low energy, no chemical and phosphorus recovery technologies. Around £120 million investment in AMP6 to remove phosphorus from over 100 sewage treatment works will help ensure we invest in technologies capable of delivering effective solutions, whilst saving costs.

Strategy in action: Change the market for the better
In March 2016, we announced our joint venture, Water Plus,with United Utilities, Water Plus, which combines our non-household retail businesses which are centrally located in Stoke-on-Trent. With the non-household retail market in England opening for competition in 2017, this joint venture will combine the complementary skills of both companies, including sales, customer service, business strategy and credit management, to deliver an attractive proposition for large and small business customers across England and Scotland. Bringing our businesses together creates synergies to provide an efficient and cost-effective operation focus on improved customer service and growth.

Strategy in action: Creating an awesome place to work
This year we launched our first ever Wellbeing Programme, proactively investing in the health and wellbeing of our colleagues resulting in benefits such as higher levels of staff engagement, improved productivity and reduced absence to name a few. Employee support for the programme has been very high and throughout the year we have undertaken a number of initiatives, including Healthy Heart days, Skin check clinics, Healthy eating promotion, skipping challenges and wellbeing kiosks. Our biggest success so far has been our Pedometer Challenge which was held in December 2015 and saw 20% of the business taking part.

Progress against our Outcome Delivery Incentives

We continue to make progress against our ODIs and financial KPIs.

1. Embed customers at the heart of all we do

Internal sewer flooding

Actual 804

Reward/Penalty 1,014

Rate of Reward/Penalty (per incident)

£42,280[1]

Why we measure it
To ensure we do everything we can to prevent flooding of customers' homes or businesses. It is one of our customers' most important priorities.

Progress in the year
We are reporting a performance of 804 internal incidents against our committed performance level of 1,014 incidents.

External sewer flooding

Actual 7,142

Reward 7,452 Penalty 7,639

Rate of Reward/Penalty (per incident)

£19,779[1]

Why we measure it
To ensure we do everything we can to prevent flooding of customers' homes or businesses. It is one of our customers' most important priorities.

Progress in the year
We are reporting a performance of 7,142 external incidents against our committed performance level of 7,639 incidents.

Minutes without supply

Actual 11.17

Reward 12 Penalty 14.5

Rate of Reward/Penalty (per minute)

£1.10m[1]

Why we measure it
Our customers value water being there when they need it. This performance commitment ensures we are driving down the impact of any interruptions to supply across our network to minimise the impact on customers.

Progress in the year
We interrupted customers' supplies for an average of 11.17 minutes (11m 10s) in 2015/16. We are ahead of our performance commitment of 13.6 minutes (13m 36s).

SIM – Customer experience

Not yet defined by Ofwat

83.7 SIM score

Why we measure it
Providing good quality service to our customers is key and the Service Incentive Mechanism ('SIM') provides us with a regular opportunity to understand our performance and implement initiatives to improve the quality of service we provide, but also deliver value for money.

Progress in the year
We have seen improvements in quantitative areas of our business although we have been inconsistent in our qualitative performance which has meant that we have reported a SIM score of 83.7 for 2015/16 against our original upper quartile target.

Complaints about water quality

Actual 13,941

Reward 9,992 Penalty 11,900

Rate of Reward/Penalty (per complaint)

£900[1]

Why we measure it
Customers value the aesthetic quality of their water. This performance commitment is designed to ensure we manage our network to minimise the number of events that cause discolouration, taste or odour problems.

Progress in the year
In 2015, whilst we reduced the number of drinking water quality complaints from 14,339 to 13,941, we did not achieve our committed performance level of 11,900.

2. Drive operational excellence and continuous innovation

Improvements to river water quality

Actual 0

Penalty/Reward 233

Rate of Penalty/Reward (per unit)

£150,000[1]

Why we measure it
We have statutory obligations to deliver, but our customers told us that we should do more where we can. This performance commitment ensures we meet our obligations and drives us to deliver more where it is possible.

Progress in the year
There are no individual schemes that were due to be completed in 2015/16; but progress has been made against a number of deliverables which will be completed during 2016/17.

Number of pollution incidents

Actual 293

Reward 374 Penalty 457

Rate of Reward/Penalty (per incident)

£53,900[1]

Why we measure it
Minimising the impact our activity has on the environment is a key concern for our customers. This performance commitment ensures we drive to improve performance in this area.

Progress in the year
We are reporting 293 category three incidents against a committed performance level of 429; this is 136 ahead of target and 81 incidents ahead of our reward dead-band of 374 incidents.

Successful catchment management schemes

Actual 0

Penalty/Reward 12 Reward Cap 21

Rate of Penalty/Reward (per scheme)

£1.03m[1]

Why we measure it
Our customers want us to look for new and innovative ways to improve water quality, whilst working in partnership with other stakeholders to deliver wider benefits. This performance commitment focuses on how our approaches are encouraging farmers and land owners to change their behaviour and practices.

Progress in the year
We have made progress increasing our internal resources and agreeing a suite of performance indicators to demonstrate successful engagement and change in practice. As planned, no schemes have been fully delivered during 2015/16. Schemes are on track to be delivered in 2018/19.

Asset Stewardship – coliform failures

Actual 5

Penalty 7

Rate of Penalty

£463,000[1]

Why we measure it
The presence of coliforms in our drinking water is unacceptable so we continually monitor our works to ensure they are not being detected.

Progress in the year
During 2015 we detected coliforms at five water treatment works sites, which is better than our committed performance level of less than eight works with coliform detections. This is an improvement on our performance in 2014 where we identified 13 water treatment works with failures.

Leakage

Actual 434

Reward/Penalty 444

Rate of Reward/Penalty (per megalitre per day)

£123,000[1]

Why we measure it
Customers see leakage as a waste of a key resource; our customers want us to reduce our level of leakage as a priority.

Progress in the year
Our outturn position for 2015/16 was a total of 434 Ml/day. We have achieved our committed performance level of 444 Ml/day.

3. Invest responsibly for sustainable growth

See our Regulated Water and Waste Water performance review.

4. Create an awesome place to work

Lost time incidents per 100,000 hrs worked

Severn Trent Water Limited

0.25

2014/15: 0.21

Business Services

0.17

2014/15: 0.30

Severn Trent engagement score[2]

52%

Progress against our financial KPIs

*2015/16 Revenue £1,550.2
*2014/15 Revenue £1,518.2

*2015/16 Group underlying PBIT £518.7
*2014/15 Group underlying PBIT £536.6

*Calendar year.

Notes
1 In 2012/13 prices after tax.
2 New engagement index used for the Group in 2015/16 to support benchmarking and gain better insight about us as an employer. UK benchmark 50%.

Key
Actual
| Severn Trent Actual Performance 2015/16

Strategic report
Market and industry overview

Achievements
It is just over 25 years since the English and Welsh water and waste water industry was privatised in 1989. Since then the industry has made significant progress through innovation, greater efficiency and a substantial increase in investment on pre-privatised levels. Investment to date is £108 billion.

This investment has helped to deliver real improvements for the industry's 50 million household and non-household consumers. Leakage has reduced by 35% since the mid-1990s, sewer flooding is 75% lower than a decade ago, and 99.96% of drinking water and 95.4% of bathing waters now meet European Union (EU) standards. At the same time, it is estimated that industry-wide efficiencies have kept customers' bills £120 lower on average than they would otherwise have been.

Severn Trent Water Limited, our regulated business, is proud of the part it has played in these achievements as one of 18 regional suppliers. Ten of these, including Severn Trent Water Limited, provide water and waste water services. The remaining eight provide water only.

Challenges
Our industry, the environment in which we work, and the needs of the customers who we serve, continue to change. And while these changes present, as we see them, fantastic opportunities, there remain challenges.

Our customers' expectations are ever changing, not least how they'd like to communicate with us. Innovation in channels such as webchats and social media are transforming our industry beyond anything contemplated at the time of privatisation. At Severn Trent Water Limited, we're committed to serving our customers 24 hours a day, using channels that are convenient to them, and that means being a leader in this new digital world.

While meeting 21st century expectations, we also have to deal with the realities of an infrastructure that dates back, in some cases, to the early 20th century. Over the next five years, we're investing £700 million in repairing and, where necessary, replacing parts of our infrastructure to leave behind an even better set of water and waste water services for the next generation.

Increasing our network's resilience is also a priority. Extreme weather associated with global warming is likely to have a major impact on how we operate and how and where we invest. We're committed to building resilience against, and adapting to, flooding and drought in our plans. Our biggest capital investment over the next five years, the £300 million Birmingham Resilience project, is just one example of how, by creating a second source of water for the UK's second largest city, we're working to safeguard our customers' future supplies.

Meanwhile the UK's population continues to grow, and new households and businesses will place greater demand on our water and waste water services. Severn Trent Water Limited currently serves 4.3 million households and businesses and it is our responsibility to invest carefully to ensure that we have the right infrastructure and resources in place to meet their needs.

And, underpinning all these challenges, we must continue to be able to finance our future investment needs in a sustainable way, so that we can keep offering affordable bills to our customers, and create value for our investors.

A changing regulatory landscape
The industry in England and Wales operates in a policy framework where standards shaped by the European Union (EU) are implemented by the Department for Environment, Food and Rural Affairs (Defra) and the Welsh Government respectively.

The Drinking Water Inspectorate (DWI) oversees the quality of drinking water, and the Environment Agency, and its Welsh counterpart, Natural Resources Wales, license water abstraction, and regulate river pollution and flooding.

Strategic report
Market and industry overview

The Consumer Council for Water, which represents the industry's customers, and Natural England which protects England's natural environment, play an important part of this framework.

It is perhaps in the economic regulation of the industry, where, in recent years, we have seen some of the most notable changes.

Ofwat, the industry's economic regulator, sets limits on the prices we can charge our customers over five year periods. These five year regulatory planning cycles, are known as Asset Management Plan (AMP) periods. This financial year was the first of AMP6, which started on 1 April 2015.

Our planning for AMP6 concluded in 2014 when Ofwat carried out its 2014 price review (PR14). In our view, PR14 represented the most significant development of the economic regulation framework since privatisation. Ofwat sought to put greater responsibility on companies to develop their plans in consultation with customers, giving them a stronger voice in determining the future of their services.

To reinforce this customer-centric approach, Ofwat changed the nature of incentives within the price setting framework. By introducing Outcome Delivery Incentives (ODIs), Ofwat better aligned the interests of companies with those of their customers using performance-related penalties and rewards. Ofwat also encouraged companies to look at the whole life costs of their assets (by switching to a total expenditure cost assessment (Totex)), and provided stronger incentives for companies to press for further efficiencies. Details about our ODIs can be found on page 9.

Our AMP6 plans, driven by our determination to embed customers at the heart of all we do, embraced these changes. Our performance review on page 14 sets out how well we did during the first year.

Contributing to the future of regulation
The regulatory framework within which we operate continues to evolve. Ofwat consulted on its future proposals for the sector in its Water 2020 document. In establishing its proposals, Ofwat encouraged water companies to contribute to a 'marketplace of ideas'.

We contributed to this on access pricing, the allocation of the regulatory capital value (RCV) and indexation.

In September 2015, we also published Charting a Sustainable Course which set out our vision for the future of the water sector. This built on our previous series of Changing Course thought leadership publications. The Ofwat Water 2020 document is aligned with a number of our proposals including developing markets for sludge trading and water resources.

For the most part we are very supportive of the proposals. We believe that they will help us deliver our vision to be the most trusted water company by creating a much stronger emphasis on companies competing to deliver the best service for their customers.

Overall we think the reforms proposed by Ofwat have the potential to deliver enormous benefits to customers through lower prices and higher service levels. The ideas around sludge competition are perhaps the most exciting given recent technological developments and we think they will help promote a more innovative and sustainable sector.

We have suggested some improvements to the proposed package of reforms, particularly around sludge, direct procurement and the proposed transition to CPI.

The most significant immediate change to the framework within which we operate, is the introduction of retail competition for non-household customers in April 2017. This will enable businesses, charities and other non-household customers to shop around for what they consider to be the best deal in water supply. Severn Trent welcomes the introduction of competition and the potential to win new customers. The Government has also asked Ofwat to look at how this choice might be extended to households and we welcome this review and are engaging with Ofwat to support its analysis.

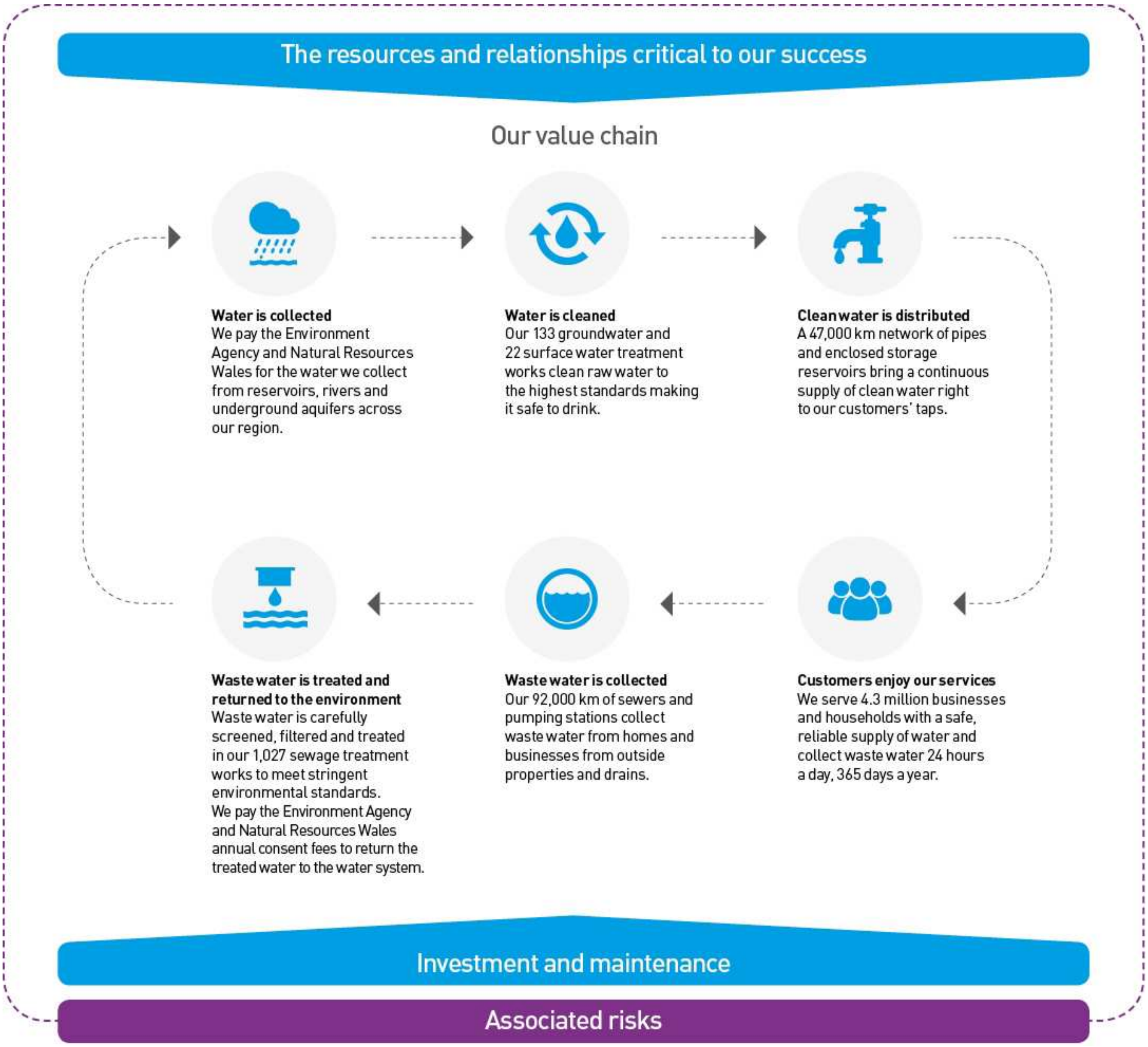
A sustainable company

The central issues as we see them are around ensuring we continue to chart a sustainable course;

- empowerment for customers in decisions about their water services;
- affordable services for customers in the long term;
- a more resilient sector for water resources;
- flooding and drainage challenges, particularly during a period of climate change;
- cost-effective delivery of further improvements to the environment;
- innovation and market solutions to benefit customers; and
- working with partners across the community to deliver the most efficient and effective solutions

Industry stakeholders and regulators are involved in a continual, constructive debate on how best to meet the changing needs and aspirations of our customers. We are proud that Severn Trent is among the leaders in that debate.

Strategic report
Business model



Strategic report
Performance review

Regulated water and waste water business model

Our regulated water and waste water business works within five year planning cycles that are determined by our economic regulator, Ofwat. Each of these periods is called an Asset Management Plan (AMP) and allows us to fund our investment programme and cover our operating costs. This was the first year of AMP6.

Our prices and asset base are adjusted by inflation each year. Under certain circumstances, for example where there is a material change in costs due to factors that are beyond our control, we can request a price review during the AMP.

The framework on which we build our activities consists of a package of 45 performance commitments that are largely unique to us and agreed with Ofwat. Of these, 33 Outcome Delivery Incentives (ODIs) reward us for doing the right thing for customers, improving services and being more efficient, or conversely penalise us for failing to do so.

This is consistent with our own strategic framework, which focuses on embedding customers at the heart of all we do; driving operational excellence and continuous innovation; investing responsibly for sustainable growth; changing the market for the better; and creating an awesome place to work.

Regulated water and waste water business performance review

Critical to our success
Putting customers first
We serve 4.3 million households and businesses in the heart of the UK, in an area stretching from the Bristol Channel to the Humber, and from mid-Wales to the East Midlands. Our customers consume almost 2 billion litres of water every day and rely on us to collect almost as much waste water – some 1.5 billion litres daily.

Customers are at the heart of all we do. They trust us to ensure that their water is not only available 24 hours a day, but is also always safe to drink.

During the year, we have increased our water quality standards compliance to 99.96%, an improvement on 99.94% in 2014. We also reduced the number of pollution incidents and made significant reductions in both internal and external sewer flooding incidents.
Our customers pay the lowest combined water and waste water bills in Britain, at £329 p.a in 2015/16 (2014/15: £333). We also continuously work hard to help our vulnerable customers who have difficulty paying their bills, through a number of schemes.

Case Study: What a big difference the Big Difference Scheme can make
One of our customers had been diagnosed with breast cancer, and as her partner suffered from Dementia and was unable to work, when her sickness pay from her employer ceased, the couple were worried about how they would manage future payments. They had paid all but £40 of their water charges, and therefore their application for a trust fund grant had been declined. The Trustees identified that they were eligible for the Big Difference Scheme and referred them successfully. At a difficult time, they were delighted to hear that Severn Trent were able to ease their financial burden and reduce their bills for 2016/17.

Our employees
We are firmly committed in our purpose to serve our communities and to build a lasting water legacy. In order to do this, we need to 'create an awesome place to work' for our colleagues and as part of this, we recognise that diversity and inclusion are important for our success. We need our workforce to reflect the customers and communities we serve, so that we can better understand and respond to their needs.

There are several aspects to this. For one, it means encouraging and celebrating diversity in all of its forms including gender, race, national origin, disability status and social background. Secondly, to help us make meaningful progress, we have prioritised three key areas: women in operational leadership positions; women and BAME (Black, Asian and Minority Ethnic) people in engineering positions; and BAME people in technical operator positions.

We are also driving a better working environment for our colleagues through our enhanced training and development initiatives such as our Awesome Leaders Programme.

Regulatory framework
Ofwat, the industry's economic regulator, sets limits on the prices we can charge our customers during each five year AMP period. Ofwat was founded at the time the industry was privatised and since then has incentivised companies to deliver better services at a lower cost, whilst ensuring efficient companies are financeable.

Standards for water, waste water and the environment are consistent across the European Union. In England, the Department for the Environment, Food and Rural Affairs (Defra) sets the overall water and sewerage policy framework. In Wales the policy framework is set by the Welsh Government.

We also work closely with a variety of other public bodies:

- The Consumer Council for Water speaks on behalf of all water consumers in England and Wales. As such, it advises consumers and takes up complaints on their behalf.
- The Environmental Agency allows us to collect water from reservoirs, rivers and aquifers and return it to the environment after it has been used by our customers and treated by us.
- Natural Resources Wales is the environmental regulator in Wales. It ensures that Wales' natural resources are sustainably maintained, enhanced and used.
- Natural England advises the Government on the natural environment in England and helps to protect nature and the landscape, with particular responsibility for freshwater and marine ecologies.
- The Health and Safety Executive helps us to eliminate dangers to our employees and customers.
- The Drinking Water Inspectorate (DWI) provides independent reassurance that water supplies in England and Wales are safe and drinking water quality is acceptable to consumers. The DWI's remit includes water quality audits, a regulatory strategy to further improve drinking water, enforcement processes and science and policy.

Associated risks

Each phase of the value chain presents risks as well as opportunities. It is our job to maximise opportunities while anticipating and mitigating the associated potential and existing risks.

Water is collected

Key asset failure could result in injuries, damage to property and /or disruption of water supply.

Principal risk ref 7 and 8

Water is cleaned

During this phase, a failure of key assets or processes may cause a decline in water quality or disrupt our supply to customers.

Principal risk ref 6 and 7

The use of potentially hazardous chemicals or processes may also result in injuries.

Principal risk ref 8

Clean water is distributed

Distribution performance could fall below the required standards, resulting in poor customer service and increasing the risk of leakage from our network.

Principal risk ref 1 and 6

Customers enjoy our services

A failure to improve or maintain our performance could result in customer disappointment.

Principal risk ref 1

Waste water is collected

Sewer flooding could be the result of failing to deal effectively with customer waste.

Principal risk ref 7

Waste water is treated and returned to the environment

Operational failures during this phase could result in damage to the local environment.

Principal risk ref 8

Potentially hazardous processes and substances may result in people being injured.

Principal risk ref 8

Strategic report
Performance review

Investment and maintenance

With a wholesale capital programme for the year of almost £500 million, our average spend was £113 per connected property. Expenditure encompassed finding and fixing more leaks, reducing the number of pollution incidents and improving our water and waste water treatment plants. Additional upgrades to our sewer network also reduced incidents of sewer flooding. We funded this programme of essential work through customer bills, the profits we generated from being efficient and through borrowings from capital markets.
The amounts we invest in improving and maintaining our networks, together with the other costs of operating the business, form the total expenditure of the business or 'Totex'. Part of our Totex is included in the calculation of current year prices and the remainder is added to our asset base, called the Regulated Capital Value (RCV).

During AMP6, we aim to increase returns to our shareholders through the potential created by Outcome Delivery Incentives (ODIs). The ODI framework means that if we deliver higher service levels where our customers value it most, we are rewarded for a year. In 2015/16 we laid the foundation for potential rewards via ODI outperformance.

Regulated water and waste water business performance

We are firmly committed to delivering even better value for money, improved services and a healthier environment between 2015 and 2020.

We aim to inspire trust among our customers by maintaining and expanding a water system on which they know they can rely upon: clean, safe, reliable and responsive to their needs.

In this section, we explain how our business performed during the last 12 months, as well as the actions we're taking to achieve success during this AMP.

Embedding customers at the heart of all we do
Severn Trent customers pay the lowest average combined water and waste water bills in Britain and will continue to do so throughout AMP6. Our average combined bill in 2015/16 was £329 (2014/15: £333), which equates to a 1.2% reduction. Our challenge is to strike the right balance between keeping bills affordable for today's generation and investing in our network and assets to ensure they remain affordable for future generations.

We have worked to help our customers who have difficulty in paying. Whilst we didn't meet our target, we were able to assist 24,110 customers through a variety of schemes. In some cases, through our new social tariff, the Big Difference Scheme, we have been able to provide reductions of up to 90% for qualifying customers. Through carefully selected third party organisations, we also make available debt management advice to help our customers who are in difficulty get back on track.

In 1997, the Severn Trent Trust Fund was established to provide assistance for those in the most financial difficulty. This independent body aids people in arrears with their water bills and can also provide help with essential household bills or costs. Since incorporation we have donated more than £56 million for the benefit of 550,000 people across our region who have fallen behind with their payments. This financial year, we have donated £3.5 million to the Fund.

In order to keep bills affordable, where possible we work to ensure that everyone who can pay, does, so they don't increase the burden on others. During the year we reduced our level of bad debts to 1.5% of turnover, one of the best performances in the sector.

In 2015/16 we began a more in-depth engagement with our customers on a range of issues, such as bill design and how we communicate. This included a survey of over 15,000 respondents, involving a much wider cross-section of our customers than we've ever reached before, achieved through more frequent and effective communication.

We have listened to our customers' comments and have made our billing information simpler and introducing more convenient ways to pay.

In response to feedback that customers wanted greater availability and accessibility of communications channels, we broadened access, setting up a webchat facility that has so far engaged in over 100,000 chats. We expanded our Twitter feed to be a 24/7 operation to better suit customers' needs.

We have also committed to investigate the underlying causes of complaints and act on them in anticipation of problems. This effort is paying off. This year, household written complaints were down by 29%.

Enhancing customer experience through the intelligent use of customer data, current and future technologies will be an important part of our approach during AMP6. We're continuing to invest in and develop systems, which will draw together the key elements of customer insights, people, processes and systems to provide a consistent experience to our customers regardless of their choice of channel. Increasing our knowledge of each customer will help us to predict their needs, so we can offer them a more personalised service. This will also support our colleagues to resolve more queries first time.

Ofwat's Service Incentive Mechanism (SIM) is an important indicator of how good our customer service is. The SIM score has two elements – qualitative and quantitative. This year SIM is based on Household customers only and the overall score calculation is weighted at 75% Qualitative and 25% Quantitative. We are reporting a Company SIM score of 83.7.

Investing responsibly
We hope to continue the strong start we've made to the current regulatory period, and plans are now in place to improve our performance further throughout AMP6.

Our £300 million Birmingham Resilience Project, due for completion in 2020, is our, and the sector's, biggest single capital investment scheme for this AMP. It will create a second major source of water for the UK's second largest city. Once operational, the new, state-of-the-art facility will supplement water flowing through the existing Elan Valley Aqueduct, a Victorian landmark. Having this alternative source in place will enable us to divert supply in order to carry out maintenance and repairs to the full 74-mile length of the aqueduct. This restoration and modernisation will keep the aqueduct going for at least another century, creating a lasting legacy for the next generation and ensuring the security of Birmingham's water supply.

We share our customers' desires for a cleaner, greener future that protects and improves our environment for generations to come. During the year, we invested £91 million towards achieving our targets on pollution, environmental compliance, biodiversity and sustainable sewage treatment. This forms part of a larger £250 million programme for AMP6 that will help ensure our assets are not preventing compliance with the Water Framework Directive.

In 2015, to expand our water catchment management programme, we recruited eight new agricultural advisors. These experts, together with other environmental colleagues, work closely with farmers throughout the Severn Trent region to promote better land management. With help from our agricultural advisors, more farmers are now using acceptable substitutes or channelling their contaminated water to prevent it joining streams and rivers. This initiative not only helps the environment, but also, by reducing the run-off of pesticides into our natural raw water sources, helps to reduce our treatment costs.

Our performance commitment score for Asset Stewardship Environmental Compliance was 97.51% for the year. This fell just short of 100% compliance, largely as a result of the time it takes to see the required flow conditions to confirm the improvements we have made.

Globally there is increased focus on mitigating the risk of climate change. During the year we reduced our overall Severn Trent Water Limited carbon emissions to 484 kilotonnes of CO_2e, a reduction of 1%, compared to 2014/15 (491 kilotonnes). Despite this reduction however, we have not met our stretching ODI target for the year. More information on our greenhouse gas impact can be found within our Corporate Responsibility report on page 37.

Renewable energy is an important part of our approach to sustainability. We will be investing up to £190 million to reach our 2020 target of producing the equivalent of half of our energy needs from renewable sources. We use a range of technologies such as anaerobic digestion of sewage sludge, food waste and crops as well as wind turbines, hydropower and solar panels. We lead the industry in this effort.

We remain on target to deliver our renewables commitment. This year we have invested in solar arrays at over 30 sites, erected two new wind turbines and we are have started construction on our second food waste anaerobic digestion site at Roundhill Staffordshire. We are also investing in Thermal Hydrolysis Process Technology to extract even more energy from our sewage sludge before we recycle it to agricultural land.

Case Study
We conducted a mini competition for the Birmingham Resilience Project to get the best prices from our One Supply Chain to procure a new tunnel boring machine, outperforming our 20% efficiency target.

Driving operational excellence and continuous improvement
For our customers, being able to rely on the quality of the water we supply to their homes and businesses is their highest priority.

To improve water quality, we have made substantial investment in our water treatment facilities. During the year, a total of £72 million was targeted at reducing water quality complaints, compliance with drinking water quality standards and reducing coliforms. Improvements include the installation of 8 ultra violet sterilisers at groundwater works, as part of our wider Operational Effectiveness Programme. We have undertaken the sector's most rigorous levels of testing, with sampling for coliform bacteria done as frequently as every 10 to 15 minutes at our critical sites. During 2015, we improved drinking water quality standards to 99.96%, which was below our target, but an improvement on 99.94% in 2014/15. We have also seen an improvement in coliform detection, down to five sites this year, compared to 13 sites the year before. The incident at Castle Donington in March 2016 however shows that there remains much work to be done to consistently deliver the services our customers rightly deserve.

Discolouration, while usually harmless, can be off-putting for our customers. More often than not, it is caused by changes in flow, which can loosen harmless iron sediments from within the pipes. During the year, we increased our pipe cleaning programme from 1000km in 2014/15 to 1500km in 2015/16. This helps to reduce complaints about water discolouration.. We still had more than 7,000 discolouration contacts in 2015 so we recognise that we have more to do to meet our targets.

We have reduced total leakage and have achieved our regulatory commitment for the fifth year running. Our 'Valuing Every Drop' programme has been part of this success.It informs customers of the challenges we all face due to greater variability in weather patterns and more frequent episodes of extreme weather. Our shared goal with customers is to reduce unnecessary usage and to do everything we reasonably can to fix leaks as quickly as possible. This year we set a target of meeting 70% of fixed visible leakage, where safe to do so, in 24 hours.
Whilst we improved to 53%, we have more to do to meet this challenging commitment.

Over the course of the year, customers experienced an average of 11 minutes 10 seconds without supply, compared to an average of 9 minutes 54 seconds the year before.

Strategic report
Performance review

Although rare, a sewer flooding is one of the worst things that can happen to a household. Whether it involves a backup within the property itself or an overflow from beyond the perimeter, the upheaval and damage can have a significant and unpleasant impact. We therefore plan to increase our spend, targeted at reducing such events, from £110 million in AMP5 to the current £135 million.

In 2015/16 we accelerated our investment in flood prevention and mitigation, and as a result, we were able to gain a better understanding of the cause of sewer floods and how best to prevent them in future. Looking at a decade of data, we also identified 'hotspots' throughout the region and have focused our investment and efforts in those locations.

Thanks to these efforts, Severn Trent had 31% fewer internal sewer floods, down from 1,168 in 2014/15 to 804 in 2015/16 and a 28% drop in external flooding during the year, down from 9,896 in 2014/15 to 7,142 in 2015/16. These improvements were ahead of target, and built on the advances already made in the previous year.

We have reduced sewer blockages by 4%, which has been achieved in part through education programmes that help customers understand how they can prevent blockages, 75% of which are caused by customers putting the wrong items down the sink or toilet. Every year it costs us £10 million to clean over 700 km of sewers, so helping customers understand how they can help prevent blockages also lessens the cost that is borne by them.

The Environment Agency has provisionally assessed our overall environmental performance at 4*. If confirmed, this would be the second time in the past three years. We have also increased our efforts in preventing pollution. During the course of the year our less serious spills (classified by the Environment Agency as category 3) were down by 21%,
while more serious incidents (categories 1 & 2) were reduced by 80%.
Throughout 2015/16, we have sought to enlist customer support to involve them more closely in what we do. That is why we launched a number of customer focused apps. These include 'In My Street,' which provides alerts to people of local water repair work and gives them the opportunity to adapt their travel and domestic arrangements accordingly, which Utility Week cited as among the sector's best. Another app, 'Track My Job', supplies real-time updates on repairs, which means that customers can keep constant focus on the latest situation around any of the jobs or issues that they've raised with us.

Case Study
As a reminder to our employees that even one injury is too many, a Goal Zero Clock is now available on every desktop to keep everyone aware of their role in perpetuating our safety culture, and to report any safety incidents as they occur.

Case Study
Our new lime plant at Frankley was installed as part of a much wider programme to improve water supply to customers in Birmingham. The plant was designed and constructed off-site, reducing on-site work from 3 months to 2 weeks.

Creating an awesome place to work
Safety is an ongoing priority, which we have embedded into daily working life as well as safety in our supply chain. We have made improvements in a number of areas, but have fallen short of where we need to be in others. Our year end Lost Time Injury ('LTI') rate was 0.25 across both Severn Trent Water Limited and our supply chain. This is slightly worse than the previous year's LTI of 0.21 per 100,000 hours worked. Overall accidents reduced by 25% this year.
At Severn Trent, a core value is to 'create an awesome place to work'. For our employees that means being part of an organisation that celebrates diversity and individual thinking, provides recognition and reward whenever it is due and offers opportunities for advancement and job enrichment through professional and personal development. During the past year, we have made progress in all of these aspects of working life.

Strategic report
Performance review

During the year, we delivered more than 15,000 training days in our UK water business. We undertook a comprehensive review of personal development plans for all senior leaders and line managers and devised tailored development programmes. On the technical side, we've provided training to all our staff on the importance of protecting drinking water quality.

Our new recognition scheme, 'Our Brilliant People' provides a new, online way of recognising individuals' exemplary performance instantly throughout the Company. So far, we have had 14,764 such recognitions.

Our initiatives for greater involvement, recognition and empowerment are working. In 2015 we reviewed and replaced our existing employee surveys into a single global survey to give us new insights into employee engagement and thinking. For its first year we are delighted that response rates have remained strong with the overall response rate at 80%. Our highest performing areas for 2015/16 were Health and Safety; Customer Focus; Diversity and Inclusion and Corporate Social Responsibility. We remain determined to further improve our scores next year.

We take a long term view of our business and are active in seeking out tomorrow's talent – particularly among women and BAME candidates for jobs in engineering and technical operations roles. We recognise that diversity and inclusion are important for success and have always made them a business imperative. Our Severn Trent Water Limited workforce remains slightly more diverse than the sector average, with female employees accounting for 30.3% of the total compared with 30% across the industry. 7.64% of our employees are BAME against an industry average of 6%.

Outlook
Only one year into AMP6, we can already see how the new regulatory framework is delivering better outcomes for our customers, our communities and for the environment. Our other stakeholders – investors and employees – are also benefitting, as ODI performance and a growing RCV provide new gains and new opportunities.

The investments we are currently making are yielding improved water and waste water services throughout our region for today's customers, and we intend to continue improving our services so that tomorrow's customers can also reap the benefits for generations to come.

Strategic report
Financial Review

The group has delivered strong financial results in the first year of the new AMP. Reduced operating costs have helped offset the impact of the lower prices agreed in the Final Determination. PBIT is profit before interest and tax; underlying PBIT is PBIT excluding exceptional items as set out in note 7.

Results

Turnover in Severn Trent Water Group decreased by £31.0 million, or 2.0%, to £1,550.2 million, largely as a result of the agreed price reduction in the Final Determination of £30.2 million. This was partially offset by growth from new customers and consumption increases of £6.7million. Tariff mix and other effects reduced turnover by £7.5 million.

Underlying PBIT decreased by 3.3% to £518.7 million (2014/15: £536.6 million) as lower operational costs partially offset the decline in turnover.

	2016	2015	Better/(worse)	
	£m	£m	£m	%
Turnover	**1,550.2**	1,581.2	(31.0)	(2.0)
Net labour costs	**(142.0)**	(157.0)	15.0	9.6
Hired and contracted costs	**(172.4)**	(164.0)	(8.4)	(5.1)
Bad debts	**(23.7)**	(28.4)	4.7	16.5
Power	**(68.9)**	(71.2)	2.3	3.2
Infrastructure maintenance	**(126.0)**	(134.8)	8.8	6.5
Depreciation	**(310.2)**	(298.9)	(11.3)	(3.8)
Other costs	**(188.3)**	(190.3)	2.0	1.1
Underlying PBIT	**518.7**	536.6	(17.9)	(3.3)

Net labour costs were £15.0 million lower year on year. Employee costs decreased by £13.7 million reflecting the benefits of the reorganisation implemented in the previous year and the closure of the defined benefit pension scheme to future accrual. These offset additional costs related to the new company-wide incentive scheme launched at the beginning of the year.

Hired and contract costs increased by £8.4 million. This is partly due to costs incurred in preparation for market opening including an increase in contributions to Open Water. In addition, we have seen an increase in distribution and tankering costs in our waste business and have paid a bonus to our supply chain for support on delivering our strong ODI performance.

Bad debt charges were 1.5% of turnover in the year (2014/15: 1.8%) and decreased by £4.7 million as a result of improved collection performance on amounts billed in the year and better management of aged debt balances.

Power costs decreased by £2.3 million mainly due to the benefit of a full year of biogas to grid generation. We continue to make good progress on our renewable energy generation, and self-generated the equivalent of 33% of gross consumption in the year, providing an increasingly effective hedge against energy price volatility.

Infrastructure renewals expenditure decreased by £8.8 million year on year due to a lower level of activity at the start of the year, and improved efficiencies in delivering the programme, as highlighted in the interim results of Severn Trent Plc.
Depreciation increased by £11.3 million primarily due to the growing asset base and an accelerated charge of £3.6 million arising from the decommissioning of older assets as part of our water quality investment programme.

Return on Regulatory Equity (‘RoRE’)

A key indicator of the performance of the regulated business is the Return on Regulatory Equity. Outperformance against the Final Determination for totex, ODIs and financing is included in RoRE.

Strategic report
Financial Review

Profits reported under IFRS accounting rules do not reflect all of the regulatory impacts of performance in the year and may reflect the regulatory impacts of performance in previous years.

Severn Trent Water's RoRE for the year ended 31 March 2016 is set out in the following table:

	%[1]
Base return[2]	5.7
Totex outperformance[3]	0.7
ODI outperformance[4]	0.7
Financing outperformance[5]	1.4
Other[6]	(0.1)
Regulatory return for the year	**8.4**

1 Based on RCV of £7,324 million in 2012/13 prices
2 Per Final Determination
3 Company share of Totex outperformance in the year
4 Company assessment of performance, subject to Ofwat review process in Autumn 2016
5 Based on actual financing cost and actual gearing
6 Includes non-household revenue, land sales and disposals, other income and the Wholesale Revenue Forecasting Incentive Mechanism

Severn Trent Water's Totex benefit to RoRE, after taking account of sharing with customers was £19.0 million in 2012/13 prices after tax.

Our assessment of performance on our Outcome Delivery Incentives (‘ODI’s) will be published in Severn Trent Water Limited's Annual Performance Report in July 2016. We earned a net reward for performance in 2015/16 of £23.2 million before tax at 2012/13 prices, which is subject to the Ofwat review process in Autumn 2016. All of this relates to ‘in AMP’ measures, which will be reflected in increased prices that we will set for 2017/18.

Severn Trent Water’s financing costs in 2015/16 were £40 million lower than the Final Determination in 2012/13 prices after tax. This is due to the impact of lower inflation on our index linked debt and nominal interest rates achieved lower than assumed in the Final Determination - a consequence of low market interest rates and savings arising from our AMP6 financing activities. In addition, we have a lower debt requirement than assumed in the Final Determination.

Exceptional items

An exceptional credit of £1.0 million was recognised for the year (2014/15: £21.5 million charge) as a result of the release of a provision that was previously recorded as an exceptional charge.

Net finance costs

The net finance costs were £203.9 million, £17.6 million lower than in the prior year. The benefits of lower interest rates, in particular on our RPI-linked debt, were partially offset by higher levels of net debt.
In March 2015, in order to mitigate financing risk in 2015/16, the group purchased approximately 26% of the €700 million, fixed rate Eurobond, which was due for repayment in March 2016. This led to a charge of £6.6 million in finance costs in 2014/15. The remaining balance of the Eurobond was repaid in accordance with the original schedule on 11 March 2016.

The group's net interest charge, excluding net gains/(losses) on financial instruments and net finance costs from pensions, was covered 4.3 times (2014/15: 4.0 times) by profit before interest, tax, depreciation, profit on disposal of fixed assets, deferred income release and exceptional items and 2.7 times (2014/15: 2.6 times) by underlying PBIT.

Gains/(losses) on financial instruments

The Group uses financial derivatives solely to hedge risks associated with its normal business activities including:

- exchange rate exposure on borrowings denominated in foreign currencies;
- interest rate exposures on floating rate borrowings; and
- exposures to increases in electricity prices.

Accounting rules require that these derivatives are revalued at each balance sheet date and, unless the criteria for cash flow hedge accounting are met, the changes in value are taken to the income statement. If the risk that is being hedged does not impact the income statement in the same period, then an accounting mismatch arises from the hedging activities and there is a net charge or credit to the income statement.

Where derivatives are held to their full term, mismatches will net out over the life of the instrument. The changes in value that are recorded during the lives of the derivatives, unless crystallised, do not represent cash flows. Therefore the Group presents underlying earnings figures that exclude these non-cash items. In exceptional circumstances the Group may terminate swap contracts before their maturity date. The payments or receipts arising from the cancellations are charged or credited against the liability or asset on the balance sheet, and amounts previously recognised in reserves are recycled through the income statement.

The Group holds interest rate swaps with a net notional principal of £518.1 million which economically act to hedge the interest rate risk on floating rate debt or the exchange rate risk on certain foreign currency borrowings. However, the swaps do not meet the hedge accounting rules of IAS 39 and therefore the changes in fair value are taken to gains/(losses) on financial instruments in the income statement. During the year there was a credit of £47.7 million (2015: charge of £195.3 million) in relation to these instruments.

An analysis of the amounts charged to the income statement in the period is presented in note 12 to the financial statements.

The Group manages its electricity costs through a combination of self generation, forward price contracts and financial derivatives. The Group has fixed around 37% of the estimated wholesale energy usage for 2016/17.

Taxation

The total tax credit for the year was £14.1 million (2014/15: charge of £25.7 million).

The current tax charge for 2015/16 was £55.2 million (2014/15: charge of £38.8 million). The deferred tax charge before exceptional tax for 2015/16 was £9.5 million (2014/15: credit of £13.1 million).

There was an exceptional deferred tax credit of £78.8 million arising from the change in tax rates (2014/15: £nil). This was a result of the Finance Act 2015 being enacted in the current year, reducing the corporation tax rate from 20% to 18% with effect from 1 April 2020.

The underlying effective rate of current tax on continuing operations, excluding prior year credits, exceptional tax credits and tax on exceptional items and financial instruments, calculated on profit from continuing operations before tax, exceptional items before tax and gains/(losses) on financial instruments was 18.6% (2014/15: 18.0%).

Group cash flow

	2016 £m	2015 £m
Cash generated from operations	**799.8**	752.3
Net capital expenditure	**(385.8)**	(392.5)
Net interest paid	**(184.0)**	(202.6)
Payment to close out interest rate swaps	**–**	(139.2)
Tax paid	**(20.0)**	(26.5)
Other cash flows	**0.1**	–
Free cash flow	**210.1**	(8.5)
Dividends	**(310.0)**	(203.7)
Net issue of shares	**(4.0)**	(2.4)
Change in net debt from cash flows	**(103.9)**	(214.6)
Non cash movements	**(8.8)**	(27.2)
Change in net debt	**(112.7)**	(241.8)
Net debt 1 April	**(4,700.8)**	(4,459.0)
Net debt at 31 March	**(4,813.5)**	(4,700.8)
Net debt comprises:		
Cash and cash equivalents	**(2.8)**	120.1
Loans payable to parent company	**(53.0)**	(27.0)
Bank loans	**(1,212.2)**	(1,240.7)
Other loans	**(3,456.4)**	(3,368.8)
Finance leases	**(117.2)**	(180.0)
Cross currency swaps	**28.1**	(4.4)
	(4,813.5)	(4,700.8)

At 31 March 2016 the group had a net overdraft of £2.8 million (2014/15: £120.1 million in cash and cash equivalents). Average debt maturity is around 15 years. Including committed facilities, the group's cash flow requirements are funded until January 2018.

Net debt at 31 March 2016 was £4,813.5 million (2014/15: £4,700.8 million). Balance sheet gearing (net debt/net debt plus equity) at the year end was 84.1% (2014/15: 86.0%).

The estimated fair value of debt as at 31 March 2016 was £861.7 million higher than the book value (2014/15: £891.3 million higher). The movement in the difference to book value is largely due to the increase in the discount rates applied, driven by market expectations of higher interest rates.

Treasury management and liquidity

The Group's principal treasury management objectives are:

- to access a broad range of sources of finance to obtain both the quantum required and lowest cost compatible with the need for continued availability;
- to manage exposure to movements in interest rates to provide an appropriate degree of certainty as to its cost of funds;
- to minimise counterparty credit exposure risk;
- to provide the Group with an appropriate degree of certainty as to its foreign exchange exposure;
- to maintain an investment grade credit rating; and
- to maintain a flexible and sustainable balance sheet structure.

The Group continues to ensure it has adequate liquidity to support business requirements and provide headroom for downside risk. At 31 March 2016 the group had committed undrawn facilities amounting to £775.0 million (2014/15: £745.0 million).

Strategic report
Financial Review

The group is funded for its projected investment and cash flow needs up to at least January 2018.

Cash is invested in deposits with financial institutions benefiting from high credit ratings and the list of counterparties is reviewed regularly.

In November 2015 the company completed its first US Private Placement debt issue raising the equivalent of £471 million at competitive pricing with maturities ranging from 11 to 15 years. The proceeds were received in March 2016 and were used to repay the remaining £396 million of our €700 million bond.

The Group's policy for the management of interest rate risk requires that not less than 40% of the Group's borrowings should be at fixed interest rates, or hedged through the use of interest rate swaps or forward rate agreements. Going forward, the Group intends to manage its existing debt portfolio and future debt issuance to increase the proportion of debt which is at floating rates. At 31 March 2016, interest rates for 51.7% (2014/15: 67.0%) of the group's net debt of £4,813.5 million were fixed.

The Group's long term credit ratings are:

Long term ratings	
Moody's	A3
Standard & Poor's	BBB+

Pensions
The Group operates two defined benefit pension schemes for its UK employees, of which the UK Severn Trent Pension Scheme ('STPS') is by far the largest. The most recent formal triennial actuarial valuations and funding agreements were carried out as at 31 March 2013 for both schemes. As a result, deficit reduction contributions of £40 million in 2013/14, £35 million in 2014/15, £15 million in 2015/16 and £12 million p.a. in subsequent years to 2024/25 were agreed. Further payments of £8 million p.a. through an asset backed funding arrangement will also continue to 31 March 2032. The next triennial valuation, as at 31 March 2016, is underway.

As previously announced, the defined benefit schemes closed to future accrual on 31 March 2015. On 1 April 2015, members of the defined benefit schemes were transferred to the defined contribution Severn Trent Group Personal Pension Scheme, which was opened on 1 April 2012.

The key actuarial assumptions for the defined benefit schemes have been updated for these accounts. On an IAS 19 basis, the estimated net position of the schemes was a deficit of £309.5 million as at 31 March 2016. This compares to a deficit of £468.9 million as at 31 March 2015. The movements in the net deficit can be summarised as follows:

	2016 £m	2015 £m
Present value at 1 April	**(468.9)**	(348.3)
Change in actuarial assumptions	**194.2**	(336.8)
Asset (under)/outperformance	**(45.9)**	193.4
Contributions in excess of income statement charge	**11.1**	22.8
Present value at 31 March	**(309.5)**	(468.9)

The funding level has increased to 86.8% (2014/15: 81.7%).

Accounting policies and presentation of the financial statements
Our consolidated financial statements are prepared in accordance with International Financial Reporting Standards that have been endorsed by the European Union. The company financial statements are prepared in accordance with FRS 101.

Strategic report
Risk Management

Our approach to risk:
Managing risk is all about understanding the uncertainties surrounding the achievement of our aims and objectives. Therefore, risk management describes the activities performed within our organisation to identify, assess and control events which may impact on our aims and objectives. We also appreciate that uncertainty can manifest itself as both negative and positive impacts, hence our goal is to minimise these threats and maximise the opportunities for the benefit of our customers, people, contractors and key stakeholders. The Board has overall accountability for ensuring that risk is effectively managed across the Group. The Board's mandate includes defining risk appetite and monitoring risk exposure to ensure significant risks are aligned with the overall strategy of the Group. The management of risk is embedded in our everyday business activities, with employees encouraged to play their part.

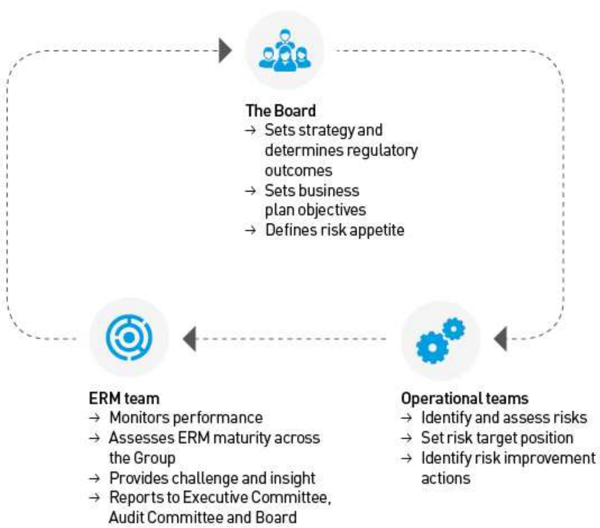
On behalf of the Board, the Severn Trent Plc Audit Committee assesses the effectiveness of the Group's Enterprise Risk Management (ERM) process and internal controls to identify, assess, mitigate and manage risk. Internal Audit supports the Audit Committee in evaluating the design and effectiveness of internal controls and risk mitigation strategies implemented by management.

The Executive Committee reviews strategic objectives and assesses the levels of risk in achieving these objectives. This 'top-down' risk process helps to ensure the 'bottom up' ERM process is aligned to current strategy and objectives.

Across the Group, we manage risks within the overall governance framework which includes clear accountabilities, delegated authority limits and reward policies. These are designed to provide employees with a holistic view of effective risk management.

Within Severn Trent Water Limited, our approach reflects our status as a regulated utility providing essential services and operating as part of the Critical National Infrastructure for the UK. The nature of our Severn Trent Water Limited business is such that there are some significant inherent risks. We aim to have a strong control framework in place to enable us to understand and manage these risks in accordance with our risk tolerance and appetite.

The ERM process



Our Enterprise Risk Management process
We use an established ERM process across the Group to assess and manage our significant risks, which are linked to our corporate objectives, core processes, key dependencies, stakeholder expectations and legal and regulatory obligations. The process is controlled by the central ERM team and underpinned by standardised tools and methodology to ensure consistency. ERM Champions and Coordinators operate throughout the business, with support and challenge from the ERM team, to identify and assess risks in their business units quarterly against a defined set of criteria considering

the likelihood of occurrence and potential financial and reputational impacts. The potential causes and subsequent impact of the risks are documented to enable the corresponding mitigating controls to reduce the likelihood and impact to be assessed. This assessment allows us to put in place effective mitigation strategies to remediate defective controls or implement additional controls.

This information is combined to form a consolidated view of risk across the Group and allows the risks to be prioritised. Our significant risks, in terms of likelihood and impact, form our Group risk profile which is reported to the Executive Committee for review and challenge ahead of final review and approval by the Audit Committee and Board half-yearly. In addition, individual risks or specific risk topics are also discussed by the Board during the year.

On a quarterly basis, the status of open risk mitigation actions across the Group risk profile and level of ERM maturity in each business unit is reported into the Executive Committee by the central ERM team. Where necessary improvement plans are agreed to ensure ERM is fully embedded and effective.

An overview of accountability for our ERM process is illustrated in the diagram above.

Risk appetite
The Board keeps under ongoing review the relationship between our strategic ambitions and the management of risk.

The ERM process establishes target risk positions for each of our significant risks. The Board formally discusses the progress towards this position and the mitigating actions being undertaken every six months.

Financial risks
Like all businesses, we need to plan future funding in line with business needs. This is part of our normal business planning process (see Principal Risk 3).

The Board receives regular updates relating to funding, solvency and liquidity matters via the Treasury Committee so we can respond quickly to any changes in our ability to secure financing (see Principal Risk 11). The pension fund trustees and Company regularly monitor our pension deficit, with advice from investment managers and advisors. An annual pension fund review paper is produced for the Board to apprise them of fund performance and proposed initiatives to manage down pension liabilities and further improve investment returns (see Principal Risk 10).

The ERM process and relevant risk assessments are factored into the ‘stress testing’ to assess the Group’s prospects as part of our Viability Statement.

Strategic report
Risk Management

Risk management in practice
Every day we collect, treat and safely return to the environment, 1.4 billion litres of waste water. We use the remaining sludge from the treatment process to generate energy by using anaerobic digesters and once this has been completed we safely dispose of the biosolids, a by-product of the process, by selling them for use by the agricultural industry as natural fertiliser. If there was ever an issue concerning the quality or safety of the biosolids, and we could no longer dispose of them in this way, we would have to use alternatives such as landfill and/or reopen the STW incinerators that are not currently in use. Not only are these alternatives costly for us, but they are less environmentally sound and fail to utilise the nutrients still present in the biosolids. That's why, in order to reduce the likelihood of this happening, we have successfully achieved Biosolids Assurance Scheme (BAS) accreditation to ensure the quality and viability of our biosolids product for use in agriculture. BAS combines legislative and non-legislative requirements, along with best practice, to ensure operational consistency and hence demonstrate transparency in the delivery of nutrients to agriculture. The investment in Thermal Hydrolysis Process (THP) technology will help to generate more energy from the sewage treatment process but also reduce the quality of the biosolids by-product we have to dispose of, further reducing our exposure to this risk.

Long Term Viability Statement

The directors' assessment of the Group's current financial position is set out in the Financial review on pages 22 to 26 and their assessment of the group's principal risks is set out in the Principal risks section on pages 31 to 36.

The Company's principal operating subsidiary is Severn Trent Water Limited, which is a regulated long term business characterised by multi-year investment programmes and stable revenues. The water industry in England and Wales is currently subject to economic regulation rather than market competition and Ofwat, the economic regulator, has a statutory obligation to secure that water companies are able to finance their appointed activities. Ofwat meets this obligation by setting price controls for five year Asset Management Periods ('AMPs'). This mechanism reduces the potential for variability in revenues from the regulated business. The current AMP runs until March 2020.
The Group has an established process to assess its prospects. The Board undertakes a detailed assessment of the Group's strategy on an annual basis and the output from this assessment sets the framework for the Group's medium term plan which is updated annually.

The plan assessed the Group's prospects and considered the potential impacts of the principal risks and uncertainties. Stress tests were performed to assess the potential impacts of combinations of those risks and uncertainties. The plan also considered the mitigating actions that might be taken to reduce the impact of such risks and uncertainties and their likely effectiveness.

The Group's investment programmes are largely funded through access to debt markets. The Group's strategic funding objectives reflect the long term nature of the Severn Trent Water Limited's business and the Group seeks to obtain a balance of long term funding at the best possible economic cost. The Group's Treasury Policy requires that it maintains sufficient liquidity to cover cash flow requirements for a rolling period of 18 months in order to mitigate the risk of restricted access to capital markets. The Group's debt maturity profile is actively managed by the Group Treasury department to spread the timing of refinancing requirements and to enable such requirements to be met under most market conditions. The weighted average maturity of debt at the balance sheet date was 15 years.

Bearing in mind the long term nature of the Group's business; the enduring demand for its services; the nature of the Group's established planning process and the changing nature of the regulation of the water industry in England and Wales, the directors have determined that three years is an appropriate period over which to assess the Group's prospects and make its viability statement.

In making its assessment the Board has made the following key assumptions:

- Any period in which the Group is unable to access capital markets to raise finance during the period under review will be shorter than 18 months.
- There will not be a catastrophic disruption to our drinking water supplies arising from external factors during any such period of market disruption.

The directors have assessed the viability of the Company over a three year period to March 2019, taking into account the Company's current position and principal risks. Based on that assessment, the directors 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 to 31 March 2019.

Going concern statement

In preparing the financial statements the Directors considered the Company's ability to meet its debts as they fall due for a period of one year from the date of this report. This was carried out in conjunction with the consideration of the Viability Statement above.

On this basis the Directors considered it appropriate to adopt the Going Concern basis in preparing the financial statements.

Principal risks

The Directors 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. These have been categorised across:

- Customer perception;
- legal and regulatory environment;
- operations, assets and people; and
- financial risks.

For each risk we state what it means for us and what we are doing to manage it.

Customer perception

1

What is the risk?

We may be unable to improve and maintain our levels of customer service sufficiently to deliver what our customers tell us they want.

Which part of Severn Trent is affected?

Group-wide

Link to how we're achieving our strategy

Embed customers at the heart of all we do

Link to our values

We put our customers first

We are passionate about what we do

We act with integrity

Performance commitments

ODIs 24-27

What does it mean for us?

We are a regulated utility providing essential services to our customers. We recognise that our customers increasingly expect more from us and demand an improved and more consistent experience. As other industries improve their levels of service, the bar continues to be raised.

Failure to deliver the service that customers expect will lead to customer dissatisfaction. This may result in financial penalties under Ofwat's Service Incentive Mechanism and associated ODI outturn.

What are we doing to manage the risk?

We have continued to focus on driving change to embed customers at the heart of what we do. We have developed six core household customer journeys so we understand customer needs and expectations. We have delivered some quick wins to augment our existing offering; Track My Job, In My Street, In My Area and SMS appointment reminders.

Providing the high quality service that our customers demand means we need the right processes, systems and resources. As part of becoming a digitally savvy organisation we are improving our web offering and digital self-service channels. We are also giving customers more choice in the way that they interact with us by introducing new contact channels such as Facebook, and ensuring our current channels are efficient and effective, for example we have invested in a strategic webchat capability to ensure we can offer this service to reach a broader audience.

We know that providing great customer service needs the right resource so we have introduced a new performance and quality framework for our contact centre staff and undertaken capability assessments to identify and close any training gaps.

To help make sure we continue to improve our service in line with our customer's expectations, we survey thousands of customers each month through our Rant & Rave tool. This gives us direct feedback on their experience of contacting us, and enables us to improve our service, spot trends and react to our customers needs. We are continuing to extend our 'voice of the customer' approach to capture feedback from more interactions across more of our business. We have used this feedback to develop a SIM forecast tool so we can predict our ODI performance for our qualitative element.

Movement in net risk exposure

2

What is the risk?

We may be unable to take full advantage of the opportunities presented by the opening up of the non-household retail market to competition.

Which part of Severn Trent is affected?

Group-wide

Link to how we're achieving our strategy

Change the market for the better

Link to our values

We are passionate about what we do

Performance commitments

N/A

What does it mean for us?

Competition will give non-household customers increased choice and will encourage companies to provide a better service. If we fail to keep pace with change or fail to recognise the needs of our business customers, we may lose customers to our competitors. We may fail to successfully grow our business by being unable to develop sufficiently attractive services to win new customers.

What are we doing to manage the risk?

We are positioning our business to succeed in this market and are actively preparing for the introduction of competition to non-household retail in England. The change programmes to govern and manage the adaption of our wholesale and retail businesses are well underway and on track for 'Shadow Operation' which commences in October 2016, and acts as a dress rehearsal for full market opening in April 2017. In February 2016, the Board signed the first of three 'Letters of Assurance' confirming to the Secretary of State for the Environment, Food and Rural Affairs that we are on track for market opening.

In March 2016, we announced a proposed joint venture with United Utilities to form a combined non-household retail business. The joint venture will combine the complementary skills and capabilities of Severn Trent and United Utilities to improve our competitive offering for customers, increase efficiency and enhance value. The introduction of competition into the non-household retail market presents us with an exciting opportunity to combine our expertise for the benefit of customers and shareholders.

We are developing a control framework to establish the protocols, policies, systems, guidance and training necessary for the operation of separate wholesale and retail business units and to ensure ongoing compliance with the relevant legislation, including competition law.

Movement in net risk exposure

Legal and regulatory environment

3

What is the risk?

We may be unable to effectively anticipate and/or influence future developments in the UK water industry resulting in our business plans becoming unsustainable.

Which part of Severn Trent is affected?

Severn Trent Water Limited

Link to how we're achieving our strategy

Change the market for the better

Investing responsibly for sustainable growth

Link to our values

N/A

Performance commitments

N/A

What does it mean for us?

Severn Trent Water Limited operates in a highly regulated environment. Whilst we are broadly content with the direction of changes proposed for our industry, there remains a risk that future changes could have a significant impact on Severn Trent Water Limited.

What are we doing to manage the risk?

Severn Trent has always contributed to the debate about our industry's future, including through our series of Changing Course publications. We will continue to be an active participant in these conversations, so we can help shape thinking about how to best serve our customers in the future.

We have contributed to the establishment of Market Operator Services Limited, the body which will help to facilitate competition in the non-household retail market.

We continue to actively participate in discussions with Ofwat regarding the development of the regulatory environment and our response to the Water 2020 consultation was submitted in February 2016. Engagement with our peers, other regulators, UK Government departments and other stakeholders, including the Welsh Government, helps us to influence the direction of regulatory policy where possible and put forward our own case for change in a constructive way.

Movement in net risk exposure

4

What is the risk?

The regulatory landscape is complex and subject to ongoing change. There is a risk that processes may fail or that our processes may not effectively keep pace with changes in legislation leading to the risk of non-compliance.

Which part of Severn Trent is affected?

Group-wide

Link to how we're achieving our strategy

Drive operational excellence and continuous innovation

Change the market for the better

Investing responsibly for sustainable growth

Link to our values

We act with integrity

We protect our environment

Performance commitments

ODIs 1-4, 19-23, 30-43

What does it mean for us?

Our policies and processes must reflect the current legal and regulatory environment and all relevant employees must be kept aware of new requirements. Due to the spread of our operations, and changes in activity and organisational structure, this is not always straightforward. The Group as a whole may face censure for non-compliance in an individual group company or a specific region in which we operate.

What are we doing to manage the risk?

Our governance framework and related policies and internal controls ensure our ongoing compliance with all applicable laws and regulations.

The forthcoming introduction of non-household retail competition means we need to refresh our policy framework. We are developing a control framework to establish the protocols, policies, systems, guidance and training necessary for the operation of separate wholesale and retail business units and to ensure ongoing compliance with the relevant legislation including competition law.

Changes to the legal and regulatory environment are captured as 'emerging risks' through our ERM process with the necessary owners and actions identified to ensure compliance when the changes come into effect.

Movement in net risk exposure

Operations, assets and people

5

What is the risk?

We may experience loss of data or interruptions to our key business systems as a result of cyber threats.

Which part of Severn Trent is affected?

Group-wide

Link to how we're achieving our strategy

Embed customers at the heart of all we do

Drive operational excellence and continuous innovation

Link to our values

We put our customers first

Performance commitments

ODIs 1-4, 5-18, 19-23, 24-37

What does it mean for us?

The risks arising from loss of one or more of our major systems or corruption of data held in those systems could have far reaching effects on our business. We have recognised the increasing threats posed by the possibility of cyber attacks on our systems and data. Whilst this threat can never be eliminated and will continue to evolve, we are focused on the need to maintain effective mitigation.

What are we doing to manage the risk?

We recognise that the cyber threat to the business is constantly evolving and one which we need to monitor and act on in a timely manner.

Using guidance from the Centre for Protection of Critical National Infrastructure ('CPNI') we have improved both our technology controls (security event alerting, enhanced email and web filtering, vulnerability management and advanced threat management solutions all installed in the last 12 months) and training and awareness (cyber security incorporated into security and awareness training, cyber roadshows to raise awareness and online training).

We have also participated in a Government led cyber exercise for the water industry and recently delivered a company-wide exercise simulating a cyber attack and subsequent widespread power loss incident. Regular penetration testing of our corporate and customer websites is completed by cyber security specialists to identify any vulnerabilities and the resilience of our systems through regularly tested disaster recovery plans are in place.

Whilst progress has been made during the year to ensure we are better prepared, due to the rapidly evolving nature and complexity of the threat, this work will continue. Ongoing monitoring and reviews will ensure that our mitigating controls and plans continue to protect us and our customers.

Movement in net risk exposure

Legal and regulatory environment

6

What is the risk?

We may fail to meet our regulatory targets including targets from Ofwat in relation to operational performance of our assets resulting in regulatory penalties.

Which part of Severn Trent is affected?

Severn Trent Water Limited

Link to how we're achieving our strategy

Embed customers at the heart of all we do

Drive operational excellence and continuous innovation

Investing responsibly for sustainable growth

Link to our values

We put our customers first

We are passionate about what we do

We protect our environment

Performance commitments

ODIs 1-45

What does it mean for us?

If we are unable to meet operational performance targets, we may be subjected to significant regulatory penalties, either within the current price review period or applied to the next price review.

Regulatory targets apply to all of our water treatment, distribution, sewerage and sewage treatment assets. Measures are in place in relation to water quality, continuous supplies, sewer flooding, sewer collapses and pollution events.

We need to ensure that our customers can trust and place confidence in the operational performance data we publish. Our data assurance needs to be robust to confirm the accuracy and integrity of this information.

What are we doing to manage the risk?

Our business plan for 2015-2020 includes considerable investment in our assets to improve the resilience of our networks, reduce interruptions and improve the service that our customers receive. We recognise areas where our performance is not as consistent as we would like and are committed to improving these areas.

Under our Cleanest Water Plan we have undertaken a significant amount of work at our water treatment works, boreholes and reservoirs, inspecting the sites and increasing our maintenance and capital replacement as well as formalising our processes, standards and operating procedures involved in delivering clean water.

We remain committed to investing in continuous improvement activities such as our Value Every Drop programme, which has reduced our time to process and react to leaks. We have also reduced total leakage and have achieved our regulatory commitment for the fifth year running.

We continued to work to reduce the impact on our customers when things unfortunately do go wrong, for example by faster despatch of emergency tankers and providing our employees with a refresh of incident management training.

To improve our waste water performance we have trialled different ways of engaging with customers to raise awareness of the problems caused by putting the wrong things down our sewers. We are also investing in capital solutions to enable us to protect properties at risk of sewer flooding.

Movement in net risk exposure

7

What is the risk?

Failure of certain key assets or processes may result in inability to provide a continuous supply of clean water and safely take waste water away within our area.

Which part of Severn Trent is affected?

Group-wide

Link to how we're achieving our strategy

Embed customers at the heart of all we do

Drive operational excellence and continuous innovation

Investing responsibly for sustainable growth

Link to our values

We put our customers first

We are passionate about what we do

Performance commitments

ODIs 1-4, 5-18, 19-23

What does it mean for us?

Some of our assets are critical to the provision of water to large populations for which we require alternative means of supply.

Examples include failure of one of our reservoirs or water treatment works. These assets are regularly inspected and maintained and our assessment of the overall condition of these assets is good.

Another example is our IT and telephony systems which are critical to our operations and failure of these systems, for example our remote monitoring system, could have a significant effect.

What are we doing to manage the risk?

During the year, a total of £72 million was devoted to reducing water quality complaints, achieving compliance with water quality standards and reducing coliforms. Under our Cleanest Water Plan we have undertaken a significant amount of work at our water treatment works, boreholes and reservoirs, inspecting the sites and increasing our maintenance and capital replacement as well as formalising our processes, standards and operating procedures involved in delivering clean water.

We've launched our Operational Effectiveness Programme to ensure maximum asset performance. We're on track to create a suite of 18 major water treatment works that are uniformed and systematic in how they're run. Consistent, undeviating processes that define how we work, will help us to produce a high quality product, regardless of which site it comes from. It will also help us to shave off unnecessary costs.

Our Proactive Asset Management programme has begun to look into how we can better use information about our network and assets to prevent failures in the first place, reducing impacts on service levels but also being more cost-effective rather than carrying out reactive repairs. Our 2015-2020 business plan includes substantial investment in some of our largest strategic assets such as the Elan Valley and Derwent Valley Aqueducts, one of the major elements of which is the £300 million investment in one of our largest ever capital schemes to improve the resilience of our water supply to Birmingham.

We continue to maintain and test our 'Being prepared framework' to ensure our business continuity arrangements are fit for purpose and the Group can react quickly to safeguard our critical operations.

In addition to investing in resilience improvements to our network we also have assurance plans in place to monitor, inspect and maintain our most critical assets and to ensure clean water is always available to our customers and we will always be able to safely take their waste water away.

We will continue to make significant investment into our network and processes but we accept there is always a risk of unexpected failures, the recent Castle Donington incident being a prime example. How we respond to these and learn from them is vital in keeping the likelihood of unexpected failures as low as possible.

Movement in net risk exposure

8

What is the risk?

Due to the nature of our operations we could endanger the health and safety of our people, contractors and members of the public as well as negatively impact our local and wider environment.

Which part of Severn Trent is affected?

Group-wide

Link to how we're achieving our strategy

Drive operational excellence and continuous innovation

Investing responsibly for sustainable growth

Create an awesome place to work

Link to our values

We protect our environment

We act with integrity

Performance commitments

ODIs 30-41, 42 & 43

What does it mean for us?

The nature of our assets, operations and business are such that threats to the safety of our employees, contractors, customers and the wider public exist. Operational failures or negligence could result in damage to the environment.

We are responsible for a large estate of assets and have to secure these from unauthorised access to ensure our operations are not impacted nor the safety of the public compromised.

What are we doing to manage the risk?

Our 2015–2020 business plan includes substantial investment in community schemes to ensure the risk of failure at key points along our Elan Valley Aqueduct, that could cause substantial damage and endanger the safety of the public, is further reduced.

We have a well established Health, Safety and Wellbeing framework to ensure all of our operations and processes are conducted in compliance with health and safety legislation and in the interests of the safety of our people and contractors. Our Goal Zero initiative clearly establishes our target that no one should be injured or made unwell as a result of what we do.

There are a number of performance commitments we have made to protect our local environment, including river water quality, pollution incidents, biodiversity improvements and environmental compliance. During the year, we invested £91 million towards our targets on pollution, environmental compliance, biodiversity and sustainable sewage treatment. Continuing our strong track record of delivery from last year, we have provisionally been rated 4* by the Environment Agency.

We recognise the impact our operations have on the wider environment and we want to reduce our carbon footprint by seeking lower carbon ways of operating our business and generating renewable energy. Our target is to increase the amount of renewable energy we generate and to invest in ways to make our processes more energy efficient, such that by 2020, 50% of the energy we use will be from renewable sources.

Movement in net risk exposure

9

What is the risk?

We are unable to deal with the impact of extreme and unpredictable weather events on our assets and infrastructure and/or are unable to successfully plan for future water resource supply and demand due to climate change.

Which part of Severn Trent is affected?

Group-wide

Link to how we're achieving our strategy

Drive operational excellence and continuous innovation

Investing responsibly for sustainable growth

Link to our values

We protect our environment

Performance commitments

ODIs 1-4, 5-18, 19-23, 42-43

What does it mean for us?

Climate change (hotter and drier summers, wetter winters and increased storminess) could result in an inability to meet customer demand, lower river levels, decreased raw water quality, flooding of our water or waste water works, sewer capacity being exceeded and increased land movement. Climate change could also be a contributing factor for principal risks 1, 6, 7 and 8 detailed above.

There are also some potential opportunities that climate change presents for us, including reduced leakage, aquifer recharge and increased biological treatment. It is important that we understand these opportunities to maximise the benefits.

What are we doing to manage the risk?

Our climate change adaption report sets out our strategy for coping with future changes to our climate.

It's important to note that we don't consider climate change risks in isolation and we view them alongside all the challenges we face. To that effect a large number of our current objectives and targets agreed as part of our performance commitments will increase our resilience against climate change, including reducing leakage, improving water efficiency, reducing properties prone to low pressure, protecting prone properties/areas from sewer flooding and increasing the resilience of our water supply and water and waste water works.

We are also adapting to climate change through innovation, with 21 catchment management projects and a doubling of our sustainable urban drainage ('SUDs') projects planned for this AMP.

Our own impact and contribution to climate change cannot be ignored and, as outlined in principal risk 8 above, there are a number of ways in which we are addressing our impact on the environment.

Movement in net risk exposure

Financial risks

10

What is the risk?

Lower interest rates, higher inflation or underperforming equity markets may require us to provide more funding for our pension schemes.

Which part of Severn Trent is affected?

Group-wide

Link to how we're achieving our strategy

Investing responsibly for sustainable growth

Link to our values

N/A

Performance commitments

N/A

What does it mean for us?

We already provide significant funding but could be called upon to provide more money to reduce pension deficits in our defined benefit schemes.

What are we doing to manage the risk?

We regularly revalue our schemes and monitor our investment performance and will continue to work closely with our third party advisers to ensure that the schemes are managed effectively.

During the year the Risk Monitoring and Assessment Committee ('RMAC') was formed, comprising representation from the Company and Trustees. The Committee focuses on monitoring investment performance, reviewing scheme risks and operates as a forum for the Company and Trustees to collaborate in taking action to minimise the scheme deficit.

Closure during the year of the main defined benefit scheme to future contributions by members was a major milestone and will help to cap future growth of the deficit (defined benefit schemes having been closed to new members in 2006).

Movement in net risk exposure

11

What is the risk?

We are unable to fund the business sufficiently in order to meet our liabilities as they fall due.

Which part of Severn Trent is affected?

Group-wide

Link to how we're achieving our strategy

Investing responsibly for sustainable growth

Link to our values

N/A

Performance commitments

N/A

What does it mean for us?

We must ensure sufficient liquidity is available to meet our near term financial commitments. We have a significant funding requirement in AMP6, to fund our investment programme and refinance maturing debt. This is a well-controlled risk, but it is important that we maintain these high standards to mitigate this risk.

What are we doing to manage the risk?

The risk is managed by our Treasury Committee and their associated policies and procedures through detailed cash flow forecasting, access to committed banking facilities, use of diverse lending sources including bonds, US Private Placement, European Investment Bank and other bank loans to spread risk, early refinancing of bonds and other maturing debt (to manage refinancing risk), interest rate monitoring and analysis of the impact interest rates could have on credit metrics and loan covenants.

The Treasury Committee regularly reports to the Board to enable us to respond quickly to changes in our ability to secure financing.

See our Viability Statement.

Movement in net risk exposure

For full list of all ODIs and the details of each see www.severntrent.com

Strategic report
Group Corporate Responsibility report

"Our approach to corporate responsibility aligns with our strategic framework. To build trust, serve our communities and leave a lasting water legacy we must make sustainable choices and act responsibly in a way that demonstrates our values."

Gordon Fryett
Chairman of the Severn Trent Plc Corporate Responsibility Committee

Our Corporate Responsibility framework

Our purpose
To serve our communities and build a lasting water legacy

Our vision
To be the most trusted water company by 2020

Underpinned by our Corporate Responsibility Commitment
By adopting responsible business practices and making sustainable choices we will be able to meet our purpose and fulfil our business strategy.

Our ambitions

The nature of what we do means that we have an important role to play in protecting water as a precious resource and the wider environment. We have identified two stretching ambitions which will help us to achieve both our vision and purpose.

Ambition One
We will make our region the most water efficient in the UK

Ambition Two
We will play a leading role to help make our region's rivers even healthier

Our values

Through our company values we will deliver commitments expected of a leading, socially responsible company. We also expect our suppliers to support our values.

- We put our customers first
- We are passionate about what we do
- We act with integrity
- We protect our environment
- We are inspired to create an awesome company

Strategic report
Corporate Responsibility report

Our ambitions

In order to achieve our vision of being the most trusted water Company by 2020, we will demonstrate environmental leadership wherever we operate. The nature of what we do means that we have an important role to play in protecting and sustaining water as a natural resource and the environment as a whole. We take water from rivers and aquifers, transport it over large distances to our customers, and return treated waste water to rivers in our region. In the future, our ability to achieve this will be challenged by matters such as maintaining the resilience of our supplies, ensuring we continue to source water sustainably, meeting tightening environmental standards, coping with extreme weather and meeting the demand from the additional 1.6 million people expected to be living in our region over the next 25 years. We are committed to meeting these challenges, which form the basis of our two ambitions, and will help us to achieve our vision and purpose as set out in this report.

Ambition One: We will make our region the most water efficient in the UK
We aim to do this through providing advice, equipment and education.

We will empower our customers to save up to 25Ml/d by 2020
We know water efficiency is important to our customers and we are committed to helping them to become more water efficient and have set ourselves an ambitious target to help them save 25 million mega litres by 2020. Through helping our customers and by continuing to reduce leakage we want to make our region the most water efficient in the UK.

We will provide 1,000 of our business customers with water efficiency devices and personal advice, working with our wholesale suppliers to reduce consumption
As part of our standard service to our key corporate customers, we engage with them on water efficiency discussions and also conduct site audits to help them manage their water consumption and costs. In 2015/16 we provided this advice to 20 of our key corporate customers and conducted 54 site audits, including ASDA, Next and several large universities, and completed 280 water efficiency audits with smaller businesses in Nottingham. In addition to this, we are working to provide third party consultancy, at no cost to customers, in key parts of our region. This is a joint engagement between our wholesale and retail teams. We are developing a segmented customer approach to engagement depending on their size and water efficiency needs.

We will improve understanding of our services through education
Our customers told us they want to better understand what we do. This year we set up our new Community Relationship Team who are focused on delivering two key messages: the importance of water efficiency and ensuring our drains remain clean and blockage free. This work is really important in protecting our environment and our customers from pollutants and external and internal flooding. In 2015/16, through a number of partnerships including local universities and City Councils, we have been able to educate 117,728 customers, a number which we anticipate will increase substantially. These partnerships are mutually beneficial; preventing blockages proactively in both our customers' networks and ours. Through education and training packages on water efficiency we also enable customers with the potential to reduce their water usage and therefore water bills.

Case Study
This year we launched our new water efficiency home check programme, starting in the Rugby area. Customers in and around the area can sign up for a free home check, where Severn Trent contractors, PN Daly, visit the customers home and fit free water saving devices, offer advice on how they can save water and check for simple leaks. This free service will help customers save water, energy and money. So far we've completed 5590 home checks and we aim to deliver more in the future.

Ambition Two: We will play a leading role to help make our region's rivers even healthier
We aim to achieve this through working with landowners and partner organisations, achieving good ecological status and improving biodiversity.

We will work with landowners and partner organisations to reduce agricultural run-off in our region's rivers
Partnerships such as those with Wye & Usk Foundation, Trent Rivers Trust, Severn Rivers Trust, Catchment Sensitive Farming and Nottinghamshire Wildlife Trust have been key to helping us deliver our AMP6 catchment ambitions. Through these partnerships we are reducing agricultural run-off, such as pesticides getting into the water and polluting it, therefore improving river water quality, reducing treatment costs and improving the river environment as a whole. Our catchment team, alongside a range of moorland partners, have been successful in securing €16 million Euros of EU support to deliver our targets in the Bamford catchment.
Newly recruited agricultural advisors will play a vital role in engaging with farmers across 27 catchments, which is a core part of our catchment scheme delivery. The team have received a pleasing number of Severn Trent Environmental Protection Scheme (STEPS) applications during their first farmer grant applicant window. The work is aimed at improving water quality in our catchments. Applicants have ranged from improved pesticide handling facilities to rainwater harvesting equipment. STEPS grants will be available to farmers in priority catchments annually until 2020. In 2016/17 we will continue to focus on farmer engagement specifically in groundwater catchments, and setting up and running 'Farmers as Producers of Clean Water' and Metaldehyde product substitution schemes in our surface water catchments.

We will do our fair share to achieve Water Framework Directive ('WFD') good ecological status in our region's failing water bodies, where it is cost-effective to do soIn AMP6 we will be delivering our largest ever environmental improvement programme, spending over £300 million to deliver improvements to rivers throughout our region, a programme which is supported by our customers who wanted to see us do more to improve river water quality.
Our investment programme seeks to contribute our fair share of the improvements needed to get targeted river lengths within our region to 'Good Ecological Status', to support the WFD objective to get all water bodies (lakes, rivers etc.) to this status. Currently only 30% of the rivers in our region meet this status, and our operational activities are responsible for a quarter of those that don't. The majority of improvements are targeted at sewage treatment works to produce a higher quality effluent, which will in turn help improve river water quality. This investment will deliver new or improved assets on site and involve complex capital schemes. We have worked closely with the Environment Agency in order to optimise the environmental benefits of our programme. We are also reducing abstractions by 85Ml/d from sources that are no longer environmentally sustainable.

We will improve biodiversity in our region by improving at least 75 hectares of Sites of Special Scientific Interest ('SSSIs')
Planning has been our primary focus this year to date, identifying all 11 SSSIs and Special Areas of Conservation that Severn Trent will be improving over AMP6, allocating specific projects to be undertaken to either improve or stop deterioration at each site and setting up monitoring processes. We have been working closely with Natural England to determine a methodology for capturing improved biodiversity and clarifying the details of our performance commitment, with the support of our customer challenge group, the Water Forum.

Waterside Care
Working with our project partners Keep Britain Tidy, the Environment Agency and the Canal and River Trust we are proud to be supporting the WatersideCare volunteers to breathe new life into their local rivers and canals. There are over 50 community groups in the Midlands who work hard to improve their local environment by clearing litter from river stretches, increasing awareness of the effects of pollution, managing invasive species and monitoring their local aquatic environment. At the end of the 5th year of the partnership, they have cleared 7,606 bags of litter, removed 1,130 bulky items from waterways, reported 48 suspected misconnections and 15 environmental crimes, giving an impressive

30,481 hours of their time to their local waterways.

Innovation in integrated water management
In Tyseley, Birmingham, we're leading on the creation of a community scale, model site, to demonstrate the practicality and societal benefits of integrated water management. Working with the community and a range of partners we are trialling a number of innovative measures including new water efficiency products and rain water harvesting for toilet flushing to reduce water consumption and our customers' bills. The outcomes will influence our investment elsewhere to ultimately benefit all our customers.

We put our customers first

Customers are at the heart of all we do and this means putting them first. We invest time to listen to our customers. We work hard to design the experience they expect and translate it into our business plans. We put our customers and communities first, aim to provide a service that is value for money, help our customers who struggle to pay their bills and to make a positive difference through volunteering.

We put our customers and communities first when carrying out our work
We recognise that planned and unplanned work on our networks can cause disruption. In February 2015 we launched 'Customers and Communities First', our guide to help our colleagues and one of our supply chain partners, deliver a great customer experience every time they carry out planned work. It explains what we need to do, who we need to engage with before work begins, during and after our work is complete. We seek feedback from our customers at the end of every scheme to ensure we successfully learn from experiences, sharing areas for improvement and best practice.

We provide a service that is good value for money
Our customers pay the lowest combined water and waste water bills in the UK, and will continue to do so in AMP6. However, our research shows that customers want more than just low bills, they expect us to make a positive difference especially when it comes to investment and the environment. Operating efficiently, we are able to do both these things and provide good value for money to customers. In an independent quarterly study of our customer base, 57.5% of our customers consider us good or very good value for money.

We help our customers who are in genuine need and struggling to pay their bills
We work hard to ensure our bills are affordable, but we understand that some customers may need additional assistance. We can help customers through a review of their account and support through one of our affordability schemes such as metering, Watersure and our new social tariff, the Big Difference Scheme. We launched the Big Difference Scheme, in April 2015, which offers between a 10% and 90% reduction to the average bills.
In 2015/16, we assisted 24,110 customers. Our target was 35,000, however, in the early part of the year application volumes were lower than expected, due in part to challenges engaging with the customers who need our support.
We also believe that the perceived social stigma associated with seeking financial support may be affecting applications. We have new engagement plans in place for 2016/17 and are determined to support more of our customers who need it the most.
Severn Trent Trust Fund provides assistance to those in the most financial difficulty..

Our people make a positive difference in the community through volunteering
In February 2016, we launched our programme of activity 'Love Our Network', focusing on volunteering, education, and network vigilance under the headings of 'Love to Care', 'Love to Share' and 'Always Aware'. We have worked with our employees, and our newly established employee community panels, to steer our approach to volunteering across the business. Following a vote by our employees, we support two charities, continuing our support with WaterAid and a new partnership with Make-A-Wish Foundation. In addition to this, we will support national set-piece fundraising events, and

local teams will be able to select the causes they wish to raise funds for, volunteer or do team building activities for. All employees have two days paid volunteering leave available to them per annum. We encourage volunteering in support of our two CR ambitions around water efficiency and healthier rivers and ensure that all volunteering activities are conducted in a safe manner.

We act with integrity

Being trusted means always doing the right thing for our customers, communities, investors, regulators and colleagues. This means that we will never tolerate fraud, bribery or corruption – and that we only ever work with suppliers and partners who care about this as much as we do.

Our employees are not afraid to stand up for what’s right.
We believe it is important that employees feel able to speak up and are confident they can raise issues and concerns, whatever the nature. Openness and transparency are both key to this, and form part of how we want to do business. Sometimes, however, that isn’t enough, and this is where our whistleblowing policy comes into play. The process is easily accessed, widely communicated and acted upon.

We involve our customers in our plans, and we’re honest about how they think we’re doing
We will invite the independent Water Forum to review and comment on our annual performance.
The Water Forum is an independently chaired, multi-stakeholder group that has a continuing role to challenge whether we are delivering our commitments to our customers, and how we communicate that performance. Over the past year the key areas of focus have been – how we measure and share our AMP6 performance and the development of our assurance plan and risk statement. In both areas The Water Forum were invited to challenge our proposals and the insight they provided shaped our final approach. To gain greater understanding of our customers, Water Forum members were invited to attend customer research focus groups undertaken as part of the non-household retail tariff review programme. This will enable members to comment on the outputs of our research that will form part of our submission to Ofwat in June 2016. We are developing a new performance report that is aimed towards our household customers and will share our performance in a clear and accessible format. This is the first year it will be published and we will work to develop it throughout the AMP.

We make a constructive contribution to developing sustainable and resilient water and wastewater services
We will publish our consultation responses on our website. We report annually on the initiatives we have taken to contribute.
We have been at the forefront of contributing to the Government’s policy debate regarding the long term structure and regulation of the water industry. In our two most recent publications, Changing Course and Charting a sustainable course, we have developed and published ideas ranging from customer empowerment, affordability, resilience, flooding and drainage, sustaining the environment and the role of competition and markets.

We are committed to working with all key stakeholders to ensure that we promote a constructive and engaging debate about the future of the water sector. Responding to public consultations is a key component of this debate and it is essential that we use these opportunities to share our views and to seek to shape the outcome. We also believe that it is imperative that our customers can see what we are saying and how we are working to safeguard these essential of services for today and tomorrow. We achieve this by publishing our responses to consultations on our website so that customers can read and understand the issues that affect them.

Case Study: Performance management based on behaviours
Our employees live our values
Ensuring our employees ‘Do the right thing’ and act with integrity forms a crucial part of our performance management framework which is called “Inspiring Great Performance”, with behaviours making up 50% of our performance rating. Inspiring Great Performance details our behaviour models

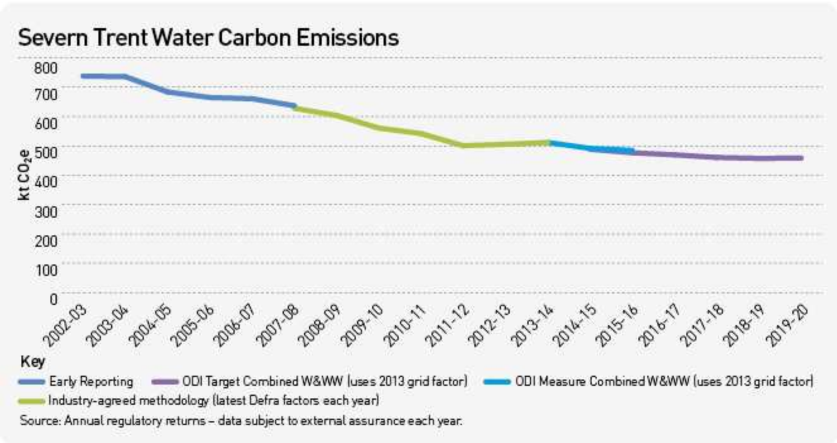
and behaviours you need to be a great colleague within Severn Trent.
We truly want everyone to be the best they can be and to reach their full potential, Inspiring Great Performance is at the heart of helping everyone to do just this.

We protect our environment

Acting responsibly and sensitively towards the environment and taking environmental issues seriously is key to how we are judged as a company and as an industry. Our environmental responsibilities extend far beyond the treatment of water and waste water to keep our rivers clean. We aim to play a leading role in promoting water as a vital resource, mitigate our environmental impact and to work with suppliers and partners to achieve this
It is also important that we engage constructively with regulators and other stakeholders to ensure a sustainable water industry. In our CR report, we focus on preventing pollutions and reducing our carbon footprint.

We do everything we can to prevent polluting the environment
Cleaning waste water means that we have to deal with unpleasant or dangerous substances that, if discharged to a watercourse untreated, could cause a serious pollution event. In 2015 we had two serious pollutions. This is a significant improvement on our 2014 performance where there were eight serious pollutions. This reduction has been achieved through continued investment in high risk assets, improving our operational processes and investigating third party sources of pollution entering our network. Our highest risk of pollution continues to be sewer blockages, resulting in sewage entering watercourses. In 2016, we will be installing over 500 monitors at high risk locations to detect the formation of blockages, in order to proactively resolve the issue before a pollution is caused. Our goal is to have zero serious pollutions (Environment Agency Category 1 or 2) by 2019. We have been awarded a provisional environmental performance rating of 4* by the Environment Agency.

We reduce our carbon footprint
We are reducing our carbon emissions year on year, primarily by being more energy efficient and generating more renewable energy. We've seen a consistent reduction, since 2002, when we began publicly reporting on our greenhouse gas emissions.



We have held the Carbon Trust Standard since 2009 in recognition of consistent emission reductions and effective carbon management processes.
Our performance against the standard is in the top 15% of all organisations.
We have seen a year on year improvement in our Carbon Disclosure Project ('CDP') score. CDP request information about climate change from companies each year on behalf of investors and score each company on the quality and completeness of their responses. This year we were recognised in the carbon disclosure leadership index for the first time (99/100), for demonstrating a considerable improvement from our previous CDP submission (2014: 85/100). This is largely due to our updated climate change risk assessment and the adaptation action report.

Severn Trent Water Direct Operational Greenhouse Gas Emissions (tonnes CO_2e) as reported for our Ofwat Outcome Delivery Incentive	2015-16	2014-15	2013-14
Emissions from combustion of fuel and operation of facilities (Scope 1)	148,380	159,037	161,249
Emissions from electricity purchased for own use (Scope 2)	325,447	321,233	333,721
Emissions from business travel, contractor sludge transportation and grid electricity transmission and distribution	34,833	32,754	34,572
Total Annual Gross Operational Emissions	**508,661**	**513,024**	**529,542**
Emissions benefit of the renewable energy we export (including biomethane exported for which we hold green gas certificates)	24,464	22,388	18,638
Total Annual Net Operational Emissions	484,196	490,636	510,904

The GHG data we report is reported internally during the year to the Corporate Responsibility Committee and to the Board. We have subjected our GHG data and processes to external assurance by Jacobs.

Our approach to reporting is based on the GHG Protocol Corporate Accounting and Reporting Standard and we have included only emissions from the assets which we own and operate and which we can directly influence and reduce, known as the financial control boundary. In accordance with the reporting regulations, we have not reported on emissions we can influence, but which we are not responsible for, referred to as indirect emissions.

For Severn Trent Water, we have calculated our emissions using the 'Carbon accounting in the UK Water Industry: methodology for estimating operational emissions, Version 10' (released April 2016). This is a peer-reviewed calculation tool developed and used by all the major water companies in the UK. It is updated each year to include the latest available emissions factors. For continuity, we have used the same grid emissions factor and the same global warming potential values throughout the three years of our reporting in this annual report and accounts. This is in line with our ODI methodology agreed as part of our Final Determination with Ofwat.

Case Study: Journey towards sustainable transport

We own a fleet of approximately 2,700 vehicles and in October 2015 we re-tendered for new vehicles that are industry leading on CO2 emissions and fuel efficiency. We measure the weekly statistics from these vehicles including CO2, miles driven, fuel used and empty miles.

In 2012/13 we also purchased three Euromec electric vehicles for ground maintenance, which we will continue to purchase through AMP6.

Climate change adaptation – Future Proofing

This year we conducted a thorough analysis of the risks that climate change poses to us and our adaptation actions. The main risks posed by climate change are:

- Increased pressure on our water resources, and the higher costs associated with meeting our customers' needs;
- Higher levels of rainfall mean run off exceeds the capacity of our sewer systems and our storage capacity; and
- Decrease in raw water quality as a result of run off from fields carrying pollutants such as pesticides.

To deal with these risks, we are investing to improve our resilience, including £300 million in a scheme to provide an alternative water supply to Birmingham. This allows us to carry out vital improvement work to the robust but ageing Victorian aqueducts that bring the city's supplies from mid-Wales. Liv Garfield, Severn Trent Chief Executive, said: "We're looking forward to delivering our plans for 2015 to 2020. Climate change presents a big challenge to us, yet it is a challenge that we can respond positively to."

During the year, we increased renewable energy generation from food waste, energy crop, sewage sludge, wind and solar power. Generating an equivalent of 33% of Severn Trent Water Limited's electricity needs, we continue to lead the UK water industry, with an aim of building on this position by generating the equivalent of 50% of our electricity needs by 2020.

Over the long term we aim to reduce our carbon emissions and increase our renewable energy generation. We plan to continue to reduce our emissions within Severn Trent Water Limited by a further 5% between 2015 and 2020, primarily by reducing our energy use and to continue to increase our renewable energy generation mainly within our business services business. Pursuing these measures will continue to reduce our key sources of emissions, reduce our reliance on the electricity grid and bring financial benefits for our customers and investors.

We are inspired to create an awesome Company

Our people are essential to achieving success. We aim to create an awesome place to work for our employees in part by looking after their health, safety and well-being and encouraging diversity and inclusiveness.

Our colleagues and community are not hurt or made unwell by the work we do
Our Company vision for health, safety and well-being is that – 'No one gets hurt or is made unwell by what we do'. We are working with the business to develop a road map to Goal Zero to set out exactly what we need to do to achieve our vision between now and 2017. A major focus this year has been on compliance with our Health, Safety and Well-being (HSW) standards and developing action plans to drive further improvements. This activity is complemented by regular 'Thinking Out Loud' campaigns, where our people submit their ideas on how to encourage everyone to follow our HSW standards, every time and every day. We also seek to ensure that members of the public are not injured as a result of our work. The 'Love Our Network' App was launched as a trial in January 2015, facilitating easy reporting of network issues and therefore protecting our communities from slips, trips and falls.

We are investing in the well-being of our colleagues to help them provide the best service we can
This year we launched our first ever WellBeing Programme, focussing our efforts on mental health. The programme has received really positive engagement and we have seen a steady decline in absences due to mental health.

We believe a diverse and inclusive workforce is a key factor in being a successful business
As a customer focused organisation, we need our workforce to reflect the customers and communities we serve to ensure we understand and can respond to their needs. We have prioritised three key areas: women in operational leadership positions; women and BAME (Black, Asian and Minority Ethnic) people in engineering positions and BAME people in technical operator positions. This year we have worked to ensure that our workplace is not only diverse but that it also inclusive and our colleagues feel that they can be themselves at work, for example recognising major faith days. We continue to work with Business Disability Forum to support disability at work. Our approach to diversity and inclusion has seen a steady development in decent years, as evidenced with a silver classification from Business in the Community ('BITC') following its 2015 diversity survey.

Our suppliers support our values

We want our supply chain to both live by and reflect our Company values, and as such require all suppliers to sign up to 'Doing the Right Thing' our Code of Conduct.

It's also important to us that we are a responsible payer, and that's why throughout 2015/16 we have worked hard to improve our payment to terms, part of which has involved bringing more suppliers onto self-bill to ensure a quicker 'procure to pay' process. This year we paid 96.4% of our invoices on time. We are committed to improving the sustainability and resilience of our supply chain, which will form an area of focus going forward. 2016/17 will see further developments and initiatives focusing on collaborative working with our suppliers, to identify and manage both environmental and social elements we could improve in line with our core values and Corporate Responsibility framework.

The Strategic report, as set out on pages 3 to 45, has been approved by the board.
By order of the board

Bronagh Kennedy
Group General Counsel and Company Secretary
23 May 2016

Board of Directors

Committee membership key
- ■ Audit Committee
- ▲ Corporate Responsibility Committee
- ✦ Executive Committee
- ● Nominations Committee
- ★ Remuneration Committee
- ◆ Treasury Committee

1. Martin Lamb BSc MBA (56) ● ★ ■
Senior Independent Non-Executive Director
Appointed to the Board on 29 February 2008

Martin brings extensive experience to the Board of managing and developing large engineering businesses in all parts of the world. His strong engineering expertise, commercial acumen, experience of managing complex projects, and familiarity with current market pressures leave him well placed to add value to the Severn Trent business. In May 2014, Martin left the Board of IMI plc having served as Chief Executive for 13 years and after 33 years with the Company. On 1 March 2014, Martin was appointed Chairman of Evoqua Water Technologies and on 14 January 2015, he was appointed Non-Executive Director of Mercia Technologies plc. On 24 April 2015, Martin was appointed Chairman of Rotork Plc. Previously Martin was a Non-Executive Director of Spectris Plc.

External appointments
- Chairman of EvoquaWater Technologies LLC
- Chairman of Rotork Plc
- Non-Executive Director of Mercia Technologies plc
- Member of the Advisory Board of AEA Investors Management (UK) Limited

2. John Coghlan BCom, ACA (58) ● ■ ◆
Independent Non-Executive Director
Appointed to the Board on 23 May 2014
Chairman of the Audit and Treasury Committees

John is a chartered accountant and has a valuable background in financial and general management across a variety of sectors. Currently, John is also a Non-Executive Director of Associated British Ports Companies, and a Non-Executive Director and Chairman of the Remuneration Committee of Lavendon Group plc. Previously, John was a Director of Exel Plc for 11 years to 2006, where he was Deputy Chief Executive and Group Finance Director. Since 2006, John has been a Non-Executive Director of various publicly-quoted and private equity-owned companies.

External appointments
- Non-Executive Director of Associated British Ports Companies
- Non-Executive Director and Chairman of the Remuneration Committee of Lavendon Group plc
- Chairman of Freight Transport Association Ireland Limited

3. James Bowling BA (Hons) Econ, ACA (47) ◆ ✦
Chief Financial Officer
Appointed to the Board on 1 April 2015

James is a chartered accountant, having started his career with Touche Ross and brings significant financial management, M&A and business transformation expertise to the Board. Prior to joining Severn Trent, James was interim Chief Financial Officer of Shire plc, where he had been since 2005, first as Head of Group Reporting and from 2008 as Group Financial Controller. Prior to joining Shire, James spent nine years at Ford Motor Company in various finance roles of increasing responsibility.

4. Dr. Angela Strank BSc PhD (63) ▲ ● ★
Independent Non-Executive Director
Appointed to the Board on 24 January 2014

Angela brings a wealth of strategic, technical and commercial experience to the Board. Angela is Head of Downstream Technology and Group Chief Scientist at BP plc. She is a member of the Downstream Executive Leadership Team. Angela is responsible for enabling delivery of the Downstream strategic agenda through the development of differentiated technology advantage across the refining, fuels, lubricants and petrochemicals businesses. Since joining BP in 1982, she has held many senior leadership roles around the world in business development, commercial and technology, including in 2012, Vice President and Head of the Chief Executive's Office. In 2010, Angela was the winner of the UK First Woman's Award in Science and Technology in recognition of pioneering UK women in business and industry. Her track record and experience in strategy, operations, technology and transformational change are a complementary addition to the Board's skill set.

External appointments
- Board Governor, University of Manchester

5. Olivia Garfield BA (Hons) (40) ▲ ✦
Chief Executive
Appointed to the Board on 11 April 2014

Olivia (Liv) brings to the Board a wealth of experience managing customer service delivery and complex infrastructure and organisations in a regulated environment. Before joining Severn Trent, Liv was Chief Executive Officer of Openreach, part of the BT Group, where she spearheaded and oversaw the commercial roll-out of fibre broadband to two thirds of the country. She joined BT in 2002 and held the pivotal roles of Group Director of Strategy and Regulation, Managing Director Commercial and Brands, Global Services and UK Customer Services Director. From 1998 to 2002, Liv worked for Accenture as a consultant in the Communications and High Tech Market Unit, designing and implementing business change solutions across a number of industry sectors.

External appointments
- Director of Water Plus Limited – joint venture with United Utilities

6. Gordon Fryett (62) ▲ ●
Independent Non-Executive Director
Appointed to the Board on 1 July 2009
Chairman of the Corporate Responsibility Committee

Gordon has extensive experience working in and with international businesses, managing significant capital expenditure. His in-depth retail expertise at both executive and operational level in a customer-facing, highly competitive environment enables him to bring substantial experience and expertise to the Board and the Corporate Responsibility Committee. Gordon held the position of Group Property Director at Tesco plc until his retirement in November 2013. He previously held a number of senior roles within the Tesco Group, including Operations Director, International Support Director and CEO Republic of Ireland.

External appointments
- Alumnus of INSEAD
- Non-Executive Director of W&J Linney Limited

7. Andrew Duff BSc FEI (57) ▲ ● ★
Non-Executive Chairman
Appointed to the Board on 10 May 2010 and Chairman on 20 July 2010
Chairman of the Nominations Committee

Andrew's extensive experience of international and regulated business, strategic management and customer service in high profile, dynamic environments has equipped him well for the role of Chairman of the Group. Andrew spent 16 years at BP in marketing, strategy and oil trading. He joined National Power in 1998 and the Board of Innogy plc upon its demerger from National Power in 2000. He played a leading role in its restructuring and transformation through the opening of competition in energy markets culminating in its subsequent sale to RWE in 2003. He became CEO of the successor Company and a member of the RWE Group Executive Committee. He was a Non-Executive Director of Wolseley Plc from July 2004 until November 2013. Andrew was appointed Non-Executive Deputy Chairman of Elementis plc on 1 April 2014 and became Non-Executive Chairman of Elementis plc on 24 April 2014.

External appointments
- Non-Executive Chairman and Chairman of the Nomination Committee of Elementis plc
- Member of the CBI President's Committee
- Trustee of Macmillan Cancer Support and Earth Trust
- Fellow of the Energy Institute

8. The Hon. Philip Remnant CBE FCA MA (61) ■ ● ★ ◆
Independent Non-Executive Director
Appointed to the Board on 31 March 2014
Chairman of the Remuneration Committee

Philip is a senior investment banker and brings substantial advisory and regulatory experience to the Board. A chartered accountant, he is Senior Independent Director of Prudential Plc and Chairman of M&G Group Limited, Deputy Chairman of the Takeover Panel, Senior Independent Director of UK Financial Investments Limited and Chairman of City of London Investment Trust plc. Previously, Philip was Vice Chairman of Credit Suisse First Boston Europe and Head of the UK Investment Banking Department. Philip was Director General of the Takeover Panel for two years between 2001 and 2003, and again in 2010. He served on the Board of Northern Rock plc from 2008 to 2010 and from 2007 to 2012 was Chairman of the Shareholder Executive.

External appointments
- Senior Independent Director and member of the Audit, Nomination and Remuneration Committees of Prudential Plc
- Chairman of M&G Group Limited
- Deputy Chairman of the Takeover Panel
- Non-Executive Director of UK Financial Investments Limited
- Non-Executive Chairman of City of London Investment Trust plc
- Governor of Goodenough College
- Director and Trustee of St Paul's Cathedral Foundation

9. Emma FitzGerald MA, DPhil Oxon, MBA (49) ✦
Managing Director, Wholesale Operations
Appointed to the Board on 1 April 2016

Emma joined Severn Trent in July 2015 as Managing Director, Wholesale Operations. Emma was previously CEO of Gas Distribution at National Grid. Until 1 December 2015, she was a Non-Executive Director of Alent Plc. Prior to joining National Grid, she pursued a 20 year career with Royal Dutch Shell where she held a variety of technical, strategic and general management positions based in Asia and Europe, including Vice President Global Retail Network and Managing Director of Shell China/Hong Kong Lubricants based in Beijing. Emma's experience and expertise brings a huge amount of value in ensuring the delivery of the commitments we have made in our business plan.

External appointments
- The Windsor Leadership Trust – Company Vice President and Trustee
- BUPA – Association Member

10. Dominique Reiniche MBA (60)
Independent Non-Executive Director
To be appointed to the Board with effect from 20 July 2016

Dominique has a wealth of operational experience in Europe and has international consumer marketing and innovation experience. Dominique is Independent Vice Chairman of CHR Hansen Holdings A/S and also a Non-Executive Director of Mondi Plc, Paypal (Europe) and AXA SA. Dominique started her career with Procter & Gamble AG before moving to Kraft Jacobs Suchard AG as Director of Marketing and Strategy where she was also a member of the Executive Committee. Dominique previously held a number of senior roles at Coca-Cola Enterprises and at Coca-Cola Company, including President – Western Europe, President – Europe and Chairman – Europe. Until December 2015, Dominique was a Non-Executive Director of Peugeot-Citroen SA.

External appointments
- Non-Executive Director of Mondi Plc
- Non-Executive Director of Paypal (Europe)
- Non-Executive Director of AXA SA
- Independent Vice Chairman of CHR Hansen Holdings A/S

11. Kevin Beeston FCMA (53)
Independent Non-Executive Director
Appointed to the Board with effect from 1 June 2016

Kevin has a wealth of commercial, financial and high level management experience. Kevin is Chairman of Taylor Wimpey plc and Equiniti plc and also a Non-Executive Director of The Football Association Premier League Limited. Previously Kevin spent 25 years at Serco plc, where he held the roles of Finance Director, Chief Executive and finally Chairman until 2010. Kevin was previously Chairman of Domestic & General Limited and Partnerships in Care Limited and a Non-Executive Director of IMI plc.

External appointments
- Chairman of Taylor Wimpey plc
- Chairman of Equiniti plc
- Non-Executive Director of The Football Association Premier League Limited

Governance
Governance report

Chairman's letter

Dear Shareholder
I am pleased to introduce our Governance report for 2016 on behalf of your Board in accordance with the September 2014 UK Corporate Governance Code (the 'Code'). Severn Trent has complied with all relevant provisions at the year end, having expanded the remit of the Audit Committee to consider the adequacy of whistleblowing arrangements (this was formerly a matter for the Corporate Responsibility ('CR') Committee).

My role, together with the Board, is to ensure that Severn Trent operates to the highest standards of corporate governance within a well-developed framework to effectively deliver the Group's strategic objectives and to meet its obligations to the Company's stakeholders. Ultimately, effective governance is integral to the successful delivery of our business objectives. It requires that the Board has access to timely, relevant and robust information, so it can run the business effectively and promote the long term success of the Company in the best interest of all stakeholders. We also have clearly defined values and standards of behaviour which we expect from everyone who works for Severn Trent.

My focus continues to be on maintaining a strong, value adding team, with a broad range of professional backgrounds, skills and perspectives. In March 2016, the Board announced the appointment of Emma FitzGerald as an Executive Director to the Boards of Severn Trent Plc and Severn Trent Water Limited (together 'the Board'), with effect from 1 April 2016.

Following year end, we announced that our longest serving Non-Executive Directors, Martin Lamb and Gordon Fryett, would retire from the Board after the Annual General Meeting. I would like to thank Martin and Gordon for their valuable contribution to the Board during their tenure. At this time, we announced the appointment of Kevin Beeston to the Board as a Non-Executive Director, with effect from 1 June 2016, and the appointment of Dominique Reiniche to the Board as a Non-Executive Director, with effect from 20 July 2016.

Kevin will succeed Martin as Senior Independent Non-Executive Director and will become a member of the Audit, Remuneration and Nominations Committees. Dominique will succeed Gordon as a Non-Executive Director and become a member of the Corporate Responsibility and Nominations Committees. Dr. Angela Strank will succeed Gordon as Chair of the Corporate Responsibility Committee.

As can be seen from their biographies on page 46, Kevin and Dominique have a wealth of experience to bring to the Board

At Severn Trent we have a broad and diverse range of skills and perspectives around the boardroom table, further details of which can be found on page 46. As at the date of this report, our Board consists of nine Directors. Our Non-Executive Directors continue to bring extensive experience, diversity and challenge to the Board. I firmly believe that we will continue to deliver value and achieve sustainable growth for our Company through the successful mix of good governance, a clear strategy with a supporting business plan, effective risk management and a strong organisational structure with the right culture in place to execute it.

Andrew Duff
Chairman

Introduction

As Severn Trent Water is not a listed company it is not required to comply with the Governance Code. However, we have voluntarily chosen to apply the principles of the Governance Code to our governance arrangements, where appropriate and reasonably practicable.

The version of the Corporate Governance Code applicable to the current reporting period is the September 2014 UK Corporate Governance Code (the 'Code'). The Code is available on the Financial Reporting Council's website (www.frc.org.uk).

The boards of Severn Trent Water and Severn Trent Plc have the same directors. This structure was implemented in 2007 to ensure that the highest standards of corporate governance were applied at the regulated subsidiary level and to promulgate greater visibility and supervision of Severn Trent Water Limited by the Plc board. Severn Trent Water Limited is therefore voluntarily complying with the 2014 UK Corporate Governance Code to ensure these high standards also apply to it.

For the whole of the financial year ended 31 March 2016, Severn Trent Water Limited was compliant with the Governance Code, with the following exceptions:

- The board committees operate at the Severn Trent Plc level rather than the company level. Whilst the board committees are not duplicated at the company level, in practice their remit includes work in respect of the company. In particular the Audit Committee reviews Severn Trent Water's:
    - Processes for producing regulatory submissions; and
    - Statutory and regulatory accounts prior to their approval by the Severn Trent Water board.

- The board committees are all led by independent non-executive directors who comprise the majority of membership of each committee. Details of the committees are reported publicly in the Severn Trent Plc Annual Report and Accounts.

- The review of the adequacy of arrangements of the Company's whistleblowing procedures fell within the remit of the Severn Trent Plc Corporate Responsibility (CR) Committee, rather than the Severn Trent Plc Audit Committee. This divergence from the Code was addressed in October 2015.

- The company does not comply with the provisions relating to Relations with Shareholders which covers Dialogue with Shareholders and Constructive use of the AGM, as it would not be appropriate to do so, however Severn Trent Plc does fully comply.

The two companies operate as distinct legal entities. The Boards comply with the Severn Trent Plc Board governance framework and the respective Matters Reserved to the Board. They are assisted through the management of separate agendas, meetings and minutes by Company Secretariat and advised in their meetings by the Company Secretary, where appropriate.
Subsidiary Company Boards are managed through designated governance processes. In particular, the relationships between Severn Trent Water Limited and our other businesses such as Severn Trent Business Services are monitored and controlled to ensure that regulatory requirements and obligations under competition law are complied with in respect of all transactions between them, or with third parties.

Governance Code

The Code sets out five key principles: Leadership, Effectiveness, Accountability, Relations with Shareholders and Remuneration. This report is structured against each of these principles which, together with the Nominations Committee report, Audit Committee report and Remuneration Committee report, detailed in the Annual Report and Accounts for Severn Trent Plc, describe how we have complied with the relevant provisions of the Code throughout the year.

1. Code principle: Leadership

Charter of Expectations

In November 2014, the Severn Trent Charter of Expectations was adopted to promote and implement best practice corporate governance. The Charter sets out the role profiles and expectations of all key positions on the Group's Boards (together referred to as the 'Board'), and Board Committees, and also reflects the Board's responsibility for setting the tone for the Group's culture, values and behaviour.

In accordance with provision A.2.1 of the Code, there is a clear division of responsibilities between the roles of Chairman and Chief Executive. These are clearly established, set out in writing and agreed by the Board in the Charter of Expectations.

The Charter of Expectations is also used to assist in the ongoing annual assessment of the effectiveness of the Board and its Committees, and that of individual Directors, and is available on our website (www.severntrent.com).

Governance framework

The Board is responsible to all stakeholders, for the approval and delivery of the Company's strategic objectives. It ensures that the necessary financial, technical and human resources are in place for the Company to meet its objectives. The Board leads the Company within a framework of prudent and effective controls which enable risk to be assessed and managed. Responsibility for the development and implementation of the Company's strategy and overall commercial objectives is delegated to the Chief Executive who is supported by the Severn Trent Executive Committee ('STEC').

The Company's principal decision making body is the Board. In line with the Code, the Board delegates certain roles and responsibilities to its various Committees. The Committees assist the Board by fulfilling their roles and responsibilities, focusing on their specific activities, reporting to the Board on decisions and actions taken, and making any necessary recommendations in line with their Terms of Reference. The Terms of Reference of each Committee comply with the provisions of the Code and have been updated to take account of best practice as part of their annual review in March 2016.

Governance framework

CHAIRMAN – Andrew Duff

Leads our unified Board, ensuring that the principles and processes of the Board are maintained in line with our Code of Conduct and Charter of Expectations.

BOARD

6 Male 3 Female

The Board's role is to: understand and meet its obligations to the Company's stakeholders; lead the Group within a framework of prudent and effective controls which enable risk to be assessed and managed; approve the Group's strategic objectives and ensure that sufficient resources are available to enable it to meet those objectives; and monitor and review the operating and financial performance of the Group. It has responsibility and accountability for the long term success of the Group.

BOARD COMMITTEES

AUDIT COMMITTEE
Chair – John Coghlan

3 Male

The Audit Committee assists the Board in discharging its responsibilities for the integrity of the Company's financial statements, the assessment of the effectiveness of the systems of Internal Controls, Risk Management and the internal and external Auditors. It also reviews the adequacy of the Company's whistleblowing arrangements.

TREASURY COMMITTEE*
Chair – John Coghlan

4 Male

The Treasury Committee provides oversight of treasury activities in implementing the policies, funding and treasury risk management plan approved by the Board. These include inter alia: the measurement and management of risks in respect of interest rates; funding; counterparty credit; liquidity and treasury operations; funding proposals; relationship with rating agencies; debt investor relations; bank relationship management; and treasury internal controls.

REMUNERATION COMMITTEE
Chair – Philip Remnant

3 Male 1 Female

On behalf of the Board, the Remuneration Committee determines the Company's policy on the remuneration of Executive Directors, other members of the Executive Committee and the Chairman of the Board.

CORPORATE RESPONSIBILITY COMMITTEE
Chair – Gordon Fryett

2 Male 2 Female

The Corporate Responsibility Committee provides guidance and direction to the Company's corporate responsibility and sustainability programme based on our values. It also reviews the Group's non-financial risks and opportunities.

NOMINATIONS COMMITTEE
Chair – Andrew Duff

5 Male 1 Female

The Nominations Committee assists the Board by keeping the structure, size, composition and succession needs of the Board under review. It also assists the Board on issues of Directors' conflicts of interest and independence.

CEO – Liv Garfield

Delegated responsibility for the development and implementation of the Group's strategy and overall commercial objectives.

Responsible for the day-to-day management of the business and the communication of Board agreed objectives to employees.

SEVERN TRENT EXECUTIVE COMMITTEE ('STEC')
Chair – Liv Garfield

4 Male 6 Female

STEC operates under the direction and authority of the CEO overseeing the development and execution of strategy. It also has accountability for achieving financial and operational performance.

EXECUTIVE SUB-COMMITTEE

DISCLOSURE COMMITTEE
Chair – James Bowling

3 Male 1 Female

The Disclosure Committee oversees the Company's compliance with its disclosure obligations and considers the materiality, accuracy, reliability and timeliness of information disclosed.

Each Board Committee has written Terms of Reference reviewed annually and approved by the Board, which are available on the Company's website.

* Membership of the Treasury Committee includes Head of Group Treasury

Indicates membership of each Committee, including gender. Male Female

Board meetings

Forward Plan

Each year the Chairman, and respective Committee Chairmen, work with the Company Secretary to develop and agree a forward agenda for Board and Committee meetings for the year ahead. The purpose of the forward agenda is to ensure that proper oversight of key areas of responsibility are scheduled regularly and that sufficient time is allocated during the year for the Board to fully consider strategic matters.

Papers, including minutes of Board and Committee meetings held since the previous meeting, are circulated approximately a week in advance of each meeting. The table overleaf sets out the main matters considered by the Board in 2015/16 at its scheduled Board meetings. The Board's agenda is normally structured, in accordance with the identified requirements of the forward agenda plan, as follows:

- Performance Review (including health and safety, operational, customer and financial matters);
- Bi-annual Enterprise Risk Management review;
- Strategic Items;
- Matters for Approval;
- Matters to Note;
- Governance and Regulatory Matters;
- Committee Reports;

The Board monitors the performance and customer service standards of the regulated water and waste water businesses at every meeting and receives monthly updates on performance against all ODIs.The Board also regularly discusses reports on capital efficiency and asset management.

The Board annually reviews and approves all financial results announcements, the Annual Report and Accounts, dividend payments and all changes to the composition of the Board and its Committees.

Board activities

Topic	Activities/Discussion	
Customers	• Discussion and review of performance and engagement reports at each meeting. • Approach in respect of social tariffs and support for vulnerable customers.	We put our customers first
Shareholders	• Review and discussion of feedback following stakeholder meetings with CEO and CFO, investor roadshows, conferences and Capital Markets Day.	We act with integrity
Strategy	• Review and discussion of strategy.	We are passionate about what we do
Environment, Health & Safety	• Discussion and review of health and safety performance at every meeting. • Discussion and review of environmental matters.	We protect our environment
Governance & Risk	• Review of Severn Trent's governance framework. • Review of the GAA. • Board Committee reports. • Board and Committee effectiveness review – including the Board, its Committees, individual Directors and conflicts of interest. • Annual review of Terms of Reference for all Board Committees. • Tender of external Auditor. More information on the tender can be found on page 84. • Review of the effectiveness of the Group's Internal Controls and Risk Management processes. • Bi-annual Enterprise Risk Management review. • Regular governance report provided by the Company Secretary, including annual review of compliance with the Code. • Bi-annual review of the Group's disclosure requirements.	We act with integrity
Financial	• Review of annual performance, including approval of full year, half year results and trading updates. • Distributions to shareholders. • Annual Report and Accounts. • Treasury funding arrangements. • Group Budget 2015/16, medium term financial plan and regulated business ODIs. • Review of the Group's financial performance against budget and forecast.	We act with integrity
Regulation	• Regulatory business discussions at every meeting. • Engagement with regulators, including relationship mapping. • Discussion and review of water quality updates.	We act with integrity We put our customers first
Employees & Leadership	• Discussion and review of employee engagement across the Group from the results of the QUEST survey. • Discussion and review of talent development and succession planning across the Group. • Annual pension fund review. • Review the composition and succession of the Board and its Committees.	We are inspired to create an awesome company
Ethics	• Discussion and review of the Group's ethics culture.	We act with integrity

Board committees

The board committees operate at the ultimate parent company level rather than the company level. The Severn Trent Plc board has established an effective committee structure to assist in the discharge of its responsibilities to the group.

The terms of reference of Audit, Remuneration and Nominations Committees comply with the provisions of the Governance Code, and are available for inspection, together with the terms of reference of the Corporate Responsibility Committee, on our website (www.severntrent.com) or may be obtained on request from the Company Secretary.

Reports from the Chairmen of these Committees are set out in pages 79 to 101 of the Severn Trent Plc Annual Report and Accounts available on our website (www.severntrent.com).

Independent advice

Directors have access to independent professional advice at the Company's expense on any matter relating to their responsibilities. There is an agreed procedure enabling them to do so, which is managed by the Company Secretary. No such independent advice was sought during the financial year.

2. Code principle: Effectiveness

Our Board's composition

As at the date of this report, the Board consisted of nine Directors. Further information on the composition of the Board can be found on page 46.

Independence of NEDs

The independence of Non-Executive Directors is formally reviewed by the Nominations Committee on an annual basis, which makes a recommendation to the Board in relation to the reappointment of Directors at the Severn Trent Plc Annual General Meeting.

In the event of a situational conflict arising, the Board has a documented authorisation process in place, ensuring that either the Director does not attend the meeting or participate in discussion in respect of any matter where a situational conflict exists.

An annual review of conflicts is carried out alongside a review of our Gifts and Hospitality Register, and is incorporated into the year end process of verifying Directors' interests. Half yearly reports are also made available to the Board detailing all Directors' conflicts and Directors are reminded of their obligations to disclose any potential conflicts.

During its last review in November 2015, the Board considered all external commitments and skillsets required, including those set out in the Code. No Director had a material interest in any contract of significance with the Company or any of its subsidiary undertakings, at any time during the year.

The Board considers that there are no business or other circumstances that are likely to affect the independence of any Non-Executive Director. In accordance with the Code, all the Directors, with the exception of Martin Lamb and Gordon Fryett, will retire at Severn Trent Plc's 2016 AGM and submit themselves for appointment or reappointment by the shareholders. Each of the Non-Executive Directors, seeking appointment or reappointment are considered to be independent in character and judgement.

Appointments to our Board and its Committees

The Board, through the Nominations Committee, has in place formal, rigorous and transparent procedures for the appointment of new Directors to the Board. In March 2016, the Board announced the appointment of Emma FitzGerald, Managing Director of Wholesale Operations and Executive Committee member, to the Board with effect from 1 April 2016. [Following year end, the Board also announced the appointments of Kevin Beeston to the Board, with effect from 1 June 2016, and Dominique Reiniche to the Board as a Non-Executive Director, with effect from 20 July 2016.

In advance of a formal recommendation for a Non-Executive Director appointment being made to the Board, the proposed, final candidate attended an individual pre-appointment meeting with Ofwat.

Terms and conditions of appointment

The terms and conditions of appointment of the Directors are available for inspection by any person at the Company's registered office during normal business hours. They will also be made available before and during the Severn Trent Plc AGM.

In accordance with the Code, any term beyond six years for a Non-Executive Director is subject to rigorous review and takes into account the need for progressive refreshing of the Board.

Evaluation of the Board

The effectiveness of the Board is reviewed at least annually and an independent externally facilitated review is conducted every three years. A full externally facilitated Board evaluation exercise was last conducted in 2015 and reported on in our 2014/15 Annual Report and Accounts.

A summary of the actions taken following the 2015 review can be found below.

Area for further focus identified in 2015 review	Actions taken (bullets)
Allocation of agenda time to agreed key strategic priorities also including length and format of Board papers.	Company Secretariat conducted a review of strategy topics to be considered at Board meetings throughout the year. The length and format of Board papers were also reviewed, with best practice guidance implemented by Directors and report writers.
Mentoring, talent management and succession planning below Executive Committee level	Discussion and review of talent and succession across the Group at July and November Board meetings.
Enhance KPIs to reflect risks and operational performance against new AMP6 Regulatory Requirements.	Instead of reporting against KPIs as in AMP5, we now report performance against ODIs at each meeting of STEC and the Board. We also report on the moving annual performance and provide updated targets for the year at each meeting.

In February 2016, the Board conducted an internally facilitated review of its effectiveness, including a review of the Board, its Committees and individual Board Directors in the context of the Company's Charter of Expectations. Emma FitzGerald, Kevin Beeston and Dominique Reiniche had not been appointed to the Board at this time. This evaluation process was led by the Chairman and the Company Secretary through a series of one to one meetings and discussions. Separate meetings were held to consider the effectiveness of the Chairman, led by our Senior Independent Non-Executive Director, Martin Lamb.

The findings of the evaluation were discussed and reviewed by the Nominations Committee and subsequently the Board in March 2016. The evaluation concluded that excellent progress had been made in respect of areas for further focus identified in the 2015 externally facilitated review. It was agreed that talent and succession planning would remain a regular Board agenda topic and that the Board strategy day meeting would be scheduled outside the normal Board meeting calendar. The evaluation also concluded that the Board and its Committees were effective and that each Director made a constructive and valuable contribution to the Board and the running of the Company.

Training and Development

Induction

On appointment to the Board, a Director's induction needs are evaluated and then they are provided with a comprehensive and personalised induction pack which includes information on our business model, key operations and processes, how we are regulated, how we are shaping future regulation, strategic plans, financial reports, business plans, information on our governance framework, Directors' roles and responsibilities and legal and regulatory duties.

Meetings are arranged with members of the Executive Committee and with external advisors who provide support to the relevant Board Committees on which the Directors may serve. Visits to operational and office sites across the Group and management presentations are also arranged for Directors appointed to the Board and subsequently throughout the year.

These arrangements have been followed for the induction of Emma FitzGerald.

Ofwat issued a letter to the Company on 19 April 2016 formalising a pre appointment meeting process as part of any Non-Executive Director appointment which will also be included in induction programmes going forward. This process was included in the induction of Kevin Beeston and Dominique Reiniche.

Training and Continuing Professional Development

As well as Board agenda items, training sessions in relation to specific topics of interest have been presented to Directors during the year as indicated in the table opposite.

The aim of the training sessions is to continually refresh and expand the Board's knowledge and skills to enable them to effectively fulfil their roles on the Board and its Committees and contribute to discussions on technical and regulatory matters. The sessions also serve as an opportunity for the Board to discuss strategy and risks with management below Executive Committee level and gain further insight into our businesses and management capability.

3. Code principle: Accountability

Charter of Expectations

Our Charter of Expectations sets out the matters for which the Board and key roles are accountable.

'Doing the Right Thing – The Severn Trent Way' ('DTRT')

Every day our employees have to make choices about what they do and how they do it. Most of the time it is clear what the right thing to do is, whether it is about doing what is safe, doing the right thing for our customers, doing what is right ethically and what is right legally.

It details the values we work by and explains who we are, what we stand for and how we work. It also tells our customers, investors and business partners that they can trust and rely on us. These principles apply to everyone in the Severn Trent Group, no matter where in the world they are based or what they do. It provides a consistent framework for responsible business practices and sets the standards we need to follow in our day-to-day activities.

During the year we have refreshed DTRT, and our Group policies, in preparation for roll-out across the Group in 2016/17 to make sure that everyone in the business understands our expectations are in relation to our values and ethical standards. All employees will be given a copy and training sessions will be provided.

4. Code principle: Remuneration

The Board has established a Remuneration Committee at Severn Trent Plc. The composition and activities of the Remuneration Committee are described in the Severn Trent Plc Annual Report and Accounts. Our Remuneration Policy has been designed to take into account the Company's strategic objectives both over the short and long term and the external market.

Governance
Group Remuneration Committee

Remuneration details
The Executive Directors of Severn Trent Water Limited mirror those of Severn Trent Plc and, consequently it is not possible to separate the remuneration received solely for their services to Severn Trent Water Limited. Therefore, the Remuneration Report that follows is a summary of the Remuneration Report found in the Severn Trent Plc Annual Report and Accounts which is available on the Severn Trent Plc website.

The Severn Trent Plc Remuneration Committee (the 'Committee') sets the Remuneration Policy for Executive Directors and other senior executive managers, taking into account the Company's strategic objectives over the short and the long term and the external market.

The Committee addresses the need to balance risk and reward. The Committee monitors the variable pay arrangements to take account of risk levels, ensuring an emphasis on long term and sustainable performance. The Committee believes that the incentive schemes are appropriately managed and that the choice of performance measures and targets does not encourage undue risk taking by the Executive Directors so that the long term performance of the business is not compromised by the pursuit of short term value. The schemes incorporate a range of internal and external performance metrics, measuring both operational and financial performance over differing and overlapping performance periods, providing a rounded assessment of overall Company performance.

Directors' remuneration and annual bonus scheme
Remuneration for Executive Directors comprises the following elements:

- base salary and benefits;
- annual bonus;
- long term incentive plan; and
- pension arrangements.

As outlined in the Severn Trent Plc Annual Report and Accounts, the non-executive Chairman, Andrew Duff, and non-executive plc directors, do not participate in the Company's incentive arrangements, i.e. annual bonus or share plans.

Base salaries and benefits
Base salaries for individual Directors are reviewed annually by the Committee and normally take effect from 1 July. Salaries are set with reference to individual performance, experience and contribution, together with developments in the relevant employment market (having regard to similar roles in publicly quoted companies of a comparable size (currently FTSE 51-150) and practice in other water companies), Company performance, affordability and internal relativities.

In addition to base salary, Executive Directors receive a benefits package which contractually includes car allowance, membership of a defined contribution pension scheme or cash allowance in lieu, family level private medical insurance, life assurance, personal accident insurance, health screening and incapacity benefits scheme. Executive Directors may also take advantage of the Severn Trent flexible benefit scheme open to all employees.

Annual Bonus 2015/16
The annual bonus is designed to encourage improved financial and operational performance and align the interests of Directors with shareholders through the partial deferral of payment in shares. The maximum bonus opportunity is 120% of salary, with 60% of base salary being paid at target.

The scorecard Key Performance Indicators (KPIs) used to measure performance in 2014/15 no longer reflect the main indicators of performance in AMP6, especially since the introduction of Outcome Delivery Incentives (ODIs). ODIs are quantifiable, transparent operational targets set for us by and monitored by Ofwat covering aspects such as water quality, leakage, asset stewardship, supply, flooding, customer experience and environmental performance. Severn Trent Water is rewarded by Ofwat if it exceeds the

Governance
Group Remuneration Committee

ODI targets and suffers financial penalties for missing them. Therefore, the bonuses for the Executive Directors for 2015/16 onwards were weighted as follows:

- 50% on STW profit before interest and tax (PBIT);
- 40% on Business Unit Objectives (including 25% based on ODI performance, 10% based on Business Services' performance and 5% based on health and safety performance); and
- 10% on personal performance.

PBIT was chosen as a measure as it is an indicator of overall financial performance and reflects efficiencies, revenue and other key levers in the Business Plan. We believe that the new structure for the bonus provides a stronger link between our financial and operational performance and the rewards earned by executives.

The table below shows a summary of the metrics and targets which were used to determine the annual bonus awards together with the actual performance achieved (please note that the Business Services PBIT element of the bonus has been omitted as it does not relate to the performance of Severn Trent Water):

Measure		***Weighting***	**Threshold (0% payable)**	**Target (50% payable)**	**Stretch (100% payable)**	**Actual Performance[(i)]**	**% Payable**
STW profit before interest and tax		*50%*	£474.1m	£502.9m	£524.1m	£520.3m	91.0%
Business Unit Objectives	STW Outcome Delivery Incentives	*25%*	£0.0m	£4.8m	£7.3m	£23.2m	100.0%
	Health & safety (no. of lost time incidents / by no. of hours worked x 100,000)	*5%*	0.20	0.18	0.17	0.25	0.00%
Personal Performance		*10%*	See below				85% for Liv Garfield and 70% for James Bowling

(i) The STW ODI figure is based on 2013/13 pre tax prices.

The directors had 10% of their bonus opportunity measured against personal objectives. Key objectives for Liv Garfield (Chief Executive Officer) related to growth and further improving the financial strength of the business, customer experience, and organisational effectiveness. Activities included education and engagement sessions for all employees on delivering outcomes for customers and end to end process reviews in operational areas, which has contributed towards 95% of operational measures being stable or improved, ODI outperformance, (net reward of £23.2 million) and a reduction in customer complaints, down 28% year on year. We have been recognised by the Environment Agency as being a leader on environmental performance and we have delivered 8.4% Return on Regulated Equity (RoRE) which was in the upper range of Ofwat expectations. In addition, the business has been strengthened by the Water Plus joint venture established with United Utilities to deliver a market leading non-household retail offer when the market opens up in 2017. As a result, the Remuneration Committee decided to award Liv Garfield a personal performance bonus at 85% of the maximum.

The objectives for James Bowling (Chief Financial Officer) related to the delivery of the finance strategy and plans, including rebalancing fixed and floating debt and creating procurement savings. Delivering on our finance strategy, active treasury management initiatives were undertaken during the year to rebalance the debt portfolio and lower index linked debt costs. This has helped deliver a £31.4 million reduction in net finance costs (excluding pensions) year on year and led to an effective finance cost of 4.5%, down from 5.4%. In addition, bad debt charges decreased from 1.8% of turnover to 1.5% as a result of improved collection performance on amounts billed in the year and better management of aged debt balances. Procurement savings have contributed to wholesale Totex of £1,017 million, £38 million lower than the Final Determination. Power costs have reduced by £2.1 million and we continue to make good progress on renewable energy, generating 33% of our energy needs through the renewables programme and on track for 50% by 2020. As a result, the Remuneration Committee decided to award James Bowling personal performance bonus at 70% of the maximum.

5% of the 2015/16 bonus opportunity for the Executive Directors related to health and safety performance targets, which were not achieved. Therefore the annual bonus weighting against this objective for 2016/17 has been increased from 5% to 8% (with a consequential reduction in the STW PBIT target (47%)) and more challenging targets set.

The bonuses awarded for 2015/16 were 105.8% of base salary for Liv Garfield (£702,142) and 104.0% of base salary for James Bowling (£416,000) out of a maximum bonus opportunity of 120% of salary for both Directors. Please note that the bonuses incorporate amounts in respect of the achievement of Severn Trent Business Services and personal performance targets. Annual bonus payments to Executive Directors are not pensionable.

50% of the annual bonus is paid in cash and 50% in shares which vest after three years (with the value of any dividends to be rolled up and paid on vesting). A claw back mechanism applies to allow the recoupment within three years of the payment of the cash bonus or the grant of deferred shares in the event of financial misstatement, error in the calculation or gross misconduct.

Annual Bonus 2016/17

For 2016/17 the annual bonus performance measures will be weighted as follows:

- 47% on Severn Trent Water PBIT;
- 43% on Business Unit Objectives (25% on STW ODIs, 10% on Business Services PBIT and 8% on health and safety performance in respect of the Chief Executive Officer and Chief Financial Officer and 35% on STW ODIs and 8% on health and safety performance in respect of the Managing Director, Wholesale Operations); and;
- 10% on personal objectives.

The weighting on health and safety performance has increased from 5% in 2015/16 to 8% in 2016/17 with a consequential reduction in the weighting on STW PBIT from 50% in 2015/16 to 47% in 2016/17. The Committee considers the forward looking performance targets to be commercially sensitive and has, therefore, determined not to disclose them in advance. Details of the targets used will be disclosed in next year's Remuneration Report.

Long Term Incentive Plan

Executive Directors may also participate in the ST Plc Long Term Incentive Plan ('LTIP') which is designed to encourage strong and sustained improvements in financial performance, in line with the Company's strategy and long term shareholder returns. Under this plan conditional awards of performance shares are made to Directors up to an annual maximum limit and vest after three years.

Governance
Group Remuneration Committee

2013 & 2014 LTIP Awards

The awards made in 2013 and 2014 were measured against the average Return on Regulatory Capital Value (RoRCV) over three financial years. 0% of each award vests if average RoRCV equals that set in the Final Determination, increasing on a straight-line basis to 50% vesting for 1.02 x Final Determination and 100% vesting for 1.07 x Final Determination. Ofwat are no longer publishing a baseline RoRCV figure in AMP6. This impacts the third measurement year of the 2013 LTIP and the second and third measurement years of the 2014 LTIP. Therefore, we have calculated the equivalent baseline figure using the component numbers set out in the Ofwat Final Determination for AMP6. To ensure consistency between this equivalent baseline and RoRCV, the baseline figure was adjusted to take into account the impact of expected income to be received under Pay As You Go (which dictates what portion of total expenditure is directly passed through into customers' bills (which is how operating expenditure was historically treated), and what is added to STW's asset base (which is how capital expenditure was historically treated). This gives a baseline figure of 3.49% for 2015/16.

2013 LTIP Outturn

The three year performance period for the 2013 LTIP award ended on 31 March 2016. The Committee determined that the average RoRCV over the three years ending in 2015/16 had outperformed the RoRCV Ofwat Final Determination by 1.23 times therefore resulting in 100% vesting. This level of vesting was considered appropriate given the Company's strong financial and operational performance over the performance period. Further details can be found in the Severn Trent Plc Annual Report & Accounts.

2015 & 2016 LTIP Awards

Awards granted from 2015 onwards are subject to an RoRE performance condition measured over three financial years. Average RoRE performance is compared with the baseline RoRE figure set by Ofwat in our Final Determination. 25% of the award will vest if average RoRE matches the baseline figure of 5.65%, increasing on a straight line basis to full vesting for out-performing the baseline by 1.29 times (equivalent to 7.29%) for the 2015 LTIP award and 1.39 times (7.85%) for the 2016 LTIP award.

The grant level for the 2016 LTIP award is 150% for the Chief Executive Officer and 100% for the Chief Financial Officer (grants worth 125% and 80% of base salary respectively were made in 2015). The 2016 grant level for the Managing Director, Wholesale Operations is 80% of base salary. The increase in award levels for the Chief Executive Officer and Chief Financial Officer is within our current LTIP policy and reflects the strong performance of the Company and individuals, their career progression and the higher RoRE stretch target for the 2016 awards.

Shareholding guidelines

The Company operates shareholding guidelines under which Executive Directors are expected to build and maintain a shareholding in the Company. The Chief Executive Officer is expected to build and maintain a holding of shares to the value of 200% of salary, and other Executive Directors 125% of salary. Executive Directors are expected to retain all of the net of tax number of shares they receive through the LTIP and deferred share bonus until the shareholding guidelines have been met.

Governance
Directors' report

The Directors present their report and the audited financial statements for the Company, for the year ended 31 March 2016. The Business performance review of the Company can be found within the Strategic Report on pages 14 to 21. This provides detailed information, its business models and strategy, the operation of its businesses, future developments and the results and financial position for the year ended 31 March 2016. The Governance section set out on pages 47 to 59 is incorporated by reference into this report and, accordingly, should be read as part of this report.

Principal activity
The principal activity of the Company is to treat and provide water and remove waste water in the UK and internationally. There have not been any significant changes to the company's principal activities in the year under review. The directors are not aware, at the date of this report, of any likely major changes in the company's activities in the next year.

Directors and their interests
Biographies of the Directors currently serving on the Board are set out on page 46.

All of the Directors at the year-end are also directors or Severn Trent Plc. With the exception of Martin Lamb and Gordon Fryett,]they will be offering themselves for appointment or reappointment at the Severn Trent Plc AGM, as set out in the Governance Report on pages 47 to 59.

Details of Directors' service contracts are set out in the Directors' Remuneration Report on pages 56-59. The interests of the Directors in the shares of Severn Trent Plc are disclosed in the Annual Report and Accounts for that company for the year ended 31 March 2016. The Board has a documented process in place in respect of conflicts which is described on pages 53.

Insurance and indemnities
The Company maintains Directors' and Officers' liability insurance in respect of legal action that might be brought against its Directors and Officers. As permitted by the Company's Articles of Association (the 'Articles'), and to the extent permitted by law, the Company indemnifies each of its Directors and other Officers of the Group against certain liabilities that may be incurred as a result of their positions with the Group. The indemnity was in force throughout the tenure of each Director during the last financial year, and is currently in force.

Indemnities were also entered into with Emma FitzGerald, Kevin Beeston and Dominique Reiniche upon their appointments to the Board.

Severn Trent Water does not have in place any indemnities for the benefit of the external Auditor.

Employees
The average number of employees within the group is shown in note 8 to the financial statements on page 86.

Severn Trent Water believes a diverse and inclusive workforce is a key factor in being a successful business. Through our Diversity and Equal Opportunities Policy, the Company seeks to ensure that every employee, without exception, is treated equally and fairly and that all employees are aware of their responsibilities. This means more than ensuring we don't discriminate in any way – we want to create and maintain a culture open to a diverse population. We are an equal opportunities employer and welcome applications from all individuals, including those with a disability. We are fully committed to supporting applications made by disabled persons, and make reasonable adjustments to their environment where possible (having regard to their particular aptitudes and abilities).

We are also responsive to the needs of our employees. As such, should any employee become disabled during their time with us, we will actively re-train that employee and make reasonable adjustments to their environment where possible, in order to keep the employee within the Group.

Governance
Directors' report

All our training, promotion and career development processes are in place for all our employees to access, regardless of their gender, race, age or disability. The provision of occupational health programmes is of crucial importance with the aim of keeping our employees fit and healthy, including an employee assistance programme which is available to Severn Trent Water Limited employees.

Employee engagement
We continuously engage with our employees in a number of ways to suit different working patterns. This includes:

- all people briefings, 'Team Talk';
- corporate communications events and roadshows held by functions across the Company;
- a dedicated intranet, 'Streamline';
- online news portal and weekly roundup, 'Pipeline News';
- an active employee social media presence, 'Yammer';
- conference calls and email;
- leadership engagement channels – Chief Executive's weekly blog, senior management monthly visibility programme and quarterly events;
- employee forum; and
- regular meetings with Unions.

Details of the financial and economic factors affecting the performance of the Company are shared with all employees at the appropriate time using the methods listed above.

We provide opportunities for employees to give their feedback to the Company in a number of ways, from team or shift meetings and annual employee satisfaction 'Quest' surveys.

The Company is keen to encourage greater employee involvement in the Group's performance through share ownership. To help align employees' interests with the success of the Company's performance, we operate an HMRC approved all-employee plan, the Severn Trent Sharesave Scheme ('Sharesave'), which is offered to UK employees on an annual basis. Over 65% of Severn Trent's UK employees participate in one or more of our Sharesave Schemes.

During the year, the Company has remained within its headroom limits for the issue of new shares for share plans as set out in the rules of the above plan.

Research and development
Innovative use of existing and emerging technologies will continue to be crucial to the successful development of new products and processes for the group and our products must continue to deliver value for customers.

Expenditure on research and development is set out in note 6 to the financial statements on page 85.

Post balance sheet events
Details of post balance sheet events are set out in note 37 to the financial statements on page 121.

Contributions for political and charitable purposes
Donations to charitable organisations during the year amounted to £86,864 (2015: £157,648). Donations are given to charities whose projects align closely with our aim to promote the responsible use of water resources and waste water services which provide the opportunity for longer term partnerships. In addition, we provide donations to employee nominated charities through a matched funding scheme and health and safety reward schemes. We are also committed to supporting WaterAid, the UK's only major charity dedicated to improving access to safe water, hygiene and sanitation in the world's poorest countries.

Severn Trent’s policy is not to make any donations for political purposes in the UK, or to donate to EU political parties or incur EU political expenditure. Accordingly neither Severn Trent Plc nor its subsidiaries made any political donations or incurred political expenditure in the financial year under review.

Under the provisions of the Political Parties Elections and Referendums Act 2000 (the relevant provisions of which are now contained in Part 14 of the Companies Act 2006), shareholder authority is required for political donations to be made or political expenditure to be incurred by the Company or any of its subsidiaries in the EU and disclosure of any such payment must be made in the Annual Report and Accounts. The legislation gives a wide definition of what constitutes political donations and political expenditure including sponsorship, subscriptions, payment of expenses, paid leave for employees fulfilling public duties and support for bodies representing the business community in policy review or reform. The Company has therefore obtained limited authority from shareholders as a precautionary measure to allow the Company to continue supporting the community and such organisations without inadvertently breaching the legislation.

At the 2015 AGM, shareholders gave the Company authority to make political donations or to incur political expenditure in the EU (which would not ordinarily be regarded as political donations) up to an aggregate annual limit of £150,000 for the Company and its subsidiaries. Pursuant to those authorities, during the year ended 31 March 2016 the Group incurred costs of £nil (2015: £nil). Those authorities will expire at the 2016 AGM and, in line with market practice to renew the authorities on an annual basis, the Board has decided to put forward a resolution to this year’s AGM to renew the authorities to make donations to political organisations and to incur political expenditure up to a maximum aggregate of £150,000 p.a. As permitted under the Companies Act 2006, this resolution also covers any political donations made or political expenditure incurred, by any subsidiaries of the Company.

Dividends
An interim dividend of 32.26 pence per Ordinary Share was paid on 8 January 2016. The Directors recommend a final dividend of 48.40 pence per Ordinary Share to be paid on 22 July 2016 to shareholders on the register on 17 June 2016. This would bring the total dividend for 2015/16 to 80.66 pence per Ordinary Share (2014: 84.90 pence).

Dividend Policy
In January 2015, Severn Trent Plc announced its dividend policy for the period 2015-2020. The Board agreed to set the 2015/16 dividend at 80.66 pence, a reduction of 5% compared to 2014/15 total dividend for the year 84.90 pence. The policy is structured so as to grow the dividend annually at no less than RPI until March 2020. This replaced the previous dividend policy of RPI+3% which expired in March 2015. The dividend policy reflects the lower cost of capital and stretching objectives and improvements in operating efficiencies required by the Final Determination. When determining the policy the Board considered various scenarios and sensitivities, and reviewed the impact of adverse changes in inflation and interest rates on key metrics. The Board believes that the dividend policy is commensurate with a sustainable investment grade credit rating.

Supplier payment policy
Individual operating companies within the Group are responsible for establishing appropriate policies with regard to the payment of their suppliers, in accordance with the Prompt Payment Code (‘PPC’). The companies agree terms and conditions under which business transactions with suppliers are conducted. It is Group policy that provided a supplier is complying with the relevant terms and conditions, including the prompt and complete submission of all specified documentation, payment will be made in accordance with agreed terms. It is also Group policy to ensure that suppliers know the terms on which payment will take place when business is agreed.

Internal controls

The Board is responsible for the Group's Internal Control systems and for reviewing their effectiveness. The Audit Committee regularly monitors and reviews the effectiveness of the systems of Internal Control, including Risk Management, financial, operational and compliance aspects, in accordance with the requirements of the Code and the Guidance, and these systems have been in place for the year ending 31 March 2016 and up to the date of the Annual Report. The Internal Control system can provide only reasonable and not absolute assurance against material misstatement or loss, as it is designed to manage rather than eliminate the risk of failure to achieve business objectives.

Throughout the year the Committee has received regular reports from Internal Audit covering the Internal Control framework in respect of financial and operating performance, significant projects and for compliance matters, with the key audit findings and the associated management's actions discussed by the Committee. During the year the Committee examined the requirements of the revised UK Corporate Governance Code in relation to the assessment and reporting of longer term viability and internal control.

The Group's procedures for exercising control and managing risk in relation to financial reporting and preparation of consolidated accounts include:

- the formulation and communication of Group accounting policies which are regularly updated for developments in IFRS and other reporting requirements;
- specification of a set of financial controls that all of the Group's operating businesses are required to implement as a minimum;
- deployment of a Group-wide consolidation system with controls to restrict access and maintain integrity of data;
- recruitment, training and development of appropriately qualified and experienced financial reporting personnel; and
- oversight by the Disclosure Committee, a sub-committee of STEC, of the Group's compliance with its disclosure obligations.

To support these control activities, the Audit Committee receives reports from Internal Audit which provide objective assurance on risk management, governance and control matters. The external Auditor reports significant financial control issues to the Audit Committee.

An independent technical assurer, Jacobs, provides objective assurance in relation to Severn Trent Water Limited's reporting against performance commitments and ODIs in the Annual Performance Report. Deloitte audit the regulatory financial reporting and the price control and additional segmental reporting and provide specific assurance on the additional regulatory information, all of which is included in the Annual Performance Report. The Committee reviews the procedures, systems and controls designed to prevent and detect fraud and bribery and receives a log of incidents of fraud or bribery every six months, which includes the actions taken to investigate and respond to the incidents. There were no material incidents during the year. The Audit Committee has not identified nor has been advised of any failings or weaknesses which it has deemed to be significant.

Long Term Viability Statement

The Directors' assessment of the Group's current financial position is set out in the Severn Trent Plc Annual Report and Accounts Financial review on pages 41 to 45 and their assessment of the Group's principal risks is set out in the Principal risks section on pages 48 to 53.

The Company's principal operating subsidiary is Severn Trent Water Limited, which is a regulated long term
business characterised by multi-year investment programmes and stable revenues. The water industry in England and Wales is currently subject to economic regulation rather than market competition and Ofwat, the economic regulator, has a statutory obligation to secure that water companies are able to finance their appointed activities. Ofwat meets this obligation by setting price controls for five year Asset Management Periods ('AMPs'). This mechanism reduces the potential for variability in revenues from the regulated business. The current AMP runs until March 2020.

Governance
Directors' report

The Group has an established process to assess its prospects. The Board undertakes a detailed assessment of the Group's strategy on an annual basis and the output from this assessment sets the framework for the Group's medium term plan which is updated annually.

The plan assessed the Group's prospects and considered the potential impacts of the principal risks and uncertainties. Stress tests were performed to assess the potential impacts of combinations of those risks and uncertainties. The plan also considered the mitigating actions that might be taken to reduce the impact of such risks and uncertainties and their likely effectiveness.

The Group's investment programmes are largely funded through access to debt markets. The Group's strategic funding objectives reflect the long term nature of the Severn Trent Water Limited business and the Group seeks to obtain a balance of long term funding at the best possible economic cost. The Group's Treasury Policy requires that it maintains sufficient liquidity to cover cash flow requirements for a rolling period of 18 months in order to mitigate the risk of restricted access to capital markets. The Group's debt maturity profile is actively managed by the Group Treasury department to spread the timing of refinancing requirements and to enable such requirements to be met under most market conditions. The weighted average maturity of debt at the balance sheet date was 15 years.

Bearing in mind the long term nature of the Group's business; the enduring demand for its services; the nature of the Group's established planning process and the changing nature of the regulation of the water industry in England and Wales, the Directors have determined that three years is an appropriate period over which to assess the Group's prospects and make its Viability Statement.

In making its assessment the Board has made the following key assumptions:

- Any period in which the Group is unable to access capital markets to raise finance during the period under review will be shorter than 18 months.
- There will not be a catastrophic disruption to our drinking water supplies arising from external factors during any such period of market disruption.

The Directors have assessed the viability of the Company over a three year period to 31 March 2019, taking into account the Company's current position and principal risks. Based on that assessment, the Directors 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 to 31 March 2019.

Going Concern

In preparing the financial statements the Directors considered the Company's ability to meet its debts as they fall due for a period of one year from the date of this report. This was carried out in conjunction with the consideration of the Viability Statement above.
On this basis the Directors considered it appropriate to adopt the Going Concern basis in preparing the financial statements.

Governance
Directors' report

Relevant audit information
The Directors confirm that:

- so far as each of them is aware, there is no relevant audit information of which the Company's Auditor is unaware; and
- each of them has taken all the steps that he/she ought to have taken as a Director to make himself/herself aware of any relevant audit information and to establish that the Company's Auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

External Auditor
Having carried out a review of their effectiveness during the year, and following the audit tender process described in the Severn Trent Plc Audit Committee report on page 84, the Audit Committee has recommended to the Board the reappointment of Deloitte LLP.
The reappointment and a resolution to that effect will be on the agenda at the Severn Trent Plc AGM. Deloitte LLP indicated their willingness to continue as Auditor. The Severn Trent Plc Audit Committee will also be responsible for determining the audit fee on behalf of the Board.
Accounts of Severn Trent Water Limited
The Annual Performance Report for Severn Trent Water Limited is prepared and sent to Ofwat. A copy of this will be available on the website of Severn Trent Water Limited or on request to the Company Secretary. There is no charge for this publication.

By order of the Board
Bronagh Kennedy
Group General Counsel and Company Secretary

23 May 2016

Governance
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 are required to prepare the Group financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and the parent company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law) including FRS 101 "Reduced Disclosure Framework". Under company law the Directors must not approve the accounts unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period in preparing the parent company 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.

In preparing the Group financial statements, International Accounting Standard 1 requires that Directors:
• properly select and apply accounting policies;
• present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
• provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
• make an assessment of the Company's ability to continue as a going concern.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the Financial Statements comply with the Companies Act 2006. 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 included on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

The Directors confirm that they consider that the Annual Report and Financial Statements, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the Company's position and performance, business model and strategy.

Responsibility statement
Each of the Directors confirm that to the best of their knowledge:
• the Financial Statements, prepared in accordance with the relevant financial reporting framework, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole; and
• the Strategic report includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

Governance
Directors' responsibilities statement

This responsibility statement was approved by the Board of Directors on 23 May 2016 and is signed on its behalf by:

Andrew Duff	**James Bowling**
Chairman	**Chief Financial Officer**
23 May 2016	

Independent auditor's report to the members of Severn Trent Water Limited

Opinion on financial statements of Severn Trent Water Limited

In our opinion:

- **the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 March 2016 and of the group's profit for the year then ended;**
- **the group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;**
- **the parent company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice including Financial Reporting Standard 101 Reduced Disclosure Framework; and**
- **the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.**

The financial statements comprise the Consolidated income statement, the Consolidated and Parent Company statements of comprehensive income, the Consolidated and Parent Company balance sheets, the Consolidated and Parent Company cash flow statement, the Consolidated and Parent company statements of changes in equity and the related Consolidated notes 1 to 40 and Parent Company notes 1 to 33. The financial reporting framework that has been applied in the preparation of the group financial statements is applicable law and IFRSs as adopted by the European Union. The financial reporting framework that has been applied in the preparation of the parent company financial statements is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) including Financial Reporting Standard 101 Reduced Disclosure Framework.

Going concern and the directors' assessment of the principal risks that would threaten the solvency or liquidity of the group

We have nothing material to add or draw attention to in relation to:

- the directors' confirmation on page 29 that they have carried out a robust assessment of the principal risks facing the group, including those that would threaten its business model, future performance, solvency or liquidity;
- the disclosures [on pages 29-34] that describe those risks and explain how they are being managed or mitigated;
- the directors' statement in note 2a to 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 group's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements;
- the directors' explanation [on page 28] as to how they have assessed the prospects of the group, 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 group 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 agreed with the directors' adoption of the going concern basis of accounting and we did not identify any such material uncertainties. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the group's ability to continue as a going concern.

Independence

We are required to comply with the Financial Reporting Council's Ethical Standards for Auditors and we confirm that we are independent of the group and we have fulfilled our other ethical responsibilities in accordance with those standards. We also confirm we have not provided any of the prohibited non-audit services referred to in those standards.

Our assessment of risks of material misstatement

The assessed risks of material misstatement described below are those that had the greatest effect on our audit strategy, the allocation of resources in the audit and directing the efforts of the engagement team.

Independent auditor's report to the members of Severn Trent Water Limited

Risk	How the scope of our audit responded to the risk
Determination of the provision for impairment of trade receivables (£124.3 million) (note 18) A proportion of Severn Trent Water Limited's customers do not or cannot pay their bills which results in the need for provisions to be made for non-payment of the customer balance.There is significant judgement involved in calculating the bad debt provision, particularly regarding the estimation of future cash collection. Provisions are made against Severn Trent Water Limited's trade receivables based on historical experience of levels of recovery from accounts in particular ageing categories.	We reviewed and challenged the information used to determine the bad debt provision by considering cash collection performance against historical trends and the level of bad debt charges over time. Specifically, we reviewed the actual history of slow paying customers in Severn Trent Water Limited in the period using data analytics to understand the collection of previously aged debtors and to recompute the ageing analysis. We tested thedesign and implementation of key management review controls and those relating to the production of the data used in the bad debt model. We have also agreed a sample of this data back to its source, being the billing system.
Revenue recognition risk in relation to the estimation of unbilled revenue (£193.0 million) (note 18) For water and waste water customers with water meters, the amount recognised depends upon the volume supplied, including an estimate of the sales value of units supplied between the date of the last meter reading and the year end. This is a key judgement because the estimated usage is based upon historical data and assumptions around consumption patterns.	We challenged the validity of management's estimate of current year accrued revenue by comparing actual amounts billed to the estimate made in the prior year to determine the accuracy of the estimation techniques. In addition, we used data analytics to recompute the total level of unbilled revenue for the current year in Severn Trent Water Limited as well as testing the design and implementation of key management review controls and those relating to the key data inputs to the model. We also agreed a sample of this data back to its source.
Determining the classification of costs between operating expenditure and capital expenditure (note 16) Severn Trent Water Limited has a substantial capital programme (fixed asset additions in the year £411.5 million) which has been agreed with the regulator ('Ofwat') and therefore incurs significant expenditure in relation to the development and maintenance of both infrastructure and non-infrastructure assets. Expenditure in relation to increasing the capacity or enhancing the network is treated as capital expenditure. Expenditure incurred in maintaining the operating capability of the network is expensed in the year (£126.0 million) in which it is incurred. Capital projects often contain a combination of enhancement and maintenance activity which are not distinct and therefore the allocation of costs between capital and operating expenditure is inherently judgemental. Whilst under AMP 6, total expenditure or totex is a key driver of regulatory performance rather than capital expenditure which was monitored under AMP 5, the accounting distintion between operating and capital expenditure remains and hence it is important that capital project expenditure is accounted for correctly in accordance with International Accounting Standards. In addition, the comparative consolidated balance sheet of Severn Trent Water Limited has been restated to reflect a reclassification between property, plant and equipment and non current trade and other payables. Contributions, which had been received in previous years in relation to infrastructure assets, and which had a carrying value of £294.5 million as at 31 March 2014, were identified as being deducted from the carrying value of property plant and equipment. In order to comply with the requirements of IAS 16 and IAS 18, these contributions have been reclassified from property plant and equipment to non-current trade and other payables. Further details are set out in note 1b.	We assessed the group's capitalisation policy to determine compliance with relevant accounting standards and tested the operating effectiveness of controls over the application of the policy to expenditure incurred on projects within the group's capital programme during the year. This includes consideration of the allocation of costs between capital and operating expenditure. In addition, for a sample of capital projects, we assessed the application of the capitalisation policy to the costs incurred by agreement to third party invoices and obtained explanations and further support for any significant changes in capital expenditure from budget. In relation to the reclassification of infrastructure asset contributions from property, plant and equipment to non current trade and other payables in Severn Trent Water Limited, we have reconciled in total the contributions received in relation to infrastructure assets to the underlying accounting records and have confirmed that the revised presentation is in line with International Accounting

Independent auditor's report to the members of Severn Trent Water Limited

	Standards.
Determining the amount of the group's retirement benefit obligations (£309.5 million deficit) (note 25) This is a key area of judgement because the process is complex and requires management (after taking advice from their actuarial advisers) to make a number of assumptions concerning long term interest rates, inflation, salary and pension increases, investment returns and longevity of current pensioners .	With support from the pension specialists within our audit team, we challenged the assumptions used in the calculation of the pension scheme deficit as detailed in note 25, specifically regarding the discount rate, inflation rate and mortality assumptions with reference to comparable market and other third party data.
Determination of current and deferred tax balances (£14.1 million credit) (note 13) Assessing the outcome of uncertain tax positions requires judgements to be made regarding the result of negotiations with, and enquiries from, tax authorities in a number of jurisdictions.	With support from the tax specialists within our audit team, we considered the likely outcomes of uncertain tax positions and reviewed correspondence with the relevant tax authorities to assess the appropriateness of the tax balances that have been recorded in the balance sheet.
The opening deferred tax balance of Severn Trent Water Limited has been restated by £67.8 million with a corresponding debit adjustment in opening reserves, primarily in order to correct the deferred tax position in light of the reclassification of contributions received in relation to infrastructure assets from property, plant and equipment to non-current trade and other payables. Further details are set out in note 1b.	We have reviewed the underlying workings supporting the restated current and deferred tax balances in Severn Trent Water Limited and challenged the revised treatment to test that it is in accordance with IAS 12 'Income Taxes'

The Severn Trent plc Audit Committee's consideration of these risks is set out on page [82] of the Severn Trent plc Annual Report and Accounts.

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.

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. We determined materiality for the group to be £16 million (2015: £16 million), which is approximately 5% (2015: 5.0%) of profit before tax, losses/gains on financial instruments and exceptional items. As in 2015, these items are excluded to focus on the group's underlying trading performance, consistent with the group's internal and external reporting. We agreed with the Audit Committee that we would report to them all audit differences in excess of £750,000 (2015: £750,000), 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	Our group audit was scoped by obtaining an understanding of the group and its environment, including group-wide controls, and assessing the risks of material misstatement at the group level. Based on that assessment, we focused our group audit scope on the consolidation at the parent company level and the audit of Severn Trent Water Limited and Severn Trent Utilities Finance Plc. Severn Trent Water Limited and Severn Trent Utilities Finance plc were subject to a full statutory audits using component materiality of £15 million and £11.2 million respectively and together

account for 100% (2015:100%) of the group's turnover and over 90% (2015: over 90%) of the group's net assets and profit before tax, gains/losses on financial instruments and exceptional items. The extent of our testing on the other subsidiary entities within the group was based on our assessment of the risks of material misstatement.

The group audit team performs the audit of the Severn Trent Water Limited and Severn Trent Utilities Finance plc.

At the parent entity level we also tested the consolidation process and carried out analytical procedures to confirm our conclusion that there were no significant risks of material misstatement of the aggregated financial information of the remaining components not subject to audit or audit of specified account balances.

Opinion on other matter prescribed by the Companies Act 2006

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

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 parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent 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 arising from these matters.

Other matters

Although not required to do so, the directors have voluntarily chosen to make a corporate governance statement detailing the extent of their compliance with the UK Corporate Governance Code. We reviewed the part of the Corporate Governance Statement relating to the company's compliance with certain provisions of the UK Corporate Governance Code. We have nothing to report arising from our review.

Our duty to read other information in the Annual Report

Under International Standards on Auditing (UK and Ireland), we are required to report to you if, in our opinion, information in the annual report is:
- materially inconsistent with the information in the audited financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the group acquired in the course of performing our audit; or
- otherwise misleading.

In particular, we are required to consider whether we have identified any inconsistencies between our knowledge acquired during the audit and the directors' statement that they consider the annual report is fair, balanced and understandable and whether the annual report appropriately discloses those matters that we communicated to the audit committee which we consider should have been disclosed. We confirm that we have not identified any such inconsistencies or misleading statements.

Respective responsibilities of directors and auditor

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. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). We also comply with International Standard on Quality Control 1 (UK and Ireland). Our audit methodology and tools aim to ensure that our quality control procedures are effective, understood and applied. Our quality controls and systems include our dedicated professional standards review team and independent partner reviews.

Independent auditor's report to the members of Severn Trent Water Limited

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/or those further matters we have expressly agreed to report to them in our engagement letter 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.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the group's and the parent company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Jane Whitlock (Senior statutory auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
Birmingham, UK
23 May 2016

Consolidated income statement

For the year ended 31 March 2016

	Notes	2016 £m	2015 £m
Turnover	5	**1,550.2**	1,581.2
Net operating costs before exceptional items	6	**(1,031.5)**	(1,044.6)
Exceptional operating items	7	**1.0**	(21.5)
Total net operating costs	6	**(1,030.5)**	(1,066.1)
Profit before interest, tax and exceptional items		**518.7**	536.6
Exceptional items before interest and tax	7	**1.0**	(21.5)
Profit before interest and tax		**519.7**	515.1
Finance income	10	**68.6**	81.2
Finance costs	11	**(272.5)**	(302.7)
Net finance costs		**(203.9)**	(221.5)
Gains/(losses) on financial instruments	12	**4.0**	(164.0)
Profit before tax, gains/(losses) on financial instruments and exceptional items		**314.8**	315.1
Exceptional items before tax	7	**1.0**	(21.5)
Gains/(losses) on financial instruments	12	**4.0**	(164.0)
Profit on ordinary activities before tax		**319.8**	129.6
Current tax excluding exceptional credit	13	**(55.2)**	(38.8)
Deferred tax excluding exceptional credit	13	**(9.5)**	13.1
Exceptional tax credit	13	**78.8**	–
Total tax on profit on ordinary activities	13	**14.1**	(25.7)
Profit for the year		**333.9**	103.9
Attributable to:			
Owners of the company		**333.9**	103.9
		333.9	103.9

All results are from continuing operations in both the current and preceding year.

Consolidated statement of comprehensive income

For the year ended 31 March 2016

	2016 £m	2015 £m
Profit for the year	**333.9**	103.9
Other comprehensive income/(loss)		
Items that will not be reclassified to the income statement:		
Net actuarial gain/(loss) on defined benefit pension schemes	**150.3**	(139.1)
Tax on net actuarial gain/loss	**(28.5)**	26.9
Deferred tax arising on change of rate	**(8.8)**	–
	113.0	(112.2)
Items that may be reclassified to the income statement:		
Loss on cash flow hedges	**(2.4)**	(10.4)
Deferred tax on loss on cash flow hedges	**0.4**	2.1
Amounts on cash flow hedges transferred to the income statement in the year	**9.3**	41.6
Deferred tax on transfers to income statement	**(1.7)**	(8.3)
	5.6	25.0
Other comprehensive income/(loss) for the year	**118.6**	(87.2)
Total comprehensive income for the year	**452.5**	16.7
Attributable to:		
Owners of the company	**452.5**	16.7
	452.5	16.7

Consolidated statement of changes in equity

For the year ended 31 March 2016

	Equity attributable to owners of the company					
	Share capital £m	Hedging reserve £m	Retained earnings £m	Total £m	Non-controlling interests £m	Total equity £m
At 1 April 2014	100.0	(123.3)	955.5	932.2	10.6	942.8
Profit for the year	–	–	103.9	103.9	–	103.9
Losses on cash flow hedges	–	(10.4)	–	(10.4)	–	(10.4)
Deferred tax on losses on cash flow hedges	–	2.1	–	2.1	–	2.1
Amounts on cash flow hedges transferred to the income statement	–	41.6	–	41.6	–	41.6
Deferred tax on transfers to the income statement	–	(8.3)	–	(8.3)	–	(8.3)
Net actuarial losses	–	–	(139.1)	(139.1)	–	(139.1)
Tax on net actuarial losses	–	–	26.9	26.9	–	26.9
Total comprehensive income for the year	–	25.0	(8.3)	16.7	–	16.7
Share options and LTIPs						
- value of employees' services	–	–	7.6	7.6	–	7.6
- own shares purchased	–	–	(2.4)	(2.4)	–	(2.4)
Current tax on share based payments	–	–	1.2	1.2	–	1.2
Deferred tax on share based payments	–	–	0.5	0.5	–	0.5
Dividends paid	–	–	(203.7)	(203.7)	–	(203.7)
At 31 March 2015	100.0	(98.3)	750.4	752.1	10.6	762.7
Profit for the year	–	–	333.9	333.9	–	333.9
Losses on cash flow hedges	–	(2.4)	–	(2.4)	–	(2.4)
Deferred tax on losses on cash flow hedges	–	0.4	–	0.4	–	0.4
Amounts on cash flow hedges transferred to the income statement	–	9.3	–	9.3	–	9.3
Deferred tax on transfers to the income statement	–	(1.7)	–	(1.7)	–	(1.7)
Net actuarial gains	–	–	150.3	150.3	–	150.3
Tax on net actuarial gains	–	–	(28.5)	(28.5)	–	(28.5)
Deferred tax arising on change of rate	–	–	(8.8)	(8.8)	–	(8.8)
Total comprehensive income for the year	–	5.6	446.9	452.5	–	452.5
Share options and LTIPs						
- value of employees' services	–	–	5.0	5.0	–	5.0
- own shares purchased	–	–	(4.0)	(4.0)	–	(4.0)
Current tax on share based payments	–	–	1.7	1.7	–	1.7
Deferred tax on share based payments	–	–	(0.9)	(0.9)	–	(0.9)
Dividends paid	–	–	(310.0)	(310.0)	–	(310.0)
At 31 March 2016	**100.0**	**(92.7)**	**889.1**	**896.4**	**10.6**	**907.0**

Consolidated balance sheet

At 31 March 2016

	Note	2016 £m	2015 £m
Non-current assets			
Goodwill		**1.3**	1.3
Other intangible assets	15	**67.0**	65.1
Property, plant and equipment	16	**7,641.7**	7,482.6
Derivative financial assets	17	**40.2**	13.5
		7,750.2	7,562.5
Current assets			
Inventory		**6.0**	6.2
Trade and other receivables	18	**432.9**	425.5
Current tax receivable		**–**	4.8
Derivative financial assets	17	**–**	11.5
Cash and cash equivalents	19	**–**	120.1
		438.9	568.1
Total assets		**8,189.1**	8,130.6
Current liabilities			
Borrowings	20	**(332.4)**	(470.3)
Derivative financial liabilities	22	**(0.4)**	(25.7)
Trade and other payables	23	**(387.3)**	(364.9)
Current income tax liabilities		**(28.8)**	–
Provisions for liabilities and charges	26	**(1.2)**	(3.0)
		(750.1)	(863.9)
Non-current liabilities			
Borrowings	20	**(4,509.2)**	(4,346.2)
Derivative financial liabilities	22	**(167.7)**	(164.6)
Trade and other payables	23	**(869.5)**	(822.9)
Deferred tax	24	**(670.2)**	(700.0)
Retirement benefit obligations	25	**(309.5)**	(468.9)
Provisions for liabilities and charges	26	**(5.9)**	(1.4)
		(6,532.0)	(6,504.0)
Total liabilities		**(7,282.1)**	(7,367.9)
Net assets		**907.0**	762.7
Equity			
Called up share capital	27	**100.0**	100.0
Other reserves	28	**(92.7)**	(98.3)
Retained earnings		**889.1**	750.4
Equity attributable to owners of the company		**896.4**	752.0
Non-controlling interests		**10.6**	10.6
Total equity		**907.0**	762.7

Signed on behalf of the board who approved the accounts on 23 May 2016.

Andrew Duff
Chairman

James Bowling
Chief Financial Officer

Company number: 02366686

Consolidated cash flow statement

For the year ended 31 March 2016

	Note	2016 £m	2015 £m
Cash generated from operations	34	**799.8**	752.3
Tax paid		**(20.0)**	(26.5)
Net cash generated from operating activities		**779.8**	725.8
Investing activities			
Interest received		**0.5**	0.8
Proceeds on disposal of property, plant and equipment and intangible assets		**12.6**	10.5
Purchases of intangible assets		**(21.9)**	(15.4)
Purchases of property, plant and equipment		**(411.5)**	(423.8)
Contributions and grants received		**35.0**	36.2
Net cash used in investing activities		**(385.3)**	(391.7)
Financing activities			
Interest paid		**(177.7)**	(196.5)
Closed out swaps		**–**	(139.2)
Interest element of finance lease payments		**(6.8)**	(6.9)
Dividends paid to shareholders of the parent		**(310.0)**	(203.7)
Repayments of borrowings		**(908.5)**	(309.8)
Repayments of obligations under finance leases		**(62.8)**	(21.2)
Repayment of intercompany borrowings		**–**	(39.0)
New loans raised		**926.4**	684.3
New intercompany loans raised		**26.0**	–
Purchase of parent company shares		**(4.0)**	(2.4)
Net cash used in financing activities		**(517.4)**	(234.4)
(Decrease)/increase in cash and cash equivalents		**(122.9)**	99.7
Net cash and cash equivalents at beginning of period		**120.1**	20.4
Net cash and cash equivalents at end of period		**(2.8)**	120.1
Net cash and cash equivalents comprise:			
Cash at bank and in hand		**–**	120.1
Bank overdrafts		**(2.8)**	–
Net cash and cash equivalents at end of period		**(2.8)**	120.1

The decrease in cash and cash equivalents is reconciled to the movement in net debt in note 34.

Notes to the group financial statements
For the year ended 31 March 2016

1 General information

The Severn Trent Water group includes Severn Trent Water Limited and its subsidiary companies.

Severn Trent Water Limited is a company incorporated and domiciled in the United Kingdom. The address of its registered office is shown on the front of the annual report and accounts.

2 Accounting policies

a) Basis of preparation

The financial statements have been prepared on the going concern basis (see strategic report on page 30) under the historical cost convention as modified by the revaluation of certain financial assets and liabilities (including derivative instruments) at fair value.

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS), International Accounting Standards (IAS) and IFRIC interpretations issued and effective and ratified by the European Union as at 31 March 2016.

Severn Trent Water Limited is a partner in Severn Trent Limited Partnership (the "partnership"), which is registered in Scotland. As the partnership is included in the consolidated accounts, the parent company has taken advantage of the exemption conferred by Regulation 7 of The Partnership (Accounts) Regulations 2008 from the requirements of Regulations 4 to 6.

The key accounting policies for the group are set out below and have been applied consistently.

b) Basis of consolidation

The consolidated financial statements include the results of Severn Trent Water Limited and its subsidiaries. Results are included from the date of acquisition or incorporation and excluded from the date of disposal.

Subsidiaries are consolidated where the group has the power to control a subsidiary.

Non-controlling interests in the net assets of subsidiaries are identified separately from the group's equity. Non-controlling interests consist of the amount of those interests at the date of the original business combination and the non-controlling interests' share of changes in equity since that date.

Transactions between the company and its subsidiaries have been eliminated on consolidation and are not included within the group financial statements.

c) Revenue recognition

Revenue includes turnover and interest income.

Turnover represents the fair value of consideration receivable, excluding value added tax, trade discounts and inter-company sales, in the ordinary course of business for goods and services provided.

Turnover is not recognised until the service has been provided to the customer.

Turnover includes an estimate of the amount of mains water and waste water charges unbilled at the year end. The accrual is estimated using a defined methodology based upon a measure of unbilled water consumed by tariff, which is calculated from historical billing information.

Interest income is accrued on a time basis by reference to the principal outstanding and at the effective interest rate applicable.

d) Exceptional items

Exceptional items are income or expenditure, which individually or, if of a similar type, in aggregate should, in the opinion of the directors, be disclosed by virtue of their size or nature if the financial statements are to give a true and fair view.

e) Taxation

Current tax payable is based on taxable profit for the year and is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred taxation is provided in full on taxable temporary differences between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred taxation is measured on a non-discounted basis using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

A deferred tax asset is only recognised to the extent it is probable that sufficient taxable profits will be available in the future to utilise it.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities.

2 Accounting policies (continued)

f) Goodwill

Goodwill represents the excess of the fair value of purchase consideration over the fair value of the net assets acquired. Goodwill arising on acquisition of subsidiaries is included in intangible assets. If an acquisition gives rise to negative goodwill this is credited directly to the income statement. Fair value adjustments based on provisional estimates are amended within one year of the acquisition, if required, with a corresponding adjustment to goodwill.

Goodwill is tested for impairment in accordance with the policy set out in note 2k below and carried at cost less accumulated impairment losses. Goodwill is allocated to the cash-generating unit that derives benefit from the goodwill for impairment testing purposes.

Where goodwill forms part of a cash-generating unit and all or part of that unit is disposed of, the associated goodwill is included in the carrying amount of that operation when determining the gain or loss on disposal of the operation.

g) Other intangible non-current assets

Intangible assets acquired separately are capitalised at cost. Following initial recognition, the historical cost model is applied.

Finite life intangible assets are amortised on a straight line basis over their estimated useful economic lives as follows:

	Years
Software	3 - 10
Other assets	2 - 20

Amortisation charged on assets is taken to the income statement through operating costs.

Intangible assets are reviewed for impairment where indicators of impairment exist (see 2k below).

Development expenditure is capitalised as an intangible asset and written off over its expected useful economic life where the following criteria are met:

- it is technically feasible to create and make the asset available for use or sale;
- there are adequate resources available to complete the development and to use or sell the asset;
- there is the intention and ability to use or sell the asset;
- it is probable that the asset created will generate future economic benefits; and
- the development cost can be measured reliably.

Research expenditure is expensed when it is incurred.

h) Property, plant and equipment

Property, plant and equipment is held at cost (or at deemed cost for infrastructure assets on transition to IFRS) less accumulated depreciation. Expenditure on property, plant and equipment relating to research and development projects is capitalised and depreciated over the expected useful life of those assets.

The costs of like for like replacement of infrastructure components are recognised in the income statement as they arise. Expenditure which results in enhancements to the operating capability of the infrastructure networks is capitalised.

Where items of property, plant and equipment are transferred to the group from customers or developers, the fair value of the asset transferred is recognised in the balance sheet. Fair value is determined based on estimated depreciated replacement cost. Where the transfer is in exchange for connection to the network and there is no further obligation, the corresponding credit is recognised immediately in turnover. Where the transfer is considered to be linked to the provision of ongoing services the corresponding credit is recorded in deferred income and released to operating costs over the expected useful lives of the related assets.

Where assets take a substantial period of time to get ready for their intended use, the borrowing costs directly attributable to the acquisition, construction or production of these assets are added to their cost.

Property, plant and equipment is depreciated to its estimated residual value over its estimated useful life, with the exception of freehold land which is not depreciated. Assets under construction are not depreciated until commissioned.

2 Accounting policies (continued)

h) Property, plant and equipment (continued)

The estimated useful lives are:

	Years
Infrastructure assets	
Impounding reservoirs	250
Raw water aqueducts	250
Mains	80 - 150
Sewers	150 - 200
Other assets	
Buildings	30 - 80
Fixed plant and equipment	20 - 40
Vehicles and mobile plant	2 - 15

i) Leased assets

Leases where the group obtains assets which transfer substantially all the risks and rewards of ownership to the group are treated as finance leases. The lower of the fair value of the leased asset or the present value of the minimum lease payments is capitalised as an asset with a corresponding liability representing the obligation to the lessor. Lease payments are treated as consisting of a capital element and a finance charge; the capital element reducing the obligation to the lessor and the finance charge being written off to the income statement at a constant rate over the period of the lease in proportion to the capital amount outstanding. Depreciation is charged over the shorter of the estimated useful life and the lease period.

Leases where substantially all the risks and rewards of ownership remain with the lessor are classified as operating leases. Rental costs arising under operating leases are expensed on a straight line basis over the term of the lease. Leases of land are normally treated as operating leases, unless ownership is transferred to the group at the end of the lease.

j) Grants and contributions

Grants and contributions received in respect of non-current assets, including certain charges made as a result of new connections to the water and waste water networks, are treated as deferred income and released to operating costs over the useful economic life of those non-current assets.

Grants and contributions which are given in compensation for expenses incurred with no future related costs are recognised in operating costs in the income statement in the period that they become receivable.

k) Impairment of non-current assets

If the recoverable amount of goodwill, an item of property, plant and equipment or any other non-current asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. Where the asset does not generate cash flows that are independent from other assets, the group estimates the recoverable amount of the cash-generating unit to which the asset belongs. Recoverable amount is the higher of fair value less costs to sell or estimated value in use at the date the impairment review is undertaken. Fair value less costs to sell represents the amount obtainable from the sale of the asset in an arm’s length transaction between knowledgeable and willing third parties, less costs of disposal. Value in use represents the present value of future cash flows expected to be derived from a cash-generating unit, discounted using a pre-tax discount rate that reflects current market assessments of the cost of capital of the cash-generating unit or asset.

The discount rate used is based on the group’s cost of capital, adjusted for the risk profiles of individual businesses.

Goodwill is tested for impairment annually. Impairment reviews are also carried out if there is an indication that an impairment may have occurred or, where otherwise required, to ensure that non-current assets are not carried above their estimated recoverable amounts.

Impairments are recognised in the income statement.

Notes to the group financial statements (continued)

For the year ended 31 March 2016

2 Accounting policies (continued)

l) Inventory

Inventory and work in progress is stated at the lower of cost and net realisable value. Cost includes labour, materials, transport and attributable overheads.

m) Trade receivables

Trade receivables, are measured at fair value on initial recognition. If there is objective evidence that the asset is impaired, it is written down to its recoverable amount and the irrecoverable amount is recognised as an expense in operating costs.

Trade receivables that are assessed not to be impaired individually are assessed collectively for impairment by reference to the group's historical collection experience for receivables of similar age.

n) Retirement benefits

(i) Defined benefit schemes

The difference between the value of defined benefit pension scheme assets and defined benefit pension scheme liabilities is recorded on the balance sheet as a retirement benefit asset or obligation.

Defined benefit pension scheme assets are measured at fair value using bid price for assets with quoted prices. Defined benefit pension scheme liabilities are measured at the balance sheet date by an independent actuary using the projected unit method and discounted at the current rate of return on high quality corporate bonds of equivalent term and currency to the liability.

Service cost, representing the cost of employee service in the period, is included in operating costs. Net finance cost is calculated by applying the discount rate used for the scheme liabilities to the net deficit.

Changes in the retirement benefit obligation that arise from:

- differences between the return on scheme assets and interest income included in the income statement;
- actuarial gains and losses from experience adjustments; and
- changes in demographic or financial assumptions,

are classified as remeasurements, charged or credited to equity and recorded in the statement of comprehensive income in the period in which they arise.

There is no contractual agreement, or stated policy, for charging the net defined benefit cost to participating group companies of the ultimate parent. As the net defined benefit cost is recognised by the sponsoring employer, Severn Trent Water Limited, the full net defined benefit cost is disclosed in the Severn Trent Water group financial statements.

(ii) Defined contribution scheme

Contributions to defined contribution pension schemes are charged to the income statement in the period in which they fall due.

o) Provisions

Provisions are recognised where:

- there is a present obligation as a result of a past event;
- it is probable that there will be an outflow of economic benefits to settle this obligation; and
- a reliable estimate of this amount can be made.

Provisions are discounted to present value using a pre-tax discount rate that reflects the risks specific to the liability where the effect is material.

p) Borrowings

The accounting policy for borrowings that are the hedged item in a fair value hedge is set out in note 2q.

All other borrowings are initially recognised at fair value less issue costs. After initial recognition, borrowings are subsequently measured at amortised cost using the effective interest rate method whereby interest and issue costs are charged to the income statement and added to the carrying value of borrowings at a constant rate in proportion to the capital amount outstanding.

Index linked debt is adjusted for changes in the relevant inflation index and changes in value are charged to finance costs.

Borrowings denominated in foreign currency are translated to sterling at the spot rate on the balance sheet date. Exchange gains or losses resulting from this are credited or charged to gains/losses on financial instruments.

2 Accounting policies (continued)

q) Derivative financial instruments

Derivative financial instruments are stated at fair value, including accrued interest. Fair value is determined using the methodology described in note 30a. The accounting policy for changes in fair value depends on whether the derivative is designated as a hedging instrument. The various accounting policies are described below.

Interest receivable or payable in respect of derivative financial instruments is included in finance income or costs.

Derivatives not designated as hedging instruments
Gains or losses arising on remeasurement of derivative financial instruments that are not designated as hedging instruments are recognised in gains/losses on financial instruments in the income statement.

Derivatives designated as hedging instruments
The group uses derivative financial instruments such as cross currency swaps, forward currency contracts and interest rate swaps to hedge its risks associated with foreign currency and interest rate fluctuations.

At the inception of each hedge relationship, the group documents:
- the relationship between the hedging instrument and the hedged item;
- its risk management objectives and strategy for undertaking the hedge transaction; and
- the results of tests to determine whether the hedging instrument is expected to be highly effective in offsetting changes in fair values or cash flows (as appropriate) of the hedged item.

The group continues to test and document the effectiveness of the hedge on an ongoing basis.

Hedge accounting is discontinued when the hedging instrument expires, is sold, terminated or exercised or no longer qualifies for hedge accounting.

Fair value hedges
Where a loan or borrowing is in a fair value hedging relationship it is remeasured for changes in fair value of the hedged risk at the balance sheet date, with gains or losses being recognised in gains/losses on financial instruments in the income statement. The gain or loss on the corresponding hedging instrument is also taken to gains/losses on financial instruments in the income statement so that the effective portion of the hedge will offset the gain or loss on the hedged item.

If hedge accounting is discontinued, the fair value adjustment arising from the hedged risk on the hedged item is amortised to the income statement over the anticipated remaining life of the hedged item.

Cash flow hedges
The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised in equity and the ineffective portion is charged to gains/losses on financial instruments in the income statement. When the gain or loss from the hedged underlying transaction is recognised in the income statement, the gains or losses on the hedging instrument that have previously been recognised in equity are recycled through gains/losses on financial instruments in the income statement.

If hedge accounting is discontinued, any cumulative gain or loss on the hedging instrument previously recognised in equity is held in equity until the forecast transaction occurs, or transferred to gains/losses on financial instruments in the income statement if the forecast transaction is no longer expected to occur. If the hedging instrument is terminated, the gains and losses previously recognised in equity are transferred to the income statement. From this point the derivative is accounted for in the same way as derivatives not designated as hedging instruments.

Embedded derivatives
Where a contract includes terms that cause some of its cash flows to vary in a similar way to a derivative financial instrument, that part of the contract is considered to be an embedded derivative.

Embedded derivatives are separated from the contract and measured at fair value with gains and losses taken to the income statement if:
- the risks and characteristics of the embedded derivative are not closely related to those of the contract; and
- the contract is not carried at fair value with gains and losses reported in the income statement.

In all other cases embedded derivatives are accounted for in line with the accounting policy for the contract as a whole.

2 Accounting policies (continued)

r) Share based payments

The group operates a number of equity settled share based compensation plans for employees. The fair value of the employee services received in exchange for the grant is recognised as an expense over the vesting period of the grant.

The fair value of employee services is determined by reference to the fair value of the awards granted, calculated using an appropriate pricing model, excluding the impact of any non-market vesting conditions. The number of awards that are expected to vest takes into account non-market vesting conditions including, where appropriate, continuing employment by the group. The charge is adjusted to reflect shares that do not vest as a result of failing to meet a non-market condition.

The grant of awards of shares of the ultimate parent company is treated as a capital contribution and credited to reserves. When awards vest, payments made to the ultimate parent company for the issue of shares are charged against the capital contributions previously received in respect of the same awards. Any payments in excess of capital contributions are treated as distributions.

s) Cash flow statement

For the purpose of the cash flow statement, cash and cash equivalents include highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value. Such investments are normally those with less than three months maturity from the date of acquisition and include cash and bank balances and investments in liquid funds.

Net cash and cash equivalents include overdrafts repayable on demand.

Interest paid in the cash flow statement includes amounts charged to the income statement and amounts included in the cost of property, plant and equipment.

t) Net debt

Net debt comprises borrowings, cross currency swaps that are used to fix the sterling liability of foreign currency borrowings (whether hedge accounted or not) and net cash and cash equivalents.

3 New accounting policies and future requirements

At the date of approval of these financial statements, the following Standards and Interpretations were in issue but not yet effective:

IFRS 9 ‘Financial Instruments’ is likely to affect the measurement and disclosure of financial instruments. This standard has not yet been adopted by the EU.

IFRS 15 ‘Revenue from contracts with customers’ will affect the measurement and recognition of revenue with effect from 1 April 2018. The impact of the standard on the results or net assets of the group has not yet been quantified.

IFRS 16 ‘Leases’ sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, ie the customer ('lessee') and the supplier ('lessor') and will be effective for the group from 1 April 2019. The impact of the standard on the results or net assets of the group has not yet been quantified.

4 Significant accounting judgements and key sources of estimation uncertainty

In the process of applying the group's accounting policies, the group is required to make certain judgements, estimates and assumptions that it believes are reasonable based on the information available. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results may ultimately differ from those estimates.

The more significant judgements were:

a) Tax provisions

Assessing the outcome of uncertain tax positions requires judgements to be made regarding the result of negotiations with and enquiries from tax authorities in a number of jurisdictions. The assessments made are based on advice from independent tax advisers and the status of ongoing discussions with the relevant tax authorities.

The key accounting estimates were:

a) Depreciation and carrying amounts of property, plant and equipment

Calculating the depreciation charge and hence the carrying value for property, plant and equipment requires estimates to be made of the useful lives of the assets. The estimates are based on engineering data and the group's experience of similar assets. Details are set out in note 2h.

b) Retirement benefit obligations

Determining the amount of the group's retirement benefit obligations and the net costs of providing such benefits requires assumptions to be made concerning long term interest rates, inflation, pension increases and longevity of current and future pensioners. Changes in these assumptions could significantly impact the amount of the obligations or the cost of providing such benefits. The group makes assumptions concerning these matters with the assistance of advice from independent qualified actuaries. Details of the assumptions made are set out in note 25 to the financial statements.

c) Unbilled revenue

Severn Trent Water raises bills and recognises revenue in accordance with its right to receive revenue in line with the limits established by the periodic regulatory price review processes. For water and waste water customers with water meters, the amount recognised depends on the volume supplied including an estimate of the sales value of units supplied between the date of the last meter read and the year end. Meters are read on a cyclical basis and the group recognises revenue for unbilled volumes based on estimated usage from the last billing to the end of the financial year. The estimated usage is based on historical data, judgement and assumptions.

d) Provision for impairment of trade receivables

Provisions are made against Severn Trent Water's trade receivables based on historical experience of levels of recovery from accounts in a particular ageing category. The actual amounts collected could differ from the estimated level of recovery which could impact operating results.

e) Fair value of derivatives

Determining the fair value of derivatives where quoted prices are not available requires estimates to be made of the future expected cash flows and an appropriate discount rate which reflects the credit risk of the counterparties. The valuation techniques and key inputs used are described in note 30.

5 Revenue

	2016 **£m**	2015 £m
Water and waste water services	**1,541.3**	1,572.7
Other services	**8.9**	8.5
Total turnover	**1,550.2**	1,581.2
Interest receivable (note 10)	**0.9**	1.1
	1,551.1	1,582.3

Notes to the group financial statements (continued)

For the year ended 31 March 2016

6 Net operating costs

			2016			2015
	Before exceptional costs	**Exceptional costs**	**Total**	Before exceptional costs	Exceptional costs	Total
	£m	**£m**	**£m**	£m	£m	£m
Wages and salaries	**193.0**	**(0.3)**	**192.7**	193.1	10.6	203.7
Social security costs	**19.6**	**–**	**19.6**	17.5	0.1	17.6
Pension costs	**18.1**	**(0.7)**	**17.4**	31.2	17.9	49.1
Share based payments	**5.0**	**–**	**5.0**	7.6	–	7.6
Total employee costs	**235.7**	**(1.0)**	**234.7**	249.4	28.6	278.0
Power	**68.9**	**–**	**68.9**	71.2	–	71.2
Raw materials and consumables	**47.2**	**–**	**47.2**	47.4	–	47.4
Rates	**76.7**	**–**	**76.7**	73.4	–	73.4
Charge for bad and doubtful debts	**23.7**	**–**	**23.7**	28.4	–	28.4
Service charges	**32.4**	**–**	**32.4**	32.6	–	32.6
Depreciation of property, plant and equipment	**290.3**	**–**	**290.3**	276.7	–	276.7
Amortisation and impairment of intangible fixed assets	**19.9**	**–**	**19.9**	22.2	–	22.2
Hired and contracted services	**172.4**	**–**	**172.4**	164.0	0.4	164.4
Operating leases rentals						
- land and buildings	**0.3**	**–**	**0.3**	0.2	–	0.2
- other	**0.3**	**–**	**0.3**	–	–	–
Research and development expenditure	**3.5**	**–**	**3.5**	4.6	–	4.6
Profit on disposal of property, plant and equipment	**(2.9)**	**–**	**(2.9)**	(0.4)	(7.7)	(8.1)
Infrastructure maintenance expenditure	**126.0**	**–**	**126.0**	134.8	–	134.8
Ofwat licence fees	**2.7**	**–**	**–**	5.3	–	5.3
Other operating costs	**41.8**	**–**	**44.5**	40.3	0.2	40.5
Other operating income	**(3.2)**	**–**	**(3.2)**	(3.0)	–	(3.0)
	1,135.7	**(1.0)**	**1,134.7**	1,147.1	21.5	1,168.6
Release from deferred income	**(10.5)**	**–**	**(10.5)**	(10.1)	–	(10.1)
Own work capitalised	**(93.7)**	**–**	**(93.7)**	(92.4)	–	(92.4)
	1,031.5	**(1.0)**	**1,030.5**	1,044.6	21.5	1,066.1

Further details of exceptional costs are given in note 7.

During the year the following fees were charged by the auditors:

	2016	2015
	£m	£m
Fees payable to the company's auditors for - the audit of the company's annual accounts and subsidiaries	**0.2**	0.2
Total audit fees	**0.2**	0.2
Fees payable to the company's auditors and their associates for other services to the group - audit related assurance services	**0.2**	0.4
Total non-audit fees	**0.2**	0.4

7 Exceptional items before tax

	2016 £m	2015 £m
Restructuring costs	**(1.0)**	29.2
Profit on disposal of fixed assets	**–**	(7.7)
Exceptional operating items before tax	**(1.0)**	21.5

Exceptional tax is disclosed in note 13.

8 Employee numbers

Average number of employees (including executive directors) during the year:

	2016 Number	2015 Number
	5,236	5,532

9 Directors' interests and remuneration

a) Directors' interests

All of the directors as at the end of the year are also directors of Severn Trent Plc, the ultimate parent undertaking, and their interests in the share capital of that company are disclosed in the Severn Trent Plc Annual Report and Accounts of that company for the year ended 31 March 2016. Share options were granted and exercised in accordance with the Severn Trent Sharesave Scheme as appropriate.

The executive directors have further interests in Severn Trent Plc ordinary shares of $97^{17}/_{19}$ p each by virtue of having received contingent awards of shares under the Severn Trent Long Term Incentive Plan (LTIP), deferred shares under the Severn Trent Annual Bonus Scheme and contingent shares under the Share Matching Plan.

The individual interests, which represent the maximum aggregate number of shares to which each individual could become entitled, are disclosed in the Annual Report and Accounts of Severn Trent Plc for the year ended 31 March 2016.

b) Directors' remuneration

The following table shows the remuneration due to directors for their services to the company during the year:

	2016 £m	2015 £m
Short term employee benefits	**3.0**	4.3
Post employment benefits	**0.1**	0.1
Share based payments	**1.2**	2.2
	4.3	6.6

The emoluments of the non-executive directors are paid by Severn Trent Plc.

There were no retirement benefits accruing to directors (2015: none) under a defined benefit scheme and one director (2015: four directors) under a defined contribution scheme.

Two directors (2015: six directors) exercised share options or received LTIP awards which vested during the year.

9 Directors' interests and remuneration (continued)

c) Highest paid director

	2016 £m	2015 £m
Aggregate emoluments (excluding pension contributions)	**2.3**	2.0
Pension contributions	**0.1**	0.1
	2.4	2.1

The highest paid director at 31 March 2016 and 31 March 2015 was not a member of the defined benefit pension scheme.

10 Finance income

	2016 £m	2015 £m
Interest revenue earned on:		
Bank deposits	**0.2**	0.4
Other financial income	**0.7**	0.7
Total interest receivable	**0.9**	1.1
Interest income on defined benefit scheme assets	**67.7**	80.1
	68.6	81.2

11 Finance costs

	2016 £m	2015 £m
Interest on bank loans and overdrafts	**19.3**	–
Interest on other loans	**162.9**	201.1
Interest on finance leases	**6.8**	6.9
Total borrowing costs	**189.0**	208.0
Other financial expenses	**0.7**	0.2
Interest cost on defined benefit scheme obligations	**82.8**	94.5
	272.5	302.7

Borrowing costs of £16.2 million (2015: £19.1 million) incurred funding eligible capital projects have been capitalised at an interest rate of 4.41% (2015: 4.89%). Tax relief of £3.3 million (2015: £4.2 million) was claimed on these costs which was credited to the income statement, offset by a related deferred tax charge of £2.9 million (2015: £4.0 million).

12 Gains/(losses) on financial instruments

	2016 £m	2015 £m
Gain on swaps used as hedging instruments in fair value hedges	**0.7**	0.2
Loss arising on debt in fair value hedges	**(2.5)**	(2.9)
Exchange (loss)/gain on other loans	**(32.6)**	73.3
Loss on cash flow hedges transferred from equity	**(9.3)**	(41.6)
Hedge ineffectiveness on cash flow hedges	**–**	2.3
Gain/(loss) arising on swaps where hedge accounting is not applied	**47.7**	(195.3)
	4.0	(164.0)

The group's hedge accounting arrangements are described in note 32.

13 Taxation

a) Analysis of tax (credit)/charge in the year

	2016			2015
	Before exceptional tax £m	**Exceptional tax £m**	**Total £m**	Total £m
Current tax				
Current year at 20% (2015: 21%)	**58.0**	**–**	**58.0**	50.4
Prior years at 21% (2015: 23%)	**(2.8)**	**–**	**(2.8)**	(11.6)
Total current tax	**55.2**	**–**	**55.2**	38.8
Deferred tax				
Origination and reversal of temporary differences - current year	**7.1**	**–**	**7.1**	(19.6)
Origination and reversal of temporary differences - prior year	**2.4**	**–**	**2.4**	6.5
Exceptional credit arising from rate change	**–**	**(78.8)**	**(78.8)**	–
Total deferred tax	**9.5**	**(78.8)**	**(69.3)**	(13.1)
	64.7	**(78.8)**	**(14.1)**	25.7

The current tax charge was £55.2 million (2015: £38.8 million before exceptional tax). This includes a credit of £2.8 million (2015: £11.6 million) arising from adjustments to prior year tax computations.

The company earns profits primarily in the UK. Therefore the tax rate used for tax on profit on ordinary activities is the main rate for UK corporation tax.

The Finance Act 2015 was enacted in the current year which implemented a reduction in the corporation tax rate from 20% to 18% with effect from 1 April 2020. This resulted in an additional exceptional deferred tax credit of £78.8 million in the income statement and a deferred tax charge of £8.8 million in reserves.

A further reduction to 17% with effect from 1 April 2020 has been announced but not yet substantively enacted. The estimated impact of this rate change will be a reduction in the deferred tax liability of approximately £37 million.

b) Factors affecting the tax (credit)/charge in the year

The tax expense for the current year is lower (2015: lower) than the standard rate of corporation tax in the UK of 20% (2015: 21%). The differences are explained below:

	2016 £m	2015 £m
Profit on ordinary activities before tax	**319.8**	129.6
Tax at the standard rate of corporation tax in the UK 20% (2015: 21%)	**63.9**	27.2
Tax effect of depreciation on non-qualifying assets	**3.7**	3.5
Tax effect of income not taxable in determining taxable profits	**(1.8)**	(0.8)
Difference between current tax and deferred tax rates	**(0.7)**	0.9
Adjustments in respect of prior years	**(0.4)**	(5.1)
Exceptional deferred tax credit arising from rate change	**(78.8)**	–
Total tax (credit)/charge	**(14.1)**	25.7

13 Taxation (continued)

c) Tax charged/(credited) directly to other comprehensive income or equity

In addition to the amount (credited)/charged to the income statement, the following amounts of tax have been charged/(credited) directly to other comprehensive income or equity:

	2016 **£m**	2015 £m
Current tax		
Tax on share based payments	**(1.7)**	(1.2)
Tax on pension contributions in excess of income statement charge	**–**	(2.8)
Total current tax credited to other comprehensive income or equity	**(1.7)**	(4.0)
Deferred tax		
Tax on actuarial gain/loss	**28.5**	(24.2)
Tax on cash flow hedges	**(0.4)**	(2.1)
Tax on transfers to the income statement account	**1.7**	8.3
Tax on share based payments	**0.9**	(0.5)
Effect of change in tax rate	**8.8**	–
Total deferred tax charged/(credited) to other comprehensive income or equity	**39.5**	(18.5)

14 Dividends

Amounts recognised as distributions to equity holders in the period:

	2016		2015	
	Pence per share	**£m**	Pence per share	£m
Interim dividend for the year ended 31 March 2016 (2015)	31.00	310.0	20.37	203.7

The company's dividend policy is shown in note 29.

15 Other intangible assets

	Computer software		Other	
	Internally generated £m	Purchased £m	Internally generated £m	Total £m
Cost				
At 1 April 2014	170.6	93.0	12.0	275.6
Additions	5.7	9.7	–	15.4
Disposals	–	(21.4)	–	(21.4)
At 1 April 2015	176.3	81.3	12.0	269.6
Additions	9.9	11.9	–	21.8
At 31 March 2016	**186.2**	**93.2**	**12.0**	**291.4**
Amortisation				
At 1 April 2014	(136.0)	(57.5)	(10.2)	(203.7)
Amortisation for the year	(10.8)	(10.8)	(0.6)	(22.2)
Disposals	–	21.4	–	21.4
At 1 April 2015	(146.8)	(46.9)	(10.8)	(204.5)
Amortisation for the year	(9.2)	(10.1)	(0.6)	(19.9)
At 31 March 2016	**(156.0)**	**(57.0)**	**(11.4)**	**(224.4)**
Net book value				
At 31 March 2016	**30.2**	**36.2**	**0.6**	**67.0**
At 31 March 2015	29.5	34.4	1.2	65.1

Other assets primarily comprise capitalised development costs and patents.

Notes to the group financial statements (continued)

For the year ended 31 March 2016

16 Property, plant and equipment

	Land and buildings £m	Infrastructure assets £m	Fixed plant and equipment £m	Movable plant £m	Assets under construction £m	Total £m
Cost						
At 1 April 2014	2,844.3	4,631.7	3,440.4	48.3	658.0	11,622.7
Additions	5.9	22.7	12.7	5.5	434.7	481.5
Transfers on commissioning	121.7	107.6	193.5	–	(422.8)	–
Disposals	(10.0)	–	(76.4)	(4.8)	–	(91.2)
At 1 April 2015	2,961.9	4,762.0	3,570.2	49.0	669.9	12,013.0
Additions	2.7	21.4	14.7	4.8	415.5	459.1
Transfers on commissioning	194.8	156.7	209.7	–	(561.2)	–
Disposals	(10.7)	(0.2)	(15.7)	(3.4)	(4.1)	(34.1)
At 31 March 2016	**3,148.7**	**4,939.9**	**3,778.9**	**50.4**	**520.1**	**12,438.0**
Depreciation						
At 1 April 2014	(984.3)	(1,194.3)	(2,133.1)	(30.8)	–	(4,342.5)
Charge for the year	(67.5)	(32.0)	(172.4)	(4.8)	–	(276.7)
Disposals	8.2	–	76.3	4.3	–	88.8
At 1 April 2015	(1,043.6)	(1,226.3)	(2,229.2)	(31.3)	–	(4,530.4)
Charge for the year	(76.7)	(31.5)	(177.3)	(4.8)	–	(290.3)
Disposals	6.1	–	15.1	3.2	–	24.4
At 31 March 2016	**(1,114.2)**	**(1,257.8)**	**(2,391.4)**	**(32.9)**	**–**	**(4,796.3)**
Net book value						
At 31 March 2016	**2,034.5**	**3,682.1**	**1,387.5**	**17.5**	**520.1**	**7,641.7**
At 31 March 2015	1,918.3	3,535.7	1,341.0	17.7	669.9	7,482.6

The carrying amount of property, plant and equipment includes the following amounts in respect of assets held under finance leases:

	Infrastructure assets £m	Fixed plant and equipment £m	Total £m
Net book value			
At 31 March 2016	**119.8**	**16.4**	**136.2**
At 31 March 2015	118.7	26.6	145.3

17 Categories of financial assets

	2016 £m	2015 £m
Fair value through profit and loss		
Cross currency swaps - not hedge accounted	**10.4**	–
Interest rate swaps - not hedge accounted	**–**	4.2
	10.4	4.2
Derivatives designated as hedging instruments		
Cross currency swaps - fair value hedges	**17.7**	20.8
Interest rate swaps - fair value hedges	**12.1**	–
	29.8	20.8
Total derivative financial assets	**40.2**	25.0
Loans and receivables (including cash and cash equivalents)		
Trade receivables (note 18)	**160.8**	156.5
Amounts due from group undertakings (note 18)	**8.4**	15.2
Short term deposits	**–**	115.0
Cash at bank and in hand	**1.4**	5.1
Total loans and receivables	**170.6**	291.8
Total financial assets	**210.8**	316.8

Disclosed in the balance sheet as:

	2016 £m	2015 £m
Non-current assets		
Derivative financial assets	**40.2**	13.5
	40.2	13.5
Current assets		
Derivative financial assets	**–**	11.5
Cash and cash equivalents	**1.4**	120.1
Trade receivables	**160.8**	156.5
Amounts due from group undertakings	**8.4**	15.2
	170.6	303.3
	210.8	316.8

18 Trade and other receivables

	2016 £m	2015 £m
Trade receivables	**285.1**	279.0
Less provisions for impairment of receivables	**(124.3)**	(122.5)
Net trade receivables	**160.8**	156.5
Amounts receivable from related parties	**8.4**	15.2
Other amounts receivable	**42.4**	30.9
Prepayments	**14.7**	16.3
Accrued income	**206.6**	206.6
	432.9	425.5

18 Trade and other receivables (continued)

Doubtful debt provision

The carrying values of trade and other receivables are reasonable approximations of their fair values.

Severn Trent Water has a statutory obligation to provide water and waste water services to customers within its region. Therefore there is no concentration of credit risk with respect to its trade receivables and the credit quality of its customer base reflects the wealth and prosperity of all of the commercial businesses and domestic households within its region. None of the other business units are individually significant to the group.

Movements on the doubtful debts provision were as follows:

	2016 **£m**	2015 £m
At 1 April	**122.5**	118.2
Charge for bad and doubtful debts	**23.7**	28.4
Amounts written off during the year	**(21.9)**	(22.1)
Reclassification	**–**	(2.0)
At 31 March	**124.3**	122.5

The aged analysis of receivables that are specifically provided for is as follows:

	2016 **£m**	2015 £m
Up to 90 days	**–**	1.3
91 - 365 days	**1.8**	3.8
1 - 2 years	**4.9**	6.3
2 - 3 years	**3.2**	6.3
More than 3 years	**4.9**	8.0
	14.8	25.7

A collective provision is recorded against assets which are past due but for which no specific provision has been made. This is calculated based on historical experience of levels of recovery.

The aged analysis of receivables that were past due at the reporting date but not individually provided for is as follows:

	2016 **£m**	2015 £m
Up to 90 days	**37.5**	40.3
91-365 days	**68.5**	64.5
1-2 years	**30.2**	29.0
2-3 years	**14.3**	13.5
More than 3 years	**10.3**	9.2
	160.8	156.5

The amounts above are reconciled to gross and net debtors in the table below:

			2016			2015
	Gross **£m**	**Provision** **£m**	**Net** **£m**	Gross £m	Provision £m	Net £m
Not due	**109.5**	**–**	**109.5**	96.8	–	96.8
Overdue not specifically provided	**160.8**	**(109.5)**	**51.3**	156.5	(96.8)	59.7
Overdue and specifically provided	**14.8**	**(14.8)**	**–**	25.7	(25.7)	–
	285.1	**(124.3)**	**160.8**	279.0	(122.5)	156.5

Notes to the group financial statements (continued)

For the year ended 31 March 2016

19 Cash and cash equivalents

	2016 £m	2015 £m
Cash at bank and in hand	**–**	5.1
Short term deposits	**–**	115.0
	–	120.1

20 Borrowings

	2016 £m	2015 £m
Bank overdrafts	**2.8**	-
Bank loans	**1,212.2**	1,240.7
Other loans	**3,456.4**	3,368.8
Amounts due to parent	**53.0**	27.0
Finance leases	**117.2**	180.0
	4,841.6	4,816.5
Disclosed in the balance sheet as:		
Current liabilities	**332.4**	470.3
Non-current liabilities	**4,509.2**	4,346.2
	4,841.6	4,816.5

21 Finance leases

Obligations under finance leases are as follows:

	2016 £m	2015 £m
Within 1 year	**5.7**	44.7
1 - 2 years	**6.1**	30.5
2 - 5 years	**21.1**	19.6
After more than 5 years	**129.8**	137.3
Gross obligations under finance leases	**162.7**	232.1
Less future finance charges	**(45.5)**	(52.1)
Present value of lease obligations	**117.2**	180.0

Net obligations under finance leases fall due as follows:

	2016 £m	2015 £m
Within 1 year	**1.6**	38.6
1 - 2 years	**2.1**	25.9
2 - 5 years	**9.6**	7.9
After more than 5 years	**103.9**	107.6
Included in non-current liabilities	**115.6**	141.4
	117.2	180.0

The remaining terms of finance leases ranged from 1 to 16 years at 31 March 2016. Interest terms are set at the inception of the leases. Leases with capital outstanding of £117.2 million (2015: £180.0 million) bear fixed interest at a weighted average rate of 5.35% (2015: 5.36%). The lease obligations are secured against the related assets.

There were no contingent rents, escalation clauses or material renewal or purchase options. The terms of the finance leases do not impose restriction on dividend payments, additional debt or further leasing.

22 Categories of financial liabilities

	2016 £m	2015 £m
Fair value through profit and loss		
Cross currency swaps - not hedge accounted	**–**	25.2
Interest rate swaps - not hedge accounted	**164.9**	164.3
	164.9	189.5
Derivatives designated as hedging instruments		
Energy swaps - cash flow hedges	**3.2**	0.8
Total derivative financial liabilities	**168.1**	190.3
Other financial liabilities		
Borrowings (note 20)	**4,841.6**	4,816.5
Trade payables (note 23)	**9.6**	25.4
Amounts due to group undertakings (note 23)	**2.2**	2.3
Total other financial liabilities	**4,853.4**	4,844.2
Total financial liabilities	**5,021.5**	5,034.5

	2016 £m	2015 £m
Disclosed in the balance sheet as:		
Non-current liabilities		
Derivative financial liabilities	**167.7**	164.6
Borrowings	**4,509.2**	4,346.2
	4,676.9	4,510.8
Current liabilities		
Derivative financial liabilities	**0.4**	25.7
Borrowings	**332.4**	470.3
Trade payables	**9.6**	25.4
Amounts due to group undertakings	**2.2**	2.3
	344.6	523.7
	5,021.5	5,034.5

23 Trade and other payables

	2016 £m	2015 £m
Current liabilities		
Trade payables	**9.6**	25.4
Social security and other taxes	**5.3**	5.2
Other amounts owed to parent and fellow subsidiary undertakings	**2.2**	2.3
Other payables	**6.9**	6.6
Deferred income	**10.9**	10.0
Accruals	**352.4**	315.4
	387.3	364.9
Non-current liabilities		
Deferred income	**867.4**	819.0
Accruals	**2.1**	3.9
	869.5	822.9

The directors consider that the carrying value of trade payables is not materially different from their fair values.

24 Deferred tax

An analysis of the movements in the major deferred tax liabilities and assets recognised by the group is set out below:

	Accelerated tax depreciation £m	Retirement benefit obligation £m	Fair value of financial instruments £m	Other £m	Total £m
At 1 April 2014	825.7	(69.6)	(32.9)	8.4	731.6
Charge/(credit) to income	13.2	–	(31.4)	5.1	(13.1)
(Credit)/charge to equity	–	(24.2)	6.2	(0.5)	(18.5)
At 1 April 2015	838.9	(93.8)	(58.1)	13.0	700.0
Charge/(credit) to income	9.2	–	1.2	(0.9)	9.5
(Credit)/charge to income arising from rate change	(83.9)	2.3	4.1	(1.3)	(78.8)
Charge to equity	–	28.5	1.3	0.9	30.7
Charge to equity arising from rate change	–	7.1	1.7	–	8.8
At 31 March 2016	**764.2**	**(55.9)**	**(49.8)**	**11.7**	**670.2**

Deferred tax assets and liabilities have been offset. The offset amounts, which are to be recovered/settled after more than 12 months, are as follows:

	2016 £m	2015 £m
Deferred tax asset	**(105.7)**	(151.9)
Deferred tax liability	**775.9**	851.9
	670.2	700.0

25 Retirement benefit schemes

a) Defined benefit pension schemes

(i) Background

The Severn Trent group operates a number of defined benefit pension schemes in the UK, covering the majority of UK employees. The defined benefit pension schemes are funded to cover future pension increases and their assets are held in separate funds administered by trustees. The trustees are required to act in the best interests of the schemes' beneficiaries. A formal actuarial valuation of each scheme is carried out on behalf of the trustees at triennial intervals by an independent professionally qualified actuary. Under the defined benefit pension schemes, members are entitled to retirement benefits calculated as a proportion (varying between 1/30 and 1/80 for each year of service) of their salary for the final year of employment with the group or, if higher, the average of the highest three consecutive years' salary in the last ten years of employment.

The defined benefit pension schemes closed to future accrual on 31 March 2015. A new defined contribution pension scheme has been established and members of the defined benefit pension schemes have become members of the new defined contribution pension scheme.

The UK defined benefit pension schemes and the date of their last formal actuarial valuation are as follows:

	Date of last formal actuarial valuation
Severn Trent Pension scheme ('STPS')*	31 March 2013
Severn Trent Mirror Image Pension Scheme	31 March 2013

* The STPS is by far the largest of the group's UK defined benefit schemes.

(ii) Amount included in the balance sheet arising from the group's obligations under defined benefit pension schemes

	2016 £m	2015 £m
Fair value of scheme assets		
Equities	**922.4**	999.5
Gilts	**283.0**	327.2
Corporate bonds	**570.7**	450.8
Property	**171.4**	159.3
Hedge funds	**11.8**	60.9
Cash	**80.5**	89.1
Total fair value of assets	**2,039.8**	2,086.8
Present value of the defined benefit obligations - funded schemes	**(2,339.9)**	(2,545.7)
	(300.1)	(458.9)
Present value of the defined benefit obligations - unfunded schemes	**(9.4)**	(10.0)
Liability recognised in the balance sheet	**(309.5)**	(468.9)

The equities, gilts, corporate bonds and hedge funds have quoted prices in active markets.

25 Retirement benefit schemes (continued)

a) Defined benefit pension schemes (continued)

(ii) Amount included in the balance sheet arising from the group's obligations under defined benefit pension schemes (continued)

Movements in the fair value of the scheme assets were as follows:

	2016 £m	2015 £m
Fair value at 1 April	**2,086.8**	1,823.6
Interest income on scheme assets	**67.7**	80.1
Group contributions	**25.7**	76.6
Other contributions from other Severn Trent group companies	**2.1**	4.4
Contributions from scheme members	**0.3**	4.8
Return on plan assets (excluding amounts included in finance income)	**(45.9)**	193.4
Scheme administration costs	**(2.3)**	(2.9)
Benefits paid	**(94.6)**	(93.2)
Fair value at 31 March	**2,039.8**	2,086.8

Movements in the present value of the defined benefit obligations were as follows:

	2016 £m	2015 £m
Present value at 1 April	**2,555.7**	2,171.9
Service cost	**–**	22.8
Past service cost	**(0.7)**	18.1
Interest cost	**82.8**	94.5
Contributions from scheme members	**0.3**	4.8
Actuarial (gains)/losses arising from changes in financial assumptions	**(147.9)**	366.2
Actuarial gains arising from experience adjustments	**(46.3)**	(29.4)
Benefits paid	**(94.6)**	(93.2)
Present value at 31 March	**2,349.3**	**2,555.7**

Of which:

	2016 £m	2015 £m
Amounts relating to funded schemes	**2,339.9**	2,545.7
Amounts relating to unfunded schemes	**9.4**	10.0
Present value at 31 March	**2,349.3**	2,555.7

The group has an obligation to pay pensions to a number of former employees, whose benefits would otherwise have been restricted by the Finance Act 1989 earnings cap. Provision for such benefits amounting to £9.4 million (2015: £10.0 million) is included as an unfunded scheme within the retirement benefit obligation.

25 Retirement benefit schemes (continued)

a) Defined benefit pension schemes (continued)

(iii) Amounts recognised in the income statement in respect of these defined benefit pension schemes

	2016 £m	2015 £m
Amounts credited/(charged) to operating costs		
Current service cost	**–**	(22.8)
Past service cost	**0.7**	(18.1)
Scheme administration costs	**(2.3)**	(2.9)
	(1.6)	(43.8)
Amounts charged to finance costs		
Interest cost	**(82.8)**	(94.5)
Amounts credited to finance income		
Interest income on scheme assets	**67.7**	80.1
Total amount charged to the income statement	**(16.7)**	(58.2)

The actual return on scheme assets was a gain of £21.8 million (2015: £273.5 million).

Actuarial gains and losses have been reported in the statement of comprehensive income. The cumulative amount of actuarial gains and losses recognised in the statement of comprehensive income since the adoption of IFRS is a net loss of £310.8 million (2015: £459.1 million).

In addition, contributions made by other Severn Trent group entities are also included in actuarial gains and losses recognised in the statement of comprehensive income.

iv) Actuarial risk factors

The schemes typically expose the company to actuarial risks such as investment risk, inflation risk and longevity risk.

Investment risk

The group's contributions to the schemes are based on actuarial calculations which make assumptions about the returns expected from the schemes' investments. If the investments underperform these assumptions in the long term then the group will need to make additional contributions to the schemes in order to fund the payment of accrued benefits.

Inflation risk

The benefits payable to members of the schemes are linked to inflation measured by RPI. The group's contributions to the schemes are based on assumptions about the future level of inflation. If inflation is higher than the levels assumed in the actuarial calculations then the group will need to make additional contributions to the schemes in order to fund the payment of accrued benefits.

Longevity risk

The group's contributions to the schemes are based on assumptions about the life expectancy of scheme members after retirement. If scheme members live longer than assumed in the actuarial calculations then the group will need to make additional contributions to the schemes in order to fund the payment of accrued benefits.

25 Retirement benefit schemes (continued)

a) Defined benefit pension schemes (continued)

(v) Actuarial assumptions

The major assumptions used in the valuation of the STPS (also the approximate weighted average of assumptions used for the valuations of all group schemes) were as follows:

	2016	2015
	%	%
Price inflation	**3.0**	3.0
Discount rate	**3.6**	3.3
Pension increases in payment	**3.0**	3.0
Pension increases in deferment	**3.0**	3.0

The assumption for price inflation is derived from the difference between the yields on longer term fixed rate gilts and on index-linked gilts. The discount rate is set by reference to AA rated sterling 18 year corporate bonds.

No salary assumption is required because the scheme closed to future accrual on 31 March 2015.

The mortality assumptions are based on those used in the triennial valuation of the STPS as at 31 March 2013. The mortality assumptions adopted at the year end and the life expectancies at age 65 implied by the assumptions are as follows:

	2016		2015	
	Men	**Women**	Men	Women
Mortality table used	**'SAPS' S1NMA_L**	**S1NFA_L**	'SAPS' S1NMA_L	S1NFA_L
Mortality table compared with standard table	**116%**	**92%**	116%	92%
Future improvement per annum	**1.0%**	**1.0%**	1.0%	1.0%
Remaining life expectancy for members currently aged 65 (years)	**21.4**	**24.6**	21.4	24.5
Remaining life expectancy at age 65 for members currently aged 45 (years)	**22.8**	**26.1**	22.7	26.1

Notes to the group financial statements (continued)

For the year ended 31 March 2016

25 Retirement benefit schemes (continued)

a) Defined benefit pension schemes (continued)

(v) Actuarial assumptions (continued)

The calculation of the scheme liabilities is sensitive to the actuarial assumptions and in particular to the assumptions relating to discount rate, price inflation and mortality. The following table summarises the estimated impact on scheme liabilities from changes to key actuarial assumptions whilst holding all other assumptions constant.

Assumption	Change in assumption	Impact on scheme liabilities
Discount rate	Increase/decrease by 0.1%	Decrease/increase by £45 million
Price inflation	Increase/decrease by 0.1%	Increase/decrease by £40 million
Mortality	Increase in life expectancy by 1 year	Increase by £65 million

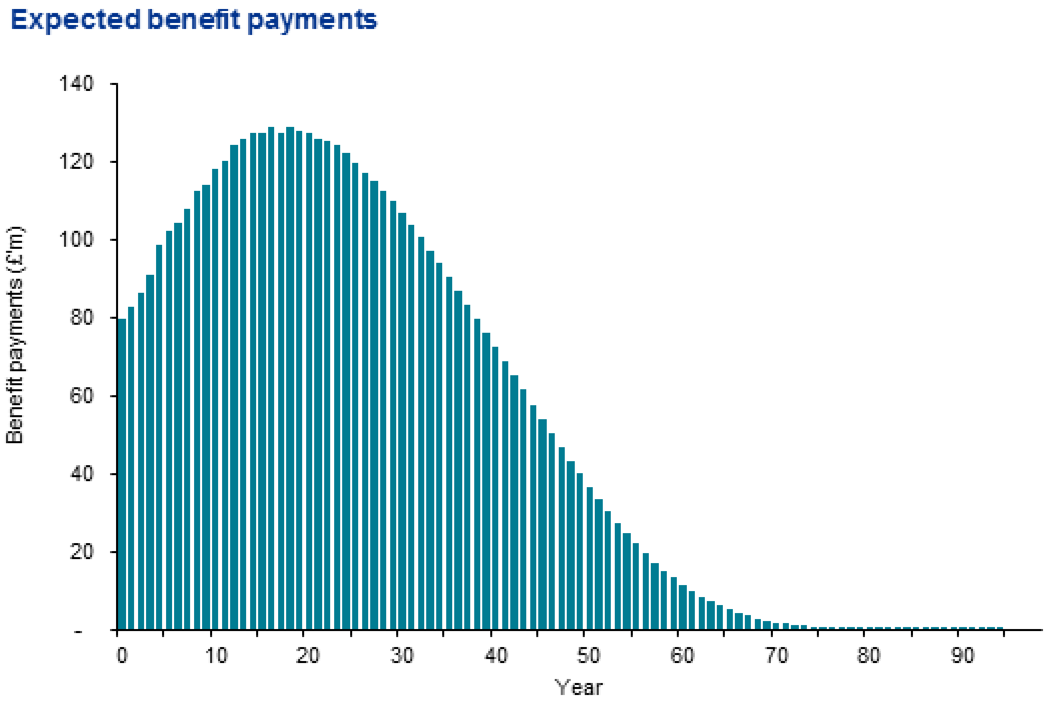
In reality, interrelationships exist between the assumptions, particularly between the discount rate and price inflation. The above analysis does not take into account the effect of these interrelationships.

In presenting the above sensitivity analysis, the present value of the defined benefit obligation has been calculated using the projected unit credit method at the end of the reporting period, which is the same as that applied in calculating the defined benefit obligation liability recognised in the balance sheet.

(vi) Effect on future cash flows

Contribution rates are set in consultation with the trustees for each scheme and each participating employer.

The average duration of the benefit obligation at the end of the year is 18 years (2015: 18 years). The expected cash flows payable from the scheme are presented in the graph below:



The most recent formal triennial actuarial valuations and funding agreements were carried out as at 31 March 2013 for both schemes. As a result, deficit reduction contributions of £40 million in 2013/14, £35 million in 2014/15, £15 million in 2015/16 and £12 million p.a. in subsequent years to 2024/25 were agreed. Further payments of £8 million p.a. through an asset backed funding arrangement will also continue to 31 March 2032. The Severn Trent Water Group's share of these contributions will be determined at the time that they are made. The next triennial valuation, as at 31 March 2016, is underway.

25 Retirement benefit schemes (continued)

b) Defined contribution pension schemes

The group also operates defined contribution arrangements for certain of its UK employees.

The Severn Trent Pension Scheme, Choices section was replaced by the Severn Trent Group Personal Pension from 1 April 2015 and all members of other pension schemes were transferred. This scheme has been open since 1 April 2012 and new employees were automatically enrolled from this date.

The total cost charged to operating costs of £18.1 million (2015: £8.2 million) represents contributions payable to these schemes by the group at rates specified in the rules of the schemes. As at 31 March 2016, contributions amounting to £1.5m (2015: £2.4 million) in respect of the current reporting period were owed to the schemes.

26 Provisions

	Restructuring £m	Onerous contracts £m	Insurance deductible £m	Other £m	Total £m
At 1 April 2015	1.3	1.0	–	2.1	4.4
(Released)/charged to income statement	(0.3)	–	5.1	–	4.8
Utilisation of provision	(0.9)	(0.7)	(0.5)	(0.1)	(2.2)
Unwinding of discount	–	–	–	0.1	0.1
Reclassification	–	(0.3)	–	0.3	–
At 31 March 2016	**0.1**	**–**	**4.6**	**2.4**	**7.1**

	2016 £m	2015 £m
Included in		
Current liabilities	**1.2**	3.0
Non-current liabilities	**5.9**	1.4
	7.1	4.4

The restructuring provision reflects costs to be incurred in respect of committed restructuring programmes. The associated outflows are estimated to arise over the next 12 months from the balance sheet date.

The onerous contract provision relates to specific contractual liabilities either assumed with businesses acquired or arising in existing group businesses, where estimated future costs are not expected to be recovered in revenues.

During the year, Severn Trent Water Limited has increased the level of self-insurance provided in the accounts for insurance deductible values previously provided in Derwent Insurance Limited; a captive insurance company of the Severn Trent Plc group. At the year end this has resulted in a provision of £4.6 million (2015: nil) for amounts that are no longer covered in the arrangement. The associated outflows are estimated to arise over a period of up to five years from the balance sheet date.

Other provisions include provisions for dilapidations and commercial disputes. The associated outflows are estimated to arise over a period up to six years from the balance sheet date.

27 Share capital

	2016 £m	2015 £m
Total issued and fully paid share capital		
1,000,000,000 shares of 10p each	**100.0**	100.0

28 Hedging reserve

The hedging reserve arises from gains or losses on interest rate swaps taken directly to equity under the hedge accounting provisions of IAS 39 and the transition rules of IFRS 1.

29 Capital management

The group's principal objectives in managing capital are:

- to access a broad range of sources of finance to obtain both the quantum required and lowest cost compatible with the need for continued availability;
- to manage exposure to movements in interest rates to provide an appropriate degree of certainty as to its cost of funds;
- to minimise exposure to counterparty credit risk;
- to provide the group with an appropriate degree of certainty as to its foreign exchange exposure;
- to maintain an investment grade credit rating; and
- to maintain a flexible and sustainable balance sheet structure.

The group seeks to achieve a balance of long term funding or commitment of funds across a range of funding sources at the best possible economic cost. The group monitors future funding requirements and credit market conditions to ensure continued availability of funds.

Whilst the group does not have a specific gearing target and seeks to maintain gearing at a level consistent with its capital management objectives described above, the board has decided to move towards a net debt/RCV gearing ratio of around 62.5% which is in line with Ofwat's notional assumption for AMP6.

The group has continued to increase exposure to currently low floating interest rates, primarily through the following:

- In April 2015, drawing down the remaining £330 million of the £530 million, floating rate facility with the European Investment Bank for a period of nine years. £200 million had previously been drawn in March 2015 for a period of eight years.

- Raising £471.4m of finance through a private placement on the US market, which was drawn down on 3 March 2016. This debt has maturities of 11, 12 and 15 years. The proceeds were used in part to repay the remaining €517.4 million of the €700 million fixed rate Eurobond on 11 March 2016.

The group's dividend policy is to declare dividends which are consistent with the group's regulatory obligations and at a level which is decided each year after consideration of a number of factors, including regulatory uncertainty, future cash flow requirements and balance sheet considerations. The amount declared is expected to vary each year as the impact of these factors changes.

The group's capital at 31 March 2016 was:

	2016	2015
	£m	£m
Cash and short term deposits	**–**	120.1
Bank overdrafts	**(2.8)**	–
Bank loans	**(1,212.2)**	(1,240.7)
Other loans	**(3,456.4)**	(3,368.8)
Loans from parent company	**(53.0)**	(27.0)
Obligations under finance leases	**(117.2)**	(180.0)
Cross currency swaps	**28.1**	(4.4)
Net debt	**(4,813.5)**	(4,700.8)
Equity attributable to the owners of the company	**(896.4)**	(752.0)
Total capital	**(5,709.9)**	(5,452.8)

30 Fair values of financial instruments

a) Fair value measurements

The valuation techniques that the group applies in determining the fair values of its financial instruments on a recurring basis are described below. The techniques are classified under the hierarchy defined in IFRS 13 which categorises valuation techniques into Levels 1 - 3 based on the degree to which the fair value is observable. All of the group's valuation techniques are Level 2.

	2016 **£m**	2015 £m	**Valuation techniques and key inputs**
Cross currency swaps			Discounted cash flow
Assets	**28.1**	20.8	Future cash flows are estimated based on forward interest rates
Liabilities	**–**	(25.2)	from observable yield curves at the year end and contract interest rates discounted at a rate that reflects the credit risk of counterparties. The currency cash flows are translated at the spot rate.
Interest rate swaps			Discounted cash flow
Assets	**–**	4.2	Future cash flows are estimated based on forward interest rates
Liabilities	**(164.9)**	(164.3)	from observable yield curves at the year end and contract interest rates discounted at a rate that reflects the credit risk of counterparties.
Energy swaps			Discounted cash flow
Assets	**–**	–	Future cash flows are estimated based on forward electricity prices
Liabilities	**(3.2)**	(0.8)	from observable indices at the year end and contract prices discounted at a rate that reflects the credit risk of counterparties.

30 Fair values of financial instruments (continued)

b) Comparison of fair value of financial instruments with their carrying amounts

The directors consider that the carrying amounts of cash and short term deposits, bank overdrafts, trade receivables and trade payables approximate their fair values. The carrying values and estimated fair values of other financial instruments are set out below:

	2016		2015	
	Carrying value £m	**Fair value £m**	Carrying value £m	Fair value £m
Floating rate debt				
Bank loans and overdraft	**958.6**	**958.5**	984.3	970.3
Currency bonds	**36.6**	**36.6**	67.4	67.4
Floating rate notes	**147.6**	**150.3**	–	–
Loan from parent company	**53.0**	**53.0**	27.0	27.0
	1,195.8	**1,198.4**	1,078.7	1,064.7
Fixed rate debt				
Bank loans	**150.0**	**150.0**	150.0	166.2
Sterling bonds	**1,857.3**	**2,221.8**	1,855.3	2,268.4
Currency bonds	**–**	**–**	370.8	391.3
Fixed rate notes	**326.9**	**399.0**	–	–
Finance leases	**117.2**	**125.4**	180.0	190.7
	2,451.4	**2,896.2**	2,556.1	3,016.6
Index-linked debt				
Bank loans	**107.8**	**116.1**	106.4	123.0
Sterling bonds	**1,088.0**	**1,494.0**	1,075.3	1,503.5
	1,195.8	**1,610.1**	1,181.7	1,626.5
	4,843.0	**5,704.7**	4,816.5	5,707.8

The above classification does not take into account the impact of hedging instruments.

Fixed rate sterling and currency bonds are valued using market prices.

Index-linked bonds are rarely traded and therefore quoted prices are not considered to be a reliable indicator of fair value. Therefore, these bonds are valued using discounted cash flow models with discount rates derived from observed market prices for a sample of bonds.

Fair values of the other debt instruments are also calculated using discounted cash flow models.

31 Risks arising from financial instruments

The group’s activities expose it to a variety of financial risks:

- market risk (including interest rate risk exchange rate risk and other price risk);
- credit risk;
- liquidity risk; and
- inflation risk.

The group’s overall risk management programme addresses the unpredictability of financial markets and seeks to reduce potential adverse effects on the group’s financial performance or position.

Financial risks are managed by a central treasury department (Group Treasury) under policies approved by the Board of Directors. The Board has established a Treasury Management Committee to monitor treasury activities and to facilitate timely responses to changes in market conditions when necessary. Group Treasury identifies, evaluates and hedges financial risks in close co-operation with the group’s operating units. The Board defines written principles for overall risk management, as well as written policies covering specific areas such as exchange rate risk, interest rate risk, credit risk and the use of derivative and non-derivative financial instruments. The group’s policy is that derivative financial instruments are not held for trading but may be used to mitigate the group's exposure to financial risk. The types of derivative instruments held and the related risks are described below.

Interest rate swaps are held to mitigate the group's exposure to changes in market interest rates. Further details are set out in sections a) (i) and note 32 below.

Cross currency swaps are held to mitigate the group's exposure to exchange rate movements on amounts borrowed in foreign currencies. Further details are set out in section a) (ii) below.

Energy swaps are held to mitigate the groups exposure to changes in electricity prices. Further details are provided in note 32 below.

Severn Trent Water, the group's most significant business unit, operates under a regulatory environment where its prices are linked to inflation measured by RPI. In order to mitigate the risks to cash flow and earnings arising from fluctuations in RPI, the group holds debt instruments where the principal repayable and interest cost is linked to RPI.

a) Market risk

The group is exposed to fluctuations in interest rates and, to a lesser extent, exchange rates. The nature of these risks and the steps that the group has taken to manage them are described below.

(i) Interest rate risk

The group’s income and its operating cash flows are substantially independent of changes in market interest rates. The group’s interest rate risk arises from long term borrowings.

Borrowings issued at variable rates expose the group to the risk of adverse cash flow impacts from increases in interest rates.

Borrowings issued at fixed rates expose the group to the risk of interest costs above the market rate when interest rates decrease.

The group’s policy is to maintain 40% to 70% of its interest bearing liabilities in fixed rate instruments in AMP6. In measuring this metric, management makes adjustments to the carrying value of debt to better reflect the amount that interest is calculated on. Details of the adjustments made are set out below:

	2016	2015
	£m	£m
Net debt (see note 34)	**4,813.5**	4,700.8
Cash and cash equivalents	**–**	120.1
Cross currency swaps included in net debt at fair value	**28.1**	(4.4)
Fair value hedge accounting adjustments	**(15.2)**	(17.4)
Exchange on currency debt not hedge accounted	**(5.9)**	22.6
Interest bearing financial liabilities	**4,820.5**	4,821.7

31 Risks arising from financial instruments (continued)

a) Market risk (continued)

(i) Interest rate risk (continued)

The group manages its cash flow interest rate risk by borrowing at fixed or index-linked rates and by using interest rate swaps. Under these swaps the group receives floating rate interest and pays fixed rate interest calculated by reference to the agreed notional principal amounts. In practice the swaps are settled by transferring the net amount. These swaps have the economic effect of converting borrowings from floating rates to fixed rates. The group has entered into a series of these interest rate swaps to hedge future interest payments to beyond 2030.

The following tables show analyses of the group's interest bearing financial liabilities by type of interest. Debt which is hedged by interest rate swaps is included in the category after taking account of the impact of the swap. Debt raised in foreign currencies has been included at the notional sterling value of the payable leg of the corresponding cross currency swap since this is the amount that is exposed to changes in interest rates.

Valuation adjustments that do not impact the amount on which interest is calculated, such as fair value hedge accounting adjustments, are excluded from this analysis.

The net principal amount of unhedged swaps is shown as an adjustment to floating rate and fixed rate debt to demonstrate the impact of the group's interest rate swaps on the amount of liabilities bearing fixed interest.

2016	**Floating rate £m**	**Fixed rate £m**	**Index-linked £m**	**Total £m**
Overdrafts	(2.8)	–	–	(2.8)
Bank loans	(954.4)	(150.0)	(107.8)	(1,212.2)
Other loans	(392.0)	(1,955.5)	(1,087.8)	(3,435.3)
Loans due to parent company	(53.0)	–	–	(53.0)
Finance leases	–	(117.2)	–	(117.2)
	(1,402.2)	**(2,222.7)**	**(1,195.6)**	**(4,820.5)**
Impact of swaps not matched against specific debt instruments	419.8	(419.8)	–	–
Interest bearing financial liabilities	**(982.4)**	**(2,642.5)**	**(1,195.6)**	**(4,820.5)**
Proportion of interest bearing financial liabilities that are fixed		**55%**		
Weighted average interest rate of fixed rate debt		**5.22%**		
Weighted average period for which interest is fixed (years)		**10.2**		

2015	Floating rate £m	Fixed rate £m	Index-linked £m	Total £m
Bank loans	(984.3)	(150.0)	(106.4)	(1,240.7)
Other loans	(47.0)	(2,251.7)	(1,075.3)	(3,374.0)
Loans due to parent company	(27.0)	–	–	(27.0)
Finance leases	–	(180.0)	–	(180.0)
	(1,058.3)	(2,581.7)	(1,181.7)	(4,821.7)
Impact of swaps not matched against specific debt instruments	316.4	(316.4)	–	–
Interest bearing financial liabilities	(741.9)	(2,898.1)	(1,181.7)	(4,821.7)
Proportion of interest bearing financial liabilities that are fixed		60%		
Weighted average interest rate of fixed rate debt		5.67%		
Weighted average period for which interest is fixed (years)		10.3		

31 Risks arising from financial instruments (continued)

a) Market risk (continued)

(i) Interest rate risk (continued)

Interest rate swaps not hedge accounted

The group has a number of interest rate swaps which are not accounted for as cash flow or fair value hedges. Economically these swaps act to fix the interest cost of debt within the group which is denominated as floating rate, but do not achieve hedge accounting under the strict criteria of IAS 39. This has led to a credit of £8.6 million (2015: charge of £119.9 million) in the income statement.

	Average contract fixed interest rate		**Notional principal amount**		**Fair value**	
	2016	2015	**2016**	2015	**2016**	2015
	%	%	**£m**	£m	**£m**	£m
Pay fixed rate interest						
1 - 2 years	**–**	–	**–**	–	**–**	–
2 - 5 years	**–**	–	**–**	–	**–**	–
5 - 10 years	**5.06**	5.06	**(450.0)**	(450.0)	**(129.2)**	(129.5)
10 - 20 years	**5.45**	5.45	**(68.1)**	(66.4)	**(35.7)**	(34.9)
	5.11	5.11	**(518.1)**	(516.4)	**(164.9)**	(164.4)
Receive fixed rate interest						
Less than one year	**–**	5.18	**–**	200.0	**–**	4.2
	–	5.18	**–**	200.0	**–**	4.2
			(518.1)	(316.4)	**(164.9)**	(160.2)

Interest rate sensitivity analysis

The sensitivity after tax of the group's profits, cash flow and equity, including the impact on derivative financial instruments, to reasonably possible changes in interest rates at 31 March is as follows:

	2016		2015	
	+1.0%	**-1.0%**	+1.0%	-1.0%
	£m	**£m**	£m	£m
Profit or loss	**42.4**	**(47.4)**	51.2	(57.3)
Cash flow	**6.6**	**(6.6)**	4.7	(4.7)
Equity	**42.4**	**(47.4)**	51.2	(57.3)

31 Risks arising from financial instruments (continued)

a) Market risk (continued)

(ii) Exchange rate risk

Except for debt raised in foreign currency, which is hedged, the group's business does not involve significant exposure to foreign exchange transactions and therefore the sensitivity of the group's results to changes in exchange rates is not material.

In order to meet its objective of accessing a broad range of sources of finance, the group has raised debt denominated in currencies other than sterling. In order to mitigate the group's exposure to exchange rate fluctuations, cross currency swaps were entered into at the time that the debt was drawn down to swap the proceeds into sterling debt bearing interest based on LIBOR.

Where the terms of the receivable leg of the swap closely match the terms of the underlying debt, the swaps are expected to be effective hedges, hence the swaps have been accounted for as fair value hedges. The notional value and fair value of these swaps is shown in note 32 a).

The group also has a number of fixed to floating rate cross currency swaps with a notional sterling value of £98.3 million (2015: £396.6 million) which are not accounted for as fair value hedges. Economically these swaps act to mitigate the exchange rate risk of debt within the group which is denominated in foreign currency, but they do not achieve hedge accounting under the strict criteria of IAS 39. This has led to a credit of £39.1 million (2015: charge of £75.4 million) in the income statement which is partly offset by the exchange loss of £32.6 million (2015: gain of £73.3 million) on the underlying debt.

The group's gross and net currency exposures arising from currency borrowings are summarised in the tables below. These show, in the relevant currency, the amount borrowed and the notional principal of the related swap or forward contract. The net position shows the group's exposure to exchange rate risk in relation to its currency borrowings.

2016	**Euro €m**	**US dollar $m**	**Yen ¥Bn**
Borrowings by currency	(19.9)	(150.0)	(2.0)
Cross currency swaps - hedge accounted	19.9	–	2.0
Cross currency swaps - not hedge accounted	–	150.0	–
Net currency exposure	**–**	**–**	**–**

2015	Euro €m	US dollar $m	Yen ¥Bn
Borrowings by currency	(537.3)	(50.0)	(2.0)
Cross currency swaps - hedge accounted	19.9	50.0	2.0
Cross currency swaps - not hedge accounted	517.4	–	–
Net currency exposure	–	–	–

31 Risks arising from financial instruments (continued)

b) Credit risk

Operationally the group has no significant concentrations of credit risk. It has policies in place to ensure that sales of products are made to customers with an appropriate credit history, other than in Severn Trent Water Limited, whose operating licence obliges it to supply domestic customers even in cases where bills are not paid. Amounts provided against accounts receivable and movements on the provision during the year are disclosed in note 18.

Cash deposits and derivative contracts are only placed with high credit quality financial institutions, which have been approved by the Board. Group Treasury monitors the credit quality of the approved financial institutions and the list of financial institutions that may be used is approved annually by the Board. The group has policies that limit the amount of credit exposure to any one financial institution.

Credit risk analysis

At 31 March the aggregate credit limits of authorised counterparties and the amounts held on short term deposits were as follows:

	Credit limit		Amount deposited	
	2016	2015	**2016**	2015
	£m	£m	**£m**	£m
AAA	**5.0**	20.0	**–**	–
Double A range	**100.0**	100.0	**–**	–
Single A range	**615.0**	600.0	**–**	115.0
Triple B range	**20.0**	–	**–**	–
	740.0	720.0	**–**	115.0

The fair values of derivative assets analysed by credit ratings of counterparties were as follows:

	Derivative assets	
	2016	2015
	£m	£m
Double A range	**–**	11.5
Single A range	**32.3**	13.5
Triple B range	**7.9**	–
	40.2	25.0

c) Liquidity risk

(i) Committed facilities

Prudent liquidity management requires sufficient cash balances to be maintained; adequate committed facilities to be available and the ability to close out market positions. Group Treasury manages liquidity and flexibility in funding by monitoring forecast and actual cash flows and the maturity profile of financial assets and liabilities, and by keeping committed credit lines available.

At the balance sheet date the group had committed undrawn borrowing facilities expiring as follows:

	2016	2015
	£m	£m
2 - 5 years	**775.0**	415.0
After more than five years	**–**	330.0
	775.0	745.0

31 Risks arising from financial instruments (continued)

c) Liquidity risk (continued)

(ii) Cash flows from non-derivative financial instruments

The following tables show the estimated cash flows that will arise from the group's non-derivative net financial liabilities. The information presented is based on the earliest date on which the group can be required to pay and represents the undiscounted cash flows including principal and interest.

Interest and inflation assumptions are based on prevailing market conditions at the year end date.

2016 Undiscounted amounts payable:	Floating rate £m	Fixed rate £m	Index linked £m	Trade payables £m	Payments on financial liabilities £m
Within 1 year	(285.9)	(119.2)	(23.9)	(9.6)	**(438.6)**
1 - 2 years	(163.2)	(519.7)	(24.3)	**–**	**(707.2)**
2 - 5 years	(38.1)	(437.4)	(75.9)	**–**	**(551.4)**
5 - 10 years	(614.5)	(1,230.8)	(299.0)	**–**	**(2,144.3)**
10 - 15 years	(178.4)	(768.9)	(334.0)	**–**	**(1,281.3)**
15 - 20 years	–	(76.9)	(125.7)	**–**	**(202.6)**
20 - 25 years	–	(60.9)	(153.1)	**–**	**(214.0)**
25 - 30 years	–	(262.2)	(183.0)	**–**	**(445.2)**
30 - 35 years	–	–	(217.8)	**–**	**(217.8)**
35 - 40 years	–	–	(646.6)	**–**	**(646.6)**
40 - 45 years	–	–	(3,163.9)	**–**	**(3,163.9)**
45 - 50 years	–	–	(29.4)	**–**	**(29.4)**
50 - 55 years	–	–	(426.5)	**–**	**(426.5)**
Total	**(1,280.1)**	**(3,476.0)**	**(5,703.1)**	**(9.6)**	**(10,468.8)**

Undiscounted amounts receivable:	Trade receivables	Cash and short term deposits	Receipts from financial assets
	£m	£m	£m
Within 1 year	160.8	1.4	**162.2**

31 Risks arising from financial instruments (continued)

c) Liquidity risk (continued)

(ii) Cash flows from non-derivative financial instruments (continued)

2015 Undiscounted amounts payable:	Floating rate £m	Fixed rate £m	Index linked £m	Trade payables £m	Payments on financial liabilities £m
Within 1 year	(42.7)	(547.2)	(23.8)	(25.4)	(639.1)
1 - 2 years	(159.4)	(132.8)	(24.1)	–	(316.3)
2 - 5 years	(661.5)	(680.4)	(74.3)	–	(1,416.2)
5 - 10 years	(223.5)	(842.7)	(304.1)	–	(1,370.3)
10 - 15 years	(32.0)	(1,192.0)	(344.4)	–	(1,568.4)
15 - 20 years	–	(91.5)	(123.2)	–	(214.7)
20 - 25 years	–	(60.9)	(149.4)	–	(210.3)
25 - 30 years	–	(274.4)	(178.8)	–	(453.2)
30 - 35 years	–	–	(213.2)	–	(213.2)
35 - 40 years	–	–	(650.0)	–	(650.0)
40 - 45 years	–	–	(3,252.7)	–	(3,252.7)
45 - 50 years	–	–	(28.9)	–	(28.9)
50 - 55 years	–	–	(445.1)	–	(445.1)
Total	(1,119.1)	(3,821.9)	(5,812.0)	(25.4)	(10,778.4)

Undiscounted amounts receivable:	Trade receivables £m	Cash and short term deposits £m	Receipts from financial assets £m
Within 1 year	156.5	120.1	276.6

Index-linked debt includes loans with maturities up to 51 years. The principal is revalued at fixed intervals and is linked to movements in the Retail Price Index. Interest payments are made biannually based on the revalued principal. The principal repayment equals the revalued amount at maturity. The payments included in the table above are estimates based on the forward inflation rates published by the Bank of England at the balance sheet date.

31 Risks arising from financial instruments (continued)

c) Liquidity risk (continued)

(iii) Cash flows from derivative financial instruments

The following tables show the estimated cash flows that will arise from the group's derivative financial instruments. The tables are based on the undiscounted net cash inflows/(outflows) on the derivative financial instruments that settle on a net basis and the undiscounted gross inflows/(outflows) on those derivatives that require gross settlement. When the amount payable or receivable is not fixed, the amount disclosed has been determined by reference to the projected interest and foreign currency rates derived from the forward curves existing at the balance sheet date. Actual amounts may be significantly different from those indicated below.

	Derivative liabilities				Derivative assets			
	Interest rate swaps	Energy swaps	Cross currency swaps		Interest rate swaps	Cross currency swaps		
2016			Cash receipts	Cash payments		Cash receipts	Cash payments	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Within 1 year	(22.6)	(0.4)	–	–	2.8	1.0	(0.2)	**(19.4)**
1 - 2 years	(22.3)	(0.8)	–	–	2.6	1.0	(0.2)	**(19.7)**
2 - 5 years	(63.0)	(2.9)	–	–	6.0	3.1	(0.9)	**(57.7)**
5 - 10 Years	(62.1)	–	–	–	1.7	23.5	(13.6)	**(50.5)**
10 - 15 Years	(12.0)	–	–	–	(0.4)	16.7	(9.3)	**(5.0)**
15 - 20 Years	(0.7)	–	–	–	–	–	–	**(0.7)**
	(182.7)	**(4.1)**	**–**	**–**	**12.7**	**45.3**	**(24.2)**	**(153.0)**

	Derivative liabilities				Derivative assets			
	Interest rate swaps	Energy swaps	Cross currency swaps		Interest rate swaps	Cross currency swaps		
2015			Cash receipts	Cash payments		Cash receipts	Cash payments	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Within 1 year	(29.1)	(0.5)	396.6	(421.7)	4.2	52.5	(42.7)	(40.7)
1 - 2 years	(21.7)	(0.1)	–	–	–	0.9	(0.3)	(21.2)
2 - 5 years	(56.7)	(0.2)	–	–	–	2.8	(1.2)	(55.3)
5 - 10 Years	(74.6)	–	–	–	–	5.0	(2.4)	(72.0)
10 - 15 Years	(16.0)	–	–	–	–	32.0	(21.2)	(5.2)
15 - 20 Years	(2.9)	–	–	–	–	–	–	(2.9)
	(201.0)	(0.8)	396.6	(421.7)	4.2	93.2	(67.8)	(197.3)

31 Risks arising from financial instruments (continued)

d) Inflation risk

The group's parent company, Severn Trent Water, operates under a regulatory environment where its prices are linked to inflation measured by RPI. Its operating profits and cash flows are therefore exposed to changes in RPI. In order to mitigate and partially offset this risk, Severn Trent Water has raised debt which pays interest at a fixed coupon based on a principal amount that is adjusted for the change in RPI during the life of the debt instrument (index-linked debt). The amount of index-linked debt at the balance sheet date is shown in section a) (i) interest rate risk, and the estimated future cash flows relating to this debt are shown in section c) (ii) cash flows from non-derivative financial instruments.

Inflation rate sensitivity analysis

The finance cost of the group's index-linked debt instruments varies with changes in RPI rather than interest rates. The sensitivity at 31 March of the group's profit and equity to reasonably possible changes in RPI is set out in the following table. This analysis relates to financial instruments only and excludes any RPI impact on Severn Trent Water's revenues and Regulated Capital Value, or accounting for defined benefit pension schemes.

	2016		2015	
	+1.0%	**-1.0%**	+1.0%	-1.0%
	£m	**£m**	£m	£m
Profit or loss	**(9.6)**	**9.6**	(9.3)	9.3
Equity	**(9.6)**	**9.6**	(9.3)	9.3

32 Hedge accounting

The group uses derivative financial instruments to hedge exposures to changes in exchange rates and interest rates. Hedge accounting is adopted for such instruments where the criteria set out in IAS 39 are met.

a) Fair value hedges

(i) Cross currency swaps

The group raises debt denominated in currencies other than sterling. Cross currency swaps are entered into at the time that the debt is drawn down to swap the proceeds into sterling debt bearing interest based on LIBOR in order to mitigate the group's exposure to exchange rate fluctuations. Where the terms of the receivable leg of the swap closely match the terms of the underlying debt, the swaps are expected to be effective hedges.

At the year end the amounts of cross currency swaps designated as fair value hedges were as follows:

	Notional principal amount		**Fair value**	
	2016	2015	**2016**	2015
	£m	£m	**£m**	£m
US dollar	**–**	27.0	**–**	7.3
Euro	**11.4**	11.4	**9.8**	8.0
Yen	**8.5**	8.5	**7.9**	5.5
	19.9	46.9	**17.7**	20.8

32 Hedge Accounting (continued)

a) Fair value hedges (continued)

(ii) Interest rate swaps

During the year the group raised £225 million of fixed rate debt through its US Private Placement programme. In line with the strategy to increase the proportion of debt at floating rates this was swapped to floating rate debt via interest rate swaps. These swaps have been designated as hedging instruments to hedge the changes in fair value of the debt arising from movements in interest rates. Since the terms of the receivable leg of the swap closely match the terms of the underlying debt the swaps are expected to be effective hedges.

	Average contract fixed interest rate		Notional principal amount		Fair value	
	2016	2015	**2016**	2015	**2016**	2015
Period to maturity	**%**	%	**£m**	£m	**£m**	£m
10 - 20 years	**3.36%**	-	**225.0**	–	**12.1**	–

b) Cash flow hedges

The group has entered into a series of energy swaps under which it has agreed to exchange the difference between fixed and market prices of electricity at six-monthly intervals up to March 2020.

Details of energy swaps that have been accounted for as cash flow hedges are summarised below:

	Average contract price		Notional contracted amount		Fair value	
	2016	2015	**2016**	2015	**2016**	2015
Period to maturity	**£/MWh**	£/MWh	**MWh**	MWh	**£m**	£m
Less than 1 year	**49.8**	54.4	**21,960**	70,272	**(0.4)**	(0.5)
1 - 2 years	**43.6**	49.8	**66,272**	21,960	**(0.8)**	(0.1)
2 - 5 years	**48.5**	46.7	**227,221**	162,000	**(2.0)**	(0.2)
			315,453	254,232	**(3.2)**	(0.8)

33 Share based payments

The group operates a number of share based remuneration schemes for employees. During the period, the group recognised total expenses of £5.0 million (2015: £7.6 million) related to equity settled share based payment transactions.

The weighted average share price during the period was £21.44 (2015: £19.74).

At 31 March 2016, there were no options exercisable (2015: none) under any of the share based remuneration schemes.

a) Long Term Incentive Plans ('LTIP's)

Under the LTIPs, conditional awards of shares may be made to executive directors and senior staff. Awards are subject to performance conditions and continued employment throughout the vesting period.

Awards outstanding

Awards made under the LTIP

The 2013 and 2014 LTIP awards are subject to Severn Trent Water's achievement of Return on Regulated Capital Value in excess of the level included in the Severn Trent Water AMP5 business plan over a three year vesting period. The 2015 LTIP awards are subject to Severn Trent Water's achievement of Return on Regulatory Equity in excess of the level included in the Severn Trent Water AMP6 business plan over a three year vesting period. It has been assumed that performance against the LTIP non-market conditions will be 100% (2015: 100%).

Details of changes in the number of awards outstanding during the year are set out below:

	Number of awards
Outstanding at 1 April 2014	265,648
Granted during the year	295,567
Vested during the year	(138,559)
Lapsed during the year	(14,225)
Outstanding at 1 April 2015	408,431
Granted during the year	235,670
Vested during the year	(132,597)
Lapsed during the year	(57,825)
Outstanding at 31 March 2016	**453,679**

Details of LTIP awards outstanding at 31 March were as follows:

		Number of awards	
Date of grant	**Normal date of vesting**	**2016**	2015
July 2012	2015	**–**	123,734
July 2013	2016	**136,784**	124,513
July 2014	2017	**157,286**	160,184
July 2015	2018	**159,609**	–
		453,679	408,431

33 Share based payments (continued)

b) Employee Sharesave Scheme

Under the terms of the Sharesave Scheme, the Board may grant the right to purchase ordinary shares in the company to those employees who have entered into an HMRC approved Save As You Earn contract for a period of three or five years.

Options outstanding

Details of changes in the number of options outstanding during the year are set out below:

	Number of share options	Weighted average exercise price
Outstanding at 1 April 2014	2,711,088	1,125p
Granted during the year	1,019,025	1,584p
Forfeited during the year	(52,566)	1,266p
Cancelled during the year	(59,887)	1,300p
Exercised during the year	(683,778)	943p
Lapsed during the year	(4,286)	1,067p
Outstanding at 1 April 2015	2,929,596	1,321p
Granted during the year	719,826	1,724p
Forfeited during the year	(99,635)	1,399p
Cancelled during the year	(63,461)	1,487p
Exercised during the year	(682,463)	1,029p
Lapsed during the year	(18,286)	1,216p
Outstanding at 31 March 2016	**2,785,577**	**1,491p**

Sharesave options outstanding at 31 March were as follows:

			Number of share options	
Date of grant	Normal date of exercise	Option price	2016	2015
January 2010	2015	808p	**–**	288,894
January 2011	2016	1,137p	**95,183**	109,804
January 2012	2015 or 2017	1,177p	**88,193**	437,273
January 2013	2016 or 2018	1,241p	**440,110**	496,489
January 2014	2017 or 2019	1,331p	**512,207**	584,406
January 2015	2018 or 2020	1,584p	**931,560**	1,012,730
January 2016	2019 or 2021	1,724p	**718,324**	–
			2,785,577	2,929,596

33 Share based payments (continued)

c) Share Matching Plan ('SMP')

Under the Share Matching Plan members of STEC have received matching share awards over those shares which had been acquired under the deferred share component of the annual bonus scheme. Matching shares may be awarded at a maximum ratio of one matching share for every deferred share and are subject to a three year vesting period. No matching shares have been awarded in the current year.

Matching shares are subject to total shareholder return over three years measured relative to the companies ranked 51 - 150 by market capitalisation in the FTSE Index (excluding investment trusts).

The number of shares subject to an award will increase to reflect dividends paid through the performance period on the basis of such notional dividends being reinvested at the then prevailing share price. Awards will normally vest as soon as the Severn Trent Plc Remuneration Committee determines that the performance conditions have been met provided that the participant remains in employment at the end of the performance period.

Details of changes in the number of awards outstanding during the year are set out below:

	Number of awards
Outstanding at 1 April 2014	69,138
Lapsed during the year	(8,183)
Vested during the year	(11,225)
Outstanding at 1 April 2015	49,730
Lapsed during the year	(22,117)
Outstanding at 31 March 2016	**27,613**

Details of share matching awards outstanding at 31 March were as follows:

		Number of awards	
Date of grant	Normal date of vesting	2016	2015
May 2012	May 2015	**–**	17,676
May 2013	May 2016	**27,613**	32,054
		27,613	49,730

d) Fair value calculations

The fair values of the share awards made and share options granted during the year were calculated using the Black Scholes method. The principal assumptions and data are out below:

	2016			2015		
	LTIP	SAYE		LTIP	SAYE	
		3 year scheme	5 year scheme		3 year scheme	5 year scheme
Share price at grant date	**2,167p**	**2,151p**	**2,151p**	1,918p	2,000p	2,000p
Option life (years)	**3.0**	**3.5**	**5.5**	3.0	3.5	5.5
Vesting period (years)	**3.0**	**3.0**	**5.0**	3.0	3.0	5.0
Expected volatility	**18.2%**	**18.2%**	**18.2%**	18.2%	18.2%	18.2%
Expected dividend yield	**3.7%**	**3.7%**	**3.7%**	4.4%	4.2%	4.2%
Risk free rate	**n/a**	**0.8%**	**1.3%**	n/a	0.7%	1.1%
Fair value per share	**1,938p**	**363p**	**362p**	1,679p	326p	311p

Expected volatility is measured over the three years prior to the date of grant of the awards or share options. Volatility has been calculated based on historical share price movements.

The risk free rate is derived from yields at the grant date of gilts of similar duration to the awards or share options.

The dividend yield is calculated using the expected dividend for the year divided by the share price at the date of grant.

34 Cash flow statement

a) Reconciliation of operating profit to operating cash flows

	2016 £m	2015 £m
Profit before interest and tax	**519.7**	515.1
Depreciation of property, plant and equipment	**290.3**	276.7
Amortisation of intangible assets	**19.9**	22.2
Pension service cost	**(0.7)**	40.9
Defined benefit pension scheme administration costs	**2.3**	2.9
Defined benefit pension scheme contributions	**(25.7)**	(76.6)
Share based payments charge	**5.0**	7.6
Profit on sale of property, plant and equipment and intangible assets	**(2.9)**	(8.1)
Deferred income movement	**(10.5)**	(10.1)
Provisions charged to the income statement	**4.8**	10.6
Utilisation of provisions for liabilities and charges	**(2.2)**	(10.5)
Operating cash flows before movements in working capital	**800.0**	770.7
Decrease in inventory	**0.3**	0.2
Decrease in amounts receivable from related companies	**4.8**	1.6
Increase in amounts receivable	**(13.7)**	(34.2)
Increase in amounts payable	**8.4**	14.0
Cash generated from operations	**799.8**	752.3
Tax paid	**(20.0)**	(26.5)
Net cash generated from operating activities	**779.8**	725.8

b) Non-cash transactions

No additions to property, plant and equipment during the year were financed by new finance leases (2015: nil). Assets transferred from developers at no cost were recognised at their fair value of £24.8 million (2015: £29.8 million).

c) Exceptional cash flows

The following cash flows arose from items classified as exceptional in the income statement:

	2016 £m	2015 £m
Restructuring costs	**(3.0)**	(24.1)
Disposal of fixed assets	**–**	9.4
	(3.0)	(14.7)

d) Reconciliation of movement in cash and cash equivalents to movement in net debt

	As at 1 April 2015 £m	Cash flow £m	Fair value adjustments £m	RPI uplift on index-linked debt £m	Foreign exchange £m	Other non cash movements £m	**As at 31 March 2016 £m**
Cash and cash equivalents	120.1	(118.7)	–	–	–	(1.4)	**–**
Bank overdrafts	–	(4.2)	–	–	–	1.4	**(2.8)**
Net cash and cash equivalents	120.1	(122.9)	–	–	–	–	**(2.8)**
Loans payable to parent company	(27.0)	(26.0)	–	–	–	–	**(53.0)**
Bank loans	(1,240.7)	30.0	–	(1.4)	–	(0.1)	**(1,212.2)**
Other loans	(3,368.8)	(47.8)	(2.5)	(12.6)	(32.6)	7.9	**(3,456.4)**
Finance leases	(180.0)	62.8	–	–	–	–	**(117.2)**
Cross currency swaps	(4.4)	–	41.2	–	–	(8.7)	**28.1**
Net debt	(4,700.8)	(103.9)	38.7	(14.0)	(32.6)	(0.9)	**(4,813.5)**

35 Contingent liabilities

a) Bonds and guarantees

Group undertakings have entered into bonds and guarantees in the normal course of business. No liability is expected to arise in respect of either bonds or guarantees.

b) Banking arrangements

The banking arrangements of the group operate on a pooled basis with certain fellow group undertakings. Under these arrangements participating companies guarantee each others balances only to the extent that their credit balances can be offset against overdrawn balances of other Severn Trent group companies.

At 31 March 2016 the company's maximum liability under these arrangements was £1.4 million (2015: £5.1 million).

36 Financial and other commitments

a) Investment expenditure commitments

	2016 **£m**	2015 £m
Contracted for but not provided in the financial statements	**130.8**	73.3

In addition to these contractual commitments, the group has longer term expenditure plans which include investments to achieve improvements in performance mandated by the Director General of Water Services (Ofwat) and to provide for growth in demand for water and waste water services.

b) Leasing commitments

At the balance sheet date the group had outstanding commitments for future minimum operating lease payments under non-cancellable operating leases, which fall due as follows:

	2016 **£m**	2015 £m
Within 1 year	**1.4**	1.8
2 - 5 years	**4.7**	4.0
After more than 5 years	**5.1**	4.7
	11.2	10.5

Operating lease payments represent rentals payable by the group for certain of its office properties, plant and equipment.

37 Post balance sheet events

Water Plus joint venture

On 1 March 2016 the group announced its intention, subject to approval from the Competition and Markets Authority ('CMA') to enter into a joint venture with United Utilities PLC to compete in the non-household water and waste water retail market in Great Britain. On 3 May the CMA announced approval of the joint venture. On this date the group determined that completion of the proposed transaction became highly probable and its non-household retail business was classified as a disposal group and discontinued operation with effect from this date.

38 Related party transactions

Transactions between the company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not included in this note. Transactions between the group and ultimate parent Severn Trent Plc are disclosed below.

Trading transactions

	Transactions with fellow subsidiary undertakings		Transactions with ultimate parent	
	2016 £m	2015 £m	**2016 £m**	2015 £m
Sale of services	**1.7**	2.1	**–**	–
Purchase of services	**7.3**	9.7	**1.4**	1.1
Amounts due from related parties	**8.3**	3.8	**1.7**	12.5
Amounts due to related parties	**(2.1)**	(1.0)	**(0.3)**	(1.3)
Net interest charge due (to)/from related parties	**–**	–	**(0.1)**	0.3
Loans due to related parties	**–**	–	**(53.0)**	(27.0)
Dividends payable to related parties	**(310.0)**	(203.7)	**–**	–
	(294.8)	(189.1)	**(50.3)**	(14.4)

The related parties are fellow subsidiary undertakings and the ultimate parent Severn Trent Plc. All outstanding balances will be settled within one year, including loans.

Remuneration of key management personnel

Key management personnel comprise the members of STEC during the year.

The remuneration of the directors is included within the amounts disclosed below.

	2016 £m	2015 £m
Short term employee benefits	**6.0**	6.1
Post employment benefits	**0.1**	0.2
Termination benefits	**–**	0.2
Share based payments	**2.7**	4.0
	8.8	10.5

39 Subsidiary undertakings

Principal subsidiary undertakings

The group's subsidiary undertakings at 31 March 2016 are shown below. Unless otherwise disclosed, all subsidiary undertakings are incorporated in the UK, are 100% owned, and with a share class of ordinary shares.

Name	Country of operation and incorporation	Percentage of share capital held	Class of share capital held
Biogas Generation Limited	United Kingdom	100%	Ordinary Shares
East Worcester Water Limited	United Kingdom	100%	Ordinary Shares
Severn Trent Funding Limited	United Kingdom	100%	Ordinary Shares
Severn Trent General Partnership Limited	United Kingdom	100%	Ordinary Shares
Severn Trent LCP Limited	United Kingdom	100%	Ordinary Shares
Severn Trent Leasing Limited	United Kingdom	100%	Ordinary Shares
Severn Trent Power Generation Limited	United Kingdom	100%	Ordinary Shares
Severn Trent Reservoirs Limited	United Kingdom	100%	Ordinary Shares
Severn Trent Utilities Finance Plc	United Kingdom	100%	Ordinary Shares

The group also has an indirect investment in Severn Trent Limited Partnership, a limited partnership registered in Scotland, as a result of Severn Trent General Partnership Limited being the general partner.

40 Ultimate parent undertaking

The immediate parent undertaking is Severn Trent Draycote Limited.

The ultimate parent undertaking and controlling party is Severn Trent Plc, which is the parent undertaking and controlling party of the smallest and largest group to consolidate these financial statements. Copies of the Severn Trent Plc consolidated financial statements can be obtained from Severn Trent Plc's registrars at Equiniti, Aspect House, Spencer Road, Lancing, West Sussex, BN99 6DA.

Severn Trent Water Limited

Income statement
For the year ended 31 March 2016

	Notes	2016 £m	2015 £m
Turnover	4	**1,550.2**	1,581.2
Net operating costs before exceptional items	5	**(1,031.5)**	(1,044.6)
Exceptional operating items	6	**1.0**	(21.5)
Total net operating costs		**(1,030.5)**	(1,066.1)
Profit before interest and tax		**519.7**	515.1
Finance income	9	**80.0**	100.9
Finance costs	10	**(295.0)**	(325.0)
Net finance costs		**(215.0)**	(224.1)
Gains/(losses) on financial instruments	11	**4.9**	(159.8)
Profit on ordinary activities before tax		**309.6**	131.2
Current tax excluding exceptional tax credit	12	**(53.7)**	(36.6)
Deferred tax excluding exceptional credit	12	**(9.3)**	13.0
Exceptional tax credit	12	**80.0**	–
Total tax on profit on ordinary activities	12	**17.0**	(23.6)
Profit for the financial year		**326.6**	107.6

All results are from continuing operations in both the current and preceding year.

Severn Trent Water Limited

Statement of comprehensive income
For the year ended 31 March 2016

	2016 £m	2015 £m
Profit for the year	**326.6**	107.6
Other comprehensive income/(loss)		
Items that will not be reclassified to the income statement:		
Net actuarial gain/(loss) on defined benefit pension schemes	**150.3**	(139.1)
Tax on net actuarial gain/loss	**(28.5)**	26.3
Deferred tax arising on change of rate	**(8.3)**	–
	113.5	(112.8)
Items that may be reclassified to the income statement:		
Loss on cash flow hedges	**(2.4)**	(10.5)
Deferred tax on loss on cash flow hedges	**0.4**	2.1
Amounts on cash flow hedges transferred to the income statement in the year	**9.3**	41.6
Deferred tax on transfers to the income statement	**(1.6)**	(8.3)
	5.7	24.9
Other comprehensive income/(loss) for the year	**119.2**	(87.9)
Total comprehensive income for the year	**445.8**	19.7

Severn Trent Water Limited

Balance sheet
As at 31 March 2016

	Notes	2016 £m	2015 Restated £m	2014 Restated £m
Non-current assets				
Goodwill		**1.3**	1.3	1.3
Other intangible fixed assets	14	**67.0**	65.1	71.9
Tangible fixed assets	15	**7,641.7**	7,482.6	7,280.2
Investments in subsidiaries	16	**347.9**	347.9	347.9
Derivative financial assets	22	**40.2**	13.5	30.2
		8,098.1	7,910.4	7,731.5
Current assets				
Inventory		**5.9**	6.1	6.4
Trade and other receivables: amounts falling due after more than one year	17	**291.8**	294.5	296.9
Trade and other receivables: amounts falling due within one year	17	**437.8**	454.4	436.3
Derivative financial assets	22	**–**	11.5	9.4
Cash and cash equivalents		**–**	119.1	19.8
		735.5	885.6	768.8
Trade and other payables: amounts falling due within one year	19	**(768.4)**	(909.7)	(732.3)
Net current liabilities		**(32.9)**	(24.1)	36.5
Total assets less current liabilities		**8,065.2**	7,886.3	7,768.0
Trade and other payables: amounts falling due after more than one year	20	**(6,123.2)**	(5,893.2)	(5,687.3)
Retirement benefit obligations	23	**(309.5)**	(468.9)	(348.3)
Provisions for liabilities and charges	24	**(692.7)**	(721.9)	(753.1)
Net assets		**939.8**	802.3	979.3
Equity				
Called up share capital	26	**100.0**	100.0	100.0
Hedging reserve	27	**(92.7)**	(98.4)	(123.3)
Retained earnings		**932.5**	800.7	1,002.6
Total equity		**939.8**	802.3	979.3

The financial statements were approved by the Board of Directors on 23 May 2016. They were signed on its behalf by:

Andrew Duff
Chairman
23 May 2016
Company Number 02366686

James Bowling
Chief Financial Officer

Severn Trent Water Limited

Statement of changes in equity
For the year ended 31 March 2016

	Share capital £m	Hedging reserve £m	Retained earnings £m	Total £m
At 1 April 2014	100.0	(123.3)	1,056.9	1,033.6
Restatement	–	–	(54.3)	(54.3)
At 1 April 2014 after restatement	100.0	(123.3)	1,002.6	979.3
Profit for the year	–	–	107.6	107.6
Loss on cash flow hedges	–	(10.5)	–	(10.5)
Deferred tax on losses on cash flow hedges	–	2.1	–	2.1
Amounts on cash flow hedges transferred to the income statement	–	41.6	–	41.6
Deferred tax on transfers to the income statement	–	(8.3)	–	(8.3)
Net actuarial losses	–	–	(139.1)	(139.1)
Tax on net actuarial losses	–	–	26.3	26.3
Total comprehensive income for the year	–	24.9	(5.2)	19.7
Share options and LTIPs				
- value of employees' services	–	–	7.6	7.6
- shares purchased	–	–	(2.4)	(2.4)
Current tax on share based payments	–	–	1.3	1.3
Deferred tax on share based payments	–	–	0.5	0.5
Dividends paid	–	–	(203.7)	(203.7)
At 31 March 2015 after restatement	100.0	(98.4)	800.7	802.3
Profit for the year	–	–	326.6	326.6
Loss on cash flow hedges	–	(2.4)	–	(2.4)
Deferred tax on loss on cash flow hedges	–	0.4	–	0.4
Amounts on cash flow hedges transferred to the income statement	–	9.3	–	9.3
Deferred tax on transfers to the income statement	–	(1.6)	–	(1.6)
Net actuarial gains	–	–	150.3	150.3
Tax on net actuarial gains	–	–	(28.5)	(28.5)
Deferred tax arising on change of rate	–	–	(8.3)	(8.3)
Total comprehensive income for the year	–	5.7	440.1	445.8
Share options and LTIPs				
- value of employees' services	–	–	5.0	5.0
- shares purchased	–	–	(4.0)	(4.0)
Current tax on share based payments	–	–	1.6	1.6
Deferred tax on share based payments	–	–	(0.9)	(0.9)
Dividends paid	–	–	(310.0)	(310.0)
At 31 March 2016	**100.0**	**(92.7)**	**932.5**	**939.8**

Severn Trent Water Limited

Cash flow statement
For the year ended 31 March 2016

	Note	2016 £m	2015 £m
Cash generated from operations	29	**808.7**	760.9
Tax paid		**(19.3)**	(24.9)
Net cash generated from operating activities		**789.4**	736.0
Investing activities			
Interest received		**0.8**	1.1
Interest received from intercompany finance leases		**5.1**	5.2
Dividends received from subsidiaries		**–**	8.2
Proceeds on disposal of intangible and tangible assets		**12.6**	10.5
Purchases of intangible assets		**(21.9)**	(15.4)
Purchases of tangible assets		**(411.5)**	(423.8)
Contributions and grants received		**35.0**	36.2
Net cash used in investing activities		**(379.9)**	(378.0)
Financing activities			
Interest paid		**(187.7)**	(206.5)
Interest element of finance lease payments		**(8.5)**	(8.8)
Interest element of intercompany finance lease payments		**(11.0)**	(11.3)
Payments to close out interest rate swaps		**–**	(139.2)
Dividends paid to owners of the company		**(310.0)**	(203.7)
Repayments of borrowings		**(485.0)**	–
Repayments of intercompany borrowings		**(423.9)**	(348.9)
New loans raised		**926.4**	684.3
New intercompany loans raised		**47.4**	11.9
Repayments of obligations under finance leases		**(74.2)**	(31.9)
Repayments of obligations under intercompany finance leases		**(2.8)**	(2.7)
Receipts from intercompany finance lease		**0.5**	0.5
Purchase of shares in ultimate parent company		**(4.0)**	(2.4)
Net cash used in financing activities		**(532.8)**	(258.7)
(Decrease)/increase in cash and cash equivalents		**(123.3)**	99.3
Net cash and cash equivalents at beginning of period		**119.1**	19.8
Net cash and cash equivalents at end of period		**(4.2)**	119.1

Notes to the financial statements

1 Accounting policies

a) Accounting convention

The financial statements have been prepared on the going concern basis (see Directors' report) under the historical cost convention as modified by the revaluation of certain financial assets and liabilities at fair value, and in accordance with applicable United Kingdom Accounting Standards and comply with the requirements of the United Kingdom Companies Act 2006 ('the Act'). The principal accounting policies, which have been applied consistently in the current and preceding year are set out below.

b) Basis of preparation

The company financial statements have been prepared in accordance with United Kingdom Accounting Standards and comply with the Companies Act 2006. The company meets the definition of a qualifying entity as defined in FRS 100 'Financial Reporting Standard 100' and accordingly, the company has elected to apply FRS 101, 'Reduced Disclosure Framework'.

Therefore the recognition and measurement requirements of EU-adopted IFRS have been applied, with amendments where necessary in order to comply with Companies Act 2006 and The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410) as the parent company financial statements are Companies Act 2006 accounts.

As permitted by FRS 101, the company has taken advantage of the disclosure exemptions available under that standard in relation to share based payments, financial instruments, capital management, presentation of comparative information in respect of certain assets, standards not yet effective, impairment of assets and related party transactions. Where required, equivalent disclosures are given in the consolidated financial statements and also where required, equivalent disclosures are given in the group accounts of Severn Trent Plc. The group accounts of Severn Trent Plc are available to the public and can be obtained as set out in note 33.

(i) Prior year restatement

The comparative balance sheet has been restated to reflect a reclassification between tangible fixed assets and non-current trade and other payables. Contributions which had been received in previous years in relation to infrastructure assets, and which had a carrying value of £294.5 million as at 31 March 2014 were identified as being deducted from the carrying value of tangible fixed assets. In order to comply with the requirements of IAS 16 and IAS 18, these contributions have been reclassified from tangible fixed assets to non-current trade and other payables.

Whilst finalising the proposed adjustments, it was noted that amortisation was not charged on these contributions before 2004 when the accounting treatment was clarified and therefore an additional £13.5m of amortisation has been credited to opening retained earnings.

In addition, the restated balances result in an increased total tax liability of £67.8 million (£1.9 million current tax and £65.9 million deferred tax) as the carrying value of the underlying infrastructure assets previously shown net reduced the deferred tax liability previously calculated. The total tax restatement of £67.8 million was charged to opening retained earnings.

Tangible fixed assets have been analysed to disclose separately the carrying value of assets under construction. This resulted in a further adjustment between tangible and intangible fixed assets of £2.6 million.

The adjustment to the opening balances at 1 April 2014 is:

	Tangible fixed assets	Other intangible fixed assets	Accruals and deferred income	Current tax	Deferred tax	Retained earnings
At 31 March 2014	6,988.3	69.3	(758.5)	50.7	(683.0)	(1,056.9)
Restatement	291.9	2.6	(281.0)	(1.9)	(65.9)	54.3
After restatement	**7,280.2**	**71.9**	**(1,039.5)**	**48.8**	**(748.9)**	**(1,002.6)**
At 31 March 2015	7,190.7	62.5	(827.3)	25.6	(651.5)	(855.0)
Restatement	291.9	2.6	(281.0)	(1.9)	(65.9)	54.3
After restatement	**7,482.6**	**65.1**	**(1,108.3)**	**23.7**	**(717.4)**	**(1,002.6)**

1 Accounting policies (continued)

c) Revenue recognition

Revenue includes turnover and interest income.

Turnover represents the fair value of consideration receivable, excluding value added tax, in the ordinary course of business for services provided. Turnover is not recognised until the service has been provided to the customer. Turnover includes an estimate of the amount of mains water and waste water charges unbilled at the year end. The accrual is estimated using a defined methodology based upon a measure of unbilled water consumed by tariff, which is calculated from historical billing information.

Interest income is accrued on a time basis by reference to the principal outstanding and at the effective interest rate applicable.

d) Interest receivable and similar income

Interest income is accrued on a time basis by reference to the principal outstanding and at the effective interest rate applicable.

Dividend income from investments is recognised when the company's rights to receive payment have been established. Interest and dividend income are included in finance income.

e) Exceptional items

Exceptional items are income or expenditure, which individually or, if of a similar type, in aggregate should, in the opinion of the directors, be disclosed by virtue of their size or nature if the financial statements are to give a true and fair view.

f) Taxation

Current tax payable is based on taxable profit for the year. The company's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is provided in full on taxable temporary differences between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax is measured on a non-discounted basis using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

A deferred tax asset is only recognised to the extent it is probable that sufficient taxable profits will be available in the future to utilise it.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities.

g) Goodwill

Goodwill represents the excess of the fair value of purchase consideration over the fair value of the net assets acquired. Fair value adjustments based on provisional estimates are amended within one year of the acquisition, if required, with a corresponding adjustment to goodwill. Goodwill is tested for impairment in accordance with the policy set out in note 1l) below and carried at cost less accumulated impairment losses.

1 Accounting policies (continued)

h) Other intangible fixed assets

Intangible assets acquired separately are capitalised at cost. Following initial recognition, the historical cost model is applied.

Finite life intangible assets are amortised on a straight line basis over their estimated useful economic lives as follows:

	Years
Software	3 - 10
Other assets	2 - 20

Amortisation charged on intangible assets is taken to the income statement through operating costs.

Intangible assets are reviewed for impairment where indicators of impairment exist, (see 1l) below).

Development expenditure is capitalised as an intangible fixed asset and written off over its expected useful economic life where the following criteria are met:

- it is technically feasible to create and make the asset available for use or sale;
- there are adequate resources available to complete the development and to use or sell the asset;
- there is the intention and ability to use or sell the asset;
- it is probable that the asset created will generate future economic benefits; and
- the development cost can be measured reliably.

Research expenditure is expensed when it is incurred.

i) Tangible fixed assets

Tangible fixed assets are held at cost (or at deemed cost for infrastructure assets on transition to FRS 101) less accumulated depreciation. Expenditure on tangible fixed assets relating to research and development projects is capitalised and written off over the expected useful lives of those assets.

The costs of like for like replacement of infrastructure components are recognised in the income statement as they arise. Expenditure which results in enhancements to the operating capability of the infrastructure networks is capitalised.

Where tangible fixed assets are transferred to the company from customers or developers, the fair value of the asset transferred is recognised in the balance sheet. Fair value is determined based on estimated depreciated replacement cost. Where the transfer is in exchange for connection to the network and there is no further obligation, the corresponding credit is recognised immediately in turnover. Where the transfer is considered to be linked to the provision of ongoing services the corresponding credit is recorded in deferred income and released to operating costs over the expected useful lives of the related assets.

Where assets take a substantial period of time to get ready for their intended use, the borrowing costs directly attributable to the acquisition, construction or production of these assets are added to their cost.

Tangible fixed assets are depreciated to their estimated residual values over their estimated useful lives, with the exception of freehold land which is not depreciated. Assets under construction are not depreciated until commissioned.

The estimated useful lives are:

	Years
Infrastructure assets	
Impounding reservoirs	250
Raw water aqueducts	250
Mains	80 - 150
Sewers	150 - 200
Other assets	
Buildings	30 - 80
Fixed plant and equipment	20 - 40
Vehicles and mobile plant	2 - 15

Notes to the financial statements

1 Accounting policies (continued)

j) Leased assets

Leases where the company obtains assets which transfer substantially all the risks and rewards of ownership of an asset to the company are treated as finance leases, the lower of the fair value of the leased asset or the present value of the minimum lease payments is capitalised as an asset and a corresponding liability representing the obligation to the lessor is recognised. Lease payments are treated as consisting of a capital element and a finance charge; the capital element reducing the obligation to the lessor and the finance charge being written off to the income statement at a constant rate over the period of the lease in proportion to the capital amount outstanding. Depreciation is charged over the shorter of the estimated useful life and the lease period.

Leases where substantially all the risks and rewards of ownership remain with the lessor are classified as operating leases. Rental costs arising under operating leases are expensed on a straight line basis over the term of the lease. Leases of land are normally treated as operating leases, unless ownership is transferred to the company at the end of the lease.

Where the company transfers substantially all the risks and rewards of ownership of an asset to a lessee (finance lease), the assets are accounted for as if they had been sold, and the net investment in the lease is shown as a receivable due from the lessee. Over the lease term, rentals are apportioned between a reduction in the net investment in the lease and finance lease income, such that finance lease income produces a constant rate of return on the net cash investment in the lease. Finance lease income is included within finance income.

k) Grants and contributions

Grants and contributions received in respect of fixed assets, including certain charges made as a result of new connections to the water and sewerage networks, are treated as deferred income and released to operating costs over the useful economic life of those fixed assets.

Grants and contributions which are given in compensation for expenses incurred with no future related costs are recognised in operating costs in the period that they become receivable.

l) Impairment of non-current assets

If the recoverable amount of goodwill, a tangible fixed asset, or any other fixed asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. Severn Trent Water is considered to be a single cash-generating unit. Therefore where the asset does not generate cash flows that are independent from other assets, the company estimates the recoverable amount of the company as a whole. Recoverable amount is the higher of fair value less costs to sell or estimated value in use at the date the impairment review is undertaken. Fair value less costs to sell represents the amount obtainable from the sale of the asset in an arm’s length transaction between knowledgeable and willing third parties, less costs of disposal. Value in use represents the present value of future cash flows expected to be derived from a cash-generating unit, discounted using a pre-tax discount rate that reflects current market assessments of the cost of capital of the cash-generating unit or asset.

The discount rate used is based on the company's estimated cost of capital.

Goodwill is tested for impairment annually. Impairment reviews are also carried out if there is an indication that an impairment may have occurred, or, where otherwise required, to ensure that fixed assets are not carried above their estimated recoverable amounts.

Impairments are recognised immediately in the income statement.

m) Investments in subsidiaries

Investments in subsidiaries are stated at cost less, where appropriate, provisions for impairment. Investments in subsidiaries are reviewed for impairment in line with note 1l) when indicators of impairment have been identified.

n) Inventory

Inventory and work in progress is stated at the lower of cost and net realisable value. Cost includes labour, materials, transport and attributable overheads.

1 Accounting policies (continued)

o) Trade debtors

Trade debtors, are measured at fair value on initial recognition. If there is objective evidence that the asset is impaired, it is written down to its recoverable amount and the irrecoverable amount is recognised as an expense in operating costs.

Debtors that are assessed not to be impaired individually are assessed collectively for impairment by reference to the company's historical collection experience for receivables of similar age.

p) Retirement benefits

(i) Defined benefit schemes
The company is the sponsoring employer of the Severn Trent group's defined benefit pension schemes. As there is no contractual agreement or stated policy for allocating the net defined benefit cost to individual group entities this company has recognised the full cost and net deficit relating to the schemes.

The difference between the value of defined benefit pension scheme assets and defined benefit pension scheme liabilities is recorded on the balance sheet as a retirement benefit asset or obligation.

Defined benefit pension scheme assets are measured at fair value using bid price for assets with quoted prices. Defined benefit pension scheme liabilities are measured at the balance sheet date by an independent actuary using the projected unit method and discounted at the current rate of return on high quality corporate bonds of equivalent term and currency to the liability. Service cost, which is the increase in the present value of the liabilities of the group's defined benefit pension schemes expected to arise from employee service in the period, is included in operating costs. Finance income and cost are calculated by applying the discount rate used to determine the present value of the scheme liabilities at the opening balance sheet date to the value of the scheme assets or liabilities respectively.

Actuarial gains and losses arising from experience adjustments, changes in actuarial assumptions and amendments to pension plans are charged or credited to equity and recorded in the statement of comprehensive income. Contributions made by other Severn Trent group companies have been disclosed within actuarial gains and losses in the statement of comprehensive income.

(ii) Defined contribution schemes
The company participates in the Severn Trent group's defined contribution pension schemes. Contributions to defined contribution pension schemes are charged to the income statement in the period in which they fall due.

q) Provisions

Provisions are recognised where:

- there is a present obligation as a result of a past event;
- it is probable that there will be an outflow of economic benefits to settle this obligation; and
- a reliable estimate of this amount can be made.

Self-insurance provisions are recognised for claims notified and for claims incurred but which have not yet been notified, based on advice from the ultimate parent company's independent insurance advisers.

Provisions are discounted to present value using a pre-tax discount rate that reflects the risks specific to the liability where the effect is material.

r) Borrowings

The accounting policy for borrowings that are the hedged item in a fair value hedge is set out in note 1s).

All other borrowings are initially recognised at fair value less issue costs. After initial recognition, borrowings are subsequently measured at amortised cost using the effective interest rate method whereby interest and issue costs are charged to the income statement and added to the carrying value of borrowings at a constant rate in proportion to the capital amount outstanding.

Index-linked debt is adjusted for changes in the relevant inflation index and changes in value are charged to finance costs.

Borrowings denominated in foreign currency are translated to sterling at the spot rate on the balance sheet date. Exchange gains or losses resulting from this are credited or charged to gains/losses on financial instruments.

1 Accounting policies (continued)

s) Derivative financial instruments

Derivative financial instruments are stated at fair value, including accrued interest. Fair value is determined using the methodology described in note 22 d). The accounting policy for changes in fair value depends on whether the derivative is designated as a hedging instrument. The various accounting policies are described below.

Interest receivable or payable in respect of derivative financial instruments is included in finance income or costs.

Derivatives not designated as hedging instruments
Gains or losses arising on remeasurement of derivative financial instruments that are not designated as hedging instruments are recognised in gains/losses on financial instruments in the income statement.

Derivatives designated as hedging instruments
The company uses derivative financial instruments such as cross currency swaps, forward currency contracts and interest rate swaps to hedge its risks associated with foreign currency and interest rate fluctuations.

At the inception of each hedge relationship, the company documents:

- the relationship between the hedging instrument and the hedged item;
- its risk management objectives and strategy for undertaking the hedge transaction; and
- the results of tests to determine whether the hedging instrument is expected to be highly effective in offsetting changes in fair values or cash flows (as appropriate) of the hedged item.

The company continues to test and document the effectiveness of the hedge on an ongoing basis.

Hedge accounting is discontinued when the hedging instrument expires, is sold, terminated or exercised, or no longer qualifies for hedge accounting.

Fair value hedges
Where a loan or borrowing is in a fair value hedging relationship it is remeasured for changes in fair value of the hedged risk at the balance sheet date, with gains or losses being recognised in gains/losses on financial instruments in the income statement. The gain or loss on the corresponding hedging instrument is also taken to gains/losses on financial instruments in the income statement so that the effective portion of the hedge will offset the gain or loss on the hedged item.

If hedge accounting is discontinued, the fair value adjustment arising from the hedged risk on the hedged item is amortised to the income statement over the anticipated remaining life of the hedged item.

Cash flow hedges
The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised in equity and the ineffective portion is charged to gains/losses on financial instruments in the income statement. When the gain or loss from the hedged underlying transaction is recognised in the income statement, the gains or losses on the hedging instrument that have previously been recognised in equity are recycled through gains/losses on financial instruments in the income statement.

If hedge accounting is discontinued, any cumulative gain or loss on the hedging instrument previously recognised in equity is held in equity until the forecast transaction occurs, or transferred to gains/losses on financial instruments in the income statement if the forecast transaction is no longer expected to occur. If the hedging instrument is terminated, the gains and losses previously recognised in equity are transferred to the income statement. From this point the derivative is accounted for in the same way as derivatives not designated as hedging instruments.

Embedded derivatives
Where a contract includes terms that cause some of its cash flows to vary in a similar way to a derivative financial instrument, that part of the contract is considered to be an embedded derivative.

Embedded derivatives are separated from the contract and measured at fair value with gains and losses taken to the income statement if:

- the risks and characteristics of the embedded derivative are not closely related to those of the contract; and
- the contract is not carried at fair value with gains and losses reported in the income statement.

In all other cases embedded derivatives are accounted for in line with the accounting policy for the contract as a whole.

Notes to the financial statements

1 Accounting policies (continued)

t) Share based payments

The Severn Trent group operates a number of equity settled share based compensation plans for employees. The fair value of the employee services received in exchange for the grant is recognised as an expense over the vesting period of the grant.

The fair value of employee services is determined by reference to the fair value of the awards granted, calculated using an appropriate pricing model, excluding the impact of any non-market vesting conditions. The charge is adjusted to reflect shares that are not expected to vest as a result of failing to meet a non-market condition.

The grant of awards of shares of the ultimate parent company is treated as a capital contribution and credited to reserves. When awards vest, payments made to the ultimate parent company for the issue of shares are charged against the capital contributions previously received in respect of the same awards. Any payments in excess of capital contributions are treated as distributions.

u) Foreign currency

Foreign currency transactions arising during the year are translated into sterling at the rate of exchange ruling on the date of the transaction. All profits and losses on exchange arising during the year are dealt with through the income statement.

2 New accounting policies and future requirements

In the current financial year there have been no new accounting policies which have been adopted which have had a material impact on the financial statements.

At the date of approval of these financial statements, the following Standards and Interpretations were in issue but not yet effective:

IFRS 9 ‘Financial Instruments’ is likely to affect the measurement and disclosure of financial instruments. This standard has not yet been adopted by the EU.

IFRS 15 ‘Revenue from contracts with customers’ will affect the measurement and recognition of revenue with effect from 1 April 2018 subject to adoption by the EU. The impacts of the changes arising from the standard have not yet been quantified.

IFRS 16 ‘Leases’ sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, ie the customer ('lessee') and the supplier ('lessor') and will be effective from 1 April 2019. The impacts of the changes arising from the standard have not yet been quantified.

3 Significant accounting judgements and key sources of estimation uncertainty

In the process of applying the company's accounting policies, the company is required to make certain judgements, estimates and assumptions that it believes are reasonable based on the information available. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results may ultimately differ from those estimates.

The more significant judgements were:

(a) Tax provisions
Assessing the outcome of uncertain tax positions requires judgements to be made regarding the result of negotiations with and enquiries from tax authorities. The assessments made are based on advice from independent tax advisers and the status of ongoing discussions with the tax authority.

The key accounting estimates were:

a) Depreciation and carrying amounts of tangible fixed assets
Calculating the depreciation charge and hence the carrying value for tangible fixed assets requires estimates to be made of the useful lives of the assets. The estimates are based on engineering data and the company's experience of similar assets. Details are set out in note 1i).

b) Retirement benefit obligations
As the sponsoring employer of the Severn Trent group's defined benefit pension schemes, the company recognises the full cost and net deficit relating to the schemes. Determining the amount of retirement benefit obligations and the net costs of providing such benefits requires assumptions to be made concerning long term interest rates, inflation, pension increases and longevity of current and future pensioners. Changes in these assumptions could significantly impact the amount of the obligations or the cost of providing such benefits. The company makes assumptions concerning these matters with the assistance of advice from independent qualified actuaries. Details of the assumptions made are set out in note 23 a) to the financial statements.

c) Unbilled revenue
The company raises bills and recognises revenue in accordance with its right to receive revenue in line with the limits established by the periodic regulatory price review processes. For water and waste water customers with water meters, the amount recognised is dependent upon the volume supplied including an estimate of the sales value of units supplied between the date of the last meter read and the year end. Meters are read on a cyclical basis and the group recognises revenue for unbilled amounts based on estimated usage from the last billing to the end of the financial year. The estimated usage is based on historical data, judgement and assumptions.

d) Provision for impairment of trade receivables
Provisions are made against trade receivables based on historical experience of levels of recovery from accounts in a particular ageing category. The actual amounts collected could differ from the estimated level of recovery which could impact operating results.

4 Revenue

The principal activity of the company is the treatment and the provision of water and the removal of waste water in England and Wales.

	2016	2015
	£m	£m
Regulated water and waste water services	**1,541.3**	1,572.7
Other services	**8.9**	8.5
Total turnover	**1,550.2**	1,581.2
Dividend income (note 9)	**–**	8.2
Interest receivable (note 9)	**12.3**	12.6
	1,562.5	1,602.0

Notes to the financial statements

5 Net operating costs

	2016			2015		
	Before exceptional items	**Exceptional items**	**Total**	Before exceptional items	Exceptional items	Total
	£m	**£m**	**£m**	£m	£m	£m
Wages and salaries	**193.0**	**(0.3)**	**192.7**	193.1	10.6	203.7
Social security costs	**19.6**	**–**	**19.6**	17.5	0.1	17.6
Pension costs	**18.1**	**(0.7)**	**17.4**	31.2	17.9	49.1
Share based payments	**5.0**	**–**	**5.0**	7.6	–	7.6
Total employee costs	**235.7**	**(1.0)**	**234.7**	249.4	28.6	278.0
Power	**61.6**	**–**	**61.6**	63.9	–	63.9
Carbon reduction commitment	**7.3**	**–**	**7.3**	7.3	–	7.3
Raw materials and consumables	**47.2**	**–**	**47.2**	47.4	–	47.4
Rates	**76.8**	**–**	**76.8**	73.4	–	73.4
Charge for bad and doubtful debts	**23.7**	**–**	**23.7**	28.4	–	28.4
Service charges	**32.4**	**–**	**32.4**	32.6	–	32.6
Depreciation of tangible fixed assets	**290.3**	**–**	**290.3**	276.7	–	276.7
Amortisation of intangible fixed assets	**19.9**	**–**	**19.9**	22.2	–	22.2
Infrastructure maintenance expenditure	**126.0**	**–**	**126.0**	134.8	–	134.8
Hired and contracted services	**172.5**	**–**	**172.5**	164.0	–	164.0
Operating lease rentals						
- land and buildings	**0.3**	**–**	**0.3**	0.2	–	0.2
- other	**0.3**	**–**	**0.3**	–	–	–
Profit on disposal of fixed assets	**(2.9)**	**–**	**(2.9)**	(0.4)	(7.7)	(8.1)
Research and development expenditure	**3.5**	**–**	**3.5**	4.6	–	4.6
Ofwat license fees	**2.8**	**–**	**2.8**	5.3	–	5.3
Other operating costs	**41.5**	**–**	**41.5**	40.3	0.6	40.9
Other operating income	**(3.2)**	**–**	**(3.2)**	(3.0)	–	(3.0)
	1,135.7	**(1.0)**	**1,134.7**	1,147.1	21.5	1,168.6
Release from deferred income	**(10.5)**	**–**	**(10.5)**	(10.1)	–	(10.1)
Own work capitalised	**(93.7)**	**–**	**(93.7)**	(92.4)	–	(92.4)
	1,031.5	**(1.0)**	**1,030.5**	1,044.6	21.5	1,066.1

Further details of exceptional items are given in note 6.

During the year the following fees were charged by the auditors:

	2016	2015
	£m	£m
Fees payable to the company's auditors for		
- the audit of the company's annual accounts	**0.2**	0.2
- other assurance services	**0.2**	0.3
Total audit fees	**0.4**	0.5
Fees payable to the company's auditors for non-audit services	**–**	0.1
	0.4	0.6

Notes to the financial statements

6 Exceptional items before tax

	2016	2015
	£m	£m
Restructuring costs	**(1.0)**	29.2
Profit on disposal of fixed assets	**–**	(7.7)
	(1.0)	21.5

7 Employee information

Average number of employees (including executive directors) during the year:

	2016	2015
	Number	Number
Average number of employees	**5,236**	5,532

8 Directors' interests and remuneration

a) Directors' interests

All of the directors as at the end of the year are also directors of Severn Trent Plc, the ultimate parent undertaking, and their interests in the share capital of that company are disclosed in the Severn Trent Plc Annual Report and Accounts for the year ended 31 March 2016. Share options were granted and exercised in accordance with the Severn Trent Sharesave Scheme as appropriate.

The executive directors have further interests in Severn Trent Plc ordinary shares of $97^{17}/_{19}$ p each by virtue of having received contingent awards of shares under the Severn Trent Long Term Incentive Plan ('LTIP'), deferred shares under the Severn Trent Annual Bonus Scheme and contingent shares under the Share Matching Plan.

The individual interests, which represent the maximum aggregate number of shares to which each individual could become entitled, are disclosed in the Annual Report and Accounts of Severn Trent Plc for the year ended 31 March 2016.

b) Directors' remuneration

The following table shows the remuneration due to directors for their services to the company during the year:

	2016	2015
	£m	£m
Short term employee benefits	**3.0**	4.3
Post employment benefits	**0.1**	0.1
Share based payments	**1.2**	2.2
	4.3	6.6

The emoluments of the non-executive directors are paid by Severn Trent Plc.

There were no retirement benefits accruing to directors (2015: none) under a defined benefit scheme and one director (2015: four directors) under a defined contribution scheme.

Two directors (2015: six directors) exercised share options or received LTIP awards which vested during the year.

Notes to the financial statements

8 Directors' interests and remuneration (continued)

c) Highest paid director

	2016 £m	2015 £m
Aggregate emoluments (excluding pension contributions)	**2.3**	2.0
Pension contributions	**0.1**	0.1
	2.4	2.1

The highest paid director at 31 March 2016 and 31 March 2015 was not a member of the defined benefit pension scheme.

9 Finance income

	2016 £m	2015 £m
Interest income earned on:		
- bank deposits	**0.2**	0.4
- amounts due from group undertakings	**1.7**	1.6
- amounts due from group undertakings for finance leases	**5.2**	5.2
Other finance income	**5.2**	5.4
Total interest receivable	**12.3**	12.6
Dividend income	**–**	8.2
Interest income on defined benefit scheme assets	**67.7**	80.1
	80.0	100.9

10 Finance costs

	2016 £m	2015 £m
Interest charged on:		
- amounts payable to group undertakings	**(170.7)**	(191.0)
- amounts payable to group undertakings from finance leases	**(11.0)**	(11.2)
- finance leases	**(8.4)**	(8.7)
- bank and other loans	**(21.9)**	(19.5)
Total borrowing costs	**(212.0)**	(230.4)
Other finance expenses	**(0.2)**	(0.1)
Pension interest cost	**(82.8)**	(94.5)
	(295.0)	(325.0)

Borrowing costs of £16.1 million (2015: £19.1 million) incurred funding eligible capital projects have been capitalised at an interest rate of 4.41% (2015: 5.00%). Tax relief of £3.3 million (2015: £4.0 million) was claimed on these costs which was credited to the income statement, offset by a related deferred tax charge of £2.9 million (2015: £3.8 million).

Notes to the financial statements

11 Gains/(losses) on financial instruments

	2016 £m	2015 £m
Gain on swaps used as hedging instruments in fair value hedges	**0.7**	0.2
Gain arising on debt in fair value hedges	**0.5**	0.3
Exchange (loss)/gain on other loans	**(5.9)**	2.5
Loss on cash flow hedges transferred from equity	**(9.3)**	(41.6)
Hedge ineffectiveness on cash flow hedges	**–**	2.3
Gain/(loss) arising on swaps where hedge accounting is not applied	**18.9**	(123.5)
	4.9	(159.8)

12 Taxation

a) Analysis of tax (credit)/charge in the year

	2016			2015
	Before exceptional tax £m	**Exceptional tax £m**	**Total £m**	Before exceptional tax £m
Current tax				
UK corporation tax at 20% (2015: 21%)				
- current year	**56.5**	**–**	**56.5**	48.2
- adjustment in respect of prior years	**(2.8)**	**–**	**(2.8)**	(11.6)
Total current tax	**53.7**	**–**	**53.7**	36.6
Deferred tax				
Origination and reversal of temporary differences				
- current year	**6.6**	**–**	**6.6**	(19.5)
- adjustment in respect of prior years	**2.7**	**–**	**2.7**	6.5
Exceptional credit arising from rate change	**–**	**(80.0)**	**(80.0)**	–
Total deferred tax	**9.3**	**(80.0)**	**(70.7)**	(13.0)
	63.0	**(80.0)**	**(17.0)**	23.6

The current tax charge was £53.7 million (2015: £36.6 million). This includes a credit of £2.8 million (2015: £11.6 million) arising from adjustments to prior year tax computations.

The Finance Act 2015 was enacted in the current year which implemented a reduction in the corporation tax rate from 20% to 18% with effect from 1 April 2020. This resulted in an additional exceptional deferred tax credit of £80.0 million in the income statement and a deferred tax charge of £8.3 million in reserves.

A further reduction to 17% with effect from 1 April 2020 has been announced but not yet substantively enacted. The estimated impact of this rate change will be a reduction in the deferred tax liability of approximately £38.1 million.

12 Taxation (continued)

b) Factors affecting the tax (credit)/charge in the year

The tax assessed for the year is lower than (2015: lower than) the standard rate of corporation tax in the UK of 20% (2015: 21%). The differences are explained below:

	2016 £m	2015 £m
Profit on ordinary activities before tax	**309.6**	131.2
Profit on ordinary activities multiplied by the standard UK corporation rate of 20% (2015: 21%)	**61.9**	27.6
Tax effect of depreciation on non qualifying assets	**3.7**	3.5
Tax effect of income not taxable in determining taxable profits	**(1.8)**	(2.4)
Current year impact of rate change	**(0.7)**	–
Adjustments to tax charge in respect of prior periods	**(0.1)**	(5.1)
Exceptional deferred tax credit arising from rate change	**(80.0)**	–
Total tax (credit)/charge for the year	**(17.0)**	23.6

c) Tax charged/(credited) directly to other comprehensive income or equity

In addition to the amount charged/(credited) to the income statement, the following amounts of tax have been charged/(credited) directly to other comprehensive income or equity:

	2016 £m	2015 £m
Current tax		
Tax on share based payments	**(1.6)**	(1.3)
Tax on pension contributions in excess of profit and loss charge	**–**	(2.1)
Total current tax credited to other comprehensive income or equity	**(1.6)**	(3.4)
Deferred tax		
Tax on actuarial gains/losses	**28.5**	(24.2)
Tax on share based payments	**0.9**	(0.5)
Effect of change in tax rate	**8.3**	–
Tax on transfers to the income statement	**1.6**	8.3
Tax on cash flow hedges	**(0.4)**	(2.1)
Total deferred tax charged/(credited) to other comprehensive income or equity	**38.9**	(18.5)

13 Dividends on equity shares

Amounts recognised as distributions to owners of the company in the year:

	2016		2015	
	Pence per share	**£m**	Pence per share	£m
Interim dividend for the year ended 31 March 2016 (2015)	**31.00**	**310.0**	20.37	203.7

The company's dividend policy is to declare dividends which are consistent with the company's regulatory obligations and at a level which is decided each year after consideration of a number of factors, including regulatory uncertainty, future cash flow requirements and balance sheet considerations.

The amount declared is expected to vary each year as the impact of these factors changes.

14 Other intangible fixed assets

	Computer software		Other	
	Internally generated £m	**Purchased £m**	**Internally generated £m**	**Total £m**
Cost				
At 1 April 2015	178.8	55.5	12.0	246.3
Restatement	(2.6)	25.8	–	23.2
At 1 April 2015 after restatement	176.2	81.3	12.0	269.5
Additions	9.9	11.9	–	21.8
At 31 March 2016	**186.1**	**93.2**	**12.0**	**291.3**
Amortisation				
At 1 April 2015	(148.1)	(25.0)	(10.7)	(183.8)
Restatement	1.3	(21.9)	–	(20.6)
At 1 April 2015 after restatement	(146.8)	(46.9)	(10.7)	(204.4)
Amortisation for year	(9.2)	(10.1)	(0.6)	(19.9)
At 31 March 2016	**(156.0)**	**(57.0)**	**(11.3)**	**(224.3)**
Net book value				
At 31 March 2016	**30.1**	**36.2**	**0.7**	**67.0**
As at 31 March 2015 (restated)	29.4	34.4	1.3	65.1

Notes to the financial statements

15 Tangible fixed assets

	Land and buildings £m	Infrastructure assets £m	Fixed plant and equipment £m	Moveable plant £m	Assets under construction £m	Total £m
Cost						
At 1 April 2015	3,012.5	4,693.2	3,968.8	49.6	–	11,724.1
Restatement	(50.6)	68.8	(398.6)	(0.6)	669.9	288.9
At 1 April 2015 after restatement	2,961.9	4,762.0	3,570.2	49.0	669.9	12,013.0
Additions	2.7	21.4	14.7	4.8	415.5	459.1
Transfers on commissioning	194.8	156.7	209.7	–	(561.2)	–
Disposals	(10.7)	(0.2)	(15.7)	(3.4)	(4.1)	(34.1)
At 31 March 2016	**3,148.7**	**4,939.9**	**3,778.9**	**50.4**	**520.1**	**12,438.0**
Depreciation						
At 1 April 2015	(1,030.8)	(1,214.2)	(2,257.6)	(30.8)	–	(4,533.4)
Restatement	(12.8)	(12.1)	28.4	(0.5)	–	3.0
At 1 April 2015 after restatement	(1,043.6)	(1,226.3)	(2,229.2)	(31.3)	–	(4,530.4)
Charge for the year	(76.7)	(31.5)	(177.3)	(4.8)	–	(290.3)
Disposals	6.1	–	15.1	3.2	–	24.4
At 31 March 2016	**(1,114.2)**	**(1,257.8)**	**(2,391.4)**	**(32.9)**	**–**	**(4,796.3)**
Net book value						
At 31 March 2016	**2,034.5**	**3,682.1**	**1,387.5**	**17.5**	**520.1**	**7,641.7**
At 31 March 2015 (restated)	1,918.3	3,535.7	1,341.0	17.7	669.9	7,482.6

The carrying amount of tangible fixed assets includes the following amounts in respect of assets held under finance leases:

	Land and buildings £m	Infrastructure assets £m	Fixed plant and equipment £m	Total £m
Net book value				
At 31 March 2016	**173.4**	**119.8**	**16.4**	**309.6**
At 31 March 2015	177.0	118.7	26.6	322.3

The net book value of land and buildings is analysed as follows:

	2016 £m	2015 £m
Freehold	**2,034.2**	1,918.0
Short leasehold	**0.3**	0.3
	2,034.5	1,918.3

16 Investments in subsidiaries

	Shares in subsidiary undertakings £m
Cost and net book value	
At 1 April 2015 and 31 March 2016	**347.9**

The company has the following subsidiary undertakings:

Subsidiary undertakings	Country of operation and incorporation	Principal activity	Percentage and class of share capital held
East Worcester Water Limited	England and Wales	Finance company	100% Ordinary and 100% non-voting
Severn Trent General Partnership Limited	Scotland	Finance company	100% Ordinary
Severn Trent LCP Limited	England and Wales	Leasing company	100% Ordinary
Severn Trent Leasing Limited	England and Wales	Leasing company	100% Ordinary
Severn Trent Reservoirs Limited	England and Wales	Finance company	100% Ordinary
Severn Trent Utilities Finance Plc	England and Wales	Finance company	100% Ordinary

The company also has an indirect investment in Severn Trent Limited Partnership, a limited partnership registered in Scotland, as a result of Severn Trent General Partnership Limited being the general partner.

In the opinion of the directors the fair values of the company's investments are not less than the amount at which they are stated in the balance sheet.

17 Trade and other receivables

Amounts falling due within one year

	2016 £m	2015 Restated £m
Trade receivables	**285.1**	279.0
Doubtful debt provision	**(124.3)**	(122.5)
Net trade receivables	**160.8**	156.5
Amounts receivable from group undertakings under finance leases	**0.6**	0.5
Other amounts due from group companies	**10.8**	16.5
Other debtors	**42.4**	30.9
Corporation tax	**–**	23.7
Prepayments	**19.8**	19.7
Accrued income	**203.4**	206.6
	437.8	454.4

Notes to the financial statements

17 Trade and other receivables (continued)

Amounts falling due after more than one year

	2016 £m	2015 £m
Loans to group companies	**109.6**	108.3
Amounts receivable from group undertakings under finance leases	**99.7**	100.3
Prepayments	**82.5**	85.9
	291.8	294.5

Prepayments includes £85.9 million (2015: £89.2 million) which represents a contribution made to Severn Trent Limited Partnership as part of an asset backed pension funding arrangement. As a result of this arrangement the Severn Trent Pension Scheme obtained the income rights in the partnership. Of this amount £3.4 million (2015: £3.3 million) is included in amounts falling due within one year.

18 Finance lease receivables

Minimum lease payments receivable are as follows:

	2016 £m	2015 £m
Within one year	**5.7**	5.7
Between one and two years	**5.7**	5.7
Between two and five years	**17.0**	17.0
After more than five years	**238.4**	244.1
	266.8	272.5
Less: unearned interest receivable	**(166.5)**	(171.7)
	100.3	100.8

The present values of minimum lease payments receivable are as follows:

	2016 £m	2015 £m
Within one year	**0.6**	0.5
Between one and two years	**0.6**	0.6
Between two and five years	**1.9**	1.8
After more than five years	**97.2**	97.9
	100.3	100.8

Disclosed in the balance sheet as:

Trade and other receivables: amounts falling due within one year	**0.6**	0.5
Trade and other receivables: amounts falling due after one year	**99.7**	100.3
	100.3	100.8

The company has granted finance leases of between 44 and 57 years in respect of concrete settling tanks. The interest terms were set at the inception of the leases. Leases bear interest at a weighted average interest rate of 5.1% (2015: 5.1%).

Notes to the financial statements

19 Trade and other payables: amounts falling due within one year

	2016 £m	2015 £m
Bank overdrafts	**4.2**	–
Bank loans	**275.0**	–
Loans due to parent and fellow subsidiary undertakings	**53.0**	470.8
Amounts owed to parent and fellow subsidiary undertakings under finance leases	**3.0**	2.8
Obligations under finance leases	**16.1**	50.1
Borrowings	**351.3**	523.7
Trade payables	**9.6**	25.4
Other amounts owed to parent and fellow subsidiary undertakings	**52.3**	62.7
Other creditors	**6.9**	6.6
Corporation tax payable	**18.2**	–
Other taxation and social security	**5.3**	5.2
Accruals and deferred income	**324.4**	285.6
Derivative financial liabilities	**0.4**	0.5
	768.4	909.7

Notes to the financial statements

20 Trade and other payables: amounts falling due after more than one year

	2016 £m	2015 Restated £m
Bank loans	**937.2**	1,240.7
Other loans	**474.6**	–
Loans due to parent and fellow subsidiary undertakings	**3,287.3**	3,235.0
Amounts owed to parent and fellow subsidiary undertakings under finance leases	**202.3**	205.3
Obligations under finance leases	**184.7**	224.9
Borrowings	**5,086.1**	4,905.9
Accruals and deferred income	**869.4**	822.7
Derivative financial liabilities	**167.7**	164.6
	6,123.2	5,893.2

Borrowings are repayable as follows:

	2016			2015		
	Loans and overdrafts not repayable by instalments £m	**Finance leases £m**	**Total £m**	Loans and overdrafts not repayable by instalments £m	Finance leases £m	Total £m
Financial liabilities due within one year	**(332.2)**	**(19.1)**	**(351.3)**	(470.8)	(52.9)	(523.7)
Between one and two years	**(562.2)**	**(20.9)**	**(583.1)**	(150.0)	(43.4)	(193.4)
Between two and five years	**(238.0)**	**(73.6)**	**(311.6)**	(1,033.5)	(67.9)	(1,101.4)
After more than five years	**(3,898.9)**	**(292.5)**	**(4,191.4)**	(3,292.2)	(318.9)	(3,611.1)
Total financial liabilities due after one year	**(4,699.1)**	**(387.0)**	**(5,086.1)**	(4,475.7)	(430.2)	(4,905.9)
	(5,031.3)	**(406.1)**	**(5,437.4)**	(4,946.5)	(483.1)	(5,429.6)

20 Trade and other payables: amounts falling due after more than one year (continued)

Loans repayable partly or wholly after five years comprise:

2016	**5 - 10 years £m**	**10 - 15 years £m**	**15 - 20 years £m**	**>20 years £m**	**Total £m**
Loans due to parent and fellow subsidiary undertakings					
Fixed rate	495.0	419.3	204.4	247.0	**1,365.7**
Floating rate	20.5	16.1	–	–	**36.6**
RPI linked	37.6	151.0	–	899.2	**1,087.8**
	553.1	586.4	204.4	1,146.2	**2,490.1**
Bank and other loans					
Fixed rate	297.0	327.5	–	–	**624.5**
Floating rate	529.4	147.1	–	–	**676.5**
RPI linked	107.8	–	–	–	**107.8**
	934.2	474.6	–	–	**1,408.8**
	1,487.3	**1,061.0**	**204.4**	**1,146.2**	**3,898.9**

2015	5 - 10 years £m	10 - 15 years £m	15 - 20 years £m	>20 years £m	Total £m
Loans due to parent and fellow subsidiary undertakings					
Fixed rate	296.6	913.3	196.0	246.9	1,652.8
Floating rate	75.0	33.5	–	–	108.5
RPI linked	37.2	149.6	–	888.5	1,075.3
	408.8	1,096.4	196.0	1,135.4	2,836.6
Bank and other loans					
Fixed rate	150.0	–	–	–	150.0
Floating rate	199.3	–	–	–	199.3
RPI linked	106.4	–	–	–	106.4
	455.7	–	–	–	455.7
	864.5	1,096.4	196.0	1,135.4	3,292.2

The weighted average interest rate on borrowings is 3.20% (2015: 3.57%).

21 Finance leases

Obligations under finance leases are as follows:

	2016 £m	2015 £m
Within one year	**36.0**	71.7
Between one and two years	**37.7**	60.9
Between two and five years	**120.4**	116.9
After more than five years	**415.2**	470.1
	609.3	719.6
Less future finance charges	**(203.2)**	(236.5)
Present value of lease obligations	**406.1**	483.1

The present values of minimum lease payments are disclosed within note 20.

The remaining terms of finance leases ranged from 1 to 16 years at 31 March 2016. Interest terms are set at the inception of the leases. Leases which bear fixed interest at a weighted average rate of 5.2% (2015: 5.2%) have capital outstanding of £322.4 million (2015: £388.0 million). The lease obligations are secured against the related assets.

There were no contingent rents, escalation clauses or material renewal or purchase options. The terms of the finance leases do not impose restriction on dividend payments, additional debt or further leasing.

22 Financial instruments

a) Categories of financial assets held at fair value

	2016 £m	2015 £m
Fair value through profit and loss		
Interest rate swaps - not hedge accounted	**–**	4.2
Cross currency swaps - not hedge accounted	**10.4**	–
	10.4	4.2
Derivatives designated as hedging instruments		
Interest rate swaps - fair value hedges	**12.1**	–
Cross currency swaps - fair value hedges	**17.7**	20.8
	29.8	20.8
Total derivative financial assets	**40.2**	25.0

b) Categories of financial liabilities held at fair value

	2016 £m	2015 £m
Fair value through profit and loss		
Interest rate swaps - not hedge accounted	**(164.9)**	(164.3)
	(164.9)	(164.3)
Derivatives designated as hedging instruments		
Energy swaps - cash flow hedges	**(3.2)**	(0.8)
	(3.2)	(0.8)
	(168.1)	(165.1)

22 Financial instruments (continued)

c) Derivatives

The company enters into a variety of derivative financial instruments to manage its exposure to interest rate and foreign exchange rate risk. These risks are managed centrally by the Severn Trent Group Treasury department. Derivative financial instruments are not held for trading.

Interest rate swaps - unhedged
The company has interest rate swaps in place to manage its exposure to interest rate risk arising from its anticipated borrowing requirements. Under the terms of the interest rate swaps, the company agrees with other parties to exchange, mainly semi-annually, the difference between fixed contract and floating rate interest rate swaps to hedge future debt. Economically these act to fix the interest cost of debt which is denominated as floating rate, but do not achieve hedge accounting under the strict criteria of IAS 39.

Interest rate swaps - hedged
During the year the company raised £225 million out of its £471 million US Private Placement programme in sterling, at fixed rates. In line with the strategy to increase the proportion of debt at floating rates this was swapped to floating rate debt via interest rate swaps. These swaps have been designated as hedging instruments to hedge the changes in fair value of the debt arising from movements in interest rates. Since the terms of the receivable leg of the swap closely match the terms of the underlying debt the swaps are expected to be effective hedges.

Cross currency swaps - unhedged
The company holds cross currency swaps to manage the exchange rate risk arising from foreign currency borrowings. Under the terms of the contracts, the company agrees with other parties to swap the foreign currency proceeds into sterling debt bearing interest based on LIBOR. Economically these swaps act to mitigate exchange rate risk arising from foreign currency borrowings however do not achieve hedge accounting under the strict criteria of IAS 39.

Cross currency swaps - hedged
The company also has a number of swaps where the terms of the receivable leg of the swap closely match the terms of the underlying debt. These swaps are expected to be effective hedges, hence the swaps have been accounted for as fair value hedges.

Energy swaps
The company has entered into a series of energy swaps under which it has agreed to exchange the difference between fixed and market prices of electricity at six-monthly intervals up to March 2020.

d) Fair value measurements recognised in the balance sheet

The fair values of financial instruments that are measured subsequent to initial recognition at fair value, are based on observable inputs other than quoted prices for identical instruments.

The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows. Future cash flows are estimated based on forward interest rates from observable yield curves at the year end and contract interest rates discounted at a rate that reflects the credit risk of counterparties.

Cross currency swaps are valued by reference to forward interest rates from observable yield curves at the year end and contract interest rates discounted at a rate that reflects the credit risk of counterparties. The currency cash flows are translated at the spot rate at the year end.

e) Changes in value of financial instruments at fair value

Changes in fair value which are included in the income statement are set out in note 11.

23 Retirement benefit scheme

a) Defined benefit pension schemes

The company is the sponsoring employer of the defined benefit pension schemes operated by the Severn Trent group in the UK. As there is no contractual agreement or stated policy for allocating the net defined benefit cost to individual group entities this company has recognised the full cost and deficit.

(i) Background

The group operates a number of defined benefit pension schemes in the UK, covering the majority of UK employees. The defined benefit pension schemes are funded to cover future pension increases and their assets are held in separate funds administered by trustees. The trustees are required to act in the best interests of the schemes' beneficiaries. A formal actuarial valuation of each scheme is carried out on behalf of the trustees at triennial intervals by an independent professionally qualified actuary. Under the defined benefit pension schemes, members are entitled to retirement benefits calculated as a proportion (varying between 1/30 and 1/80 for each year of service) of their salary for the final year of employment with the group or, if higher, the average of the highest three consecutive years' salary in the last ten years of employment.

The defined benefit pension schemes closed to future accrual on 31 March 2015. A new defined contribution pension scheme has been established and members of the defined benefit pension schemes have become members of the new defined contribution pension scheme.

The UK defined benefit schemes and the date of their last formal valuation are as follows:

	Date of last formal actuarial valuation
Severn Trent Pension Scheme ('STPS')*	31 March 2013
Severn Trent Mirror Image Pension Scheme	31 March 2013

* The STPS is by far the largest of the group's UK defined benefit schemes.

(ii) Amount included in the balance sheet arising from the company's obligations under defined benefit pension schemes

	2016 £m	2015 £m
Fair value of scheme assets		
Equities	**922.4**	999.5
Gilts	**283.0**	327.2
Corporate bonds	**570.7**	450.8
Property	**171.4**	159.3
Hedge funds	**11.8**	60.9
Cash	**80.5**	89.1
Total fair value of assets	**2,039.8**	2,086.8
Present value of the defined benefit obligations - funded schemes	**(2,339.9)**	(2,545.7)
	(300.1)	(458.9)
Present value of the defined benefit obligations - unfunded schemes	**(9.4)**	(10.0)
Liability recognised in the balance sheet	**(309.5)**	(468.9)

The equities, gilts, corporate bonds and hedge funds have quoted prices in active markets.

23 Retirement benefit scheme (continued)

a) Defined benefit pension schemes (continued)

(ii) Amount included in the balance sheet arising from the company's obligations under defined benefit pension schemes (continued)

Movements in the fair value of the scheme assets were as follows:

	2016	2015
	£m	£m
Fair value at 1 April	**2,086.8**	1,823.6
Interest income on scheme assets	**67.7**	80.1
Company contributions	**17.5**	68.4
Contribution from intra-group asset backed funding arrangement	**8.2**	8.2
Other contributions from Severn Trent group companies	**2.1**	4.4
Contributions from scheme members	**0.3**	4.8
Return on plan assets (excluding amounts included in finance income)	**(45.9)**	193.4
Scheme administration costs	**(2.3)**	(2.9)
Benefits paid	**(94.6)**	(93.2)
Fair value at 31 March	**2,039.8**	2,086.8

Other contributions from Severn Trent group companies are included in actuarial gains/losses recognised in the statement of comprehensive income.

Movements in the present value of the defined benefit obligations were as follows:

	2016	2015
	£m	£m
Present value at 1 April	**2,555.7**	2,171.9
Service cost	**–**	22.8
Past service cost	**(0.7)**	18.1
Interest cost	**82.8**	94.5
Contributions from scheme members	**0.3**	4.8
Actuarial (gains)/losses arising from changes in financial assumptions	**(147.9)**	366.2
Actuarial gains arising from experience adjustments	**(46.3)**	(29.4)
Benefits paid	**(94.6)**	(93.2)
Present value at 31 March	**2,349.3**	2,555.7

23 Retirement benefit scheme (continued)

a) Defined benefit pension schemes (continued)

(ii) Amount included in the balance sheet arising from the company's obligations under defined benefit pension schemes (continued)

Of which:

	2016 £m	2015 £m
Amounts relating to funded schemes	**2,339.9**	2,545.7
Amounts relating to unfunded schemes	**9.4**	10.0
Present value at 31 March	**2,349.3**	2,555.7

The group has an obligation to pay pensions to a number of former employees, whose benefits would otherwise have been restricted by the Finance Act 1989 earnings cap. Provision for such benefits amounting to £9.4 million (2015: £10.0 million) is included as an unfunded scheme within the retirement benefit obligation.

(iii) Amounts recognised in the income statement in respect of these defined benefit pension schemes

	2016 £m	2015 £m
Amounts charged to operating costs		
Current service cost	**–**	(22.8)
Past service cost	**0.7**	(18.1)
Scheme administration costs	**(2.3)**	(2.9)
	(1.6)	(43.8)
Amounts charged to finance costs		
Interest cost	**(82.8)**	(94.5)
Amounts credited to finance income		
Interest income on scheme assets	**67.7**	80.1
Total amount charged to the income statement	**(16.7)**	(58.2)

The actual return on scheme assets was a gain of £21.8 million (2015: gain of £273.5 million).

Actuarial gains and losses for the current and prior year are reported in the statement of comprehensive income. The cumulative amount of actuarial gains and losses recognised in equity since the adoption of the recognition and measurement principles of IFRS is a net loss of £310.8 million (2015: net loss of £459.1 million).

In addition, contributions made by other Severn Trent group entities are also included in actuarial gains and losses recognised in the statement of comprehensive income.

23 Retirement benefit scheme (continued)

a) Defined benefit pension schemes (continued)

iv) Actuarial risk factors

The schemes typically expose the company to actuarial risks such as investment risk, inflation risk and longevity risk.

Investment risk

The group's contributions to the schemes are based on actuarial calculations which make assumptions about the returns expected from the schemes' investments. If the investments underperform these assumptions in the long term then the group will need to make additional contributions to the schemes in order to fund the payment of accrued benefits.

Inflation risk

The benefits payable to members of the schemes are linked to inflation measured by RPI. The group's contributions to the schemes are based on assumptions about the future level of inflation. If inflation is higher than the levels assumed in the actuarial calculations then the group will need to make additional contributions to the schemes in order to fund the payment of accrued benefits.

Longevity risk

The group's contributions to the schemes are based on assumptions about the life expectancy of scheme members after retirement. If scheme members live longer than assumed in the actuarial calculations then the group will need to make additional contributions to the schemes in order to fund the payment of accrued benefits.

23 Retirement benefit scheme (continued)

a) Defined benefit pension schemes (continued)

(v) Actuarial assumptions

The major assumptions used in the valuation of the STPS (also the approximate weighted average of assumptions used for the valuations of all group schemes) were as follows:

	2016 **%**	2015 %
Price inflation	**3.0**	3.0
Discount rate	**3.6**	3.3
Pension increases in payment	**3.0**	3.0
Pension increases in deferment	**3.0**	3.0

The assumption for price inflation is derived from the difference between the yields on longer term fixed rate gilts and on index-linked gilts. The discount rate is set by reference to AA rated sterling 18 year corporate bonds.

No salary assumption is required in the current year because the scheme closed to future accrual on 31 March 2015.

The mortality assumptions are based on those used in the triennial valuation of the STPS as at 31 March 2013. The mortality assumptions adopted at the year end and the life expectancies at age 65 implied by the assumptions are as follows:

	2016		2015	
	Men	**Women**	Men	Women
Mortality table used	**'SAPS' S1NMA_L**	**S1NFA_L**	'SAPS' S1NMA_L	S1NFA_L
Mortality table compared with standard table	**116%**	**92%**	116%	92%
Future improvement per annum	**1.0%**	**1.0%**	1.0%	1.0%
Remaining life expectancy for members currently aged 65 (years)	**21.4**	**24.6**	21.4	24.5
Remaining life expectancy at age 65 for members currently aged 45 (years)	**22.8**	**26.1**	22.7	26.1

23 Retirement benefit scheme (continued)

a) Defined benefit pension schemes (continued)

(v) Actuarial assumptions (continued)

The calculation of the scheme liabilities is sensitive to the actuarial assumptions and in particular to the assumptions relating to discount rate, price inflation and mortality. The following table summarises the estimated impact on scheme liabilities from changes to key actuarial assumptions whilst holding all other assumptions constant.

Assumption	Change in assumption	Impact on scheme liabilities
Discount rate	Increase/decrease by 0.1%	Decrease/increase by £45 million
Price inflation	Increase/decrease by 0.1%	Increase/decrease by £40 million
Mortality	Increase in life expectancy by 1 year	Increase by £65 million

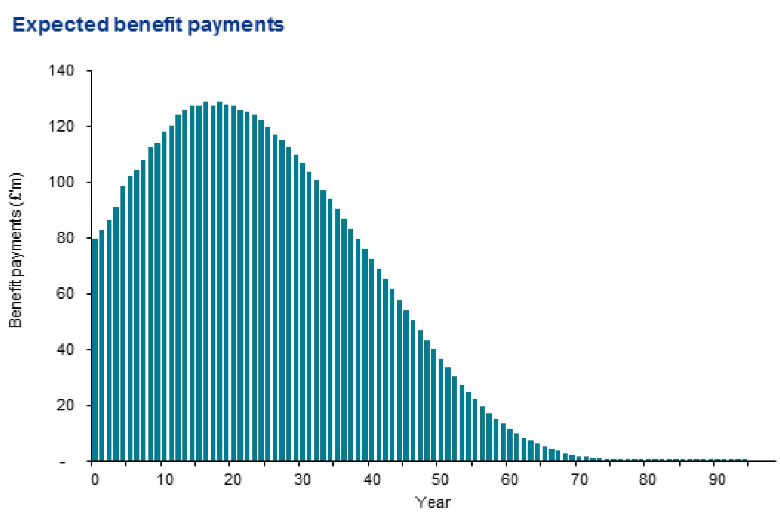
In reality, interrelationships exist between the assumptions, particularly between the discount rate and price inflation. The above analysis does not take into account the effect of these interrelationships.

In presenting the above sensitivity analysis, the present value of the defined benefit obligation has been calculated using the projected unit credit method at the end of the reporting period, which is the same as that applied in calculating the defined benefit obligation liability recognised in the balance sheet.

(vi) Effect on future cash flows

Contribution rates are set in consultation with the trustees for each scheme and each participating employer.

The average duration of the benefit obligation at the end of the year is 18 years (2015: 18 years). The expected cash flows payable from the scheme are presented in the graph below.



The most recent formal triennial actuarial valuations and funding agreements were carried out as at 31 March 2013 for both schemes. As a result, deficit reduction contributions of £40 million in 2013/14, £35 million in 2014/15, £15 million in 2015/16 and £12 million p.a. in subsequent years to 2024/25 were agreed. Further payments of £8 million p.a. through an asset backed funding arrangement will also continue to 31 March 2032. The next triennial valuation, as at 31 March 2016, is underway.

23 Retirement benefit scheme (continued)

b) Defined contribution pension scheme

The company participates in the group defined contribution scheme. The Severn Trent Pension Scheme, Choices section was replaced by the Severn Trent Group Personal Pension from 1 April 2015 and all members of other pension schemes were transferred. This scheme has been open since 1 April 2012 and new employees were automatically enrolled from this date. The pension charge for this scheme for the year ended 31 March 2016 was £18.1 million (2015: £8.2 million). As at 31 March 2016, contributions amounting to £1.5 million (2015: £2.4 million) in respect of the current reporting period were owed to the schemes.

24 Provisions for liabilities and charges

	Deferred tax	Restructuring	Insurance deductible	Other provisions	Total
	£m	£m	£m	£m	£m
At 1 April 2015	651.5	1.3	–	3.2	656.0
Restatement	65.9	–	–	–	65.9
At 1 April 2015 after restatement	717.4	1.3	–	3.2	721.9
(Credited)/charged to income statement	(70.7)	(0.3)	5.1	–	(65.9)
Utilised in year	–	(0.9)	(0.5)	(0.8)	(2.2)
Charged to other comprehensive income	38.9	–	–	–	38.9
At 31 March 2016	**685.6**	**0.1**	**4.6**	**2.4**	**692.7**

The restructuring provision reflects costs to be incurred in respect of committed programmes. The associated outflows are expected to arise over the next 12 months from the balance sheet date.

During the year, Severn Trent Water Limited has increased the level of self-insurance provided in the accounts for insurance deductible values previously provided in Derwent Insurance Limited; a captive insurance company of the group. At the year end this has resulted in a provision of £4.6 million (2015: £nil) for amounts that are no longer covered in the arrangement. The associated outflows are estimated to arise over a period of up to five years from the balance sheet date.

Other provisions consist of dilapidation costs and onerous leasehold property costs. The associated outflows are estimated to arise over a period of up to five years (2015: six years) from the balance sheet date.

Severn Trent Water Limited

Notes to the financial statements

25 Deferred tax

An analysis of the movements in the major deferred tax liabilities and assets recognised by the company is set out below:

	Accelerated tax depreciation £m	Retirement benefit obligation £m	Fair value of financial instruments £m	Other £m	Total £m
At 1 April 2014	759.3	(69.5)	(33.4)	26.6	683.0
Restatement	66.4	–	(0.6)	0.1	65.9
At 1 April 2014 after restatement	825.7	(69.5)	(34.0)	26.7	748.9
Charge/(credit) to income statement	13.1	–	(30.4)	4.3	(13.0)
(Credit)/charge to other comprehensive income	–	(24.2)	6.2	(0.5)	(18.5)
At 1 April 2015 after restatement	838.8	(93.7)	(58.2)	30.5	717.4
Charge/(credit) to income statement	9.3	–	1.3	(1.3)	9.3
(Credit)/credit to income statement arising from rate change	(83.9)	2.5	4.4	(3.0)	(80.0)
Charge to other comprehensive income	–	28.5	1.2	0.9	30.6
Charge to other comprehensive income arising from rate change	–	6.9	1.4	–	8.3
At 31 March 2016	**764.2**	**(55.8)**	**(49.9)**	**27.1**	**685.6**

Deferred tax assets and liabilities have been offset. The offset amounts, which are to be recovered/settled after more than 12 months, are as follows:

	2016 £m	2015 Restated £m
Deferred tax asset	**(105.7)**	(151.9)
Deferred tax liability	**791.3**	869.3
	685.6	717.4

26 Share capital

	2016 £m	2015 £m
Total issued and fully paid		
1,000,000,000 ordinary shares of 10p each	**100.0**	100.0
	100.0	100.0

27 Hedging reserve

The hedging reserve arises from gains or losses on interest rate swaps taken directly to equity under the hedge accounting provisions of IAS 39 and the transition rules of IFRS 1.

28 Share based payments

At 31 March 2016 there were no options exercisable under any of the share based remuneration schemes (2015: nil).

a) Long Term Incentive Plan (‘LTIP’)

Under the LTIP annual conditional awards of shares in the ultimate parent company may be made to executive directors and senior staff. Awards are subject to performance conditions and continued employment throughout the vesting period.

The 2013 and 2014 LTIP awards are subject to Severn Trent Water's achievement of Return on Regulated Capital Value in excess of the level included in the Severn Trent Water AMP5 business plan over a three year vesting period. The 2015 LTIP awards are subject to Severn Trent Water’s achievement of Return on Regulatory Equity in excess of the level included in the Severn Trent Water AMP6 business plan over a three year vesting period. It has been assumed that performance against the LTIP non-market conditions will be 100% (2015: 100%).

The weighted average remaining contractual life of the awards is 1.30 (2015: 1.31).

b) Employee Sharesave Scheme

Under the terms of the Sharesave Scheme, the board of the ultimate parent company may grant the right to purchase ordinary shares in Severn Trent Plc to those employees who have entered into an HMRC approved Save As You Earn contract for a period of three or five years.

The weighted average share price at the date of exercise for share options exercised during the period was £21.44 (2015: £19.74). The options outstanding at 31 March 2016 had a weighted average option price of £14.91 (2015: £16.81) and a weighted average remaining contractual life of 2.26 years (2015: 2.14 years).

c) Share Matching Plan (‘SMP’)

Under the terms of the Share Matching Plan members of STEC have received matching share awards over those shares which had been acquired under the deferred share component of the annual bonus scheme. Matching shares may be awarded at a maximum ratio of one matching share for every deferred share and are subject to a three year vesting period. No matching shares have been awarded in the current year.

Matching shares are subject to total shareholder return over three years measured relative to the companies ranked 51 - 150 by market capitalisation in the FTSE Index (excluding investment trusts).

The number of shares subject to an award will increase to reflect dividends paid through the performance period on the basis of such notional dividends being reinvested at the then prevailing share price. Awards will normally vest as soon as the Severn Trent Plc Remuneration Committee determines that the performance conditions have been met provided that the participant remains in employment at the end of the performance period.

Notes to the financial statements

29 Cash flow statement

a) Reconciliation of operating profit to operating cash flows

	2016 £m	2015 £m
Profit before interest and tax	**519.7**	515.1
Depreciation of tangible fixed assets	**290.3**	276.7
Amortisation of intangible fixed assets	**19.9**	22.2
Pension service cost	**(0.7)**	40.9
Defined benefit pension scheme contributions	**(17.5)**	(68.4)
Defined benefit pension scheme administration costs	**2.3**	2.9
Share based payments charge	**5.0**	7.6
Profit on sale of tangible and intangible fixed assets	**(2.9)**	(8.1)
Deferred income movement	**(10.5)**	(10.1)
Provisions charged to the income statement	**4.8**	10.8
Utilisation of provisions for liabilities and charges	**(2.2)**	(10.6)
Operating cash flows before movements in working capital	**808.2**	779.0
Decrease in inventory	**0.3**	0.2
Increase in amounts receivable	**(15.4)**	(34.2)
Increase in amounts payable	**15.6**	15.9
Cash generated from operations	**808.7**	760.9
Tax paid	**(19.3)**	(24.9)
Net cash generated from operating activities	**789.4**	736.0

b) Non-cash transactions

No additions to fixed assets during the year were financed by new finance leases (2015: none). Assets transferred from developers at no cost were recognised at their fair value of £24.8 million (2015: £29.8 million).

c) Exceptional cash flows

The following cash flows arose from items classified as exceptional in the income statement:

	2016 £m	2015 £m
Restructuring costs	**(3.0)**	(24.1)
Proceeds on disposal of fixed assets	**–**	9.4
	(3.0)	(14.7)

Notes to the financial statements

29 Cash flow statement (continued)

d) Reconciliation of movement in cash and cash equivalents to movement in net debt

	As at 1 April 2015 £m	Cash flow £m	Fair value adjustments £m	RPI uplift on index-linked debt £m	Foreign exchange £m	Other non cash movements £m	**As at 31 March 2016 £m**
Cash and cash equivalents	119.1	(119.1)	–	–	–	–	**–**
Bank overdrafts	–	(4.2)	–	–	–	–	**(4.2)**
Net cash and cash equivalents	119.1	(123.3)	–	–	–	–	**(4.2)**
Loans receivable from other group companies	108.3	1.3	–	–	–	–	**109.6**
Loans payable to other group companies	(3,705.8)	376.5	(1.0)	(12.6)	–	2.6	**(3,340.3)**
Bank loans	(1,240.7)	30.0	–	(1.4)	–	(0.1)	**(1,212.2)**
Other loans	–	(471.3)	1.5	–	(5.9)	1.1	**(474.6)**
Finance leases payable	(275.1)	74.3	–	–	–	–	**(200.8)**
Intercompany finance leases payable	(208.0)	2.7	–	–	–	–	**(205.3)**
Finance leases receivable from other group companies	100.8	(0.5)	–	–	–	–	**100.3**
Cross currency swaps	20.8	–	12.3	–	–	(5.0)	**28.1**
Net debt	**(5,080.6)**	**(110.3)**	**12.8**	**(14.0)**	**(5.9)**	**(1.4)**	**(5,199.4)**

30 Financial commitments

a) Investment expenditure commitments

Capital commitments are as follows:

	2016 £m	2015 £m
Contracted for but not provided for	**130.8**	73.3

In addition to these contractual commitments, the company has longer term expenditure plans which include investments to achieve improvements in performance mandated by the Director General of Water Services (Ofwat) and to provide for growth in demand for water and waste water services.

b) Leasing commitments

At the balance sheet date, the company had outstanding commitments for future minimum operating lease payments under non-cancellable operating leases, which fall due as follows:

	2016 £m	2015 £m
Within one year	**1.4**	1.8
Between two and five years	**4.7**	4.0
After five years	**5.1**	4.7
	11.2	10.5

Operating lease payments represent rentals payable by the company for certain of its office properties, plant and equipment.

31 Contingent liabilities

The banking arrangements of the company operate on a pooled basis with certain fellow group undertakings. Under these arrangements participating companies guarantee each others' balances only to the extent that their credit balances can be offset against overdrawn balances of other Severn Trent group companies.

At 31 March 2016 the company's maximum liability under these arrangements was £nil million (2015: £4.1 million).

32 Related party transactions

Directors' remuneration is disclosed in note 8.

The retirement benefit schemes entered into by the company are considered to be related parties. Details of transactions and balances with the retirement benefit schemes are disclosed in note 23.

33 Ultimate parent undertaking

The immediate parent undertaking is Severn Trent Draycote Limited.

The ultimate parent undertaking and controlling party is Severn Trent Plc, which is the parent undertaking and controlling party of the smallest and largest group to consolidate these financial statements. Copies of the Severn Trent Plc consolidated financial statements can be obtained from Severn Trent Plc’s registrars at Equiniti, Aspect House, Spencer Road, Lancing, West Sussex, BN99 6DA.