Registered number 05819317 (England and Wales)

Kemble Water Finance Limited

Annual report and consolidated financial statements

For the year ended 31 March 2021

Contents

Introduction

Kemble Water Finance Limited ("the Company" or "KWF") is an intermediate holding company of the Kemble Water Holdings Limited Group of companies ("the KWH Group"). The Kemble Water Finance Limited Group of companies ("the Group") represents the consolidated results of Kemble Water Finance Limited and its subsidiaries. These consolidated financial statements are prepared as a requirement of the Kemble Water Finance Limited covenants, which govern the way the Group borrows funds.

The Company acts as an intermediate holding company within the KWH Group and also acts as the borrower of funds both directly and through its direct subsidiary Thames Water (Kemble) Finance plc ("TW(K)F") for use within the wider Group. Under these arrangements the Group has at 31 March 2021, £1,464.9 million of external debt, £949.8 million (£938.8 million book value) of which has been raised directly by the Group and £515.1 million (£513.2 million book value) has been raised by its financing subsidiary TW(K)F and lent to the Group. This structurally subordinated secured debt is issued outside of the whole business securitisation group comprising the operating subsidiary, Thames Water Utilities Limited (TWUL), its financing subsidiary Thames Water Utilities Finance plc (TWUF) and its parent, Thames Water Utilities Holdings Limited (TWUHL). The KWF Group has £14,105.0 million of external debt at 31 March 2021 (excluding intercompany loan from parent).

The principal activity of the Group is the appointed supply of water and wastewater services to customers in London, the Thames Valley and surrounding area, delivered entirely through its wholly owned indirect subsidiary, Thames Water Utilities Limited ("TWUL" or "Thames Water"), in accordance with TWUL's Licence of Appointment. References to "our" or "we" in this report relates to the activities of the Group including TWUL.

In addition, the Group operates a separately managed property business. The property business manages the Group's property portfolio and the sale of land and other property that is no longer required by the appointed business.

As the performance of the Group is dependent largely on its appointed activities, this report makes reference to the performance of TWUL in order to provide appropriate explanation as to the performance of the overall Group.

The Group's management structure separates the Directors of the Company, who are all Non-Executives, and have no role to play in the day-to-day running of the appointed business (although certain matters require the approval of the Company's board having regard to the interests of its shareholders). In addition to their responsibilities to TWUL, the Executive Directors of TWUL also carry out work on behalf of the Group.

Unless otherwise stated; all current year data included in this report is for the year ended 31 March 2021 ("2020/21").

Directors and Advisors

Directors

M McNicholas
S Deeley
J Divoky
G Lambert
A Hall
P Noble
S Obozian
G Pestrak
C Schmidt
F Sheng
M Bloch-Hansen
C Pham
P McCosker
H De Run
M Wang
G Tucker

Independent auditors

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23 Forbury Road
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Company secretary and registered office

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S Billet
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Vastern Road
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RG1 8DB

Strategic report

The Directors present their strategic report of the Kemble Water Finance Limited Group ("the Group") for the year ended 31 March 2021. This strategic report should be read in conjunction with the strategic report of Thames Water Utilities Limited, which can be found at https://www.thameswater.co.uk/about-us/investors/our-results and provides a more detailed insight into the regulated business.

Business review

Principal Activities

The principal activity of the Group is the appointed supply of water and wastewater services through its wholly owned indirect subsidiary, Thames Water Utilities Limited ("TWUL"). The Company's principal activity is to act as the holding company of the Group.

The main functional areas to the TWUL business are:

Customer experience:	comprises the household business segment and provides certain customer-facing activities, billing and revenue collection, including amounts relating to construction of the Thames Tideway Tunnel (TTT) which has also been shown separately in the financial statements. From 1 April 2017, this business segment is also responsible for billing and cash collection of wholesale market charges to licensed non-household retailers for both water and wastewater, including amounts relating to construction of the TTT which is shown separately in the financial statements;
Capital delivery:	comprises the management of water network assets, as well as the investment in and maintenance of the business' water and wastewater infrastructure to ensure it is sufficiently resilient to continue customer delivery, whilst also meeting the challenges of population growth and climate change.
Operations:	responsible for all aspects of raw water abstraction, treatment as well as the distribution of high quality drinking water and wastewater collection, treatment and safe disposal for household and non-household customers; and
Support services:	responsible for other areas including digital, regulation, finance, legal and HR.

Whilst the appointed supply of water and wastewater services provides approximately 98% of the Group's appointed gross revenue; TWUL also manages certain non-appointed activities including:

- property searches, including the provision of information required by property developers; and
- treatment of trade effluent and other septic waste.

In addition, outside of TWUL, the Group operates a property business to manage and optimise the value of the Group's property portfolio.

Business strategy

The Group's strategy is as follows:

- For the appointed business of TWUL, to deliver life's essential service, so our customers, communities and the environment can thrive. This means keeping customers' bills as low as possible whilst investing efficiently in assets to ensure its customers' needs are met now and in the future. From a shareholder perspective, this means meeting and outperforming our regulatory outputs and financial settlement to provide the returns they expect and require.

- Outside of the appointed business, the Group continues to provide property search services to conveyancers and homebuyers. The Group also retains a property services arm which focuses on the development and enhancement of the value of land and sites that are no longer required for the appointed business, including disposal to third parties.

Principal risks and uncertainties

Changes to risk landscape

Over the course of 2020/21 internal and external factors have influenced the risk agenda:

Covid-19: many risks were compounded by the impact of Covid-19, with a focus on ensuring our workforce have the equipment and working environment they need; health, safety and wellbeing is maintained at home or in the field; our supply chain is able to consistently deliver and maintain the standard we expect of them; and we maintain sufficient money to operate alongside reduced revenue.

Brexit: There was a minor impact on the supply chain following the introduction of border controls and the Group is preparing for full controls at the border in July.

Pollutions /river water quality: we no longer accept the discharge of untreated sewage into rivers, even when legally permitted. We will need to work with stakeholders to accelerate work to stop them being necessary.

Cyber security: There has been an increase in targeted cyber security attacks on water and regulated industries internationally.

Principal risks and uncertainties (continued)

Changes to risk landscape (continued)

Quantum of change: The Group needs to increase the pace of change to deliver our turnaround plan and meet challenging transformation and performance targets at a time of significant further change in senior leadership.

Emerging risks
There are several emerging risks which we will be a focus for further analysis in 2021/22:

- Longer term impact of Covid-19 and the changing distribution of service demand.
- Maintaining good mental health whilst transitioning to new ways of working.
- Continued pressure internally and externally to improve the environment.
- Transitional climate change risks.
- Capacity in sector to deliver capital programmes.
- Ongoing supply of chemicals due to dependency on a small number of suppliers and reduced availability of specific critical chemicals in the long term.

Changes to principal risks

The Group has updated its principal risks model to reflect our internal priorities and revised accountabilities:

Business planning and delivering transformational change: This reflects the scale of transformation needed to achieve the AMP7 business plan and to prepare a robust PR24 business plan.

Health, safety and wellbeing: The Group has included wellbeing to reflect the importance of, and potential challenges around mental health.

People: The Group has emphasised embedding the right behaviours and culture.

We also added a new principal risk:

Understanding our assets: this considers the importance of robust, accurate and reliable asset information to make informed asset investment decisions, maintain the asset base and effectively respond to incidents. The principal risks have been used as the basis for the downside events and scenarios in the Viability Statement on page 17.

Principal risks and uncertainties

<table>
<tr><th colspan="2">1. Environmental protection and climate change</th></tr>
<tr><td colspan="2">We may cause damage to/pollute the natural environment through our operations, be unable to deal with the physical impacts of climate change (e.g. extreme weather events and temperature rise) or fail to meet our zero carbon targets and commitments.</td></tr>
<tr><td>Trend
⇧</td><td>Explanation of trend
• Increased scrutiny from stakeholders on river water quality and use of combined sewer overflows with commitment to preventing discharges of untreated sewage which requires broad stakeholder support to deliver.
• Preparing for increase in reporting to align with the requirements of Climate Change (TCFD).</td></tr>
<tr><td colspan="2">Risk impact

Short to long-term environmental damage, increased disruption and cost to maintain our operational service due to extreme weather and temperature rise, and reputational damage if we fail to make sufficient progress.</td></tr>
<tr><td colspan="2">How we are managing the risk
• Working with stakeholders to accelerate work to stop discharges of untreated sewage being necessary, as a result of wet weather.
• Implementing our Pollution Incident Reduction Plan focusing on prevention through proactive sewer cleaning, infrastructure upgrades, improved monitoring, enhanced training and behaviour and improved response when pollutions happen.
• Working with local partners on Smarter water catchments initiatives to nurture the water cycle, improve river quality and enhance ecosystems.
• Trialling the monitoring of river quality, at agreed pilot locations, for the purposes of establishing designated bathing rivers.
• Increasing resilience of our waste network to wet weather through catchment infiltration reduction plans.
• Net Zero Carbon Taskforce and development of our Net Zero Carbon Route Map to achieve net zero operational carbon by 2030 and to go further by 2040.
• Reviewing physical and transitional climate change risks, in particular, preparing our Climate Change Adaptation Report for Defra and reviewing our financial reporting on climate matters as set out in our TCFD report.</td></tr>
</table>

Principal risks and uncertainties (continued)

Principal risks and uncertainties (continued)

2. Political, regulatory, legislative, and societal changes	
We may be unable to effectively anticipate and/or influence future developments in wider society and/or the political, regulatory or legislative environment.	
Trend ⇔	Explanation of trend • Overall, this risk has remained stable, with political, regulatory and societal changes aligning with our own strategies and objectives to protect the environment, contribute to wider society, innovate and plan for the long term. • Covid-19 has influenced how we’ve collaborated with stakeholders with an increase in digital communication and higher expectations from us as stakeholders balance competing priorities.
Risk impact Our operations might be impacted by changes to the regulatory framework or legislation which influence how we govern ourselves or require significant investment over what we anticipated in our business plan.	
How we are managing the risk • Ongoing monitoring of the political and regulatory environment. • Active and ongoing engagement and consultation with regulators, politicians and regional and local stakeholders on a broad range of issues, particularly those of high concern such as resilience, river water quality and the impact of Covid-19. • Facilitating discussion and collaborative work on matters of policy. • Working in partnership with other organisations such as Water UK, other water companies and industry bodies to inform the public policy debate around the water sector.	

3. Maintaining the trust and confidence of stakeholders	
Failure to secure the trust and confidence of our stakeholders (regulators, investors, communities, pressure groups, etc.), if we fail to meet their expectations or deliver on our promises and commitments.	
Trend ⇔	Explanation of risk trend • Remains a challenging environment with continued external scrutiny driven by our poor operational performance and customer service. • We have new leadership in place, are increasing our level of transparency and openness and have overhauled our communications and engagement during incidents.
Risk impact We may be unable to secure the necessary engagement, support and investment necessary to deliver our long-term ambitions.	
How we’re managing the risk • Extensive engagement with stakeholders at national, regional and local levels to understand their needs, expectations and preferences. • Implementing our turnaround plan to improve our performance. • Public value programme to support wider community engagement and environmental improvement. • Implemented robust 24/7 communication and engagement with stakeholders during incidents. • Proactive engagement with impacted customers and stakeholders to support delivery of our AMP7 Capital Delivery programme. • Proactive consultation with stakeholders on key business plans, 2050 Vision, Water Resources Management plan (WRMP) and Drainage and Wastewater Management Plan (DWMP). • Introduced new structures and processes to support stakeholder engagement across the business to support a more coordinated approach internally. • Working to ensure all commitments have been properly thought through and are tracked through to completion.	

Principal risks and uncertainties (continued)

Principal risks and uncertainties (continued)

4. Business planning and delivering transformational change

We may be unable to effectively plan, deliver and embed the scale of change necessary to achieve our AMP7 business plan and prepare for PR24 and beyond.

Trend	Explanation of risk trend
⇔	• We have a clear view of where we need to focus to deliver and embed transformational change and recognise the scale of transformation required in key areas of our operations, particularly water networks and customer service. • We are insourcing capability in our Capital Delivery model and transition to an Intelligent Client to help deliver our £3.1bn capital programme for AMP7.

Risk impact

We may fail to allocate funds appropriately or deliver the scale of transformation needed to meet our customers and stakeholders needs, or fail to achieve the necessary confidence to secure a PR24 plan which enables us to deliver our long-term ambitions.

How we're managing the risk

- Implementing our turnaround plan to improve our performance with targeted business wide transformation programmes for customer, operations, people, strategic planning, and understanding our assets.
- Robust investment governance process in place to ensure we're being efficient and optimising our activities.
- Enhancing established business planning process to ensure we're doing the right thing at the right time.
- Developing our Vision 2050 plan to guide long term long-term decision making.
- Improving our decision making around assets by developing an asset management system that is ISO 55001 certified.
- During the Covid-19 pandemic, we have continued to monitor decisions which impact our performance targets and have postponed some non-essential projects, and have assessed the impact of these to our business.

5. Supply of enough 'wholesome' water

We may be unable to provide a reliable supply of 'wholesome' water and maintain a robust water network

Trend	Explanation of risk trend
⇔	• Leakage and mains repairs have been higher than forecast due to the cold winter and the impact of a freeze thaw event in February. Over the year we've invested at a number of water treatment works, improving their reliability, and have increased our understanding of our water supply resilience and worked with customers and stakeholders to identify areas for improvement.

Risk impact

We may impact business, domestic customers and communities due to interruptions to water supply or cause danger to public health due to poor water quality.

How we're managing the risk

- Reducing water demand through improvements in customer water efficiency, installing digital water meters and addressing customer side leakage.
- Proactively maintaining our network through leakage detection and trunk main monitoring, and undertaking repair and replacement programmes.
- Increasing our use of data through monitoring across key water quality processes and improving real-time awareness of our network and calming pressure across our system to prevent bursts and reduce leakage through our Smart Metering rollout and Smart Water programme which have allowed us to meet unprecedented demand for water during Covid-19.
- Refurbishing critical water assets such as our ring main and several water treatment works.
- Enhancing the competency of our staff to minimise water quality failures and supply interruptions.
- Enhanced incident management arrangements to reduce response times and developed playbooks for critical systems to maintain supply.
- Undertaken Water supply system resilience assessments, with active engagement from customers and stakeholders, to prioritise future resilience investment.
- Our Water Resource Management Plan sets out how we will manage the water supplies in our region to meet current and future needs up to 2100.

Principal risks and uncertainties (continued)

Principal risks and uncertainties (continued)

6. Collection, treatment and recycling of wastewater	
We may be unable to collect and treat wastewater and safely return clean water to the environment or recycle sludge.	
Trend ⇔	Explanation of risk trend • Overall this risk has been stable with ongoing focus on enhancing our wastewater systems to prevent spills, responding to wet weather due to infiltration, improving the resilience at a number of sewage treatment works, and preparing for evolving bioresources and sludge treatment markets.
Risk impact We may disrupt business and domestic customers due to interruption to drainage services and sewer flooding.	
How we're managing the risk • Working with the government, Ofwat, the Environment Agency and others to accelerate work to stop discharges of untreated sewage being necessary. • Implementing our Pollution Incident Reduction Plan focusing on prevention through proactive sewer cleaning, infrastructure upgrades and improved monitoring. • Improved response when pollutions happen and enhanced training programmes. • Increasing our use of data through the installation of sewer depth monitors across our network to enable intelligence-based proactive maintenance and targeted interventions. • Increasing resilience of our waste network to wet weather through catchment infiltration reduction plans. • Developing our Drainage and Wastewater Management Plan which sets out how we will manage the waste service in our region to meet current and future needs. • Continuing our network enforcement activity to reduce fats, oils and grease being disposed to sewers, whilst campaigning for the "fine to flush" standard to be adopted by all manufacturers. • Engaging with WaterUK regarding the future of sludge recycling and developing long term strategy for sludge to land. • Developing wastewater resilience assessment, based on good practice in water supply, to prioritise future resilience investment.	

7. Physical and cyber security	
We may be unable to protect our sites, systems, and assets (incl. data) from internal, or increasingly sophisticated malicious, external threats such as a targeted cyber-attack.	
Trend ⇔	Explanation of risk trend • No material increases in vulnerability. • Close monitoring of targeted cyber-attacks on utilities and government bodies internationally.
Risk impact May result in data loss, damage to property or infrastructure or disruption to operational and customer services. This may cause reputational harm, regulatory investigations or penalties.	
How we're managing the risk • Clear policies and procedures and mandatory security awareness training and communications. • Technological security measures, including effective modern firewalls, patching policies, threat/vulnerability monitoring, identity management controls, multifactor authentication and encryption of information. • Increasing the use of incident alerting tools, and tools to prevent the deliberate and accidental loss of data. • Regular risk assessments of physical security threats and measures. • Physical and electronic site security controls, including site alarms and CCTV that are actively monitored with programme of maintenance and improvement. • Improving the quality and accuracy of user information in our systems. • Incident response process.	

Principal risks and uncertainties (continued)

Principal risks and uncertainties (continued)

8. Information and operational technology

We may be unable to prevent service interruptions or become blind to the actual state of critical assets due to information (IT) or operational (OT) failures.

Trend	
⇔	Explanation of risk trend • IT systems have coped well with significant shifts in homeworking during 2020-21. • Reduction in system outages demonstrating impact of continued investment in IT infrastructure resilience • Increased focus on improving operational technology.

Risk impact

May result in disruption to our corporate, operational and customer systems and services.

How we're managing the risk

- Continuous improvement of the stability of our IT systems.
- Migration of applications to cloud platforms to improve accessibility, application rationalisation and cessation of grey IT.
- Standardisation of agreements with IT providers to increase reliability and consistency of service provision.
- Replacement of operational field devices to enhance staffs' working experience, reduce hardware failures and address security risks.
- Improvements to continuity planning and recovery plans for key systems including regular testing.
- We have successfully replaced the legacy RTAP system in London with a modern SCADA system to oversees the production, treatment and delivery of drinking water.
- Operational technology lease line upgrade programme.

9. Customer service

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

Trend	
⇔	Explanation of risk trend • Remains a challenging environment with high, but improving, level of complaints received, particularly for charging and billing.

Risk impact

If we are unable to deliver the levels of customer service expected by our customers we may experience an increase in complaints, perform relatively poorly on C-MeX and D-MeX measures and fail to achieve the necessary customer advocacy and support to secure a PR24 plan which enables us to deliver our long-term ambitions.

How we're managing the risk

Stabilise, optimise and transform customer service with a consistent and low effort customer experience by:

- End-to-end customer intent led transformation in retail (around billing and metering journeys) and operations (water and waste) that enables improved satisfaction, reduced complaints and channel shift to digital.
- Introduction and optimisation of next generation contact centre and workforce management systems, improving the interface and interaction with all our other back-end systems (including billing and website).
- Transform data quality by focussing on data completeness, accuracy and integration of property, asset and customer data.
- Continued focus on driving inclusive service by actively seeking data sharing with third parties to drive up reach of priority services and affordability as well as maintain our certification of BSI 18477 (inclusive service provision).
- Continue to build and develop a customer-centric culture where everyone feels responsible and empowered to deliver for our customers.

Principal risks and uncertainties (continued)

Principal risks and uncertainties (continued)

10. People

We may be unable to attract, develop and retain an appropriately skilled, diverse, and engaged workforce and leadership team that demonstrate standards of behaviour, attitudes and actions that make for a positive workplace culture.

Trend	Explanation of risk trend
⇩	• Risk trend is improving demonstrated by increasing employee engagement, and continued improvements in diversity and the competency of our workforce.

Risk impact

Without an appropriately skilled, diverse, and engaged workforce and leadership team we may be unable to deliver the transformational change necessary to deliver our AMP7 plan and long-term ambitions.

How we're managing the risk

- People strategy based on engagement, equality, diversity, talent attraction and development, training, reward and recognition.
- Talent and succession planning and leadership development programmes in place with increased investment in Graduate and Apprenticeship schemes to promote emerging talent.
- Learning management and mandatory training programmes in place supported by developing competency framework.
- Ongoing monitoring of employee engagement and targeted response plans.
- Strategic workforce plan in place to identify short, medium and long-term resourcing requirements.
- Investment in recruitment and on-boarding systems to ensure a positive hiring and induction experience.
- Working with EU Skills to understand where the workforce is today and where it needs to be for the future.
- Developing future ways of working to ensure we implement a flexible and efficient hybrid working model.
- Engaging on how we pay and contract in the future.
- Implementing a robust Licence to Operate programme to further develop technically competent colleagues and demonstrate competency to our regulators.
- Focus in the coming year on 'behavioural re-set' programme to underpin an inclusive culture.

11. Health, safety, and wellbeing

We may endanger the health, safety or wellbeing of our people, operating partners and/or members of the public.

Trend	Explanation of risk trend
⇔	• Risk is stable with ongoing monitoring of the effect of Covid-19 and new ways of working on the physical and mental health and wellbeing of our people. • Over the year there has been a significant reduction in lost time and RIDDOR notifiable incidents, including a significant reduction in the number of incidents where electrical, telecom and gas pipes and cables were struck during road excavations.

Risk impact

Physical or psychological harm to members of the public and our people, damage to property and third-party infrastructure including disruption to our operations.

How we're managing the risk

- Strong health and safety and wellbeing culture throughout the business.
- Robust health and safety management system externally accredited to ISO 45001.
- Board Health, Safety and Environment Committee monitors performance and oversees and reviews health and safety risks
- Robust mental and physical health strategies alongside health and safety advisers, in-house occupational health team and mental health first aiders.
- During the Covid-19 pandemic, measures undertaken include the provision of appropriate PPE to frontline staff, modifying work practices to maintain social distancing and enhanced resources to ensure our employees are kept up to date with company activity and evolving protocols.
- External risk-based audits of critical operational areas.
- Focus in the coming year on everyone understanding the basics of health and safety management whilst raising the bar through peer-to-peer inspections and focus on behaviours.

Principal risks and uncertainties (continued)

Principal risks and uncertainties (continued)

12. Supply chain management

We may be unable to source high-calibre suppliers/ expertise, and manage contracts and supplier relationships to deliver innovation and best value services in a sustainable and ethical way.

Trend
⇔

Explanation of risk trend

- Our position has stabilised following an initial negative outlook as a result of Covid-19, with no major supplier failures or supply chain driven failures in critical service.
- Looking forward, there is uncertainty about potential import difficulties post Brexit and the impact on our supply chain following the closure of the government Furlough scheme.
- We are anticipating a significant scale up in our capital programme.

Risk impact

Failure to effectively engage our supply chain may result in under delivery of our performance commitments, services to customers and transformation objectives or increases in totex expenditure. Failure to manage our contracts effectively may result in a reduced pool of suppliers that are willing and able to work with the water sector and company. Failure of suppliers for critical goods and services may result in operational disruption.

How we're managing the risk

- Enhanced monitoring of supply chain health in face of Covid-19 economic fallout.
- Active participation with Water UK and the government on resilience in the chemical supply chain.
- Improved approach to supplier management including centralised governance, improved visibility and management of suppliers and understanding of early warning signs.
- Enhancing market knowledge and engagement to make better and more informed decisions creating further optionality in sources of goods or services.
- Embedding an Intelligent Client Model including in enhancing capability and capacity.
- Collaborating with our supply chain to deliver innovations that drive towards a more sustainable service, including mitigating single source supply.

13. Understanding our assets

We may be unable to optimise delivery of water / wastewater services, prevent H&S incidents, invest effectively for the long-term, or miss our performance commitments if we don't fully understand our assets – their condition, performance and risk.

Trend
NEW

Explanation of risk trend

- Asset data and insight is one of our top five transformation priorities with increasing internal and external focus on asset health and improving our understanding and visualisation of assets. This is a long-term area for development to understand the condition, performance and risk of our assets.

Risk impact

If we don't have a comprehensive understanding of our assets, we may fail to deliver our transformation plans and achieve the necessary confidence in our PR24 plan to enable us to build resilience for the long-term.

How we're managing the risk

- Maintain an asset risk register which is used to define targeted maintenance programmes.
- Asset standards in place with monitoring and continual improvement.
- Developing a long-term plan to enhance our understanding of the data we hold, identify where there may be gaps and opportunities to enhance monitoring and real time data collection and visualisation.
- Developing how we raise and manage asset risk and visualise risk to inform investment planning.
- Building smart platforms to improve our visualisation of water and wastewater system performance.
- Implementing an asset management system that is ISO 55001 certified to maximise the value from our assets.

Principal risks and uncertainties (continued)

Principal risks and uncertainties (continued)

14. Legal and regulatory compliance

We may fail to comply with legal and regulatory obligations and responsibilities.

Trend ⇧

Explanation of risk movement

- Risk has increased as we continue to face the risk of prosecution for historic pollution incidents and have also seen an increase in the size and complexity of material litigations, including a recent class action.

Risk impact

Failure to comply with legal and regulatory obligations could lead to financial penalties, reputational harm and loss of customer and investor confidence. We could be subject to lengthy investigations and resultant fines linked to company turnover, particularly in the areas of environmental, health and safety, competition and data protection.

How we're managing the risk

- The Executive, with oversight from the Board, promotes high ethical standards of behaviour and ensures the effective contribution of all Directors.
- Horizon scanning for changes to the legal and regulatory environment.
- An embedded policy framework to understand and meet legal and regulatory compliance obligations.
- Documented processes and controls for key activities, together with a compliance programme.
- Active monitoring of consent and permit compliance.
- Robust health and safety culture and audit and review programme.
- Mandatory training programmes.

15. Financing our business

We may be unable to fund the business sufficiently to meet our liabilities as they fall due.

Trend ⇔

Explanation of risk trend

- Despite the economic uncertainty caused by Covid-19 and certain periods of market volatility, we continue to have efficient access to debt capital markets. Furthermore, we have ready access to significant credit facilities.

Risk impact

If we are unable to fund the business sufficiently this may trigger a deterioration in credit ratings which could potentially give rise to increases in associated funding costs and/or reduced access to debt capital markets. This, in turn, may adversely impact our ability to deliver transformational change.

How we're managing the risk

- Focus on cashflow management to maintain a strong liquidity position supported by available committed banking facilities.
- Ongoing focus on credit ratings and financial covenant headroom in budget setting.
- Treasury strategy covering funding, hedging and cash management in place.
- Tailored bad-debt recovery alongside financial assistance to household customers affected by Covid-19.
- Robust investment governance process in place.
- Regular communication with key stakeholders (e.g. lenders and credit rating agencies).

See the Viability Statement on page 17 for further details on financial resilience.

Financial review

Key financial performance indicators

	Underlying £m	**BTL £m**	**Total £m**	Underlying £m	BTL £m	Total £m
Revenue (£m)	**2,033.0**	**73.8**	**2,106.8**	2,108.6	64.3	2,172.9
Operating expenses (£m)	**(1,764.1)**	**(0.2)**	**(1,764.3)**	(1,694.9)	(0.2)	(1,695.1)
Operating profit (£m)	**391.1**	**73.6**	**464.7**	493.1	64.1	557.2
Net finance expense (£m)	**(890.3)**	**-**	**(890.3)**	(1,012.4)	-	(1,012.4)
Net (losses)/gains on financial instruments (£m)	**(524.9)**	**-**	**(524.9)**	190.8	-	190.8
Loss before tax (£m)	**(1,024.1)**	**73.6**	**(950.5)**	(328.5)	64.1	(264.4)
Loss after tax (£m)	**(831.3)**	**59.6**	**(771.7)**	(389.7)	58.0	(331.7)
Capital expenditure (£m)	**1,105.0**	**-**	**1,105.0**	1,223.0	-	1,223.0
Statutory net debt (£m)	**(20,593.9)**	**-**	**(20,593.9)**	(19,676.7)	-	(19,676.7)
Post maintenance interest cover ratio (PMICR) *	**1.6**	**n/a**	**n/a**	1.7	n/a	n/a
Gearing (%) **	**91.0**	**n/a**	**n/a**	89.6	n/a	n/a
Credit rating ***	**n/a**	**n/a**	**Baa2 stable**	n/a	n/a	Baa2 stable

* As defined on page 55.
** Ratio of covenant net debt to Regulatory Capital Value ("RCV"), defined on page 55.
*** Representing the Corporate Family Rating ("CFR") assigned by Moody's for the operating subsidiary, TWUL. Separately during April 2021, Moody's reaffirmed ratings of KWF guaranteed debt as B1, with stable outlook. During April 2021 Fitch reaffirmed KWF's rating as B+ with negative outlook.

Overall performance

Revenue

The bills we send our customers for the essential water and wastewater services we provide make up our revenue. Our economic regulator, Ofwat, determines the amounts we charge in our bills every five years through a price review process, which is driven by the costs we expect to incur to invest in and operate our business over that five-year regulatory period. Our current regulatory period covers 1 April 2020 to 31 March 2025 ("AMP7").

Our total revenue for the year end 31 March 2021 decreased by £66.1 million to £2,106.8 million (31 March 2020: £2,172.9 million). The decrease was driven by the combination of lower allowed revenue set by Ofwat in AMP7, the adverse impact of Covid-19 on the nonhousehold market with many business premises being empty or at reduced capacity throughout the period and the impact of Covid-19 on household bad debt (see below note).

Decreases in revenue have been partly offset by an increase in household water consumption due to warm weather and home working. BTL revenue increased by £9.5 million to £73.8 million (31 March 2020: £64.3 million) due to the phasing of construction works.

Our revenue is generated from the bills we send our customers for the essential water and wastewater services we provide.

Capital expenditure

During the year, we invested £1,105.0 million (31 March 2020: £1,223.0 million) in our assets, of which £69.7 million related to capitalised borrowing costs. This investment is down on last year due to transitioning into a new AMP with the associated supply chain engagement and mobilisation. In addition to this, Covid-19 has had an impact on delivery over the year. Excluding capitalised borrowing costs from the table below, key projects within capital expenditure include:

- £167.0 million through our Infrastructure Alliance on our Water Network (Water) to reduce leakage and improve our trunk main network
- £44.0 million on our metering programme (water)
- £23.0 million on connecting our network to the Thames Tideway Tunnel
- £8.0 million on Beckton STW for future population growth and readiness to receive flow from the Thames Tideway Tunnel

Financing our investment

As we are investing heavily in the business, we continue to focus on the importance of ongoing investor engagement to support our strategy of diversifying our sources of funding and maintaining a balanced debt maturity profile. Our strategy of adopting a prudent approach to liquidity has continued given the ongoing uncertainty that the Covid-19 pandemic has introduced. Our statutory net debt (as defined in the accounting policies section) has increased by £917.2 million to £20,593.9 million (2020: £19,676.7 million). This has been accompanied by an increase in the Regulatory Capital Value ("RCV") of £296.0 million to £15,025.3 million (2020: £14,729.3 million). Overall gearing (on a covenant basis), was 91.0% (2020: 89.6%), below the permitted maximum of 95.0%. Additionally, our Post Maintenance Interest Cover Ratio (PMICR) in the current year is 1.6 x (2020: 1.7x) and is above the permitted minimum of 1.05x.

Overall performance (continued)

Financing our investment (continued)

In anticipation of our 2020 to 2025 investment programme, during the year ended 31 March 2019 TWUL Group increased the size of its Revolving Credit Facility (RCF) from £950.0 million to around £1.65 billion, and in November 2020 extended the maturity of £1.44 billion of that facility by one year from 2024 to 2025. Throughout the year, total new debt issuance and facilities of £1,187 million equivalent were completed in TWUL Group, as follows:

- £350 million bond due 2040 issued in April 2020;
- £40 million of privately placed debt due 2050 was issued in May 2020, along with a £110 million term loan maturing in 2023, which was subsequently cancelled in line with other financing initiatives;
- £612 million equivalent of debt was issued through a series of privately placed transactions (£84.7 million due 2023; €500m due 2023; $57 million due 2030 and $40 million due 2027) between October and December 2020; and
- £75 million Class B revolving credit facility commencing in April 2021 and maturing in April 2024 was entered into in November 2020.

Since 31 March 2021, TWUL Group has further strengthened its financing position, entering into a £180.0 million Class B loan facility due June 2026, which is currently undrawn. Since 31 March 2021, £525.0 million of the Class A RCF has been drawn and the following debt has been repaid:

- £214.3 million Class B RCF
- £225.0 million Class A bond due April 2021
- £300.0 million Class B term loan due June 2023

The Company raised £100 million of new debt through two £50 million privately placed transactions in July and August 2020 respectively. In September 2020, £80 million of this was down-streamed through intercompany loans and loan repayments to enable TWUL to repay debt. A further £380 million of loan repayments by the holding companies to TWUL are planned during AMP7, to enable TWUL to repay debt. In November 2020, Thames Water (Kemble) Finance plc, the Company's financing subsidiary, raised £250 million due 2026 through a public bond issue, which was increased by £150 million to £400 million in February 2021. The proceeds were used in November 2020 to repurchase, through a public tender, £60 million of the issuer's bond debt due in 2022, and in December 2020 for the early repayment by the Company of a £75 million loan due in 2022. We currently expect to have in excess of 18 months of liquidity.

The associated net finance expense has decreased by £122.1 million to £890.3 million (2020: £1,012.4 million), which has been driven primarily by higher interest income on swaps. Some of our interest expense is incurred in relation to borrowings raised to deliver major capital projects. Under the IFRS accounting framework we capitalise the interest costs related to major capital projects with the finance expense in the income statement being shown net of these capitalised costs. Capitalised interest costs were £69.7 million this year (2020: £97.6 million).

Bad debt

Bad debt arises predominantly from those who choose not to pay their bill, despite being financially able to, as opposed to those who cannot pay. We offer a range of support for people in financially vulnerable circumstances. We are working hard to reduce bad debt and we have started to see the impact of a number of new initiatives implemented during the prior year.

During the year ended 31 March 2021, we have seen an increase in our overall bad debt cost of £12.7 million to £86.6 million (31 March 2020: £73.9 million). The increase is primarily due to the impact of Covid-19 on our current year cash collections, offset by the initiatives implemented in the prior year to reduce the bad debt.

These initiatives have allowed our prior year collection rates to increase compared to comparative prior periods. The current year charge is split between bad debt relating to current year bills (amounts that are not expected to be collected when invoiced) of £49.9 million (31 March 2020: £33.1 million), which is shown as a deduction in revenue, and bad debt relating to bills from prior years of £36.7 million (31 March 2020: £40.8 million), which is shown within operating expenses. Our total bad debt charge equates to 4.1% (31 March 2020: 3.4%) of total gross revenue.

Operating expenses

Total operating expenses have increased by £72.0 million increase in total.

The increase in operating expenses is primarily driven by:

- £30.7 million increase in depreciation and amortisation, as we continue with our significant investment programme;
- £27.8 million increase in our employment costs, arising from additions to our team to improve our service to customers;
- £23.3 million increase in our rates costs following the receipt of a one-off rebate in the prior period;
- £1.7 million increase in other operating expense, relating to increase professional fees and research and development expenditure;
- Offset by a decrease in 'exceptional' costs of £11.4 million relating to a significant restructuring of the business that primarily occurred in the previous period.

Overall performance (continued)

Financial instruments

Our borrowings, revenue and total expenditure ("totex") (as defined in the alternative performance measures section) are exposed to fluctuations in external market variables such as changes in interest rates, inflation and foreign exchange rates. We manage these exposures by entering into derivative contracts in order to hedge against future changes in these external rates.

We have approximately £9.7 billion of derivative financial instruments (face value). A total loss on financial instruments of £524.9 million was recognised in the income statement during the year (2020: gain of £190.8 million). This is driven by £630.4 million net fair value loss on swaps, a £37.5 million loss on cash flow hedge transferred from reserves and £2.7 million loss on part repayment of debt, partially offset by £145.7 million net foreign exchange gain on foreign currency loans. Note 7 to the financial statements provides detail of the amounts charged to the income statement in relation to financial instruments

Credit rating

We retain investment grade credit ratings for TWUL Group, that allow us to access efficiently priced debt to fund our investment programme, whilst keeping bills affordable for our customers. In April 2021, Moody's reaffirmed the Corporate Family Rating ("CFR") for TWUL as Baa2 with a stable outlook (2020: Baa2 with stable outlook). Moody's also reaffirmed our securitisation group companies' senior secured (Class A) debt rating as Baa1 with stable outlook (2020: Baa1 with stable outlook) and subordinated (Class B) debt rating as Ba1 with stable outlook (2020: Ba1 with stable outlook). In January 2021, S&P reaffirmed our securitisation group companies' credit ratings of BBB+ and BBB- (2020: BBB+ & BBB-) in relation to our senior secured (Class A) debt and our subordinated (Class B) debt respectively, both with negative outlook (2020: negative outlook).

In April 2021, Fitch affirmed the KWF's senior secured debt rating at B+ (2020: BB-) and KWF's Long-Term Issuer Default Rating at B+ with negative outlook (2020: BB- rating watch negative). In April 2021 Moody's reaffirmed the rating of Thames Water (Kemble) Finance plc's senior secured debt at B1 with stable outlook (2020: B1 with stable outlook).

Dividends

The Company's dividend policy is to pay a progressive dividend commensurate with the long-term returns and performance of the business, after considering the business's current and expected regulatory and financial performance, regulatory restrictions, management of economic risks and debt covenants. Directors, in assessing the dividend to be paid, are required to ensure that:

- Payment of a proposed dividend should not impair short term liquidity or compliance with our covenants
- Payment of a proposed dividend should not impair the longer term financability of the Company's business
- Assessment of the impact that payment of the dividend may have on all stakeholders including employees, pension members and customers
- Our financial performance, that underpins the opportunity to pay the dividend, is as a result of operational performance that meets the level required of a supplier of essential services
- If a net dividend is declared above Ofwat's 4% dividend yield guidance, applied to Ofwat's notional company, the Thames Water Utilities Board will consider whether the additional returns result from performance (including progress towards degearing) that has benefited customers and may therefore be reasonably applied to finance a dividend.

No dividends or interest on shareholder debt was paid to external shareholders in 2020/21 The shareholders of the Company have supported the operating Company Board's decision to not pay dividends over and above those required by the Kemble Water Holdings Limited Group to service group debt obligations and working capital requirements during the 2015-2021 regulatory period, while investment is prioritised to improve service to customers.

Pensions

We operate four pension schemes for our employees – three defined benefit schemes and one defined contribution scheme. During 2020/21, we contributed £15.2 million (2020: £13.1 million) to the defined contribution scheme.

Our defined benefit scheme accounting valuation has been updated to 31 March 2021 on our behalf by independent consulting actuaries, Hymans Robertson LLP. The total net retirement benefit obligation for the three schemes as at 31 March 2021 was £ 226.8 million (2020: net retirement benefit obligation of £121.6 million).This comprises a £277.1m net deficit (2020: £209.1m net deficit) in the Thames Water Pension Scheme (TWPS), (which was closed to accrual during the year, a further net deficit of £7.6m (2020: £7.0 million net deficit) in the SUURBS pension scheme, and a surplus of £57.9m (2020: surplus of £94.5 million) for the Thames Water Mirror Image Pension Scheme (TWMIPS). We have been taking measures to reduce the overall deficit including regular contributions and deficit repair payments. The increase in the deficit is mostly driven by a change in actuarial assumptions primarily driven by external market factors, such as an increase in the discount rate.

Capital, financial and actuarial risk management policies and objectives

The Group's operations expose it to a variety of capital, financial and actuarial risks.

Capital risk management

Capital risk primarily relates to whether the Group is adequately capitalised and financially solvent. The key objectives of the funding strategy are to maintain customer bills at a level which is both affordable and sustainable, retain the Group's investment grade credit rating and provide liquidity sufficient to fund ongoing obligations.

The Board reviews the Group's exposure to these risks and actively oversees the treasury activities, reviewing the treasury policy and approving the treasury strategy and funding plan.

The capital structure of the Group consists of net debt and equity as disclosed in note 19. The Group's net debt is comprised of cash and cash equivalents, short-term investments, bank loans and intercompany loans from subsidiary undertakings that issue secured bonds.

The Group's funding policy is to maintain a broad portfolio of debt (diversified by source and maturity in order to protect the Group against risks arising from adverse movements in interest rates and currency exposure) and to maintain sufficient liquidity to fund the operations of the business for a minimum of a 15-month forward period on an on-going basis. Derivative financial instruments are used, where appropriate, to manage interest rate risk, inflation risk and foreign exchange risk. No open or speculative positions are taken.

Financial risk management

(i) Market risk

Market risk is the risk that changes in market variables, such as inflation, foreign currency rates and interest rates, will affect the Group's income or the value of its holdings of financial instruments. Financial instruments entered into by the Group include RPI linked bonds, loans and swaps. These instruments are exposed to movements in the UK RPI index. The principal operating company of the Group, TWUL, is a regulated water company with RPI linked revenues. Therefore the Group's index-linked borrowings form a partial economic hedge as the assets and liabilities partially offset. The Group also uses derivatives to manage inflation risk on non-index-linked borrowings.

The Group's foreign currency risk exposure results from debt raised in currencies other than Sterling. The Group uses cross currency swaps to hedge the foreign currency exposure of debt issued in a foreign currency. All hedges are undertaken for commercial reasons with the objective of minimising the impact of exchange rate fluctuations. The Group has no material unhedged monetary assets and liabilities denominated in a currency different from the local currency of the Group. Further disclosures regarding financial instruments can be found in note 19

Interest rate risk arises on interest-bearing financial instruments. Fixed rate borrowings are exposed to a risk of change in their fair value due to changes in interest rates. Floating rate borrowings are exposed to a risk of change in interest cash flows due to changes in interest rates. The Group uses interest rate swaps which economically hedge future cash flows to protect against interest rate movements.

(ii) Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's trade receivables, short-term investments and cash flows receivable from counterparties to the derivative financial instruments.

TWUL has a statutory obligation to provide water and wastewater services to customers within its region. Due to the large area served by TWUL and the significant number of household and business customers within this area, there is considered to be no concentration of trade receivables credit risk, however, TWUL's credit control policies and procedures are in place to minimise the risk of bad debt arising from its trade receivables. Amounts provided against trade receivables and movements in the provision in the year are disclosed in note 15.

(iii) Liquidity risk

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group manages long-term liquidity by maintaining continuity of funding through access to different market and debt instruments, raising funds in the capital markets and ensuring that manageable debt maturity profiles are maintained. The Group also maintains a level of committed liquidity facilities provided by a range of financial institutions. Details of the Group's borrowings and other financial instruments are disclosed in note 18 and 19, respectively.

Actuarial risks

The defined benefit pension schemes are exposed to actuarial risks including investment risk, inflation risk and longevity risk. For further details of these risks, please refer to note 23.

The trustees continue to control the level of investment risk within the schemes by reducing the schemes' exposures to higher risk assets and increasing the level of protection against adverse movements in interest rates and inflation. The trustees also review the risk exposures taking into consideration the longer term objectives of the respective schemes.

Viability statement

The Directors have assessed the longer-term viability of the Group over a ten year period to 31 March 2031. Due to the prolonged look-forward period, the level of certainty of the assumptions used reduces the further into the future we look. The high degree of confidence for the first few years of AMP7, is followed by moderate confidence in the remaining years of AMP7 and a lower level of confidence for AMP8 and AMP9. In spite of the reduced confidence levels in the later years of the look forward period, the Directors continue to consider the ten year period to be appropriate given the long term nature of the business, and the necessity to adopt a sustainable approach.

The Directors have considered the current position of the Group, its ability to effectively and efficiently manage its finances, the current regulatory regime, its continued access to the debt markets, and its ability to maintain a strong investment grade credit rating, whilst having regard to the principal risks and uncertainties as described on pages 4 to 12.

The performance of the Group is mainly dependent on the appointed activities of TWUL which is responsible for the supply of water and wastewater services to customers in London, the Thames Valley and surrounding area. As such, this assessment takes into account the long-term viability of TWUL where the Directors of TWUL have a reasonable expectation that TWUL will be able to operate within its financial covenants and maintain sufficient liquidity facilities to meet its funding needs over the same ten year assessment period.

As part of the Group's financial resilience assessment, management has designed a number of 'stress tests' which subject the Group's existing model, that underlies the Group's planning processes, to a number of severe but plausible scenarios and tests its sensitivity to these. The stress tests consider factors, both individually and in combination. These include:

- Fluctuations in interest rates, which could affect the cost of financing the business;
- Fluctuations in inflation rates, which could affect the cost of investment and day-to-day operations, in addition to impacting amounts we bill our customers;
- Increase in operating and capital expenditure, which would increase costs and reduce cash flows;
- Operational underperformance and the crystallisation of certain regulatory risk events leading to regulatory and legal penalties / fines; and
- Inability to secure new finance and/or delays in raising finance, reducing the cash available to deliver our investment programme.

The assessment showed, in the absence of any mitigating actions, that there are severe but plausible downsides which indicated the need to undertake mitigating actions to avoid non-compliance of financial covenants. It should be recognised that such pressure on the Group's viability is based on hypothetical sensitivities where the probability of these scenarios occurring is uncertain. The analysis showed pressures crystallising at a point in time well into the assessment period, thereby providing sufficient time to implement any mitigating actions if so required. As part of its risk management, the Directors regularly monitor compliance of financial covenants, so as to ensure any issues are appropriately addressed to avoid or reduce the impact of occurrence of the underlying risk.

The Directors believe there are a number of options available, these include but are not limited to the following:

- Modifying or temporarily waiving existing financial covenants and debt amortisations;
- Improving liquidity by increasing the size of its existing £110 million bank facility. This would extend the period over which the Company is able to meet the interest payments of its external debt in the event that there are no distributions from TWUL or when the Company exceeds certain financial covenants. Currently the facility is expected to cover more than 18 months of interest payments; and
- Raising additional capital in the form of deeply subordinated instruments and / or equity from shareholders.

The viability of the Group is heavily influenced by the Company's ability to service external (non-shareholder) debt. Noticeably, these costs have been met by distributions from TWUL. In circumstances where distributions were not made available by TWUL, the Company, as mentioned above, has access to a £110 million bank facility which is sufficient to cover more than 18 months of interest payments. In the event where the absence period of such distributions exceeded that provided by the bank facility, the Company would be reliant on additional support from its shareholders to meet its obligations. The Directors of the Company have discussed this matter with the shareholders, whom they represent, and are confident that support would be available if required.

Taking account of the range of scenarios, the Directors consider that the Group has sufficient mitigating actions available to address particular circumstances and events, should they arise. The Directors 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 assessment. This conclusion has been made assuming capital markets continue to operate under normal market conditions and that no renationalisation of the water sector take place over the assessment period.

s172 reporting

The Directors of the Company must act in accordance with the duties contained in s172(1) of the Companies Act 2006 as follows:

> "A Director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the Company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to:
>
> (a) the likely consequences of any decision in the long term;
>
> (b) the interests of the Company's employees;
>
> (c) the need to foster the Company's business relationships with suppliers, customers and others;
>
> (d) the impact of the Company's operations on the community and the environment;
>
> (e) the desirability of the company maintaining a reputation for high standards of business conduct; and
>
> (f) the need to act fairly as between members of the Company."

On appointment, as part of their induction of becoming a Director, each Director is briefed on their duties and the availability of professional advice from either the Company Secretary or, if they consider it necessary, from an independent adviser. The Directors of the Company have access to the resources provided to the Directors of the Group's main trading company, Thames Water Utilities Limited.

During the year, the Company has continued to act as an intermediate holding company within the Kemble Water Holdings Limited group. Day-to-day running of the Company is managed by the Company's management team, consisting of employees from the Group's main trading company, Thames Water Utilities Limited. During the year updates of debt issuance programme documentation and renewal of facilities, reviewing the impact of the price control review, and the approval of the Company's annual report and financial statements. The Company had no employees during the year, or as at the date of this report, nor did it have any external customers or trading arrangements with suppliers.

Likely consequences of decisions in the long term

Much of the Board's decision making is focussed around ensuring that the Group's business is sustainable in the long term. The consideration of the impact to Ofwat's price control review and the Group's response is consistent with that objective.

Stakeholder management

The Company's stakeholders are considered to be external debt investors, shareholders and other companies within the Kemble Water Holdings Limited Group. The Company places considerable importance on communication with investors and through a Group-wide approach, regularly engages with them on a wide range of topics. The Group's Head of Corporate Finance is responsible for facilitating communication with investors and analysts and maintains an active investor relations programme. Wider stakeholder engagement occurs regularly throughout the year, both formally and informally.

Community and Environment

The Board supports the Group-wide commitment to seeking to continually improve the delivery of water and wastewater services in the most sustainable way, which means complying with regulation, delivering public value and leaving the environment in a better state than we found it at the end of each regulatory period.

The Board of Directors of the Company consider, both individually and together, that they have acted in the way they consider, in good faith, would be most likely to promote the success of the Company for the benefit of its members as a whole, having regard to the stakeholders and matters set out in s172(1)(a-f) of the Companies Act 2006. The Board of Directors manage the Group and further details of how they have carried out their duties is disclosed in the financial statements of the ultimate controlling party Kemble Water Holdings Limited. The Group's annual report is available from the address shown in note 29.

Approved by the Board of Directors on 5 July 2021 and signed on its behalf by:

P Noble
Director

Clearwater Court
Vastern Road
Reading
Berkshire
RG1 8D

Directors' report

The Directors present their annual report and the audited financial statements of Kemble Water Finance Limited (the "Company") and the audited consolidated financial statements of its Group ("the Group") for the year ended 31 March 2021. These are the Group and Company's statutory accounts as required to be delivered to the Registrar of Companies. This Directors' report includes certain disclosures required under the Companies Act 2006.

The Directors consider that the annual report and audited financial statements, taken as a whole, is fair, balanced and understandable, and provides the information necessary for shareholders to assess both the Group's and Company's position and performance, business model and strategy.

The Directors have carried out a robust assessment of the principal risks and emerging risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity, and details of these risks and their management or mitigation can be found on pages 4 to 12.

The registered number of the Company is 05819317 (England and Wales).

Principal activity

The Group's principal activity is the appointed supply of water and wastewater services to customers in London, the Thames Valley and surrounding area, delivered through its wholly owned subsidiary Thames Water Utilities Limited ("TWUL" or "Thames Water") in accordance with TWUL's licence of appointment.

Details of the associated and subsidiary undertakings of the Group at 31 March 2021 has been provided in the notes to these financial statements.

Future outlook

The future outlook of the Group is discussed in the strategic report.

Directors

The Directors who held office during the year ended 31 March 2021 and to the date of this report were:

M McNicholas	
S Deeley	
J Divoky	
A Hall	
G Lambert	
P Noble	
S Obozian	(appointed 16 November 2020)
G Pestrak	
C Schmidt	(appointed 30 November 2020)
G Tucker	(appointed 21 May 2020)
M Bloch-Hansen	
E Howell	(resigned 8 April 2020)
C Pham	
F Sheng	
J Cogley	(resigned 21 May 2020)
B Moncik	(resigned 21 May 2020)
I Grund	(resigned 16 November 2020)
P McCosker	
M Wang	
H De Run	(appointed 8 April 2020)
Y Deng	(appointed 21 May 2020)

During the year under review, none of the Directors had significant contracts with the Company or any other body corporate other than their contracts of service (2020: none). Directors are allowed to appoint an alternative Director to represent them if they are unable to attend a meeting. The following Directors have formally appointed alternate Directors to represent them when they are unavailable:

Director	**Alternate Director**
C Pham	J Divoky
P Noble	H De Run
A Hall	S Obozian
M Bloch-Hansen	S Obozian
G Lambert	P McCosker
M McNicholas	S Obozian
G Tucker	C Schmidt

Directors' indemnities

Subject to the conditions set out in Section 234 of the Companies Act 2006 and subject to shareholder approval the Group has made qualifying third party indemnity provisions for the benefit of its Directors and for the benefit of other persons who are directors of associated companies of the Group and these remain in force at the date of this report.

Share capital

As at 5 July 2021, the Company's issued share capital was 1,000,001 ordinary shares of £1 each amounting to £1,000,001. There were no movements in the Company's share capital during the year. Further details of the Company's share capital can be found in note 22.

Operations outside the United Kingdom

There are no active operations conducted outside the United Kingdom.

Going concern

The Group is in a net current liabilities position of £188.3 million as at 31 March 2021. The viability of the Group beyond the going concern assessment period of 12 months from the signing of the financial statements, is considered in the Long-Term Viability Statement on page 17.

The consolidated financial statements for the year ended 31 March 2021 have been prepared on the going concern basis. In forming this assessment the Directors have considered the Group's liquidity position, cashflow, profitability, compliance with covenants and the potential impact of Covid-19 on financial performance.

The Directors believe, after due and careful enquiry, that the Group has sufficient resources to meet its present obligations as they fall due for a period of at least 12 months from the date of approval of the consolidated financial statements. For this reason, the Board considers it appropriate to adopt the going concern basis in preparing the financial statements.

Although in a net current liabilities position, the Group has considerable financial resources and a strong liquidity position for at least the 12 months from the signing of these financial statements. The Group has cash and cash equivalents of £806.8 million. It also has ongoing revenue streams and a great diversification of customer types. Revenue includes the set amounts which can be expected to be collected from customers and the rewards/penalties associated with operational out/under performance compared against certain targets set by the regulator.

The water sector in England and Wales has been much less affected to date than many other sectors by the COVID-19 pandemic. The existing regulatory framework provides protection against reduced revenues arising from lower consumption and the regulatory recovery mechanisms ensure that the economic value impact is generally immaterial. In addition, the impact of COVID-19 on the Group's ability to provide essential water and wastewater services has been mitigated through Government's recognition that these services are essential and the Group's quick response to enable effective working practices in the challenging operational environment. Moody's, a credit rating agency, identified the water industry as having low exposure to the coronavirus.

Management has assessed the likely impact of COVID-19 to the financial position of the Group, with particular focus on operating cashflows and the AMP7 capital programme, and currently predicts a short-term reduction in cash receipts and a deferral of a reasonable portion of the capital programme into future AMP7 years. The cash receipts impact is anticipated to come from deferred payments from household customers and lower billable volumes in the non-household sector, due to reduced consumption. Management has analysed scenarios to assess its going concern, which include plausible and severe downside scenarios, and in all cases we are a going concern in compliance with covenants and have adequate liquidity for a period of at least 12 months from the signing of these financial statements. To mitigate the impact of potential lower cash collections, Management are closely reviewing the operating cashflow, assessing and implementing changes to the collections process and the cost base in a considered manner to ensure optimal financial and operational performance. There remains a risk that the impact of COVID-19 is greater than that modelled by the Group.

The Group's business activities, together with the factors likely to affect its future development, performance and position, the financial position of the Group, its cash flows, liquidity position and borrowing facilities are set out in the strategic report. As a consequence of these factors and having accepted the five year plan for 2021-2025 (the Final Determination), the Directors believe that the Group is well placed to manage its business risks successfully and have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future.

The Directors believe, after due and careful enquiry, and noting that the Group is in a net current liabilities position as at the year end, that both the Group and Company have sufficient resources for their present requirements and are able to meet their liabilities as they fall due for the foreseeable future. For these purposes the foreseeable future is taken to mean a period of at least twelve months from the date of approval of these financial statements. This is based upon a review of the Group's and Company's financial forecasts for the forthcoming financial year, consideration of the Group's compliance with its covenants, and the cash, current asset investments and available facilities of the Group and Company.

On this basis the Directors consider it appropriate to prepare the financial statements on a going concern basis.

Corporate Governance

The Kemble Water Holdings Board is responsible for the long-term success of the Kemble Water Finance Limited Group by providing leadership and strategic direction on the Group's culture, values and purpose. It provides governance oversight and ensures effective management of risk. It balances the interests of our shareholders with those of our wide range of other stakeholders including customers, employees, and suppliers and the impact on local communities and the environment. The Board also serves as an Audit Committee for all entities with listed private placements that are not overseen by the TWUL Audit Risk and Reporting Committee. This includes Kemble Water Finance Limited. The Board is made up of Non-Executive Directors (NEDs), who are nominated and appointed by the Group's external shareholders, which is why they are not classified as independent. They provide strong experience of financial asset management and value creation, and constructively challenge and monitor the performance and delivery of the Group's strategy, as well as that of the TWUL Executive Board. The Kemble Board is not deemed to require a committee for Director Remuneration, Nomination, Regulatory Strategy, Customer Service, or the Health, Safety and Environment, as all such matters are closely monitored by committees reporting into the TWUL Board.

The Board's system of risk management and internal control aims to ensure that every effort is made to manage risk appropriately, rather than eliminate risk completely, and can only provide reasonable, rather than complete, assurance against material impact. Our management of risk supports this through a number of key company level internal controls and responses:

- Business planning, budgeting and forecasting. These activities support resilient operations and sustainable and robust finances. The annual budgeting exercise includes a detailed budget for the year and a view for remainder of the asset management plan ("AMP").
- Performance reporting – the Board and shareholders receive monthly management reports, including an overview of key performance metrics.
- System of delegated authority – delegated levels of decision making authority are reviewed and approved by the Board;
- Insurance – insurance programme and insurance team in place. The Board review and approve the strategic approach being taken to level and type of cover;
- Company policies, standards, guidelines and procedures – relevant governance documentation is reviewed regularly and is intended to manage our inherent risk;
- Code of conduct and Whistleblower hotline – code of conduct and confidential whistleblowing processes are in place to be investigated by a dedicated team.

Our Enterprise Risk Management and Internal Audit teams also provide reporting and assurance over our management of key business risks.

Financial risk management

During the period the Company had access to the Chairman and the Executive Team of TWUL, who also manage the wider Kemble Water Holdings Limited group ("KWH Group") on a day-to-day basis on behalf of the Directors of individual group companies. The Board receives regular reports from all areas of the business. This enables prompt identification of financial and other risks so that appropriate actions can be taken in the relevant group companies.

The Group's operations expose it to a variety of financial risks and information on the use of financial instruments by the Group to manage these risks is disclosed in the strategic report.

Political donations

No political donations were made by the Group or Company during the current or preceding year.

Charitable donations

Charitable donations of £3.8 million were made by the Group during the year (2020: £0.3 million).

Intellectual property

The Company protects intellectual property of material concern to the business as appropriate, including the filing of patents where necessary.

Research and development

The Group's research and development programme consists of a portfolio of projects designed to address technical needs across the range of water cycle activities, delivering innovative technical solutions aligned with business needs to address challenges and also provide specialist technical support to the business.

The development and application of new techniques and technology is an important part of the Group's activities. The Group is a member of UK Water Industry Research ("UKWIR") and participates and benefits from its research programme. The UKWIR research programme covers water, wastewater, sustainability, regulation, customers and asset management. In addition, we carry out research and development in-house, including solutions to improve the resilience of our water supplies, developing insight into the deterioration of critical assets, novel approaches to tackle leakage and pollutions from our water and wastewater networks respectively, and wastewater treatment processes to allow us to meet increasingly stringent regulatory requirements.

Expenditure on research and development totalled £11.2 million for the year (2020: £3.8 million).

Employee engagement

Over 80% of employees took part in our annual survey (2019/20: 84%) with an overall engagement score of 75% (2019/20: 64%). This demonstrates that our employees are willing to express how they are feeling about working at Thames – both the good aspects and what we can do to improve. Employees commented favourably on health and safety, diversity and inclusion and work/ life balance as well as the fact that they are proud to work for Thames Water.

We continuously seek to listen to and act on feedback from our employees, putting voices into action throughout the year. Ian Pearson continues to act as designated Non-Executive Director for workforce engagement – to take accountability for ensuring that workforce issues are appropriately considered by the Board. Ian is supported in this by the other members of the Board who actively participate in engagement activities. This year, Ian held 11 virtual employee engagement sessions with across the business, providing employees with informal opportunities to meet with and be listened to by Board members.

Our Executive team reviews feedback from a variety of sources including our 'Hear For You' survey and joint meetings with our recognised trade unions (UNISON, GMB and Unite), as well as internal Yammer communications and local feedback channels.

Recruitment, employment and training of disabled people

We are proud to be the first water company to be awarded Disability Confident Leader status, which we achieved in July 2019. This is a testament to our approach to attracting and retaining people with disabilities and long-term health conditions. We provide an automatic interview for people with disabilities who meet the essential criteria and utilise alternative formats and reasonable adjustments at every stage, such as the use of British Sign Language interpreters.

Throughout 2020/21 we have continued to raise awareness, educate, improve accessibility and nurture a culture of inclusion. This has included adaptation to deliver training virtually, using auto captions, voice overs and alternative formats. We have additionally updated our access to work standards to make the process more seamless for employees.

As a result, we have achieved a 16% increase in employee engagement among those with disabilities or long-term health conditions, and 77% of people with a disability or long-term health condition state that we are an inclusive equal opportunity employer.

Operational Greenhouse Gas Emissions and Energy Management

Our net operational emissions fell from 290.5 $kTCO_2e$ in 2019/20 to 268.2 $kTCO_2e$ in 2020/21, a reduction of 22.3 $kTCO_2e$ or 8%, when compared using a like-for-like methodology. Our total energy consumption fell from 1,879 GWh in 2019/20 to 1,618 GWh. We calculate our greenhouse gas emissions using the UK Water Industry Research Carbon Accounting Workbook ("CAW"). The CAW is the industry standard which is updated annually to reflect changes to emission factors and carbon reporting guidance from the Department for Environment, Food and Rural Affairs (Defra). Emissions of greenhouse gases are standardised to global warming potential represented as carbon dioxide equivalents ("CO_2e"). For 2020/21 the Water Industry updated its carbon accounting methodology and Thames Water updated its reporting approach. Using the newer methodology in 2019/20 would have resulted in higher reported operational emissions last year: 290.5 $ktCO_2e$ rather than our previously reported 257.9 $ktCO_2e$.

Key trends

In 2020/21 we made significant progress reducing our greenhouse gas emissions and improving our energy performance:

- We have achieved a reduction in our gross operational emissions of 7% since last year, based on a like-for-like methodology.
- We reduced our use of fossil fuels from 37.2 $kTCO_2e$ to 29.9$kTCO_2e$, a reduction of 20%.
- We reduced our total energy consumption by 61GWh, from 1,679 GWh to 1,618 GWh.
- Our total electricity consumption reduced by 40 GWh from 1,305 GWh to 1,265 GWh.
- We generated 23% of our electricity needs from on-site renewables.
- Covid lockdown restrictions impacted our renewable generation from sludge and resulted in a reduction of 12 GWh to 301 GWh.
- At the same time, we have increased our renewable heat generation by 15 GWh to 159 GWh.
- Together with our other renewables (wind and solar photovoltaics) we have increased our energy generation by 3GWh.

Where we're not able to produce our own renewable electricity, we continue to source Renewable Energy Guarantees of Origin ("REGO") accredited renewable electricity through contracts with our suppliers.

Our carbon targets

We have made a commitment to reduce our net carbon emissions from our operations to zero by 2030 and to then become net negative. We have already reduced our emissions by 68% compared to our 1990 baseline level, a 577.6 $ktCO_2e$ absolute reduction. A taskforce has been created to work towards our target of being a net negative carbon business. Some of the key aims as part of this target include maximising the energy and resource recovery from our sewage sludge, the electrification of our fleet of vehicles, and the increased efficiency of our assets.

Operational Greenhouse Gas Emissions and Energy Management (continued)

Emissions

During 2020/21, we reduced our gross operational emissions by 20.9 $kTCO_2e$ to 275 $kTCO_2e$, including 7.4 $kTCO_2e$ through reduced consumption of fossil fuels (decarbonisation) and 11.2 $kTCO_2e$ from reductions to our Wastewater and Sludge Process and Fugitive emissions.

Our net operational emissions reduced by 22.3 $kTCO_2e$ to 268.2 $kTCO_2e$, a fall of 8%. We have achieved numerous successes, realising emissions reductions through a combination of actions including:

- A 97% reduction in our emissions from fossil fuel use in combined heat and power ("CHP") engines, saving 1.8 $kTCO_2e$ – the equivalent of 5,000 flights from London to New York.
- Our CHP engines have also exported more renewable electricity when we did not need it ourselves, which has generated an additional 1.3 $kTCO_2e$ carbon offset.
- A 5% reduction in fossil fuel use in outsourced activities, saving 1.7$kTCO_2e$.
- Covid restrictions have also impacted the business, and we have seen a sharp 64% decrease, or 1.4 $kTCO_2e$ reduction, in emissions from business travel on public transport and private vehicles used for Company business.
- As a result of the decrease in the amount of sludge being received around London – caused largely by the impact of Covid-19 on working locations, usual residence and tourism – we focused on stabilising our digestion processes and switched off our Sludge Powered Generator at Beckton (which is a less efficient process), resulting in a 0.6 $kTCO_2e$ reduction in fossil fuel usage.

We have also reduced the emissions associated with each megalitre (Ml) of water and wastewater we supply and treat, and our emissions intensity.

Water:	18.8 $kgCO_2e$ per Ml	down 1.6 $kgCO_2e$ per Ml
Wastewater:	121.4 $kgCO_2e$ per Ml	down 12.1 $kgCO_2e$ per Ml

The emissions reported are associated with the operational emissions of the whole regulated operational business including our head offices and include:

- Scope 1 (Direct emissions).
- Scope 2 (Indirect energy use emissions).
- Scope 3 (Emissions from outsourced services and business travel).
- Carbon intensity ratios per megalitre day (Ml/d) of service delivered.

	FY2021 $kTCO_2e$	**FY2020 $kTCO_2e$** (like for like methodology)
Scope 1	225.0	242.7
Scope 2[1]	-	-
Scope 3	50.1	53.4
Gross	**275.1**	**296.1**
Net offs	(6.9)	(5.6)
Net	**268.2**	**290.5**

[1] Scope 2 – Renewable Energy Guarantees of Origin ("REGO") accredited renewable electricity purchased.

Energy

Supported by our ISO50001-certified Energy Management System, we have delivered energy efficiency improvements across both Water and Wastewater business units. We have reduced the net electricity intensity for each megalitre of water and wastewater we supply and treat.

Water:	523 kWh/Ml	down 0.4%
Wastewater:	249 kWh/Ml	down 2%

This was achieved through a series of actions including efficiencies and generation increases at several sites, notable examples being:

- At Maple Lodge STW, in April 2020 (despite Covid) we commissioned two brand-new CHP engines replacing the four very old, smaller and less efficient dual-fuel engines. This has enabled us to generate 6.8 GWh more renewable electricity, cutting fossil fuel use by 6.9 GWh and our carbon emissions by over 1.8 $kTCO2e$ in the last year.

- At Crossness STW, we have reconfigured the sludge treatment process to produce more of the steam we need from renewables. Steam is used to heat and help break down sludge, creating sewage gas during the digestion process. Sewage gas is then re-used in the THP boilers to produce heat and in the CHP engines to produce heat and electricity. This has helped us reduce our fossil fuel use at process level by 49% and save over 3.6 $kTCO2e$ carbon emissions.

- At Turnford Borehole, we have installed a new electrical system – Variable Speed Drive (VSD) – on the pump. VSD allows better control of pump flowrate, allowing site to cope with a dynamic demand more efficiently. The delivery of this investment saved approximately 320 MWh per year, which equates to the annual consumption of nearly 100 homes.

Funding

In anticipation of our 2020 to 2025 investment programme, during the year ended 31 March 2019 TWUL Group increased the size of its Revolving Credit Facility (RCF) from £950.0 million to around £1.65 billion, and in November 2020 extended the maturity of £1.44 billion of that facility by one year from 2024 to 2025. Throughout the year, total new debt issuance and facilities of £1,187 million equivalent were completed in TWUL Group, as follows:

- £350 million bond due 2040 issued in April 2020;
- £40 million of privately placed debt due 2050 was issued in May 2020, along with a £110 million term loan maturing in 2023, which was subsequently cancelled in line with other financing initiatives;
- £612 million equivalent of debt was issued through a series of privately placed transactions (£84.7 million due 2023; €500m due 2023; $57 million due 2030 and $40 million due 2027) between October and December 2020; and
- £75 million Class B revolving credit facility commencing in April 2021 and maturing in April 2024 was entered into in November 2020

Since 31 March 2021, TWUL Group has further strengthened its financing position, entering into a £180.0 million Class B loan facility due June 2026, which is currently undrawn. Since 31 March 2021, £525.0 million of the Class A RCF has been drawn and the following debt has been repaid:

- £214.3 million Class B RCF
- £225.0 million Class A bond due April 2021
- £300.0 million Class B term loan due June 2023

The Company raised £100 million of new debt through two £50 million privately placed transactions in July and August 2020 respectively. In September 2020, £80 million of this was down-streamed through intercompany loans and loan repayments to enable TWUL to repay debt. A further £380 million of loan repayments by the holding companies to TWUL are planned during AMP7, to enable TWUL to repay debt. In November 2020, Thames Water (Kemble) Finance plc, the Company's financing subsidiary, raised £250 million due 2026 through a public bond issue, which was increased by £150 million to £400 million in February 2021. The proceeds were used in November 2020 to repurchase, through a public tender, £60 million of the issuer's bond debt due in 2022, and in December 2020 for the early repayment by the Company of a £75 million loan due in 2022.

Disclosure of information to the auditor

In accordance with Section 418 of the Companies Act 2006, the Directors who held office at the date of approval of this Directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditors are unaware; and each Director has taken all the steps that they ought to have taken as Director to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Independent auditors

Pursuant to section 487 of the Companies Act 2006, the auditors, PricewaterhouseCoopers LLP, have indicated their willingness to continue in office and a resolution concerning their reappointment will be proposed at the Annual General Meeting.

Approved by the Board of Directors on 5 July 2021 and signed on its behalf by

P Noble
Director

Clearwater Court
Vastern Road
Reading
Berkshire
RG1 8DB

Statement of directors’ responsibilities in respect of the financial statements

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulation.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the group and the company financial statements in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006.

The group and company have also prepared financial statements in accordance with and international financial reporting standards adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union.

Under company law, directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the group and company and of the profit or loss of the group for that period. In preparing the financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- state whether applicable international accounting standards in conformity with the requirements of the Companies Act 2006 and international financial reporting standards adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union have been followed, subject to any material departures disclosed and explained in the financial statements;
- make judgements and accounting estimates that are reasonable and prudent; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group and company will continue in business.

The directors are also responsible for safeguarding the assets of the group and company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the group’s and company’s transactions and disclose with reasonable accuracy at any time the financial position of the group and company and enable them to ensure that the financial statements comply with the Companies Act 2006.

The directors are responsible for the maintenance and integrity of the company’s website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Directors’ confirmations
In the case of each director in office at the date the directors’ report is approved:

- so far as the director is aware, there is no relevant audit information of which the group’s and company’s auditors are unaware; and
- they have taken all the steps that they ought to have taken as a director in order to make themselves aware of any relevant audit information and to establish that the group’s and company’s auditors are aware of that information.

P Noble
Director

Clearwater Court
Vastern Road
Reading
Berkshire
RG1 8DB

Independent auditors' report to the members of Kemble Water Finance Limited

Report on the audit of the financial statements

Opinion

In our opinion, Kemble Water Finance Limited's group financial statements and company financial statements (the "financial statements"):

- give a true and fair view of the state of the group's and of the company's affairs as at 31 March 2021 and of the group's loss and the group's and company's cash flows for the year then ended;
- have been properly prepared in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the Annual report and consolidated financial statements (the "Annual Report"), which comprise: the consolidated and company statements of financial position as at 31 March 2021; the consolidated income statement, the consolidated statement of other comprehensive income, the consolidated and company statements of cash flows, and the consolidated and company statements of changes in equity for the year then ended; the accounting policies; and the notes to the financial statements.

Our opinion is consistent with our reporting to the Kemble Water Holdings Board.

Separate opinion in relation to international financial reporting standards adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union

As explained in the accounting policies to the financial statements, the group and company, in addition to applying international accounting standards in conformity with the requirements of the Companies Act 2006, have also applied international financial reporting standards adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union.

In our opinion, the group and company financial statements have been properly prepared in accordance with international financial reporting standards adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union.

Basis for opinion

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

Independence

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

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided.

Other than those disclosed in note 2 to the financial statements, we have provided no non-audit services to the company or its controlled undertakings in the period under audit.

Our audit approach

Overview

Audit scope

- Two significant components within the group are subject to a full scope audit; Thames Water Utilities Limited and Thames Water Utilities Finance Plc.
- Two additional entities, Kemble Water Finance Limited and Thames Water (Kemble) Finance Plc, were considered in scope for certain financial statement line items, to obtain sufficient coverage of the cash, borrowings and finance expenses of the group.
- For the company only accounts and the significant components we tested both the design and operation of relevant business process controls and performed substantive testing over material financial statement line items.

Key audit matters

- Valuation of financial derivatives (group)
- Provision for bad and doubtful debts (group)
- Valuation of retirement benefit obligation (group)
- Classification of costs between capital and operating expenditure (group)
- Impact of COVID-19 (group and parent)
- Investment in Subsidiaries (parent)
- Recoverability of Goodwill (group)

Materiality

- Overall group materiality: £30m (2020: £30m) based on 0.14% of total assets.
- Overall company materiality: £53.5m (2020: £49.1m) based on 1% of total assets.
- Performance materiality: £22.5m (group) and £40.1m (company).

The scope of our audit

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

Key audit matters

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

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

The key audit matters below are consistent with last year.

Key audit matter	How our audit addressed the key audit matter
Valuation of financial derivatives (group) The group derivative position as at 31 March 2021 was an asset of £163m (2020: £374m) and liability of £1,470m (2020: £1,061m). The net derivative fair value as at 31 March 2021 was a liability of £1,307m (2020: £687m). The valuation of derivatives is designated as a significant risk as the total fair value of the derivative contracts are material, the valuation methodology can be judgemental and some of the contracts are unusual, complex or long dated which can cause additional complexities. Refer to note 19 of the financial statements.	Our procedures included: Obtaining independent confirmations from the external counterparties and contracts to confirm the existence and terms of all derivative contracts held. Engaging with our valuations team who have performed independent testing of the pre-credit risk adjusted valuations for a sample of the derivative population. Performing procedures to assess the validity of assumptions and calculations management have made in performing the credit risk component of fair value. Performing an analysis of the directional movement in the derivative position relative to movements in inflation, exchange rates and interest rates. Testing management controls in operation to reconcile the derivative valuations to those provided by the external counterparties. Overall, we consider that the valuation methodology and judgements management have used are reasonable and the fair values recorded at the balance sheet date are appropriate.
Provision for bad and doubtful debts (group) The recoverability of customer debts is always a key issue for water companies. The company uses significant judgements and estimates to determine their provision for bad and doubtful debts, which amounted to £146m (2020: £188m). Management makes key assumptions based on historical trends relating to non-payment of invoices including	We evaluated the model used to calculate the provision and confirmed its consistency with prior years (excluding the COVID-19 overlay) and the appropriateness of the model in line with requirements of IFRS 9. We also tested the underlying data upon which the calculations were based and assessed the appropriateness of the judgements applied in calculating the provision, using the latest available cash collection, cancellation and rebill data for the current year.

comparisons of the relative age of the individual balance and consideration of the actual write-off history. These historical trends are used as a basis to assess expected credit losses in the future. These assumptions are then used in a complex model to compute the provision for bad and doubtful debt, which is sensitive to changes in these assumptions. The provision includes an additional overlay in the current year, consistent with prior year, to reflect the potential impact of the COVID-19 pandemic, which involves a high degree of estimation uncertainty. Management have also considered plausible downside scenarios in assessing the impact of COVID-19 on the receivable balance. Refer to note 15 of the financial statements.	We re-performed the calculations used in the model and ensured accuracy of these calculations. We challenged management's assumptions used in the model and tested a sample of inputs. We also tested a sample of receivables to ensure appropriateness of the aging classifications used in the model. We assessed the various downside scenarios considered by management on account of COVID-19 and tested the additional overlay provision. We challenged management's assumptions with regards to the impact of COVID-19 on the future cash flows and recoverability of trade receivables based on our understanding of the business and industry knowledge. In addition, we performed sensitivity analysis on the downside scenarios considered by management. The result of the sensitivity analysis showed that the downside scenario considered by management is reasonable and did not have a material impact on management's assessment. We also assessed the adequacy of disclosures in the notes to the financial statements of the key judgements and estimates involved in the provision for bad and doubtful debts and the impact of COVID-19 on trade receivables. Overall we consider that the provision and disclosure for bad and doubtful debts is reasonable as at 31 March 2021.
Valuation of retirement benefit obligation (group) Valuation of total scheme liabilities £2,729m (2020: £2,523m). The valuation of retirement benefit obligations requires significant levels of judgement and technical expertise, including the use of actuarial experts to support the directors in selecting appropriate assumptions. Small changes in a number of the key financial and demographic assumptions used to value the retirement benefit obligation, (including discount rates, inflation rates, salary increases and mortality) could have a material impact on the calculation of the liability. The pension liability and disclosures are also an area of interest to key stakeholders; this is especially so in the current year in light of the COVID-19 crisis and the new triennial valuations completed. Refer to note 23 of the financial statements.	We used our own actuarial experts to evaluate the assumptions made in relation to the valuation of the scheme liabilities. We benchmarked the various assumptions used (e.g. discount, inflation rates and mortality assumptions) and compared them to our internally developed benchmarks; assessed the salary increase assumption against the group's historical trends and expected future outlook; considered the consistency and appropriateness of methodology and assumptions applied compared to the prior year end. The last formal triennial valuation took place as at 31st March 2019 and this has been used in the calculation of the defined benefit obligation although the actuary has refined their calculation for information received from the scheme actuary. This information comes in the form of the underlying cashflows from the triennial valuation. In order to get comfortable with this approach and conclude that the accounting liabilities are reasonable, we have performed an independent roll forward from the valuation results to the accounting results and were able to agree to within materiality levels. We assessed the impact on COVID-19 on the scheme assets to ensure that the scheme assets were able to be valued accurately at the balance sheet date based on current valuations. The impact of COVID-19 on the financial assumptions has been included in the bond yields and inflation curves used as they are based on market conditions at the reporting date so include the impact of the pandemic. We note the TWPS closed to future accrual during the year. We have assessed the actuary's treatment of the closure and have been able to conclude it as reasonable. Overall, we concur that the methodology and assumptions used by management at 31 March 2021 are reasonable.
Classification of costs between capital and operating expenditure (group) Additions to Assets under construction (AUC) during the period amounted to £1,021bn (2020: £1,105bn). Within this is £220m (2020:£183m) of own works capitalised and £70m (2020: £94m) of borrowing costs incurred with the remainder being external costs incurred.	We have tested the controls regarding the assessment by management of each project as being either operating or capital in nature.

There is a high degree of judgement applied when allocating costs to operating and capital expenditure given the nature of certain projects which include both repairs and maintenance as well as asset enhancement. There is therefore the potential for misstatement between the income statement and the statement of financial position. In addition, internal expenditure including staff costs to support capital projects is capitalised only if it can be demonstrated that it is directly attributable to the asset, provides probable economic benefit to the company and can be measured reliably. There is a risk that costs capitalised do not meet these criteria. Refer to note 12 of the financial statements.	For a sample of projects open during the financial year we ensured that the classification of expenditure into capital or operating is consistent with how this has been classified in the financial statements. We performed sample testing at an individual expense level of costs classified within both AUC additions and those shown as repairs and maintenance accounts in the period. We then agreed these to third party evidence to verify the amount and so to assess whether the costs have been classified appropriately. We tested the borrowing costs calculation and the qualifying projects involved. Our procedures over own works capitalised included: - Testing the control process over assessing the level of spend incurred by each cost centre that should be capitalised. - Obtaining management's assessments of what spend by cost centre should be capitalised and noted that a consistent approach to the prior year has been used, adequate consideration at an individual cost centre level is being applied and that there is no indication of bias. - Performing sample testing at a cost centre level and challenged management as to the nature of these costs and whether they meet the capitalisation criteria. Overall, we consider that the judgements management have made over the classification of costs as operating or capital are reasonable at 31 March 2021 and estimates used in calculating relevant costs to be capitalised to be appropriate.
Impact of COVID-19 (group and parent) The company is an intermediate parent company to Thames Water Utilities Limited ('TWUL') which is the main trading entity of the Kemble Water Holdings Limited Group ('Group'). The impact of COVID-19 on the Group is therefore principally driven by the impact to TWUL. Relative to companies in other industries the impact to TWUL whilst signfiicant, has not resulted in a shut down of operations as the company continued to fulfil its primary responsibility to provide water and waste water services (aided by its employees being deemed essential workers) throughout the year. It has also not made direct use of any COVID-19 relief schemes. COVID-19 has had an impact on the group's cash flows (receivables from household customers having a significant impact) specifically in relation to variances in consumption levels compared to pre pandemic levels with increased demand from householders as its customers worked from home, and decreased demand in its Non-household business as offices and retailers closed or operated at reduced capacity for much of the financial year. The pandemic has also seen increased pressure on customers ability to pay their bills and operational cost changes as the company responded to geographical changes in demand, with increased pressure on water treatment sites outside of London as demand patterns changed. Considering the above the specific areas of the financial statements where we have assessed the impact of COVID-19 are as below: • Going concern- As the company is reliant on a letter of support from Kemble Water Holdings Limited ('KWH'), which in turn is reliant on the performance of its main trading subsidiary TWUL, our work has considered the impact of COVID-19 on TWUL and the KWH Group and the impact the pandemic has had on the Group to	Our response to the risk arising from the impact of COVID-19 is set out below: • Going concern: Refer to our procedures in respect of going concern as set out below. • Investment in subsidiaries (Parent)- Refer to Key Audit Matter 'Investment in subsidiaries' • Recoverability of Goodwill (Group)- Refer to Key Audit Matter 'Recoverability of Goodwill) In addition, we have considered other impacts of COVID-19 on the Company and specifically the increased level of remote working, on the Company's internal control environment, including fraud risk, business process control activities, IT general controls and cyber risk. We performed all of our standard walkthrough procedures via video conference. Based on the inquiries performed and the results of our audit procedures, we did not identify any evidence of a significant deterioration of the control environment. Overall, we consider management's assessment of the impact of COVID-19 on the financial statements to be reasonable.

remain compliant with financial covenants and its ability to refinance its debt. Refer to the Accounting policies of the financial statements for more information. • Investment in subsidiaries (Parent). Refer to Accounting Policies and Note 32 of the financial statements. • Recoverability of Goodwill (Group) Refer to Accounting Policies and Note 9 of the financial statements.	
Investment in Subsidiaries (parent) Investments at 31 March 2021 is £4,292.3m (2020: £4,292.3m) and is required to be assessed annually for impairment. The assessment is based on the deemed recoverable amount compared to the book value and requires the use of significant estimates which are subjective. The key estimates and assumptions assessed include the Regulatory Capital Value (RCV) and the expected premium on RCV that an investor would pay to purchase a controlling share in the group. Refer to Note 32 of the financial statements.	Our procedures included: We have obtained management’s model and verified the mathematical accuracy of calculations used. We have reviewed the assessment management have performed to determine the premium on RCV and determined that the assessment performed is reasonable. We have traced net debt used in management's assessment at 31 March 2021 to the audited financial statements. We have verified the RCV used by management to the latest Ofwat publication. Overall, we concur with the assessment that management have made and that there is no impairment at 31 March 2021.
Recoverability of Goodwill (group) Goodwill at 31 March 2021 is £1,468.1m (2020: £1,4681.1m) and is required to be assessed annually for impairment. The assessment is based on the deemed recoverable amount compared to the book value and requires the use of significant estimates which are subjective. The key estimates and assumptions assessed include the Regulatory Capital Value (RCV) and the expected premium on RCV that an investor would pay to purchase a controlling share in the group. Refer to note 9 of the financial statements.	Our procedures included: We have obtained management’s model and verified the mathematical accuracy of calculations used. We have reviewed the assessment management have performed to determine the premium on RCV and determined that the assessment performed is reasonable. We have agreed the net debt used in management’s assessment at 31 March 2021 to the audited financial statements. We have also verified the RCV used by management to the latest Ofwat publication. Overall, we concur with the assessment that management have made and that there is no impairment at 31 March 2021.

How we tailored the audit scope

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

Our scoping is based on the group’s consolidation structure. We define a component as a single reporting unit which feeds into the consolidation. Two legal entities in the group were considered financially significant and therefore subject to full scope audits for group purposes; Thames Water Utilities Limited due to holding the significant proportion of the group's total assets and all its trade and Thames Water Utilities Finance Plc due to holding a significant amount of the group's external debt.

Two additional entities, Kemble Water Finance Limited and Thames Water (Kemble) Finance Plc, were considered in scope for certain financial statement line items, in order to obtain sufficient coverage of the cash, borrowings and finance expenses of the group. We additionally obtained full coverage over the consolidation journal entries for the group.

Materiality

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

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

	Financial statements - group	Financial statements - company
Overall materiality	£30m (2020: £30m).	£53.5m (2020: £49.1m).
How we determined it	0.14% of total assets	1% of total assets
Rationale for benchmark applied	Total assets has been determined to be the appropriate benchmark for both significant components of the group, therefore group materiality will also be based on total assets. For Public Interest Entities (PIE) a percentage of up to 1% of total assets is typical. However, we have considered multiple factors and given due consideration to other benchmarks, using the lower percentage of 0.14% of total group assets was deemed to be most appropriate.	Total assets has been determined to be the appropriate benchmark for the company as it is a holding company with no revenue of its own. For Public Interest Entities (PIE) a percentage of up to 1% of total assets is typical.

For each component in the scope of our group audit, we allocated a materiality that is less than our overall group materiality. The range of materiality allocated across components was £25.5 million and £28.5 million. Certain components were audited to a local statutory audit materiality that was also less than our overall group materiality.

We use performance materiality to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds overall materiality. Specifically, we use performance materiality in determining the scope of our audit and the nature and extent of our testing of account balances, classes of transactions and disclosures, for example in determining sample sizes. Our performance materiality was 75% of overall materiality, amounting to £22.5m for the group financial statements and £40.1m for the company financial statements.

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

We agreed with the Kemble Water Holdings Board that we would report to them misstatements identified during our audit above £3.0 million (group audit) (2020: £3.0million) and £2.9million (company audit) (2020: £2.9million) as well as misstatements below those amounts that, in our view, warranted reporting for qualitative reasons.

Conclusions relating to going concern

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

- Assessing the ability of management to rely on the letter of support it has obtained from KWH through assessing the ability of the KWH group to remain compliant with the various financial covenants that the group is subject to. In addition we have assessed the group's ability to meet its liabilities as they fall due and what financial support the wider group may require and whether this would impact the ability of KWH to support the company.
- Obtaining covenant compliance certificates and verifying the mathematical accuracy and testing inputs back to either the year end financial numbers or for forecasted information to the Board approved budget.
- Assessing the disclosure given in the financial statements in respect of going concern and whether it gives a fair and balanced view.

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

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

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

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

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

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

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

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

Strategic report and Directors' Report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic report and Directors' Report for the year ended 31 March 2021 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

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

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

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

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

Auditors' responsibilities for the audit of the financial statements

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

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

Based on our understanding of the group and industry, we identified that the principal risks of non-compliance with laws and regulations related to Ofwat Regulations including licence conditions, Environmental regulations, Listing rules, Pension legislation and Tax legislation, and we considered the extent to which non-compliance might have a material effect on the financial statements. We also considered those laws and regulations that have a direct impact on the financial statements such as the Companies Act 2006. We evaluated management's incentives and opportunities for fraudulent manipulation of the financial statements (including the risk of override of controls), and determined that the principal risks were related to the posting of journal entries to manipulate the financial results in the year, specifically journals to increase revenue, to reclassify costs from the income statement to Property Plant and Equipment or to conceal the misappropriation of cash. We have also considered the risk of management bias in forming its significant accounting judgements or estimates and in the related disclosures. Audit procedures performed by the engagement team included:

- Discussions and inquiries of management, internal audit function and legal counsel, including consideration of known or suspected instances of non-compliance with laws and regulation and fraud;
- Evaluation of management's controls designed to prevent and detect irregularities;
- Challenging assumptions made by management in determining significant accounting estimates and judgments. In particular in relation to the Key Audit Matters as set our in our report along with provisions and contingent liabilities as detailed in notes 21 and 25 respectively. We have tested significant accounting estimates and judgements to supporting documentation, considering alternative information where appropriate along with considering the appropriateness of the related disclosures in the financial statements;
- Identifying and testing a sample of journal entries throughout the whole year, which met our pre-determined fraud risk criteria;
- Reviewing minutes of meetings of those charged with governance and reviewing internal audit reports.

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

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

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

Use of this report

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

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

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

We have no exceptions to report arising from this responsibility.

Appointment
Following the recommendation of the Kemble Water Holdings Board, we were appointed by the directors on 27 June 2018 to audit the financial statements for the year ended 31 March 2019 and subsequent financial periods. The period of total uninterrupted engagement is 3 years, covering the years ended 31 March 2019 to 31 March 2021.

Katharine Finn (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP

Chartered Accountants and Statutory Auditors

Reading

5 July 2021

Consolidated income statement

For the year ended 31 March

		2021			2020		
	Note	**Underlying £m**	**BTL £m**	**Total £m**	Underlying £m	BTL £m	Total £m
Revenue	1	**2,033.0**	**73.8**	**2,106.8**	2,108.6	64.3	2,172.9
Operating expenses excluding net impairment losses on financial and contract assets [1]	2	**(1,727.6)**	**-**	**(1,727.6)**	(1,654.3)	-	(1,654.3)
Net impairment losses on financial and contract assets	2	**(36.5)**	**(0.2)**	**(36.7)**	(40.6)	(0.2)	(40.8)
Total operating expenses	2	**(1,764.1)**	**(0.2)**	**(1,764.3)**	(1,694.9)	(0.2)	(1,695.1)
Other operating income	4	**122.2**	**-**	**122.2**	79.4	-	79.4
Operating profit		**391.1**	**73.6**	**464.7**	493.1	64.1	557.2
Finance income	5	**174.7**	**-**	**174.7**	73.2	-	73.2
Finance expense	6	**(1,065.0)**	**-**	**(1,065.0)**	(1,085.6)	-	(1,085.6)
Net (losses)/gains on financial instruments	7	**(524.9)**	**-**	**(524.9)**	190.8	-	190.8
(Loss)/profit on ordinary activities before taxation		**(1,024.1)**	**73.6**	**(950.5)**	(328.5)	64.1	(264.4)
Taxation on loss/(profit) on ordinary activities	8	**192.8**	**(14.0)**	**178.8**	(61.2)	(6.1)	(67.3)
(Loss)/profit for the year		**(831.3)**	**59.6**	**(771.7)**	(389.7)	58.0	(331.7)

[1] Underlying operating expenses for the year ended 31 March 2021 includes £16.3 million (31 March 2020: £27.7 million) of costs that are considered to be exceptional. A summary of exceptional costs is included within note 3.

The Group activities above are derived from continuing activities.

Bazalgette Tunnel Limited ("BTL") is an independent company, appointed in 2015 to construct the Thames Tideway Tunnel. We have recognised revenue, cost and profit on the arrangement with BTL and have disclosed our underlying performance separately as required by some of our financial covenants. Information on how the Group accounts for this arrangement is detailed in the accounting policies on pages 43.

Consolidated statement of other comprehensive income

For the year ended 31 March

			2021			2020	
		Underlying	**BTL**	**Total**	Underlying	BTL	Total
	Note	**£m**	**£m**	**£m**	£m	£m	£m
(Loss)/profit for the year		**(831.3)**	**59.6**	**(771.7)**	(389.7)	58.0	(331.7)
Other comprehensive (loss)/income							
Will not be reclassified to the income statement:							
Net actuarial (loss)/gain on pension schemes	23	**(195.6)**	**-**	**(195.6)**	168.9	-	168.9
Deferred tax credit/(charge) on net actuarial (loss)/gain including impact of deferred tax rate change in prior year		**43.2**	**-**	**43.2**	(27.0)	-	(27.0)
May be reclassified to the income statement:							
Losses on cash flow hedges	19	**-**	**-**	**-**	(4.1)	-	(4.1)
Cash flow hedge transferred to income statement	19	**37.5**	**-**	**37.5**	34.9	-	34.9
Deferred tax charge on cash flow hedge gain including impact of deferred tax rate change in prior year		**(7.1)**	**-**	**(7.1)**	(3.0)	-	(3.0)
Other comprehensive (loss)/income for the year		**(122.0)**	**-**	**(122.0)**	(169.7)	-	(169.7)
Total comprehensive (loss)/income for the year		**(953.3)**	**59.6**	**(893.7)**	(220.0)	58.0	(162.0)

Bazalgette Tunnel Limited (“BTL”) is an independent company, appointed in 2015 to construct the Thames Tideway Tunnel. We have recognised revenue, cost and profit on the arrangement with BTL and have disclosed our underlying performance separately as required by some of our financial covenants. Information on how the Group accounts for this arrangement is detailed in the accounting policies on pages 43.

Consolidated statement of financial position

As at 31 March

	Note	2021 Underlying £m	2021 BTL £m	2021 Total £m	2020 Underlying £m	2020 BTL £m	2020 Total £m
Non-current assets							
Goodwill	9	**1,468.1**	**-**	**1,468.1**	1,468.1	-	1,468.1
Intangible assets	11	**276.5**	**-**	**276.5**	273.7	-	273.7
Property, plant and equipment	12	**16,796.7**	**-**	**16,796.7**	16,328.7	-	16,328.7
Right of use asset	13	**41.6**	**-**	**41.6**	52.3	-	52.3
Trade and other receivables	15	**51.4**	**228.9**	**280.3**	71.1	159.0	230.1
Pension asset TWMIPS	23	**57.9**	**-**	**57.9**	94.5	-	94.5
Derivative financial assets	19	**151.1**	**-**	**151.1**	374.3	-	374.3
		18,843.3	**228.9**	**19,072.2**	18,662.7	159.0	18,821.7
Current assets							
Inventories and current intangible assets	14	**14.9**	**-**	**14.9**	13.6	-	13.6
Contract assets	15	**240.0**	**5.8**	**245.8**	235.4	1.5	236.9
Trade and other receivables	15	**635.3**	**(7.3)**	**628.0**	484.9	5.1	490.4
Short term investments	19	**-**	**-**	**-**	300.0	-	300.0
Cash and cash equivalents	16	**803.2**	**3.6**	**806.8**	815.2	2.6	817.8
Derivative financial assets	19	**12.3**	**-**	**12.3**	-	-	-
		1,705.7	**2.1**	**1,707.8**	1,849.1	9.6	1,858.7
Current liabilities							
Contract liabilities	17	**(121.9)**	**(2.1)**	**(124.0)**	(123.8)	(0.3)	(124.1)
Trade and other payables	17	**(607.1)**	**(11.4)**	**(618.5)**	(661.1)	(10.3)	(671.4)
Lease liabilities	13	**(7.5)**	**-**	**(7.5)**	(7.9)	-	(7.9)
Borrowings	18	**(1,146.1)**	**-**	**(1,146.1)**	(1,814.9)	-	(1,814.9)
Derivative financial liabilities	19	**-**	**-**	**-**	(15.0)	-	(15.0)
		(1,882.6)	**(13.5)**	**(1,896.1)**	(2,622.7)	(10.6)	(2,633.3)
Net current liabilities		**(176.9)**	**(11.4)**	**(188.3)**	(773.6)	(1.0)	(774.6)
Non-current liabilities							
Contract liabilities	17	**(757.3)**	**-**	**(757.3)**	(707.3)	-	(707.3)
Lease liabilities	13	**(52.9)**	**-**	**(52.9)**	(62.4)	-	(62.4)
Borrowings	18	**(20,191.9)**	**-**	**(20,191.9)**	(18,906.7)	-	(18,906.7)
Derivative financial liabilities	19	**(1,469.9)**	**-**	**(1,469.9)**	(1,045.9)	-	(1,045.9)
Deferred tax	20	**(1,033.6)**	**-**	**(1,033.6)**	(1,120.8)	-	(1,120.8)
Provisions for liabilities and charges	21	**(145.0)**	**-**	**(145.0)**	(145.6)	-	(145.6)
Pension deficit	23	**(284.7)**	**-**	**(284.7)**	(216.1)	-	(216.1)
		(23,935.3)	**-**	**(23,935.3)**	(22,204.8)	-	(22,204.8)
Net (liabilities)/assets		**(5,268.9)**	**217.5**	**(5,051.4)**	(4,315.7)	158.0	(4,157.7)
Equity							
Called-up share capital	22	**1.0**	**-**	**1.0**	1.0	-	1.0
Cash flow hedge reserve	22	**(59.8)**	**-**	**(59.8)**	(90.2)	-	(90.2)
(Accumulated losses) / retained earnings	22	**(5,210.1)**	**217.5**	**(4,992.6)**	(4,226.5)	158.0	(4,068.5)
Total deficit		**(5,268.9)**	**217.5**	**(5,051.4)**	(4,315.7)	158.0	(4,157.7)

Bazalgette Tunnel Limited ("BTL") is an independent company, appointed in 2015 to construct the Thames Tideway Tunnel. We have recognised amounts in the statement of financial position in relation to the arrangement with BTL and have disclosed our underlying amounts separately as required by some of our financial covenants. Information on how the Group accounts for this arrangement is detailed in the accounting policies on page 41.

The consolidated financial statements (which include the accompanying accounting policies and notes) for Kemble Water Finance Limited, registered in England & Wales company number 05819317, were approved by the Board of Directors on 5 July 2021 and signed on its behalf by:

P Noble
Director

Company statement of financial position
As at 31 March

	Note	**2021** **£m**	2020 £m
Non-current assets			
Investment in subsidiaries	32	**4,292.3**	4,292.3
Trade and other receivables	33	**0.5**	0.6
Intercompany receivables	33	**417.0**	366.4
Deferred tax asset	34	**6.7**	8.4
		4,716.5	4,667.7
Current assets			
Intercompany receivables	33	**352.1**	208.3
Cash and cash equivalents	35	**286.5**	28.7
		638.6	237.0
Current liabilities			
Trade and other payables	36	**(1.7)**	(0.1)
Borrowings	38	**(21.0)**	(17.0)
		(22.7)	(17.1)
Net current assets		**615.9**	219.9
Non-current liabilities			
Trade and other payables	36	**(0.3)**	(0.3)
Borrowings	38	**(8,607.1)**	(7,605.7)
		(8,607.4)	(7,606.0)
Net liabilities		**(3,275.0)**	(2,718.4)
Equity			
Called-up share capital		**1.0**	1.0
Accumulated losses		**(3,276.0)**	(2,719.4)
Total equity		**(3,275.0)**	(2,718.4)

As permitted by Section 408 of the Companies Act 2006, no income statement is presented for the parent Company. For the year ended 31 March 2021 the Company generated a loss after taxation of £556.6 million (2020: loss after taxation of £533.6 million)

The financial statements (which include the accompanying accounting policies and notes) for Kemble Water Finance Limited, registered in England & Wales company number 05819317, were approved by the Board of Directors on 5 July 2021 and signed on its behalf by:

P Noble
Director

Consolidated statement of changes in equity
For the year ended 31 March

	Called-up share capital £m	Cash flow hedge reserve £m	Retained earnings £m	**Total equity £m**
At 1 April 2019	1.0	(118.0)	(3,878.1)	**(3,995.1)**
Loss for the year	-	-	(331.7)	**(331.7)**
Loss on cash flow hedges	-	(4.1)	-	**(4.1)**
Cash flow hedges transferred to income statement	-	34.9	-	**34.9**
Deferred tax charge on cash flow hedge losses including impact of deferred tax rate change	-	(3.0)	-	**(3.0)**
Actuarial gain on pension schemes	-	-	168.9	**168.9**
Loss on disposal of pension assets	-	-	(0.6)	**(0.6)**
Deferred tax charge on actuarial gain	-	-	(34.7)	**(34.7)**
Impact of deferred tax rate change on pension schemes	-	-	7.7	**7.7**
At 31 March 2020	**1.0**	**(90.2)**	**(4,068.5)**	**(4,157.7)**
Loss for the year	-	-	(771.7)	**(771.7)**
Cash flow hedges transferred to income statement	-	37.5	-	**37.5**
Deferred tax charge on cash flow hedge gain	-	(7.1)	-	**(7.1)**
Actuarial loss on pension schemes	-	-	(195.6)	**(195.6)**
Deferred tax credit on actuarial loss	-	-	43.2	**43.2**
At 31 March 2021	**1.0**	**(59.8)**	**(4,992.6)**	**(5,051.4)**

Company statement of changes in equity
For the year ended 31 March

	Called-up share capital £m	Accumulated losses £m	**Total equity £m**
At 1 April 2019	1.0	(2,185.8)	**(2,184.8)**
Loss for the year	-	(533.6)	**(533.6)**
At 31 March 2020	1.0	(2,719.4)	**(2,718.4)**
Loss for the year	-	(556.6)	**(556.6)**
At 31 March 2021	1.0	(3,276.0)	**(3,275.0)**

Consolidated statement of cash flows
For the year ended 31 March

	Note	2021 Underlying £m	2021 BTL £m	2021 Total £m	2020 Underlying £m	2020 BTL £m	2020 Total £m
Cash generated from operations	28	**929.4**	**1.0**	**930.4**	1,153.1	(0.6)	1,152.5
Group relief received / (paid)		**-**	**-**	**-**	455.0	(4.4)	450.6
Overseas tax paid		**(0.5)**	**-**	**(0.5)**	(0.9)	-	(0.9)
Net cash generated by/(used in) operating activities[1]		**928.9**	**1.0**	**929.9**	1,607.2	(5.0)	1,602.2
Investing activities:							
Interest received		**178.8**	**-**	**178.8**	56.6	-	56.6
Decrease/(increase) in current asset investments		**300.0**	**-**	**300.0**	(300.0)	-	(300.0)
Purchase of property, plant and equipment		**(1,050.2)**	**-**	**(1,050.2)**	(1,137.9)	-	(1,137.9)
Purchase of intangible assets		**(54.8)**	**-**	**(54.8)**	(86.1)	-	(86.1)
Proceeds from sale of property, plant and equipment		**10.6**	**-**	**10.6**	-	-	-
Net cash used in investing activities		**(615.6)**	**-**	**(615.6)**	(1,467.4)	-	(1,467.4)
Financing activities:							
New loans raised		**2,071.6**	**-**	**2,071.6**	3,481.6	-	3,481.6
Repayment of borrowings		**(1,981.0)**	**-**	**(1,981.0)**	(2,366.5)	-	(2,366.5)
Interest paid		**(376.5)**	**-**	**(376.5)**	(807.7)	-	(807.7)
Fees paid		**(12.7)**	**-**	**(12.7)**	(11.6)	-	(11.6)
Repayment of lease principal		**(11.4)**	**-**	**(11.4)**	(11.0)	-	(11.0)
Derivative accretion settlement[2]		**(15.3)**	**-**	**(15.3)**	(123.2)	-	(123.2)
Net cash generated by financing activities		**(325.3)**	**-**	**(325.3)**	161.6	-	161.6
Net increase/(decrease) in cash and cash equivalents		**(12.0)**	**1.0**	**(11.0)**	301.4	(5.0)	296.4
Net cash and cash equivalents at beginning of year		**815.2**	**2.6**	**817.8**	513.8	7.6	521.4
Net cash and cash equivalents at end of year		**803.2**	**3.6**	**806.8**	815.2	2.6	817.8

[1] Net cash generated by operating activities for the year ended 31 March 2021 includes £69.7 million (31 March 2020: nil) of payments that are considered to be exceptional. This exceptional outflow is related to the remaining pension deficit repayments covering AMP7 for the TWPS. Excluding this exceptional cash payment, underlying net cash generated by operating activities would be £999.1 million for the year ended 31 March 2021 (31 March 2020: £1,153.1 million).
[2] Derivative accretion settlement includes £15.3 million (2020: £123.2 million) relating to index-linked swaps where accretion is payable periodically.

Bazalgette Tunnel Limited ("BTL") is an independent company, appointed in 2015 to construct the Thames Tideway Tunnel. Included in the cashflow are amounts in relation to the arrangement with BTL and therefore our underlying amounts are disclosed separately as required by some of our financial covenants. Information on how the Group accounts for this arrangement is detailed in the accounting policies on page 43.

Company statement of cash flows
For the year ended 31 March

	Note	**2021 £m**	2020 £m
Cash generated used in operations	40	**33.2**	41.0
Group relief received		**4.2**	465.8
Net cash generated by operating activities		**37.4**	506.8
Investing activities:			
New loans issued		**(82.0)**	(249.8)
Interest received		**0.1**	0.3
Net cash (used in)/generated by investing activities		**(81.9)**	(249.5)
Financing activities:			
New loans raised		**497.2**	339.8
Repayment of borrowings		**(134.9)**	(399.3)
Interest paid		**(55.2)**	(515.9)
Fees paid		**(4.8)**	(2.4)
Net cash (used in)/generated by financing activities		**302.3**	(577.8)
Net (decrease)/increase in cash and cash equivalents		**257.8**	(320.5)
Net cash and cash equivalents at beginning of the year		**28.7**	349.2
Net cash and cash equivalents at end of the year		**286.5**	28.7

Accounting policies

The principal accounting policies adopted in the preparation of these consolidated and company financial statements, which have been applied consistently, unless otherwise stated, are set out below.

General information

Kemble Water Holdings Limited ("the Company") is a company incorporated and domiciled in the United Kingdom under the Companies Act 2006 whose principal activity is to act as the holding company for the Kemble Water Holdings Limited group of companies ("the Group"). The trading address and the address of the registered office of both the Company and the Group is Clearwater Court, Vastern Road, Reading, RG1 8DB.

The Group's principal activity is that of an appointed water and wastewater services provider, including acting as a retailer for household customers, operating in London, the Thames Valley and surrounding area, delivered through its wholly owned subsidiary Thames Water Utilities Limited ("TWUL" or "Thames Water") in accordance with TWUL's licence of appointment.

Statement of compliance with International Financial Reporting Standards ("IFRS")

The policies applied in these consolidated and Company financial statements for the year ended 31 March 2021 are based on the IFRS, International Accounting Standards ("IAS") and International Financial Reporting Interpretations Committee ("IFRS IC") interpretations issued and effective and ratified by the EU as of 5 July 2021, the date that the Board of Directors approved these financial statements.

Basis of preparation

The consolidated and Company financial statements have been prepared in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006 as applicable to companies using IFRS and international financial reporting standards adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union.

Going concern

The consolidated and company financial statements for the year ended 31 March 2021 have been prepared on the going concern basis. In forming this assessment the Directors have considered the Group's liquidity position, cashflow, profitability, compliance with covenants and the potential impact of Covid-19 on financial performance.

The Directors believe, after due and careful enquiry, that the Group has sufficient resources to meet its present obligations as they fall due for a period of at least 12 months from the date of approval of the consolidated financial statements. For this reason, the Board considers it appropriate to adopt the going concern basis in preparing the financial statements.

The consolidated financial statements for the year ended 31 March 2021 have been prepared on the going concern basis, under the historical cost convention, as modified by the revaluation of certain financial assets and liabilities at fair value, and the Disclosure and Transparency Rules ("DTR") issued by the Financial Conduct Authority.

In assessing the appropriateness of the going concern basis, the Directors have considered the following factors.

The Group is the monopoly provider of the public water supply and wastewater treatment to areas including most of London and the Thames Valley. The regulatory regime in England and Wales provides water companies with stable and predictable revenues over an AMP. The framework ensures protection against reduced revenues arising from lower consumption and the regulatory recovery mechanisms ensure that the economic value impact is generally immaterial. In addition, the impact of Covid-19 on the Group's ability to provide essential water and wastewater services has been mitigated through the Government's recognition that these services are essential and the Group's quick response to enable effective working practices in the challenging operational environment.

The Group's liquidity position and cashflow projections are closely monitored and updated regularly. Mitigating measures are also continually reviewed and actioned where appropriate. The Group has significant financial resources in the form of cash and committed bank facilities. Furthermore, during the pandemic, the Group has continued to efficiently access capital markets. The potential impact of Covid-19 on the Group's financial performance has been assessed with a particular focus on operational cashflows and capital expenditure.

Various scenarios have been assessed, all of which show the Group having significant liquidity headroom and compliant with covenants for a period of at least 12 months from the signing of these financial statements.

Based on the above, the Board is satisfied that the Group has adequate resources, for a period of at least 12 months from the date of approval of the condensed financial statements, to continue operations and discharge its obligations as they fall due. For this reason, the Board considers it appropriate to adopt the going concern basis in preparing the financial statements.

Accounting policies (continued)

Basis of consolidation

The Group financial statements consolidate the financial statements of the Company and entities controlled by the Company (its subsidiaries) and incorporate the results of its share of joint ventures using equity accounting. Associates are accounted for on an equity basis either where the Group's holding exceeds 20% or the Group has the power to exercise significant influence. Control is achieved where the Company has the power to govern the financial and operating policies, generally accompanied by a shareholding of more than one half of the voting rights, of an investee entity so as to obtain benefits from its activities. All intra-group transactions, balances, income and expenses are eliminated on consolidation.

Where necessary, adjustments have been made to the financial statements of subsidiaries to align the accounting policies used under the relevant IFRS standards into line with those used by the Group.

The results of subsidiary undertakings acquired or disposed of during the year are included in the consolidated profit and loss account from the date of acquisition or up to the date of disposal.

Bazalgette Tunnel Limited ("BTL") arrangement

Bazalgette Tunnel Limited ("BTL") is an independent company, appointed in 2015 to construct the Thames Tideway Tunnel. We have recognised revenue, cost and profit on the arrangement with BTL and disclosed our underlying performance separately, as required by some of our financial covenants.

The arrangement with BTL and Ofwat means the Group has included amounts to recover costs of the Thames Tideway Tunnel within its bills to wastewater customers. As cash is collected, these amounts are subsequently paid to BTL, under the 'pay when paid' principle.

Accounting standards require the Group to present the amounts billed as revenue in our financial statements, and with an associated cost representing bad debt on amounts billed, this also gives rise to reporting profit which is taxable. This non-appointed revenue, cost and profit are excluded from our key performance indicators, which is consistent with our financial covenants. The revenue, cost and resulting profit on this arrangement is disclosed separately to the Group's underlying performance in the financial statements. As a result of this arrangement, a prepayment is created and recorded by the Group as BTL will transfer the use of the tunnel to Thames Water Utilities Limited once construction is complete, against which this prepayment will be utilised.

As part of the construction of the Thames Tideway Tunnel, buildings are acquired by the Group and will be recognised within Land and Buildings within Property, Plant and Equipment. These will be disposed of in future financial periods once construction is completed.

Revenue recognition

The core principle of IFRS 15 "Revenue from Contracts with Customers" requires an entity to recognise revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration that it expects to be entitled to in exchange for transferring those goods or services to the customer. The Company has a variety of customers including, household customers (Directly billed or Indirectly billed by other Water Only Companies ("WOCS")) and non-household customers (retailers and NAVs "New appointments and Variations").

Revenue is recognised when, or as, the performance obligations to the customer are satisfied. Consideration received in advance of recognising the associated revenue from the customer is recorded within contract liabilities (deferred income). Bad debt on bills raised in the year considered uncollectable at the time of billing based on historical experience is excluded from revenue, as it does not fall within the IFRS 15 criteria, to ensure that revenue is recorded at the amount which the Company expects to receive for providing its services to customers.

The Company considers the performance obligation associated with our core revenue to be the continued provision of water and wastewater services to customers.

Revenue includes an estimate of the amount of mains water and wastewater charges unbilled at the period end, which are recorded within contract assets (accrued income). The usage is estimated using a defined methodology based upon historical data and assumptions. For unmeasured customers, the amount to be billed is dependent upon the rateable value of the property, as assessed by an independent rating officer. The amount billed, typically in advance of delivery, is recorded within contract liabilities (deferred income) and is apportioned to revenue over the period to which the performance obligation is satisfied. When the Company identifies the occupants, the bill is sent out in the customer's name if known or if not in the name of the occupier. If the Company has not identified an occupant within six months, and the bill remains unpaid, the bill is cancelled, and the property is classified as empty.

Revenue includes amounts that the Company billed to wastewater customers in respect of construction costs for the Thames Tideway Tunnel. This is discussed in the previous BTL arrangement section on this page.

Refer to page 57 and 58 for significant accounting estimates and judgements concerning revenue recognition.

Accounting policies (continued)

Other operating income

The Company considers the combination of activities comprising a Service Connection to represent a distinct performance obligation to the customer. The service connections charge levied includes the cost of excavating, connecting and reinstating (if needed) the new supply, including the installation of a stop valve, boundary box and external water meter as well as any associated pipework between the connection and the boundary box. This income is recognised within other operating income at the point in time that the service is complete, as no continuing obligation remains once the connection has been made. Deferred service connections income is recorded within contract liabilities (deferred income). Typically amounts received will be fully recognised within a year following receipt.

Requisitions & Diversions income is recognised over time in other operating income using the input method by estimating complete satisfaction of the performance obligation and applying this to the transaction price in the contract with the customer. The estimated progress is based upon the costs incurred for the performance obligation. Deferred requisitions and diversions income is recorded within contract liabilities (deferred income). These income streams encompass a wide variety of schemes, from those with short durations that would be fully recognised by the end of the year following receipt to large multi-phase developments for which income could be recognised over the course of several years.

Contributions received for infrastructure charges (which meet the extra demands which new connections put on existing water mains, sewers and other network infrastructure) are initially held within contract liabilities (deferred income). The Company considers that the obligation to invest in the network is highly interrelated with the ongoing and future obligation to provide water and wastewater services, particularly to maintain continuous supplies going forward. The investment in the network from the infrastructure charges enables the Company to continue providing value to the customer through water and wastewater services. The associated asset arises from the investment in the network and therefore the Company recognises infrastructure charges in other operating income on a straight-line basis over the life of the associated asset. Notwithstanding the length of time between when the Company performs its obligations and when the customer pays, infrastructure charges are not adjusted for the time value of money given the trivial monetary impact.

Interest income

Interest income is accrued on a time basis by reference to the principal outstanding and the Effective Interest Rate (“EIR”) applicable. The EIR is the rate that exactly discounts the estimated future cash receipts over the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or liability. Interest income is presented within finance income in the consolidated income statement.

Interest expense

Interest expense is accrued on a time basis by reference to the principal outstanding and the Effective Interest Rate (“EIR”) applicable. The EIR is the rate that exactly discounts the estimated future cash payments over the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or liability. Interest expense is presented within finance expense in the consolidated income statement.

Contract assets

Contract assets are presented in the statement of financial position when the Group’s right to consideration is met in advance of billing. The Group applies the IFRS 9 simplified approach to measuring expected credit losses which uses a lifetime expected loss allowance. Refer to the “Trade and other receivables (excluding prepayments)” section for more information.

Contract liabilities

Contract liabilities are presented in the statement of financial position where a customer has paid an amount of consideration prior to the Group performing the transfer of the related good or service to the customer. An example would be for an unmeasured customer where the amount billed is dependent upon the rateable value of the property. The amount is billed at the start of the financial year and is apportioned to revenue over the period. In addition, included within contract liabilities is deferred revenue in relation to nil cost assets adopted during the year and receipts in advance from our capital projects, infrastructure charges, diversions and service connections.

Accounting policies (continued)

Net gains/(losses) on financial instruments

The Group raises debt in a variety of currencies and uses derivative contracts to manage the foreign exchange risk exposure on this debt. The Group also uses derivative contracts to manage interest rate and inflation risk.

Borrowings denominated in foreign currencies at the financial reporting date are retranslated to the functional currency at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement as net losses / gains on financial instruments. The following are also recognised in the income statement as net losses / gains on financial instruments:

- movement in fair values of derivatives, which are not designated as hedging instruments, and
- in case of derivatives which are designated as hedging instruments, amounts recycled from cash flow hedge reserve.

Net gains/ (losses) on financial instruments do not include any interest expense or income. Refer to Derivative financial instrument and hedging accounting policy on pages 51 and 52 for more details.

Taxation

Tax on the profit or loss for the period comprises current and deferred tax. Tax is recognised in the consolidated income statement except to the extent that it relates to items recognised directly within equity, in which case it is recognised within the consolidated statement of other comprehensive income.

Current tax

Current tax is the expected tax payable or receivable on the taxable profit or loss for the period, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustments to tax payable in respect of previous periods.

Taxable profit differs from the profit on ordinary activities before tax as reported in the income statement as it excludes items of income or expense that are taxable or deductible in other periods and items that are never taxable or deductible. It also includes the effect of tax allowances.

Deferred tax

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax is measured on a non-discounted basis using tax rates enacted or substantively enacted at the balance sheet date and that are expected to apply in the period when the deferred tax asset is realised or the deferred tax liability is settled.

Deferred tax liabilities are generally recognised for all taxable temporary differences. Deferred tax assets are recognised only to the extent that it is probable that sufficient future taxable profits will be available against which deductible temporary differences can be utilised.

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

Uncertain tax positions

Tax rules can be subject to interpretation and a tax provision is recognised where it is considered more likely than not that an amount will be paid to the tax authorities. Management use their experience, and seek professional advice where appropriate, to prudently assess the likelihood of an outflow arising. The amount recognised is the single most likely outcome. As at 31 March 2021, there are no uncertain tax positions (2020: none).

Investments in subsidiary undertakings

Investment in subsidiary undertaking is stated at cost, less any provision for impairment. This impairment would be recognised within the Company income statement only. An impairment review is performed on an annual basis.

Goodwill

Goodwill arises on the acquisition of subsidiaries and represents the excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition date fair value of any previous equity interest in the acquiree over the fair value of the identifiable net assets acquired. Goodwill impairment reviews are undertaken annually or more frequently if events or changes in circumstances indicate a potential impairment. For the purpose of impairment testing, the carrying value of goodwill acquired in a business combination is compared to the recoverable amount, which is the higher of the value in use and the fair value less costs of disposal. Any impairment is recognised immediately as an expense within the income statement and is not subsequently reversed.

Accounting policies (continued)

Intangible assets (excluding goodwill)

Separately acquired intangible assets, and internally generated intangible assets once commissioned, are stated at cost, less accumulated amortisation and any provision for impairment. Amortisation is charged to the income statement on a straight-line basis over the estimated useful economic life of the intangible asset from the date the intangible asset becomes available for use. The estimated useful economic lives are as follows:

	Years
Software	5-10

Assets in development are not amortised until they are commissioned. Borrowing costs that have been capitalised within purchase of intangible assets are included within “Purchase of intangible assets” within investing activities in the statement of cash flows. All other borrowing costs are included as finance expenses within the consolidated income statement.

Property, plant and equipment

Property, Plant and Equipment (“PP&E”) is comprised of network assets (including water mains, sewers, pumped raw water storage reservoirs and sludge pipelines) and non-network assets (including buildings, operational structures and fixtures & fittings). PP&E is stated at cost (or at deemed cost in the case of network assets, being the fair value at the date of transition to IFRS) less accumulated depreciation and provision for impairment.

The Group capitalises the directly attributable costs of procuring and constructing PP&E, which include labour and other internal costs incremental to the business. Subsequent costs are capitalised only when it is probable that future economic benefits associated with the item will flow to the Group and the cost can be measured reliably.

Within Land and Buildings are assets acquired in relation to the Thames Tideway Tunnel project. These land and buildings were acquired to perform necessary works relating to the construction and integration of the tunnel into our network and will be disposed of in due course once required works have been completed in line with the agreement with Ofwat.

Where a qualifying asset takes a substantial period of time to get ready for its intended use, the borrowing costs directly attributable to the acquisition, construction or production of the asset are added to the cost. Borrowing costs that have been capitalised within purchase of property, plant and equipment are included within “Purchase of property, plant and equipment” within investing activities in the statement of cash flows. All other borrowing costs are included as finance expenses within the consolidated income statement.

Where items of PP&E are transferred to the Group from customers or developers, generally in the form of adopted water mains, self-lay sewers or adopted pumping stations, the fair value of the asset transferred is recognised in the statement of financial position. Fair value is determined based on estimated replacement cost. Where the transfer is in exchange for connection to the network and there is no further obligation for ongoing services, the corresponding credit is recognised immediately within other operating income. Where the transfer is considered to be linked to the provision of ongoing services, the corresponding credit is recorded in contract liabilities (deferred income) and is released to other operating income over the expected useful economic lives of the associated assets.

PP&E is depreciated to its estimated residual value on a straight-line basis over its estimated useful life, with the exception of freehold land which is not depreciated. Assets in the course of construction are not depreciated until they are commissioned. The estimated useful economic lives are as follows:

	Years
Network assets:	
Reservoirs	250
Strategic sewer components	200
Wastewater network assets	150
Water network assets	80-100
Raw water tunnels and aqueducts	80
Non-network assets:	
Land and buildings:	
Buildings	15-60
Operational structures	30-100
Plant and equipment:	
Other operational assets	7-40
Fixtures & fittings	5-7
Vehicles	4-5
Computers	3-5
Fixed and mobile plant	4-60

Accounting policies (continued)

BTL arrangement

On completion of construction of the Thames Tideway Tunnel, substantially all the risks and rewards of ownership will lie with the Group. The Group will therefore account for the transaction arrangement with BTL post construction in accordance with IFRS 16 'Leases'. The tunnel will be recognised as a right of use asset and depreciated over the life of the contract. On inception of the contract, the tunnel will be recognised at fair value, being the BTL prepayment plus the present value of the future minimum contract payments, with a corresponding liability being recognised as a lease liability. Interest will be recognised in the income statement over the period of the lease.

Impairment of non-financial assets

The carrying amounts of the Group's non-financial assets are reviewed at each financial reporting date to determine whether there is any indication of impairment. If any such indication exists then the recoverable amount of the asset is estimated, which is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generate cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit"). Management do not consider there to be any significant judgements relating to the impairment of non-financial assets.

An impairment loss is recognised if the carrying amount of an asset or its cash generating unit exceeds its estimated recoverable amount. Impairment losses are recognised in the income statement, and those recognised in prior periods are assessed at each financial reporting date for any indications that the loss has decreased or no longer exists.

Non-derivative financial instruments

Trade and other receivables (excluding prepayments)

Trade receivables are measured at their transaction price on initial recognition and subsequently at amortised cost using the effective interest method. Other receivables such as loans or insurance receivables are recognised at fair value on initial recognition.

Included within other receivables are amounts owed to the Group in respect of insurance claims. Insurance receivables and these other receivables are only recognised when the Group is virtually certain that the amount will be recoverable.

IFRS 9 requires an entity to reduce the gross carrying amount of a financial asset when the entity has 'no reasonable expectations of recovering' a financial asset. Write-offs are recognised as an expense within operating costs and can relate to a financial asset in its entirety or to a portion of it.

Expected credit losses

The Group applies the IFRS 9 simplified approach to measuring expected credit losses which uses a lifetime expected loss allowance for all trade receivables, contract assets and insurance claims receivable where those assets may be subject to significant increase in credit risk for example due to the impact of Covid-19. The Group's assessment for calculating expected credit losses is explained below. In addition, Management has considered the continued impact of Covid-19, and has increased the provision to reflect the expected adverse impact on customers' ability to pay their water and wastewater bills, than otherwise would be the case.

(i) Directly billed
A bad debt model is used to calculate the provision for directly billed customers. This uses performance in the year to determine the level of provision required. The model takes the closing receivables balance and then deducts the amounts that are expected to be collected or cancelled based on performance in the year. The amount that remains will be uncollectable and therefore needs to be covered by a bad debt provision. Debt that is older than 5 years is fully provided for. There are also provisions to cover billing that is cancelled and not rebilled and also the collectability of any rebilling and a bad debt provision against unbilled debtors i.e., debts that have not been billed yet but are part of the metered sales accrual. Using the output of the model together with management's judgement of expected performance in the future, a management judgement is formed regarding the level of provision required for future credit losses. Refer to pages 57 and 58 for significant judgement.

Accounting policies (continued)

Non-derivative financial instruments (continued)

Expected credit losses (continued)

Directly Billed Write Off Policy

The bad debt write off policy has remained unchanged and has been consistently applied in the current year. Debt is only written off after all available economic options for collecting the debt have been exhausted and the debt has been deemed to be uncollectable. This may be because the debt is impossible, impractical, inefficient or uneconomic to collect.

Situations where this may arise and where debt may be written off are as follows:

- Where the customer has absconded without paying and strategies to trace their whereabouts and collect outstanding monies have been fully exhausted.
- Where the customer has died without leaving an estate or has left an insufficient estate on which to levy execution.
- Where the value of the debt makes it uneconomic to pursue – all debts of less than £5 are written off.
- Where the age of the debt exceeds the statute of limitations – all debts of greater than 6 years old are written off, taking into account usual business rules.
- Where county court proceedings and attempts to recover the debt by debt collection agencies (multiple in some cases) have proved unsuccessful including where the customer does not have any assets/has insufficient assets on which to levy execution.
- Where the customer has been declared bankrupt, is in liquidation or is subject to insolvency proceedings or a debt relief order and no dividend has been or is likely to be received.

For debt to be written off there must be a legitimate charge against the debtor and no reasonable expectation of recovery; and disclosure of information regarding financial assets that are written off but are still subject to enforcement activity.

(ii) WOCs
A provision is also made against debts held by Water Only Companies (WOCs) who bill their customers for sewerage services on behalf of the Group. Since detailed information about the debt held on our behalf by the WOCs is limited, we provide for the debt with a rate calculated using the bad debt provision applied by the WOCs in their most recent statutory accounts, as a percentage of their billed and unbilled debts. We consider current performance and any information available to create the provision we then make management judgements in respect of future credit losses, in accordance with the requirements of IFRS 9.

(iii) BTL
The arrangement with BTL means the Group has included construction costs of the Thames Tideway Tunnel within its bills to wastewater customers. As cash is collected, these amounts are subsequently paid to BTL. This arrangement gives rise to recognising revenue within the Group and associated bad debt. The bad debt methodology is consistent with directly billed customers.

(iv) Non-Household
The Group has assessed the risk of credit losses for non-household customers to be low and therefore no bad debt provision has been made. The Group has assessed specific debts held in respect of non-household customers which are subject to query by those customers, and made a revenue loss provision on those debts within accrued income based on historical collections experience.

Intercompany loans receivable

Interest bearing loans issued to other group companies are initially recognised at fair value plus transaction costs that are directly attributable to the acquisition of the financial asset. They are subsequently measured at amortised cost using the effective interest rate method, less any provision for impairment. The amortisation is included within finance income in the income statement and is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the effective interest rate.

For loans repayable on demand, expected credit losses are based on the assumption that repayment of the loan is demanded in full at the reporting date. This is because Paragraph B5.5.38 of IFRS 9 states the maximum period over which expected impairment losses should be measured is the longest contractual period where an entity is exposed to credit risk. The Group has considered the recoverability of the intercompany receivables as part of the Kemble Group's annual impairment assessment of all intercompany balances under IFRS 9. Various scenarios were considered in a

multiple factor analysis performed at the reporting date with no expected credit loss on these loans identified. As such there is no concern over the recoverability of intercompany receivables, the Directors do not consider that there is any need to book an impairment provision and expect to materially recover the intercompany amount.

Accounting policies (continued)

Non-derivative financial instruments (continued)

Trade and other payables (excluding other taxation and social security)

Trade and other payables (excluding other taxation and social security) represent liabilities for goods and services provided to the Group prior to the end of the reporting period which are unpaid. These amounts are usually unsecured and are provided with credit terms of payment.

Trade and other payables are recognised in the statement of financial position when it is probable that an outflow of resources embodying economic benefits will result from the settlement of a present obligation and the amount at which the settlement will take place can be measured reliably. These conditions are satisfied when goods and services have been supplied to the Group. Therefore, payables and accruals must be recognised when goods and services have been received.

Trade and other payables include amounts owed to BTL that represent revenue collected and due to BTL for the construction of the Thames Tideway Tunnel, which have not yet been paid at the reporting date.

Cash and cash equivalents

Cash and cash equivalents are held at either amortised cost or fair value through profit or loss and include cash on hand, deposits held at call with financial institutions, money market funds, other short-term, highly liquid investments with original maturities of three months or less that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

Included within cash and cash equivalents are amounts collected in relation to BTL revenue which have not yet been paid across to BTL at the reporting date.

Short-term investments

Short-term investments are held at amortised cost and include term deposits which are not readily convertible into cash.

Interest bearing borrowings including those issued to other group companies

Interest bearing borrowings are financial liabilities recognised initially at fair value less attributable transaction costs and subsequently at amortised cost using the effective interest method.

An exchange or modification of interest-bearing borrowing with substantially different terms is accounted for as an extinguishment of the original financial liability and the recognition of new financial liability, with any costs or fees incurred are recognised as part of the gain or loss on the extinguishment. In case of exchange or modification of interest-bearing borrowings without substantially different terms, the difference between net present value of existing contractual cash flows and modified contractual cash flows, both discounted at the original effective interest rate, is recognised as a modification gain or loss on the income statement.

Inventories and current intangible assets

Inventories are stated at the lower of cost and net realisable value (“NRV”).

Prepayments

Prepayments are recorded where the Group has paid for goods or services before delivery of those goods or services. Included within prepayments are amounts paid and payable to BTL which represent a prepayment for the use of the Thames Tideway Tunnel once the tunnel has been constructed and is available for use.

Retirement and other employment benefits

Defined benefit schemes

The Group operates three, independently administered, defined benefit pension schemes, all of which are closed to new employees. One of these schemes, Thames Water Pension Scheme (“TWPS”), was closed to future accrual as of 31 March 2021. Actuarial valuations are carried out as determined by the Trustees, at intervals of not more than three years. The rates of contributions payable and the pension cost are determined on the advice of the actuaries, having regard to the results of these valuations.

The difference between the value of defined benefit pension scheme assets and liabilities is recorded within the statement of financial position as a retirement benefit surplus or deficit. A retirement benefit surplus is only recognised if the assessment contained within the accounting standard

IFRIC 14 IAS 19 ‘The Limit of a Defined Benefit Asset, Minimum Funding Requirements and their Interaction’ is met, i.e. that the entity has an unconditional right to a refund or to reductions in future contributions on the wind-up of the pension scheme.

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

Service costs, representing the cost of employee service in the period, and scheme administration expenses are included within operating expenses in the income statement. The net finance cost is calculated by applying the discount rate used for the scheme liabilities to the net (deficit) / surplus.

Accounting policies (continued)

Retirement and other employment benefits (continued)

Defined benefit schemes (continued)

Changes in the retirement benefit surplus or obligation may arise from:

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

Such changes are classified as re-measurements and are charged or credited to equity and recorded within the statement of other comprehensive income in the period in which they arise.

Defined contribution schemes

The Group operates a Defined Contribution Stakeholder Pension Scheme (“DCSPS”) managed through Aon MasterTrust from October 2020. Prior to that, DCSPS was managed through Standard Life Assurance Limited. From 1 April 2011 the DCSPS is the only scheme to which new employees of the Group are eligible. The assets of the DCSPS are held separately from those of the Group and obligations for contributions to the scheme are recognised as an expense in the income statement in the periods during which they fall due.

The Group also operates two closed defined contribution pension schemes. The Group has no further payment obligations, however defined funds for former employees are held within these schemes.

Long-term incentive plans (“LTIP”) and bonus

LTIP
Cash based LTIP awards are accrued in the financial statements for the duration of the award. The accrual is based on the values assessed for the applicable schemes, taking into account the duration of the individual scheme, and by comparing the Company’s performance against the assumptions used to award payments. These are recognised as the present value of the benefit obligation. Where Company’s performance does not meet the criteria for the LTIP to be awarded, no accruals are recognised.

LTIP 2021/24 is a three-year LTIP scheme with a performance period from 1 April 2021 to 31 March 2024. The targets for the LTIP have been set to deliver critical elements of the Company’s stretching business plan. 50% of the targets are focused on the delivery of an overarching “Integrated Performance Assessment” measured using the Return on Regulated Earnings (RORE). This assessment provides a measure of successful delivery for customer, the environment and shareholders since it is impacted by all aspects of our business plan. To provide increased focus on customer and the environment, the LTIP includes additional elements targeting delivery of business plans for customer service, leakage, water quality and pollutions. This management incentive was accrued during the period based on management’s assessment of performance against the targets set.

The on target pay out for eligible senior management is an amount of up to 100% of their salary with a maximum payment of 200% of salary for delivery of stretch targets.

LTIP 2019/20 is a three-year LTIP scheme with a performance period from 1 April 2019 to 31 March 2022. The targets for the LTIP have been set to deliver critical elements of the Company’s stretching business plan and 80% of the targets are focused on delivery of key customer outcomes including the delivery of leakage and environmental targets. This management incentive was accrued during the period based on management’s assessment of performance against the targets set. This management incentive was accrued during the period based on management’s assessment of performance against the targets set. The on target pay out for eligible senior management is an amount of up to 100% of their salary with a maximum payment of 200% of salary for delivery of stretch targets.

LTIP impacting previous period only
The transformation incentive was based on performance over a 2-year period from 1 April 2018 to 31 March 2020. The targets were focused on critical customer, environmental, operational and regulatory outcomes. The transformation incentive was accrued during the prior period based on management’s assessment of performance against the targets set. This incentive entitled the eligible senior management to an amount of up to 100% of their salary following the end of the performance period.

Bonus
Bonus payments are accrued in the period based on assessments of performance against targets set at the beginning of the financial year. Bonuses are paid in the following financial year, once performance has been measured against targets set and approved by the Remuneration Committee.

Share in Your Success 2020 was introduced in the 2017/18 financial year. The scheme’s performance period ran from April 2017 to March 2020 and was open to all non-manager grade employees. The scheme entitled eligible employees to earn an amount of up to 5% of their salary following the end of the performance period. All payments related to this scheme were made in the prior period.

Accounting policies (continued)

Provisions for liabilities and charges

Provisions are recognised when:

- the Group has a present legal or constructive obligation as a result of past events;
- it is probable that an outflow of resources will be required to settle the obligation; and
- the amount can be reliably estimated.

Provisions for insured liabilities arise from insurance claims from third parties received by the Group and are recognised or released by assessing their adequacy using current estimates of future cash flows under insurance contracts. Where we have insurance cover for these claims, we recognise a receivable for the reimbursement value from third party insurance companies net of retentions. The timing for the insurance claims is uncertain and therefore both the liability and receivable have been recognised as non-current.

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.

Outcome delivery incentives

The Asset Management Plan ("AMP") is the five-year period covered by a water company's business plan. The current period 1 April 2020 to 31 March 2025 is known as AMP7, and the prior period 1 April 2015 to 31 March 2020 was known as AMP6.

The price determination process is undertaken by Ofwat where they determine the amount of revenues that can be earned from customer bills for delivering an agreed level of service.

Outcome delivery incentives ("ODIs") introduce rewards for providing a service which exceeds the level committed and may incur penalties for delivering a lower level of service. These rewards and penalties are in the form of revenue adjustments or Regulatory Capital Value ("RCV") adjustments. The Group adjusts future tariffs to reflect such amounts in response to the change in amount of revenues that the Group is entitled to earn over the AMP period. The ability to benefit from such increases or suffer from decreases is linked to the provision of future services as well as future performance over the rate setting period and therefore, is not an asset or liability (right or obligation) at the balance sheet date.

The majority of our AMP7 performance commitments (PCs) have financial ODIs, and are subject to either an in-period or an end-of-AMP revenue adjustment. For PCs with an in-period adjustment, the eligible outperformance or underperformance payment will be assessed during the annual reconciliation process and applied to the revenue allowance with a two-year lag. For PCs with an end-of-AMP adjustment, the eligible payment will be assessed at the next price review and applied to the revenue allowance for the next price review period.

Derivative financial instruments and hedging

Derivatives are used to manage exposure to movements in interest rates, foreign exchange rates and inflation. Derivatives are measured at fair value at each financial reporting date, using the methodology described in note 19.

Derivative financial instruments not designated as hedging instruments

Initially recognition is at fair value, with transaction costs being taken to the income statement. Gains or losses on re-measurement to fair value are recognised immediately in the income statement.

Derivative financial instruments designated as hedging instruments

The group uses derivative financial instruments, such as forward starting interest rate swaps to hedge its interest rate risks. 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 cash flows or fair values (as applicable) of the hedged item.

The economic relationship between the hedge item and the hedging instrument is determined by analysing the critical terms of the hedge relationship i.e. qualitative assessment of effectiveness is performed. Hedge ineffectiveness is determined at the inception of the hedge relationship, and through periodic prospective effectiveness assessment. The Group uses the hypothetical derivative method to assess effectiveness. Changes in critical terms and changes in credit rating may result in ineffectiveness. Hedge accounting discontinues when the hedging instrument no longer qualifies for hedge accounting.

Accounting policies (continued)

Derivative financial instruments and hedging (continued)

Cash flow hedges

The effective part of any gain or loss on the derivative financial instrument designated as a cash flow hedge is recognised directly in the cash flow hedge reserve. Any ineffective portion of the hedge is recognised immediately in the income statement as net gains/(losses) on financial instruments. When a hedging instrument expires or is sold, terminated or exercised, or the Group revokes designation of the hedge relationship but the hedged forecast transaction is still expected to occur, the cumulative gain or loss at that point remains in the cash flow hedge reserve within equity and is recognised in accordance with the above policy when the transaction occurs. If the hedged transaction is no longer expected to take place, the cumulative unrealised gain or loss recognised in equity is recognised in the income statement immediately as net gains/(losses) on financial 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 host 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 host 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.

Offsetting financial instruments

Financial assets and financial liabilities are offset and the net amount reported in the statement of financial position if there is currently and in all circumstances an enforceable legal right to offset the recognised amounts and there is an intention to settle on a net basis or to realise the assets and settle the liabilities simultaneously.

Financial guarantees

The Group is part of a Whole Business Securitisation ("WBS") group as described in note 19. Companies in the WBS group raise debt in external debt markets through the issuance of secured bonds and loans. All companies in the WBS group guarantee the principal and interest payments due under the terms of the bonds. Where the Group enters into financial guarantee contracts to guarantee the indebtedness of other companies within this group, the Group considers these to be insurance arrangements and accounts for them as such. In this respect, the Group treats the guarantee contract as a contingent liability until such a time as it becomes probable that the Group will be required to make a payment under the guarantee and the amount can be reliably measured.

Foreign currency

Transactions in foreign currencies are translated to sterling, the Group's presentational currency, at the foreign exchange rate ruling at the date of the transaction.

Monetary assets and liabilities denominated in foreign currencies at the financial reporting date are retranslated to the functional currency at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement.

IFRS 16: Leases

Recognition of Right of use assets and lease liabilities

IFRS 16 Leases sets out the principles for the classification, measurement, presentation and disclosure of lease arrangements. Under the provisions of IFRS 16, most leases are recognised in the statement of financial position as both a right-of-use asset and a largely offsetting lease liability. The right-of-use asset and lease liability are both based on the present value of lease payments due over the term of the lease, with the asset being depreciated in accordance with IAS 16 Property, Plant and Equipment and the liability increased for the accretion of interest and reduced by lease payments.

Accounting policies (continued)

IFRS 16: Leases (continued)

Recognition of Right of use assets and lease liabilities (continued)

At the transition date from IAS 17 Leases in the previous period (1 April 2019) the following practical expedients permitted by the standard were applied:

- applying a single discount rate to a portfolio of leases with reasonably similar characteristics;
- relying on previous assessments on whether leases are onerous as an alternative to performing an impairment review;
- accounting for operating leases with a remaining lease term of less than 12 months as short-term leases;
- excluding initial direct costs for the measurement of the right-of-use asset at the date of initial application and using hindsight in determining the lease term where the contract contains options to extend or terminate the lease;
- contracts of low value (£5,000 as determined by the Group) were not considered as leases; and
- the Group was not required to reassess whether a contract is, or contains, a lease at the date of initial application (1 April 2019). The Group therefore only applied IFRS 16 principles to contracts that were previously identified as leases under IAS 17 and IFRIC 4 at the date of initial application, and all subsequent leases entered into or modifications made after the initial application date.

Recognition of leases

As a lessee

The Group's leasing activities consist of rentals payable for office properties and other land and buildings. Other rentals are short term or of low value. Lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions.

A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. At commencement or on modification of a contract that contains a lease component, along with one or more other lease or non-lease components, the Group accounts for each lease component separately from the non-lease components. The Group allocates the consideration in the contract to each lease component on the basis of its relative stand-alone price and the aggregate stand-alone price of the non-lease components.

Right-of-use asset

Right-of-use assets are recognised at cost comprising the following components:

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

The right-of-use asset is depreciated over the lease term on a straight-line basis.

Lease liability

Lease liabilities include the net present value of the following lease payments:

- fixed payments (including in-substance fixed payments), less any lease incentives receivable;
- variable lease payments that are based on an index or a rate;
- amounts expected to be payable by the Group under residual value guarantees;
- the exercise price of a purchase option if the Group is reasonably certain to exercise that option; and
- payments of penalties for terminating the lease, if the lease term reflects the Group exercising that option.

The lease payment is discounted using the incremental borrowing rate "IBR". The IBR is the rate of interest that the Group would have to pay to borrow the funds necessary to obtain the right-of-use asset in a similar economic environment at the date of lease inception.

The lease payment is allocated between the liability and the finance cost. The finance cost is recognised in the income statement within 'finance expenses' so as to produce a constant periodic rate of interest over the remaining balance of the liability for each period.

Lease payments represent rentals payable by the Group for certain office properties. Where the Group has the ability and intent to exit a property lease prior to the term end date and it is reasonably certain that this option will be exercised, we have only included lease payments up to the assumed lease exit date. The rent payable is not contingent in nature and the Group has the ability to mutually agree changes to the arrangement with the lessor.

Accounting policies (continued)

IFRS 16: Leases (continued)

Recognition of leases (continued)

Lease liability (continued)

The Group is subject to a loan covenant under which lease liabilities are classified as unsecured debt, the level of which cannot exceed a specified ratio of 0.8% as a percentage of RCV. However, leases that would have been identified as operating leases prior to the IFRS 16 transition (1 April 2020) do not contribute towards the specified ratio provided that the aggregate amount of financial indebtedness does not exceed a higher specified ratio of 2%.

Short-term leases and leases of low-value assets

The Group has elected not to recognise right-of-use assets and lease liabilities for lease of low-value assets (£5,000) and short-term leases. The Group recognises the lease payments associated with these leases as an expense on a straight-line basis over the lease term.

As a lessor

The Group has one material lease for which it is a lessor, which relates to the acquisition of a long leasehold of an office building, Camelford House. The primary purpose of acquiring the building was to provide access to a construction site as part of the construction of the Thames Tideway Tunnel. It is incidental to our business that the Group is acting as a lessor with income received. The Group recognises lease payments received under operating leases as income on a straight-line basis over the lease term as part of 'other operating income'.

New accounting policies and financial reporting changes

The accounting policies adopted in the preparation of these financial statements are consistent with those of the previous financial year.

Exceptional items

Exceptional items are those charges or credits, and their associated tax effects, that are considered to be unusual by the Directors, either by nature or by scale and that are of material significance that separate disclosure is required for the financial statements to be properly understood by the users of the financial statements.

The determining factor for exceptional items is whether or not the item is considered unusual in nature, although exceptional charges may impact the same asset class or business segment over time. Market conditions that have deteriorated significantly over time will only be captured to the extent observable at the balance sheet date. Examples of items that may be considered exceptional include business restructuring and reorganisation or transformation costs, significant gains or losses on disposal, material impairment charges or reversals and provisions in relation to contractual settlements associated with significant disputes and claims.

Exceptional items recognised in the consolidated and Company only financial statements relate to transformation expenditure incurred from restructuring the business. This commenced in the previous financial year and concluded in the current financial year. These costs significantly changed how the Company operates and therefore are considered to be exceptional in nature and outside the ordinary course of business. The Group has additionally made a pension deficit repair payment of £69.7 million covering the financial periods from 2021/22 to 2024/25. This has been treated as an exceptional cash flow in the current year since this deficit repayment over the remaining AMP period is unusual by scale and of such significant that it would be beneficial to users of the financial statements to be disclosed separately in order to ensure our reporting cash flow movement reflects our ordinary business.

The Directors consider that any individual gain or loss on disposal of greater than £30.0 million would be disclosed as being exceptional by nature of its scale. Other gains or losses on disposal below this level may be considered to be exceptional by reference to specific circumstances. These will be explained in the notes of the accounts on a case-by-case basis where relevant.

IBOR reform

Following the financial crisis, the reform and replacement of benchmark interest rates such as the London Interbank Offer Rate (''LIBOR'') and other interbank offered rates (''IBORs'') has become a priority for global regulators. There is currently uncertainty around the timing and precise nature of these changes in some of the various jurisdictions affected, although the UK FCA has announced the timetable for the cessation of all LIBORs.

We cannot rely on GBP LIBOR being published after the end of 2021 and the industry-led Working Group on Sterling Risk-Free Reference Rates is supporting the transition from GBP LIBOR to SONIA (Sterling Overnight Index Average). There are key differences between GBP LIBOR and SONIA. GBP LIBOR is a 'term rate', which means that it is published for a borrowing period (such as 3 months), and it is 'forward-looking', because it is published at the beginning of the borrowing period. SONIA is a 'backward-looking' rate; it is based on overnight rates from actual transactions, and it is published at the end of the overnight borrowing period. Furthermore, GBP LIBOR includes a credit spread over the risk-free rate, which SONIA does not explicitly incorporate. To transition existing contracts and agreements that reference GBP LIBOR to SONIA, adjustments for term differences and credit differences might need to be applied to SONIA, to enable the two benchmark rates to be economically equivalent on transition.

Accounting policies (continued)

IBOR reform (continued)

Industry working groups have published documentation regarding methodologies for calculating adjustments between GBP LIBOR and SONIA. The Company has established a project to oversee the GBP LIBOR transition plan. This transition project will include changes to systems, processes, risk and valuation models, as well as managing related tax and accounting implications. The Company currently anticipates that the areas of greatest change will be amendments to the contractual terms of GBP LIBOR-referenced floating-rate debt and swaps, both for external and intercompany contracts, which it plans to implement prior to the end of 2021.

The International Accounting Standards Board ("IASB") has issued amendments to IFRS 9, IAS 39 and IFRS 7 in September 2019 that provide temporary relief from applying specific hedge accounting requirements to hedging relationships directly affected by IBOR reform. As at 31 March 2021, the Company had no designated hedge relationship and hedge accounting was not applied.

Interest Rate Benchmark Reform — Phase 2 (Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16) is effective for financial years beginning on or after 1 January 2021 and addresses issues that might affect financial reporting during the reform of an interest rate benchmark, including the effects of changes to contractual cash flows or hedging relationships arising from the replacement of an interest rate benchmark. We have not early adopted the standard for the current year.

IAS 12 – Income Taxes

Amendments have been proposed by the IASB to clarify how companies account for deferred tax on leases and decommissioning obligations. This is not effective until 2023. We are considering the implications of these amendments.

Alternative performance measures

In the reporting of financial information, the Directors have adopted various Alternative Performance Measures ("APMs"). These measures are not defined by IFRS and therefore may not be directly comparable with other companies' APMs, including those in the Group's industry. These APMs are not intended to be a substitute for, or superior to, IFRS measurements. Directors and management use APMs to provide additional useful information on the performance and position of the Company, and to enhance the comparability of information between reporting periods.

Capital expenditure ("capex")

Management review capex, which is the expenditure to acquire or upgrade tangible and intangible assets such as property, pipes, treatment works and software. The capex measure equates to intangible and tangible asset additions in the financial year including capitalised borrowing costs (see notes11 and 12 respectively) and capital accruals.

Net debt

Net debt is presented in note 19 on both a statutory and covenant basis. The covenant basis of net debt is the measure used when assessing the Group's gearing (see below) against the level stipulated in the whole business securitisation covenants. Net debt on a statutory basis consists of borrowings (including lease liabilities recorded under IFRS 16) less cash. Net debt on a covenant basis consists of borrowings less cash, excluding amounts owed to other group companies for which there is no related external debt, accrued interest, unamortised debt issuance costs and discounts and including certain derivative financial liabilities as explained in note 19.

The Group is subject to a covenant under which lease liabilities are classified as unsecured debt. Refer to note 19 for more information.

Regulatory Capital Value ("RCV")

The RCV has been developed for regulatory purposes by Ofwat and is one of the critical components for setting our customers' bills. When assessing the revenues that the Company needs, Ofwat consider the return on capital invested in the business, and the RCV is the capital base used in this assessment. There is no equivalent statutory measure.

Gearing

Gearing is the percentage of the Company's covenant net debt to RCV and is a key covenant ratio for the Group's financing arrangements with its lenders. There is no equivalent statutory measure.

Post Maintenance Interest Cover Ratio ("PMICR")

PMICR measures the amount of underlying cash generated by operating activities of the Company, adjusted for RCV depreciation, relating to the interest paid on the Group's debt. This ratio is a key covenant set by our lenders, and in modified forms, also used by rating agencies as part of their analysis when determining credit ratings. There is no equivalent statutory measure.

Accounting policies (continued)

Alternative performance measures (continued)

Credit rating

The Company must maintain an investment grade credit rating in accordance with our licence of appointment as a water and wastewater service provider. An investment grade rating equates to BBB- or higher from Standard & Poor's and Baa3 or higher from Moody's. The assessment by these two agencies provides an independent view of the Group's performance and future prospects. There is no equivalent statutory measure.

Underlying

Underlying represents the financial performance of the Group excluding the arrangement with Bazalgette Tunnel Limited ("BTL"). The underlying performance of the Group has been included within our financial statements and associated notes separate to our performance from the BTL arrangement.

As required by some of our financial covenants, we disclose our underlying performance separately.

BTL

BTL represents the financial performance of the Group from the arrangement with BTL. The performance from the BTL arrangement is included within our financial statements and associated notes separate to our underlying performance. Refer to page 43 for more information on the BTL arrangement.

EBIT

Earnings before interest and taxation ("EBIT") is a key performance metric used by management. As the Company has significant capital investment it is necessary that amounts relating to depreciation and amortisation are included in this metric. However, as interest expense and income and gains/losses on financial instruments are largely driven by external factors management deem it most appropriate to use EBIT as a key performance metric.

Significant accounting judgements and key sources of estimation uncertainty

The preparation of annual financial statements requires the Group to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expense. Actual results may differ from these estimates. The significant judgements made by management in applying the Group's accounting policies and the key sources of estimation uncertainty for the year ended 31 March 2021 are contained in the sections below:

Revenue recognition

Accounting judgement – revenue recognition

Water and wastewater services

The Group bills customers in accordance with its entitlement to receive revenue in line with the limits established by the periodic regulatory review processes. Revenue is recognised when performance obligations are met and when collection of the resulting receivable is probable. Determination of the probability of collection and hence the fair value of revenue recognised during the year is judgemental. Management considers historical trends in determining an adjustment to revenue to reflect instances where collection is not probable at the point of delivery. This has resulted in a decrease in revenue for the current year of £49.9 million (2020: £33.1 million), with a corresponding decrease in receivables as shown in note 15.

When the criteria for revenue recognition for a transaction are not met, recognition of the revenue is delayed until collectability is reasonably certain. Payments received in advance of entitlement are recorded within contract liabilities. Advance payments received from unmeasured customers for the year ended 31 March 2021 was £75.4 million (2020: £78.2 million).

Connections, requisitions and diversions

Management considers these types of income to be within the scope of IFRS 15, since a contract (as defined in the standard) exists with the developer or other third party.

The performance obligation is to install/extend the network to a property development (or to divert the network). This is a service since the control of the assets concerned is not transferred to the developer. In the case of connections, revenue is recognised at the point in time of completion. For diversions and requisitions, revenue is recognised over the period of service. The amount recognised is the transaction price multiplied by the percentage of completion, since an asset is created with no alternative use and the Group will have a present right to payment for work performed to date.

The charges are standalone and are not reflective of the ongoing obligation to supply the occupants of the newly connected properties. Supply to the occupants is charged on a standalone basis. This supports the decision not to defer connections/requisitions charges beyond completion of the service to the developer.

Infrastructure charges

Management consider that the obligation to invest in the network is highly interrelated with the ongoing and future obligation to provide water and wastewater services.

This right to charge comes from our licence of appointment as a water and wastewater services provider. The income earned from the infrastructure charges enables us to invest in the network, to continue to fulfil our obligation to provide water and wastewater services to our customers. As a result of this obligation and long term investment in our network, we deem that the income earned from infrastructure charges should be recognised over time rather than upfront.

Accounting judgement and estimation – provision for expected credit losses

As part of our future consideration, management has considered the impact of Covid-19 on customers' ability to pay their water and wastewater bills and has increased the provision by £9.0 million (2020: £15.2 million) across directly billed customers and WOCs. No adjustment has been made for non-household customers as management have assessed the future cash flows and the risk of non-payment was considered to be not material. The accounting treatment of revenue has also been unchanged by Covid-19 since it has not impacted how the performance obligations are measured.

For Directly billed customers the judgement was based on an average of three scenarios:

- Higher write-offs as a result of uncollected debt due to Covid-19 from 2020/21 billing being carried into the following year, which had an impact of £8.5 million on the provision;
- As above, but with the added expectation that reduced collections work in 2020/21 should therefore attribute a higher level of collectability to this debt in the following year since this contained debt of customers who have the ability to pay but have not been engaged with through collections activity yet, albeit not to the level expected in the year of billing. Therefore. this had an impact of £6.3 million on the provision; and
- As above, but with the added expectation that reduced collections work in 2020/21 should therefore attribute a higher level of collectability to this debt in the following year; which had a reduced impact of £6.3m on the provision; and
- Ongoing challenges causing collection rates to be worse than expected by 2%, which had an impact of £8.0 million on the provision.

Significant accounting judgements and key sources of estimation uncertainty (continued)

Revenue recognition (continued)

Accounting judgement and estimation – provision for expected credit losses (continued)

The average impact of these scenarios was £7.6 million.

For WOCs the judgement was based on an average of two scenarios:

- The budgeted Covid-19 percentage impact proposed for 2021/22 by the WOCs to their cash collection forecasts, applied to debt in proportion to the overall bad debt provision rate, which had an impact of £1.0 million on the provision; and
- The Covid-19 percentage impact used by the WOCs in 2020/21 and applied to all debt, which had an impact of £1.8 million on the provision.

The average impact of these scenarios was £1.4 million.

The actual level of receivables collected may differ from the estimated level of recovery which could affect operating results positively or negatively. The bad debt provision at 31 March 2021 was £146.3 million (2020: £187.8 million). The decrease was due to write offs in the year, primarily related to legacy debt, and a reduction in the total household provision due to an improvement in prior year debt collection rates following successful execution of our debt transformation programme.

We have performed a sensitivity analysis on the main components of the directly billed and WOC bad debt models. The main component of the bad debt model for the directly billed customers is based on cash collection rates; for the WOCs it is the information from their statutory accounts in relation to the level of bad debt provision held for billed and unbilled debtors. The sensitivity analysis is summarised below:

Directly Billed

Scenario	£m	Outcome
Current year cash collection rates increase by 1%	3.3	Increase in charge
Current year cash collection rates reduce by 1%	(3.3)	Reduction in charge

WOCs

Scenario	£m	Outcome
Reduction in WOC provision rates by 1%	(0.9)	Reduction in charge
Increase in WOC provision rates by 1%	0.9	Increase in charge

Non-Household customers

Queries relating to de-registration of properties are provided for in full. We performed sensitivity analysis on the revenue loss provision based on the % of payments made on all remaining queries from the non-household market, held at year end.

Scenario	£m	Outcome
Increase in payment % by 10%	0.3	Increase in charge
Decrease in payment % by 10%	(0.3)	Reduction in charge

Significant accounting judgements and key sources of estimation uncertainty (continued)

Property, plant and equipment and intangible assets

Accounting judgement – capitalisation of costs

The Group's activities involve significant investment in construction and engineering projects and assessing the classification of these costs between capital expenditure and operating expenditure requires management to make judgements. The Group capitalises expenditure relating to water and wastewater infrastructure where such expenditure enhances assets or increases the capacity of the network. Maintenance expenditure is taken to the income statement in the period in which it is incurred. Differentiating between enhancement and maintenance works is subjective, particularly in the instances where a single project may include a combination of both types of activities. Property, plant and equipment additions for the year ended 31 March 2021 were £1,050.2 million (2020: £1,136.3 million). Intangibles additions for the year ended 31 March 2021 were £54.8 million (2020: £86.7 million). Both figures include capitalised overheads and capitalised borrowing costs.

Management capitalises employee time and other expenses incurred by central functions on capital programmes and consequently management judgement is applied concerning whether those costs represent costs related to capital programs, following which management then apply a management estimate by calculating the capitalisation rate used. In addition, management capitalises borrowing costs incurred for significant projects that meet certain criteria and judgement is required to identify which projects qualify for this. The capitalised borrowing costs for both property, plant and equipment and intangible assets for the year ended 31 March 2021, net of commissioning, were £69.7 million (2020: £97.6 million).

Accounting estimate – depreciation and amortisation

Calculation of the depreciation and amortisation charges requires management to make estimates regarding the useful economic lives ("UELs") of the assets. These estimates are based on the Group's experience of similar assets and engineering data. Where management identifies that actual UELs materially differ from the estimate used to calculate the charge, that charge will be adjusted in the period that the difference occurred and future periods. The total depreciation charge for the year ended 31 March 2021 was £559.3 million (2020: £547.6 million) and the total amortisation charge for the year was £52.0 million (2020: £32.8 million). As the Group makes significant investment in PP&E and intangible assets, the differences between the estimated and actual UELs could increase or decrease the charge to the income statement. Sensitivity analysis has been performed on the useful lives, which can be summarised below:

Scenario	£m	Outcome
5 year increase in average remaining useful life	£75.0	Decrease in total depreciation and amortisation charge in the year ended 31 March 2021
5 year decrease in average remaining useful life	£99.8	Increase in total depreciation and amortisation charge in the year ended 31 March 2021

Provisions for other liabilities and charges

Accounting judgement – recognition of other provisions

A provision is recognised when it is probable that the Group has an obligation for which a reliable estimate can be made of the amount of the obligation. The Group is subject to commercial and legal claims that are related to the day-to-day operation of its business. These include contractual, employment and environmental matters which are defended and managed in the ordinary course of business. Assessing the outcome of uncertain commercial and legal cases requires judgement to be made regarding the extent to which any claim against the Group is likely to be successful. On a case-by-case basis, management evaluates the likelihood of adverse verdicts or outcomes to these matters and makes a judgement about whether or not a provision should be recognised.

Other provisions, which are detailed in note 21, total £46.4 million as at the year ended 31 March 2021 (2020: £32.0 million).

Accounting estimate – valuation of provisions

Assessing the financial outcome of uncertain commercial and legal cases requires estimates to be made regarding the amount by which the Group is liable. These estimates are made after considering available information including notifications, settlements, estimates performed by independent parties and legal counsel, available facts, identification of other potentially responsible entities and their ability to contribute, and prior experience. The amount provided may change in the future as additional information becomes available as a result of new developments. In such circumstances the provision will be adjusted in the future period the new information becomes available.

Provisions for liabilities and charges as at 31 March 2021 totalled £145.0 million (2020: £145.6 million). There is a risk that the final outcome of commercial and legal cases could be materially different to amounts provided.

Significant accounting judgements and key sources of estimation uncertainty (continued)

Investment in subsidiaries and goodwill

Accounting estimation – impairment of investments in subsidiaries and goodwill

Determining whether the Group's investments in subsidiaries or the carrying value of goodwill have been impaired requires estimations of the investment or cash generating unit's net realisable value. An enterprise valuation is derived through the application of an observable market multiplier uplift to the underlying entities' Regulatory Capital Value ("RCV"). The recoverable amount is thus most sensitive to the uplift multiplier used in the valuation model. See notes 9 and 32 for the net carrying value of goodwill investments and associated impairment provision.

Retirement benefit obligations

Accounting judgement – IFRIC 14 'IAS 19 'The Limit of a Defined Benefit Asset, Minimum Funding Requirements and their Interaction'

The Trust Deed for the Thames Water Mirror Image Scheme ("TWMIPS") provides the Company with an unconditional right to a refund of surplus assets assuming the full settlement of plan liabilities in the event of a plan wind-up. Furthermore, in the ordinary course of business the Trustee can only force a wind-up once all benefits have been distributed, at which point any surplus would be taken by the Company. Based on these rights, any net surplus in the scheme is recognised in full. Therefore, the Group considers that under IFRIC 14, it is appropriate to recognise the net surplus in TWMIPS.

Accounting estimate – actuarial valuations

The Group operates three defined benefit pension schemes for which full actuarial valuations are carried out as determined by the Trustees at intervals of not more than three years. In June 2019, the latest triennial valuations of these two defined benefit pension schemes as at 31 March 2019, were signed off by the actuary appointed by the scheme trustees, David Gardiner of Aon. The pension liability and net cost recognised under IAS 19 *Employee Benefits* are assessed using the advice of an actuary appointed by the Group, based on the latest actuarial valuation and assumptions determined by the scheme actuary. These assumptions are based on information supplied to the Group actuary, supplemented by discussions between the Group actuary and management and are used to estimate the present value of defined benefit obligations.

The actuarial assumptions used in determining the pension obligations and net costs recognised affect the profit before tax figure in the income statement and the net asset figure in the statement of financial position and together represent a key source of estimation uncertainty. These assumptions include:

- the discount rate;
- pay growth;
- mortality; and
- inflation.

The actual rates may materially differ from the assumptions due to changes in economic conditions and differences between the life expectancy of the members of the pension schemes and the wider UK population. These could have a positive or negative impact on the financial statements. The total net retirement benefit obligation for the two schemes as at 31 March 2021 was £219.2 million (2020: £114.6 million), which includes a pension deficit of £277.1 million (2020: £209.1 million) for the TWPS scheme, offset by a pension surplus of £57.9 million (2020: £94.5 million) for the TWMIPS scheme. Refer to note 23 for more information on the key assumptions and sensitivities of the pension schemes.

Derivative financial assets and liabilities

Accounting estimate – valuation of derivatives

The Group holds derivative financial instruments that fall into the following categories:

- index-linked swaps;
- cross currency swaps; and
- interest rate swaps.

The fair value of financial assets and liabilities represents the price that would be received to sell an asset or paid to transfer a liability. The techniques for determining the fair value of financial instruments are classified under the hierarchy defined in IFRS 13 *Fair Value Measurement* which categorises inputs to valuation techniques into levels 1-3 based on the degree to which the fair value is observable.

Level 1: Quoted prices in active markets for identical assets or liabilities that can be accessed.
Level 2: Significant inputs other than within Level 1 that are observable for the asset or liability, either directly or indirectly.
Level 3: Inputs for the assets or liabilities that are not based on observable market data and require management assumptions or inputs from unobservable markets.

Significant accounting judgements and key sources of estimation uncertainty (continued)

Derivative financial assets and liabilities (continued)

Accounting estimate – valuation of derivatives (continued)

Unless otherwise stated, all of the Group's inputs to valuation techniques are level 2 – the fair value is determined from inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. This technique uses discounted future cash flows to value the financial assets and liabilities. The future cash flows are estimated based on observable forward interest rates and inflation rates and are discounted at a rate that reflects the credit risk of the Group and counterparties. Currency cash flows are translated at spot rate. In case where unobservable inputs are used and such use does not significantly impact the result, the relevant derivative instruments are classified as level two. The net total of derivative financial assets and liabilities as at 31 March 2021 was a liability of £1,306.5 million (31 March 2020 a liability of: £686.6 million). Refer to Note 19 for more information on the key assumptions and sensitivities of the financial instruments.

The restructure of a derivative measured at fair value may result in a change to the observed fair value on the restructure date. Changes in the fair value may be attributable to both observable and unobservable factors. IFRS 9 does not permit the recognition of a restructure date fair value change on the income statement unless it relates to factors that are fully observable in the market. In cases where, due to unobservable factors, it is not possible to reliably identify the actual fair value movement, the whole of the observed fair value movement is capitalised and recognised in the income statement over the maturity period of the relevant restructured derivative. During the prior year, three index-linked swaps were restructured. At the restructuring date the fair value of these instruments, as indicated by their fair value immediately prior to the restructuring, could not be supported by observable inputs alone. In management's view the reduction in value of £38.0 million at the restructuring date is supported by unobservable factors including the counterparty's credit, capital, funding and trading charges. Therefore, such movement was deferred on the balance sheet in compliance with IFRS 9 and will be recognised in the income statement on a straight-line basis over the life of the underlying derivative instrument. As at 31 March 2021, £35.3 million (31 March 2020: £37.3 million) remained capitalised and £2.0 million had been recognised in the income statement (31 March 2020: £0.7 million). See note 19 for more information.

Judgement that relates to Bazalgette Tunnel Limited ("BTL")

Accounting judgement – principal vs. agent

BTL is the independent licenced utility company appointed to construct the Thames Tideway Tunnel. Under the terms of BTL's licence, BTL will earn and collect revenues by charging the Group for its services. The Group will subsequently charge these amounts to its wastewater customers (based on modifications to the Company's licence). Judgement has been exercised in assessing whether the Group is acting as principal or agent in its relationship with BTL.

Under IFRS 15 an entity must determine whether the nature of its promise is a performance obligation to deliver a good or service itself, or to arrange for them to be provided by another party. The Group is deemed to have primary responsibility for providing the 'end to end' services relating to the disposal of waste from its wastewater customers from collection, transportation (through the existing infrastructure and the Thames Tideway Tunnel) to the processing in the Group's sewage treatment plants. The Group continues to charge its wastewater customers for the end-to-end waste management service and the BTL element will not be separately reflected in customer bills.

Additionally, the Group, as the sole future user of the Tunnel, will remain exposed to the risks and rewards associated with the service of the overall sewerage system (which includes the Tunnel). These risks include reputational risks. Management therefore consider the Group is operating as principal in the relationship with BTL.

Notes to the Group financial statements

1. Revenue

	2021 Underlying £m	**2021 BTL £m**	**2021 Total £m**	2020 Underlying £m	2020 BTL £m	2020 Total £m
Gross revenue	**2,082.6**	**74.1**	**2,156.7**	2,141.4	64.6	2,206.0
Charge for bad and doubtful debts	**(49.6)**	**(0.3)**	**(49.9)**	(32.8)	(0.3)	(33.1)
Net revenue	**2,033.0**	**73.8**	**2,106.8**	2,108.6	64.3	2,172.9

Bazalgette Tunnel Limited ("BTL") is responsible for the construction of the Thames Tideway Tunnel. The Group has included costs of the Thames Tideway Tunnel within its bills to wastewater customers. As cash is collected it is paid over to BTL under the 'pay when paid' principle. The revenue on this arrangement has been disclosed separately to the Group's underlying performance in the table above, which is consistent with our financial covenants. The primary reason for the increase in BTL revenue is driven by the phasing of construction works.

Contract assets and liabilities

The Group has recognised the following revenue-related contract assets and liabilities:

	2021 £m	2020 £m
Contract assets		
Current		
Accrued revenue for services provided to metered customers	**176.7**	173.5
Accrued income for other activities[1]	**68.6**	62.9
Total current contract assets	**245.3**	236.4
Contract liabilities		
Non-current		
Deferred revenue from infrastructure charges	**517.3**	511.9
Deferred revenue from other activities[2]	**240.0**	195.4
Total non-current contract liabilities	**757.3**	707.3
Current		
Advance payments received from unmeasured customers	**75.4**	78.2
Deferred revenue from infrastructure charges	**5.3**	5.3
Deferred revenue from other activities[2]	**43.3**	40.6
Total current contract liabilities	**124.0**	124.1
Total contract liabilities	**881.3**	831.4

[1] Other activities includes accrued income from capital projects and the BTL arrangement (discussed on page 43).
[2] Other activities includes deferred revenue for nil cost assets received during the year and receipts in advance from our capital projects.

Revenue recognised in relation to contract liabilities

The following table shows how much revenue recognised in the current reporting period relates to brought forward contract liabilities and how much relates to performance obligations that were satisfied in a prior period.

	2021 £m	2020 £m
Revenue recognised that was included in the contract liability balance at the beginning of the period:		
Advance payments received from unmeasured customers	**78.2**	75.6
Deferred revenue from infrastructure charges	**5.2**	5.1
Deferred revenue from other activities	**40.6**	33.3
Total	**124.0**	114.0

Notes to the Group financial statements (continued)

1. Revenue (continued)

Transaction price allocated to wholly or partly unsatisfied contracts

The following table shows how much revenue is expected to be recognised in future reporting periods in respect of ongoing contracts which are partially or fully unsatisfied as at the reporting date.

	2021 **£m**	2020 - Restated £m
Aggregate amount of the transaction price allocated to contracts that are partially or fully unsatisfied at the reporting date:		
Service connections	**6.0**	7.4
Requisitions and diversions[1]	**206.6**	175.6
Infrastructure charges	**522.8**	517.1
Other	**4.3**	3.6
Total	**739.7**	703.7

[1] The prior year restatement is to disclose future income we are contracted to receive related to diversions, which was not disclosed in the previous financial year. The amount previously stated was £16.4m which has been restated to £175.6m as at 31 March 2020. The restated amount of £175.6 million includes £7.7million for High Speed 2, which relates to the relocation of assets to allow for the ongoing construction of this rail project. In the current year the amount relating to High Speed 2 is £41.0 million.

The Group considers the combination of activities comprising a Service Connection to represent a distinct performance obligation to the customer. This income is recognised within other operating income at the point in time that the service is complete, as no continuing obligation remains once the connection has been made. Typically amounts received in respect of service connections will be fully recognised within a year following receipt.

The Group considers the performance commitment associated with Requisitions and Diversions to be the delivery of the associated asset and accordingly recognises this income over time. Requisitions & Diversions encompass a wide variety of schemes from those with short durations that would be fully recognised in the year following receipt to large multi-phase developments for which income could be recognised over the course of several years.

For infrastructure charges the Company considers its performance commitment to align with its obligation to incur the expense to which the income relates, being the depreciation charge of the associated network reinforcement assets. Accordingly, the total amounts disclosed in the table above represent the total un-amortised amount which will be recognised as income as the assets continue to depreciate.

Notes to the Group financial statements (continued)

2. Operating expenses

	2021			2020		
	Underlying £m	**BTL £m**	**Total £m**	Underlying £m	BTL £m	Total £m
Wages and salaries	**302.0**	**-**	**302.0**	280.2	-	280.2
Social security costs	**33.3**	**-**	**33.3**	30.7	-	30.7
Severance costs	**0.9**	**-**	**0.9**	-	-	-
Pension costs – defined benefit schemes	**24.4**	**-**	**24.4**	26.8	-	26.8
Pension costs – defined contribution schemes	**15.2**	**-**	**15.2**	13.1	-	13.1
Apprenticeship Levy	**1.5**	**-**	**1.5**	1.3	-	1.3
Total employee costs	**377.3**	**-**	**377.3**	352.1	-	352.1
Power	**132.0**	**-**	**132.0**	129.0	-	129.0
Carbon reduction commitment	**-**	**-**	**-**	(1.1)	-	(1.1)
Raw materials and consumables	**53.0**	**-**	**53.0**	53.9	-	53.9
Rates[1]	**121.5**	**-**	**121.5**	98.2	-	98.2
Research and development expenditure	**11.2**	**-**	**11.2**	3.8	-	3.8
Insurance	**40.2**	**-**	**40.2**	39.8	-	39.8
Legal and professional fees	**41.8**	**-**	**41.8**	28.2	-	28.2
Other operating costs[2]	**513.3**	**-**	**513.3**	495.6	-	495.6
Own work capitalised	**(219.8)**	**-**	**(219.8)**	(183.0)	-	(183.0)
Net operating expenses before depreciation and amortisation	**1,070.5**	**-**	**1,070.5**	1,016.5	-	1,016.5
Depreciation of property, plant and equipment	**580.8**	**-**	**580.8**	569.0	-	569.0
Depreciation of right-of use assets	**8.0**	**-**	**8.0**	8.2	-	8.2
Amortisation of intangible assets	**52.0**	**-**	**52.0**	32.9	-	32.9
Net operating expenses excluding exceptional items	**1,711.3**	**-**	**1,711.3**	1,626.6	-	1,626.6
Exceptional costs[3]						
Company reorganisation - severance	**0.1**	**-**	**0.1**	12.2	-	12.2
Associated programme management costs	**16.2**	**-**	**16.2**	15.5	-	15.5
Operating expenses excluding impairment losses on financial and contract assets	**1,727.6**	**-**	**1,727.6**	1,654.3	-	1,654.3
Impairment losses on financial and contract assets[4]	**36.5**	**0.2**	**36.7**	40.6	0.2	40.8
Total operating expenses	**1,764.1**	**0.2**	**1,764.3**	1,694.9	0.2	1,695.1

[1] Rates expense in the current period include £nil rebates (2020: £23.0 million relating to reassessment of the business rates expense in the period 2005-2015).
[2] Other operating costs primarily relate to costs for contracted services and repairs and maintenance of assets, including associated labour costs, which do not qualify as capital expenditure under IAS 16: *Property, plant and equipment*.
[3] Exceptional costs of £16.3 million (2020: £27.7 million) relate to transformation expenditure incurred as a result of the significant restructuring of the business that commenced in the previous financial year and continued into this financial year. These costs are considered to be exceptional in nature with significant expenditure incurred that is not in the ordinary course of business. The restructure of the business involved significant changes in the way that the Company operates and therefore this transformation expenditure is deemed exceptional by nature. The tax impact of exceptional items is an increase in the tax credit in the income statement of £3.1 million (2020: £5.3 million) applying the 19% corporation tax rate.
[4] Impairment loss for the prior year is net of £5.1 million relating to excess payments received from customers in the past and recognised during the year. In the current year, £14.6 million is recognised in other income.

Notes to the Group financial statements (continued)

2. Operating expenses (continued)

Auditors remuneration

Amounts payable to the Group's auditor are shown below in respect of the following services to the Group:

	2021 £'000	2020 £'000
Fees payable to the Group's auditor:		
Fees payable for the audit of the Company's financial statements	**40.0**	41.0
Fees payable for the audit of the financial statements of subsidiaries pursuant to legislation	**1,470.8**	1,215.0
Fees payable to the Group's auditor for other services:		
Audit related assurance services	**765.5**	823.0
Other	**224.5**	146.0
Total aggregate remuneration	**2,500.8**	2,225.0

Fees payable for the audit of the Group's financial statements in the current financial year exclude £3,000 (2020: £10,000) for out of pocket expenses incurred for delivery of the audit.

Other assurance services include certain agreed upon procedures performed by PricewaterhouseCoopers LLP in connection with the Group's regulatory reporting requirements to Ofwat.

No fees, other than those disclosed, were payable to PricewaterhouseCoopers LLP in respect of the Company, or Group, in the current or preceding financial year.

3. Employees and Directors

Employees

All Group employees are based in the United Kingdom. The average number of persons employed by the Group during the year (including Executive Directors), analysed by category, was as follows:

	2021 Number	2020 Number
Employed by Thames Water Utilities Limited:		
Operations	**3,420**	3,313
Customer experience	**1,452**	1,456
Support services	**1,139**	1,099
Digital, strategy and transformation	**379**	300
Delivery office	**135**	128
	6,525	6,296
Employed by other group companies:		
Property services	**4**	5
Total	**6,529**	6,296

The Company has no employees (2020: none).

Directors

The Directors' emoluments were as follows:

	2021 £'000	2020 £'000
Salary and fees	**2,599.9**	566
Pension and pension allowances	**159.0**	35
Bonus	**510.0**	234
Payment on loss of office	**-**	787
Other benefits	**481.0**	5
Total	**3,749.9**	1,627

Notes to the Group financial statements (continued)

3. Employees and Directors (continued)

Included in the table above, is £1.5 million (2020: £3.6 million) for the Executive Directors for their services to Thames Water Utilities Limited. In addition, the Executive Directors received total remuneration of £0.5 million (2020: £1.2 million) for their services to other companies within the Kemble Water Holdings Group.

In the current and preceding financial years no amounts were accruing to any Directors under the Company's defined benefit scheme in respect of services to the Company. The Company contributed cash of £119,000 (2020: £106,000) as a pension supplement for two Directors (2020: two Directors). In the current and preceding years the Company made no contributions into the Company's defined contribution pension scheme in relation to the Directors.

Other benefits includes medical benefits, car allowances and other incentives.

Amounts disclosed in respect of the long-term incentive plan ("LTIP") are those where all performance and service conditions have been met. Detailed disclosures of items of remuneration, including those accruing under LTIPs can be found within the Remuneration Committee Report in the financial statements of Thames Water Utilities Limited. Refer to note 30 for disclosure on key management personnel.

Highest paid Director

Total emoluments, including payments and accruals under long term incentive schemes of the highest paid Director in respect of work done for the Group during the year were £921,351 (2020: £743,187).

4. Other operating income

The Group has recognised the following amounts relating to other operating income in the income statement since they are separate to our ongoing obligation to provide water and wastewater services to customers:

	2021 £m	2020 £m
Power income[1]	**10.9**	12.1
Requisitions and diversions charges	**27.0**	29.4
Service connection charges	**18.2**	18.9
Amortisation of deferred income recognised on adoption of assets at nil cost	**3.7**	3.1
Release from deferred income – infrastructure charges	**5.3**	5.1
Gain/(loss) on sale of PPE	**8.3**	(4.1)
Rental income[2]	**31.7**	3.3
Other income[3]	**17.1**	4.6
Total	**122.2**	79.4

[1] Power income comprises income from the sale of internally generated electricity.
[2] In the current year we recognise £27.7 million of rental income relating to previous years which was previously held on the Balance Sheet. The rental income relates to a property purchased for the delivery of the Thames Tideway Tunnel. This building was acquired to perform necessary works relating to the construction and integration of the tunnel into our network and will be disposed of in due course once required works have been completed.
[3] Other income includes £14.6 million relating to excess payments received from customers in the past and recognised during the current year. In the prior year, £5.1 million is recognised in impairment losses on financial and contract assets. See note 2 'Operating expenses' for further detail.

Power income comprises of income from the sale of internally generated electricity.

5. Finance income

During the year ended 31 March 2021, the Group recognised finance income of £174.7 million (Year ended 31 March 2020: £73.2 million) relating mainly to interest on swaps and interest on bank deposits.

	2021 £m	2020 £m
Interest income on bank deposits	**1.3**	2.2
Interest income on swaps	**171.8**	65.2
Other finance income on swaps	**0.9**	0.2
External trading interest income	**0.7**	5.6
Total	**174.7**	73.2

Notes to the Group financial statements (continued)

6. Finance expense

The Group also recognised finance expenses of £1,065.0 million (2020: £1085.6 million) relating mainly to interest and accretion on loans and other borrowings, interest on intercompany borrowings, leases and defined benefit pension obligations.

	2021 £m	2020 £m
Interest in relation to bank and other loans:		
Interest expense	**(474.0)**	(467.0)
RPI accretion on loans	**(50.2)**	(105.1)
Interest in relation to intercompany borrowings:		
Interest expense	**(633.2)**	(613.2)
Interest in relation to leases:		
Leases	**(3.4)**	(3.7)
Interest in relation to defined benefit obligation:		
Net interest expense on defined benefit obligation	**(2.1)**	(6.3)
Fees:		
Other finance (fees)/credit[1]	**(1.8)**	0.5
Gross finance expense	**(1,164.7)**	(1,194.8)
Amortisation	**30.0**	11.6
Capitalised borrowing costs	**69.7**	97.6
Total finance expense	**(1,065.0)**	(1,085.6)

[1]For the prior year ended 31 March 2020, fees of £0.3 million and a credit of £0.8 million related to a reversal of fee accrual was disclosed separately; in the table above a net amount of £0.5 million has been disclosed.

7. Net (losses)/gains on financial instruments

	2021 £m	2020 £m
Net exchange gains/(losses) on foreign currency borrowings	**145.7**	(52.1)
Net (loss)/gain arising on swaps where hedge accounting is not applied [1]	**(630.4)**	277.8
Loss on cash flow hedge transferred from equity [2]	**(37.5)**	(34.9)
Loss on part repayment of debt [3]	**(2.7)**	-
Total	**(524.9)**	190.8

[1] Loss arising on swaps where hedge accounting is not applied primarily reflects higher RPI expectations and appreciation of GBP against USD and EUR. This excludes interest which is disclosed in note 5 finance income and note 6 finance expense.

[2] Refer to Note 19 Financial Instruments on pages 88 and 89 for more information on the loss on cash flow hedge transferred from equity.

[3] In November 2020, the Group repurchased £59.9 million debt (out of the £175.0 million external debt due 2022) at a £2.7 million premium, with the tender price taking into account the above market interest rate on the bond and its trading price prior to the announcement of the tender. The £2.7 million premium was recognised as a loss on part settlement of debt.

Notes to the Group financial statements (continued)

8. Taxation

Tax charge/(credit) in the income statement

	2021 Underlying £m	**2021** BTL £m	**2021** Total £m	2020 Underlying £m	2020 BTL £m	2020 Total £m
Current tax:						
Current year amounts payable/(receivable) in respect of group relief	**(141.1)**	**14.0**	**(127.1)**	(125.9)	6.1	(119.8)
Overseas tax payable	**0.5**	**-**	**0.5**	1.7	-	1.7
Adjustment in respect of prior periods	**(1.1)**	**-**	**(1.1)**	(0.6)	-	(0.6)
	(141.7)	**14.0**	**(127.7)**	(124.8)	6.1	(118.7)
Deferred tax:						
Origination and reversal of timing differences	**(52.1)**	**-**	**(52.1)**	68.1	-	68.1
Adjustment in respect of corporation tax rate change	**-**	**-**	**-**	117.1	-	117.1
Adjustment in respect of prior periods	**1.0**	**-**	**1.0**	0.8	-	0.8
	(51.1)	**-**	**(51.1)**	186.0	-	186.0
Tax (credit)/charge on (loss)/profit on ordinary activities	**(192.8)**	**14.0**	**(178.8)**	61.2	6.1	67.3

The total tax credit for the year ended 31 March 2021 is lower (2020: higher charge) than the standard rate of corporation tax in the UK. The differences are explained below:

	2021 Underlying £m	**2021** BTL £m	**2021** Total £m	2021 Effective tax rate %	2020 Underlying £m	2020 BTL £m	2020 Total £m	2020 Effective tax rate %
(Loss)/profit on ordinary activities before taxation	**(1,024.1)**	**73.6**	**(950.5)**	**-**	(328.5)	64.1	(264.4)	
Current tax at 19% (2020: 19%)	**(194.6)**	**14.0**	**(180.6)**	**19.0%**	(62.4)	12.2	(50.2)	19.0%
Effects of:								
Recurring items:								
Depreciation on assets that do not qualify for tax relief	**4.4**	**-**	**4.4**		4.3	-	4.3	
Disallowable expenditure [1]	**2.8**	**-**	**2.8**		0.5	-	0.5	
Non-taxable income [2]	**(4.5)**	**-**	**(4.5)**		(4.6)	-	(4.6)	
Property disposals [3]	**(0.8)**	**-**	**(0.8)**		(0.1)	-	(0.1)	
Tax differential on profits and losses of overseas subsidiaries	**0.4**	**-**	**0.4**		0.1	-	0.1	
Group relief not paid at standard rate	**-**	**-**	**-**		6.1	(6.1)	-	
Tax as adjusted for recurring items	**(192.3)**	**14.0**	**(178.3)**	**18.8%**	(56.1)	6.1	(50.0)	18.9%
Non-recurring items:								
Tax rate change on temporary timing differences[4]	**(0.4)**	**-**	**(0.4)**		117.1	-	117.1	
Adjustments to tax charge in respect of prior periods – group relief [5]	**(1.1)**	**-**	**(1.1)**		(0.6)	-	(0.6)	
Adjustments to tax charge in respect of prior periods – deferred tax	**1.0**	**-**	**1.0**		0.8	-	0.8	
Total tax charge/(credit)	**(192.8)**	**14.0**	**(178.8)**	**18.8%**	61.2	6.1	67.3	(25.5%)

[1] Disallowable expenditure includes fines included in operating expenses.
[2] Non-taxable income relates primarily to income from new service connections. This income is reflected in the accounts as non-taxable income under IFRS principles, while cost of the new service connections fixed assets is not eligible for capital allowances.
[3] Tax arising on property disposals is lower than the accounting profits recognised for these disposals because of additional deductions available for tax purposes.
[4] The deferred tax rate changed in the prior year from 17% to 19%. A one-off charge of £117.1 million arose in that year on the restatement of deferred tax balances to 19%.
[5] The current tax credit in respect of prior periods of £1.1 million is in respect of group relief receivable from the Company's immediate parent company. The effective tax rate, as adjusted for recurring tax items, of 18.8% is slightly lower than the standard rate of corporation tax for the year of 19.0%.

Notes to the Group financial statements (continued)

8. Taxation (continued)

Tax charge/(credit) in the income statement (continued)

The Group is not currently in a tax paying position with HMRC (although companies within the Group do pay for group relief), primarily due to capital allowances on capital expenditure and tax deductions for borrowing costs. The differences between (loss)/profit on ordinary activities before taxation at the standard tax rate and the current tax (credit)/charge for the year are set out below.

	2021			2020		
	Underlying £m	**BTL £m**	**Total £m**	Underlying £m	BTL £m	Total £m
(Loss)/profit on ordinary activities before taxation	**(1,024.1)**	**73.6**	**(950.5)**	(328.5)	64.1	(264.4)
Tax at 19% (2020: 19%)	**(194.6)**	**14.0**	**(180.6)**	(62.4)	12.2	(50.2)
Effects of:						
Depreciation on assets that do not qualify for relief	**4.4**	**-**	**4.4**	4.3	-	4.3
Disallowable expenditure	**2.8**	**-**	**2.8**	0.5	-	0.5
Non-taxable income	**(4.5)**	**-**	**(4.5)**	(4.6)	-	(4.6)
Property disposals	**(0.8)**	**-**	**(0.8)**	(0.1)	-	(0.1)
Tax differential on profits and losses of overseas subsidiaries	**0.4**	**-**	**0.4**	0.1	-	0.1
Capital allowances for the year (in excess of)/less than depreciation	**(12.7)**	**-**	**(12.7)**	(3.3)	-	(3.3)
Capitalised borrowing costs allowable for tax [6]	**(13.3)**	**-**	**(13.3)**	(18.5)	-	(18.5)
Taxable profit on IFRS 16 and other restatements	**-**	**-**	**-**	5.5	-	5.5
Losses/(profits) on financial derivatives [7]	**89.9**	**-**	**89.9**	(48.8)	-	(48.8)
Pension cost charge higher than/(lower than) pension contributions [8]	**(17.1)**	**-**	**(17.1)**	(1.9)	-	(1.9)
Other short term timing differences	**4.9**	**-**	**4.9**	(1.1)	-	(1.1)
Group relief not paid at standard rate	**-**	**-**	**-**	6.1	(6.1)	-
Adjustments in respect of prior periods	(1.1)	-	(1.1)	(0.6)	-	(0.6)
Current tax (credit)/charge for the year	(141.7)	14.0	(127.7)	(124.8)	6.1	(118.7)

[6] Capitalised borrowing costs are eligible for a full tax deduction in the year.
[7] Accounting fair value profits and losses arising on our derivatives are non-taxable and non-deductible respectively, as instead they are taxed as the cash flows arise. Deferred tax is provided on these temporary differences.
[8] The Group made higher pension contributions in the year as a result of the additional pension deficit repair payment, which will receive tax relief. The Group reduced its claim for capital allowances accordingly so that current tax was not affected; as a result, no amounts have been booked to OCI in respect of the pension deficit repair payment.

Uncertain tax positions

At 31 March 2021 the total value of provisions for uncertain corporation tax positions was £nil (2020: £nil).

Notes to the Group financial statements (continued)

8. Taxation (continued)

Tax credited/(charged) directly to other comprehensive income

The deferred tax credited/(charged) directly to other comprehensive income during the year is as follows:

	2021 £m	2020 £m
Deferred tax:		
Tax (charge)/credit on net actuarial (gain)/loss in year	**43.2**	(34.7)
Impact of deferred tax rate change on net actuarial (gains)/losses	**-**	7.7
	43.2	(27.0)
Deferred tax:		
Tax (charge)/credit on cash flow hedges in year	**(7.1)**	(5.2)
Impact of deferred tax rate change on cash flow hedges	**-**	2.2
	(7.1)	(3.0)
Total (charged)/credited directly to other comprehensive income	**36.1**	(30.0)

In the Spring Budget 2021, the Government announced that from 1 April 2023 the corporation tax rate will increase to 25%. Since the proposal to increase the rate to 25% had not been substantively enacted at the balance sheet date, its effects are not included in these financial statements. However, it is likely that the overall effect of the change for the Group, had it been substantively enacted by the balance sheet date, would be to increase the net deferred tax liability by £314.1m, comprising an increase of £402.2m in the liability for accelerated depreciation, less a £88.1m increase in the assets for pensions, derivatives and other timing differences. The tax expense for the period would increase by £351.1m and the credit to reserves would increase by £37.0m.

9. Goodwill

The Directors have reviewed the carrying value of goodwill in line with the accounting policy on page 45 and do not consider there to be any impairment to this carrying value for the year ended 31 March 2021 (2020: £nil).

All purchased goodwill, which arose on acquisition of the Thames Water Utilities Limited in 2006, has been allocated to the regulated water and wastewater business. Impairment of this purchased goodwill occurs where the carrying value is in excess of the net realisable value, the expected sales value of the regulated business.

An equity valuation model has been used which takes an external, observable, market multiplier uplift to the Regulatory Capital Value ("RCV") of the regulated business. This model has also been informed by recent equity transactions, involving the sale of shares in KWH by existing shareholders. Ofwat, an external regulator, have developed the RCV as a measure of the capital value of the business, and the use of a multiplier reflects any premium to which the equity of publicly listed water utilities is being traded.

The critical assumption is thus the multiple of RCV used. As at 31 March 2021, for the carrying amount of goodwill to exceed the recoverable amount, a reduction of 27.0% (2020: 22.8%) to the multiplier used would be required.

10. Interests in joint venture

Thames Water Limited, a wholly owned subsidiary of the Group, controls 50% of the share capital of Foudry Properties Limited ("Foudry"), a property company incorporated in the United Kingdom. Foudry made a loss in 2021 of £0.3 million (2020: £0.5 million) and has net liabilities of £12.3 million (2020: £12.1 m). The Group's share of these losses relate solely to loan and associated interest balances owed to the Group, which have been fully provided for, and consequently no separate provision in respect of these losses has been recognised.

As at 31 March 2021 the joint venture did not have any significant contingent liabilities to which the Group was exposed and the Group did not have any significant contingent liabilities in relation to its interests in the joint venture (2020: £nil). The Group had no capital commitments in relation to its interests in the joint venture as at 31 March 2021 (2020: £nil).

Notes to the Group financial statements (continued)

11. Intangible assets

	Software £m	Other £m	Assets in development £m	**Total £m**
Cost:				
At 1 April 2019	240.9	1.3	154.4	**396.6**
Additions	-	-	86.7	**86.7**
Transfers	(4.1)	-	-	**(4.1)**
Transfers between categories and from PPE	222.5	-	(214.3)	**8.2**
Disposals	(0.6)	-	-	**(0.6)**
At 31 March 2020	458.7	1.3	26.8	**486.8**
Additions	-	-	54.8	**54.8**
Transfers between categories	35.9	-	(35.9)	**-**
Disposals	(89.0)	-	-	**(89.0)**
At 31 March 2021	405.6	1.3	45.7	**452.6**
Amortisation:				
At 1 April 2019	(177.4)	(1.0)	-	**(178.4)**
Amortisation charge	(32.8)	(0.1)	-	**(32.9)**
Transfers from PPE	(2.2)	-	-	**(2.2)**
Disposals	0.4	-	-	**0.4**
At 31 March 2020	(212.0)	(1.1)	-	**(213.1)**
Amortisation charge	(51.9)	(0.1)	-	**(52.0)**
Disposals	89.0	-	-	**89.0**
At 31 March 2021	(174.9)	(1.2)	-	**(176.1)**
Net book value:				
At 31 March 2021	230.7	0.1	45.7	**276.5**
At 31 March 2020	246.7	0.2	26.8	**273.7**

Additions in the previous financial year relate to IT projects undertaken including the implementation of new customer relationship management and billing (“CRMB”) system and a new meter data management system. No borrowing costs were capitalised during the year (31 March 2020: £3.4 million). The write offs are included under operating expenses in the income statement. The effective rate of borrowing costs for 2020 was 4.55%.

During the previous financial year, assets previously categorised as property, plant and equipment were reclassified as Software assets and therefore were transferred from property, plant and equipment to intangible assets. The amount transferred was £6.0 million net of depreciation (£8.2 million of asset cost and £2.2 million of accumulated depreciation).

During the current financial year we disposed of £89.0 million of assets. These wholly relate to assets with a nil NBV on our fixed asset register and were removed as they are now obsolete.

The gross carrying amount of intangible assets that was fully depreciated at 31 March 2021 amounted to £60.9 million (31 March 2020: £141.4 million).

Notes to the Group financial statements (continued)

12. Property, plant and equipment

	Land & buildings	Plant & equipment	Network assets	Assets under construction	**Total**
	£m	£m	£m	£m	**£m**
Cost:					
At 1 April 2019	3,850.7	8,191.1	7,363.8	2,627.8	**22,033.4**
Additions	-	0.4	30.9	1,105.0	**1,136.3**
Transfers between categories	62.3	379.8	428.5	(878.8)	**(8.2)**
Write-offs	-	(5.1)	-	(0.7)	**(5.8)**
Disposals	(2.0)	(8.2)	(0.1)	-	**(10.3)**
At 31 March 2020	3,911.0	8,558.0	7,823.1	2,853.3	**23,145.4**
Additions	-	0.2	28.6	1,021.4	**1,050.2**
Transfers between categories	125.1	482.9	548.1	(1,156.1)	**-**
Disposals	-	(184.5)	-	-	**(184.5)**
At 31 March 2021	4,036.1	8,856.6	8,399.8	2,718.6	**24,011.1**
Depreciation:					
At 1 April 2019	(1,078.1)	(4,550.8)	(627.7)	-	**(6,256.6)**
Depreciation charge	(59.1)	(371.5)	(138.4)	-	**(569.0)**
Transfers to IA	-	2.2	-	-	**2.2**
Disposals	0.5	6.2	-	-	**6.7**
At 31 March 2020	**(1,136.7)**	**(4,913.9)**	**(766.1)**	**-**	(6,816.7)
Depreciation charge	(64.0)	(379.5)	(137.3)	-	**(580.8)**
Disposals	-	183.1	-	-	**183.1**
At 31 March 2021	**(1,200.7)**	**(5,110.3)**	**(903.4)**	**-**	**(7,214.4)**
Net book value:					
At 31 March 2021	2,835.4	3,746.3	7,496.4	2,718.6	**16,796.7**
At 31 March 2020	2,774.3	3,644.1	7,057.0	2,853.3	**16,328.7**

£69.7 million of borrowing costs were capitalised in the period (2020: £94.2 million). The effective annual capitalisation rate for borrowing costs was 3.3% (2020: 4.55%).

In the prior year, assets previously categorised as property, plant and equipment were reclassified as Software assets and therefore were transferred from property, plant and equipment to intangibles. The amount transferred was £6.0 million net of depreciation (£8.2 million of asset cost and £2.2 million of accumulated depreciation).

The gross carrying amount of property, plant and equipment that was fully depreciated at 31 March 2021 amounted to £2,557.9 million (31 March 2020: £2,485.1 million).

Land and Buildings include purchases made in relation to the Thames Tideway Tunnel project; an element of which will not be capitalised when the asset is brought into use. These land and buildings were acquired to perform necessary works relating to the construction and integration of the tunnel into our network and will be disposed of in due course once required works have been completed.

Land and Buildings includes a balance relating to the lease of a property leased in connection with the construction of the Thames Tideway Tunnel. This lease meets the definition of an Investment Property and is therefore accounted for under the cost method of IAS 40 with a carrying value of £113.1m. The fair value of this property at 31 March 2021 and 31 March 2020 is assessed by the Company to be materially the same as its carrying value. The rental income earned by the Company in relation to this property in the year ended 31 March 2021 is £5.8 million (31 March 2020: £5.7 million).

During the current financial year we disposed of £184.5 million of property, plant and equipment assets. £181.4 million relate to assets with a nil NBV on our fixed asset register and were removed since being obsolete. We have also had business-as-usual disposals of £3.1 million relating to fleet and property as they are now obsolete.

Notes to the Group financial statements (continued)

13. Leases

(i) Amounts recognised in the statement of financial position

Right-of-use assets **As at**	**31 March 2021**	31 March 2020
	£m	£m
Land and buildings	**41.6**	52.3
Total	**41.6**	52.3

Additions to right-of-use assets during the year ended 31 March 2021 were £ 0.7 million (31 March 2020: £ £6.3 million).

Lease liabilities **As at**	**31 March 2021**	31 March 2020
	£m	£m
Current	**(7.5)**	(7.9)
Non-current	**(52.9)**	(62.4)
Total	**(60.4)**	(70.3)

(ii) Amounts recognised in the income statement

For the year ended	**31 March 2021**	31 March 2020
	£m	£m
Depreciation charge of right-of-use assets	**8.0**	8.2
Interest expense included in finance costs	**3.4**	3.7
Expense relating to short-term leases, low value assets and variable lease payments not included in lease liabilities	**6.6**	5.0
Total	**18.0**	16.9

The total cash outflow for leases during the year ended 31 March 2021 was £10.9 million (31 March 2020: £11.0 million).

The Group’s leasing activities consist of rentals payable for office properties and other land and buildings.

14. Inventories and current intangible assets

	2021	2020
	£m	£m
Raw materials and consumables	**14.9**	13.6
Total	**14.9**	13.6

Notes to the Group financial statements (continued)

15. Trade and other receivables

	2021			2020		
	Underlying £m	**BTL £m**	**Total £m**	Underlying £m	BTL £m	Total £m
Non-current:						
Prepayments and accrued income	**-**	**228.9**	**228.9**	-	159.0	159.0
Insurance claims receivable	**45.1**	**-**	**45.1**	64.4	-	64.4
Other receivables	**6.3**	**-**	**6.3**	6.7	-	6.7
	51.4	**228.9**	**280.3**	71.1	159.0	230.1
Current:						
Gross trade receivables	**441.2**	**15.2**	**456.4**	475.9	13.5	489.4
Less doubtful debt provision	**(143.1)**	**(3.2)**	**(146.3)**	(185.1)	(2.7)	(187.8)
Net trade receivables	**298.1**	**12.0**	**310.1**	290.8	10.8	301.6
Amounts owed by associated undertakings	**0.4**	**-**	**0.4**	0.1	-	0.1
Amounts receivable/(payable) in respect of group relief	**268.5**	**(20.1)**	**248.4**	126.4	(6.1)	120.3
Prepayments and accrued income	**38.4**	**-**	**38.4**	32.0	-	32.0
Other receivables	**29.9**	**0.8**	**30.7**	35.6	0.8	36.4
	635.3	**(7.3)**	**628.0**	484.9	5.5	490.4
Current:						
Contract assets	**240.0**	**5.8**	**245.8**	235.4	1.5	236.9
Total	**926.7**	**227.4**	**1,154.1**	791.4	166.0	957.4

The Directors consider that the carrying amount of trade and other receivables is approximately equal to their fair value. The Directors believe that the Group is well placed to manage its business risks successfully, despite the current uncertainties in the economy as a result of Covid-19.

Non-current prepayments at 31 March 2021 includes £228.9 million (2020: £159.0 million) of prepayment relating to the Bazalgette Tunnel Limited ("BTL") arrangement. The prepayment is created and recorded by the Group as BTL will transfer the use of the tunnel to Thames Water Utilities Limited once construction is complete, against which this prepayment will be utilised.

Contract assets at 31 March 2021 includes £176.7 million (2020: £173.5 million) of services provided to metered customers. Included within this amount is £7.1 million of bad debt (31 March 2020: £5.9 million). The remaining amount is for accrued capital contributions and accrued income from the BTL arrangement.

Expected credit loss provision

Movements in the expected credit losses provision were as follows:

	2021 £m	2020 £m
At 1 April	**(187.8)**	(176.6)
Charge for bad and doubtful debts – charged against revenue	**(41.0)**	(33.1)
Charge for bad and doubtful debts – included within operating expenses	**(36.7)**	(40.8)
Excess credits recognised during the year	**-**	(5.1)
Amounts written off (utilised)	**119.2**	67.8
Total at 31 March	**(146.3)**	(187.8)

[1] included within this is a £8.9 million reduction in the cancel rebill provision. This covers amounts which have been billed, but will be cancelled at a later date and then not rebilled. The decrease of the provision in the current financial year is credited to gross revenue. The remaining amount pertains to the £49.9m charge for bad and doubtful debts against revenue as seen in note 1.

Ageing of gross receivables is as follows:

	2021 £m	2020 £m
Up to 365 days	**318.3**	274.3
1 – 2 years	**73.0**	78.5
2 – 3 years	**33.6**	94.4
More than 3 years	**31.5**	42.2
Total	**456.4**	489.4

Notes to the Group financial statements (continued)

15. Trade receivables (continued)

The ageing of gross BTL receivables[1] is as follows:

	2021 £m	2020 £m
Up to 365 days	**11.4**	8.3
1 – 2 years	**2.6**	2.4
2 – 3 years	**1.2**	2.8
Total	**15.2**	13.5

[1]This relates to the amount of receivables collected from other parties and passed on to BTL.

The Group applies the IFRS 9 simplified approach to measuring expected credit losses which uses a lifetime expected loss allowance for all trade receivables and contract assets. This is calculated based on historical experience of levels of recovery and what might happen in the future.

Expected credit loss split by ageing is as follows:

	2021 £m	2020 £m
Up to 365 days	**74.5**	82.1
1 – 2 years	**29.5**	32.4
2 – 3 years	**15.4**	44.4
More than 3 years	**26.9**	28.9
Total	**146.3**	187.8

The ageing of impaired BTL receivables[1] is as follows:

	2021 £m	2020 £m
Up to 365 days	**2.0**	1.4
1 – 2 years	**0.8**	0.6
2 – 3 years	**0.4**	0.7
Total	**3.2**	2.7

[1]This relates to the amount of receivables collected from other parties and passed on to BTL

16. Cash and cash equivalents

		2021			2020	
	Underlying £m	**BTL £m**	**Total £m**	Underlying £m	BTL £m	Total £m
Cash at bank and in hand	**6.4**	**-**	**6.4**	16.7	-	16.7
Money market funds	**796.8**	**3.6**	**800.4**	798.5	2.6	801.1
Total	**803.2**	**3.6**	**806.8**	815.2	2.6	817.8

BTL cash represents amounts collected from wastewater customers, for the construction costs of the Thames Tideway Tunnel, which has not yet been paid at the reporting date.

Notes to the Group financial statements (continued)

17. Trade and other payables

	2021 Underlying £m	2021 BTL £m	2021 Total £m	2020 Underlying £m	2020 BTL £m	2020 Total £m
Non-current:						
Contract liabilities	**757.3**	**-**	**757.3**	707.3	-	707.3
Current:						
Trade payables – operating	**196.2**	**-**	**196.2**	229.7	-	229.7
Amounts owed to Bazalgette Tunnel Limited	**-**	**11.4**	**11.4**	-	10.3	10.3
Accruals and deferred income	**370.5**	**-**	**370.5**	341.4	-	341.4
Other taxation and social security	**8.3**	**-**	**8.3**	7.2	-	7.2
Other payables	**32.1**	**-**	**32.1**	82.8	-	82.8
	607.1	**11.4**	**618.5**	661.1	10.3	671.4
Current:						
Contract liabilities	**121.9**	**2.1**	**124.0**	123.8	0.3	124.1
Total	**1,486.3**	**13.5**	**1,499.8**	1,492.2	10.6	1,502.8

Current contract liabilities at 31 March 2021 includes £75.4 million (2020: £78.2 million) of receipts in advance from customers for water and wastewater charges. The remaining amount relates to payment in advance for compensation for operating costs and infrastructure charges.

Non-current contract liabilities at 31 March 2021 includes £522.7 million (2020: £511.9 million) of deferred infrastructure charges, £227.8 million of deferred income for nil cost "adopted" assets (2020: £179.7 million) with the remaining amount relating to payments received in advance for compensation for operating costs.

The Directors consider that the carrying amount of trade and other payables within the scope of IFRS 7 is approximately equal to their fair value.

18. Borrowings

	2021 £m	2020 £m
Secured bank loans and private placements	**4,443.0**	5,563.5
Bonds	**9,737.2**	8,642.5
Amounts owed to group undertakings	**3,100.6**	3,100.6
	17,280.8	17,306.6
Interest payable on secured bank loans, private placements and bonds	**192.0**	183.0
Interest payable on amounts owed to group undertakings	**3,865.2**	3,232.0
	4,057.2	3,415.0
Total	**21,338.0**	20,721.6
Disclosed within current liabilities	**1,146.1**	1,814.9
Disclosed within non-current liabilities	**20,191.9**	18,906.7

Secured bank loans refers to (i) the Company's secured bank loans under an Intercreditor Deed with the holding company's Security Trustee; and (ii) the secured bank loans under an arrangement whereby each Obligor (representing each of the companies within the whole business securitisation group) has entered into a Security Trust and Intercompany Deed ("STID") with the operating company's Security Trustee. Pursuant to this arrangement, TWUHL has guaranteed the obligations of each other Obligor (TWUL and TWUF) under the finance agreement. Additionally, TWUL and TWUF have guaranteed the obligations of each other under the finance agreement, in each case to the Security Trustee.

Notes to the Group financial statements (continued)

18. Borrowings (continued)

Breakdown of secured bank loans and private placements:

	2021 £m	2020 £m
Thames Water Utilities Limited:		
£75.0m 1.350% index linked loan due 2021 (e), (h)	**92.9**	91.6
£215.0m 0.460% index-linked loan due 2023 (a), (h)	**258.4**	254.8
£215.0m 0.380% index-linked loan due 2032 (a), (b), (h)	**195.0**	209.5
£100.0m 3.261% index-linked loan due 2043 (a), (d), (h)	**135.0**	133.1
£100.0m 0.790% index-linked loan due 2025 (a), (e), (h)	**114.4**	112.8
£125.0m 0.598% index-linked loan due 2026 (a), (e), (h)	**142.3**	140.4
£70.0m Class B 3.867% fixed rate loan due 2026 (a)	**70.0**	70.0
£50.0m Class B 3.875% fixed rate loan due 2026 (a)	**50.0**	50.0
£20.0m Class B floating rate loan due 2026 (a)	**20.0**	20.0
£39.0m Class B 3.918% fixed rate loan due 2026 (a)	**38.6**	38.5
$55.0m 3.380% private placement due 2023 (a), (f)	**39.9**	44.2
$285.0m 3.570% private placement due 2025 (a), (f)	**206.5**	229.0
£216.0m 2.450% private placement due 2028 (a)	**215.5**	215.4
£210m 2.550% private placement due 2030 (a)	**209.4**	209.3
£40m 2.620% private placement due 2033 (a)	**39.8**	39.8
£150.0m floating rate loan due 2024 (a)	**149.7**	149.7
£125.0m floating rate loan due 2024 (a)	**124.6**	124.4
£50.0m floating rate loan due 2022 (a)	**49.9**	49.9
£63.1m floating rate loan due 2027 (a)	**62.9**	62.9
£63.1m floating rate loan due 2029 (a)	**62.9**	62.9
£63.1m floating rate loan due 2031 (a)	**62.8**	62.8
Thames Water Utilities Limited total	**2,340.5**	2,371.0
Thames Water Utilities Finance plc		
£600.0m 1.029% floating rate loan due 2021 (c), (j)	**-**	600.0
£300.0m 1.029% floating rate loan due 2021 (c), (j)	**-**	300.0
£300.0m 1.001% floating rate loan due 2021 (c), (j)	**-**	300.0
£214.3m 1.082% Class B floating rate loan due 2020 (c)	**-**	214.3
£214.3m 0.968% Class B floating rate loan due 2021 (c), (g)	**214.3**	-
£150.0m 1.713% Class B floating rate loan due 2023 (k)	**150.0**	150.0
£150.0m 1.708% Class B floating rate loan due 2023 (k)	**150.0**	-
$106.0m 4.070% private placement due 2026 (a), (f)	**76.8**	85.1
$131.0m 4.270% private placement 2029 (a), (f)	**94.7**	105.1
€50.0m 2.100% private placement due 2030 (a), (f)	**42.4**	44.1
$150.0m 3.870% private placement due 2022 (f)	**108.9**	120.7
$200.0m 4.020% private placement 2024 (f)	**145.2**	161.0
$250.0m 4.220% private placement due 2027 (f)	**181.4**	201.2
Thames Water Utilities Finance plc total	**1,163.7**	2,281.5
Kemble Water Finance Limited:		
£75.0m floating rate loan due 2022 (a), (i)	**-**	74.5
£200.0m floating rate loan due 2025 (a)	**198.5**	198.1
£4.5m 5.3% fixed rate loan due 2025 (a)	**4.4**	4.4
£5.5m 5.3% fixed rate loan due 2025 (a)	**5.4**	5.4
£100.0m 5.3% fixed rate loan due 2025 (a)	**98.6**	98.3
£200.0m 5.3% fixed rate loan due 2025 (a)	**197.1**	196.6
£149.8m 5.39% fixed rate loan due 2026 (a)	**147.6**	147.2
£190.0m floating rate loan due 2024 (a)	**188.4**	186.5
£50.0m 5.26% private placement due 2027 (a)	**49.5**	-
£50.0m 5.27% private placement due 2028 (a)	**49.3**	-
Kemble Water Finance Limited total	**938.8**	911.0
Total secured bank loans and private placements	**4,443.0**	5,563.5

Notes to the Group financial statements (continued)

18. Borrowings (continued)

All TWUL and TWUF loans are Class A except where highlighted.

(a) These loans and private placements are shown net of issuance costs.
(b) This debt amortises in equal tranches from 2017 onwards.
(c) The interest margins of these loans are based on (i) a ratings grid and will increase should the operating company securitisation group senior debt credit rating be downgraded by both Standard and Poor's and Moody's; and (ii) the Group's GRESB score.
(d) This debt amortises from 2023 to 2033 in tranches of £3.0 million, followed by annual tranches of £750,000 until maturity where there will be a bullet repayment of £25.0 million.
(e) These loans contain a collar mechanism that limits total accretion repayment within a predetermined range.
(f) The Group has entered into cross currency swap agreements which convert this debt into sterling debt.
(g) In March 2021, £214.3 million out of the £214.3 million Class B revolving credit facility was drawn. In April 2021, this Class B drawdown was fully repaid.
(h) The value of the capital and interest elements of the index-linked loans is linked to movements in the Retail Price Index ("RPI").
(i) During the year ended 31 March 2021, the £75.0m floating rate loan originally due in 2022 was repaid early.
(j) These loans represent drawdowns from the £1,432.1 million Class A revolving credit facility. As at 31 March 2021, £nil was drawn (2020: £1,200.0 million).
(k) The interest margins of these loans are based on a ratings grid and will increase should the operating company securitisation group senior debt credit rating be downgraded by both Standard and Poor's and Moody's.

Breakdown of bonds:	**2021 £m**	2020 £m
Thames Water Utilities Finance plc		
£200.0m 5.050% fixed rate due 2020 (c), (h)	**-**	200.3
£225.0m 6.590% fixed rate due 2021 (l)	**225.3**	233.7
£175.0m 3.375% index-linked due 2021 (b), (d)	**295.2**	290.4
£330.0m 6.750% fixed rate due 2028 (b), (i)	**373.0**	382.1
£200.0m 6.500% fixed rate due 2032 (b), (c), (j)	**236.7**	242.4
£600.0m 5.125% fixed rate due 2037 (b), (c), (k)	**649.3**	653.7
£300.0m 1.680% index-linked due 2053 (b), (d)	**454.7**	447.4
£300.0m 1.681% index-linked due 2055 (b), (d)	**454.7**	447.4
€113.0m 2.300% CPI index-linked bond due 2022 (a), (c)	**104.7**	108.0
£300.0m 5.750% class B Fixed rate bond due 2030 (b), (e)	**298.9**	298.5
£300.0m 4.375% fixed rate bond due 2034 (b)	**296.1**	295.9
¥20.0bn 3.280% fixed rate bond due 2038 (a), (b), (c)	**131.2**	149.4
£50.0m 3.853% index-linked bond due 2040 (g)	**67.5**	66.6
£500.0m 5.500% fixed rate bond due 2041 (b)	**490.3**	490.0
£50.0m 1.980% index-linked bond due 2042 (d)	**71.3**	70.4
£55.0m 2.091% index-linked bond due 2042 (b), (d)	**75.8**	74.7
£40.0m 1.974% index-linked bond due 2045 (b), (d)	**45.2**	46.3
£300.0m 4.625% fixed rate bond due 2046 (b)	**293.5**	293.4
£100.0m 1.846% index-linked bond due 2047 (d)	**142.5**	140.9
£200.0m 1.819% index-linked bond due 2049 (b), (d)	**284.7**	281.3
£200.0m 1.771% index-linked bond due 2057 (b), (d)	**284.6**	281.3
£350.0m 1.760% index-linked due 2062 (b), (d)	**498.1**	492.1
£500.0m 4.000% fixed rate due 2025 (b)	**497.1**	496.5
£40.0m 0.750% index-linked loan due 2034 (b), (d)	**45.3**	44.7
£45.0m 0.721% index-linked loan due 2027 (b), (d)	**50.9**	50.2
£300.0m 3.500% fixed rate loan due 2028 (b)	**297.3**	297.0
£400.0m 7.738% fixed rate bond due 2058 (b)	**418.7**	419.3
£250.0m 1.875% fixed rate bond due 2024 (b)	**248.9**	248.5
£250.0m 2.625% fixed rate bond due 2032 (b)	**247.7**	247.6
£300.0m 2.375% class B Fixed rate bond due 2023 (b)	**299.3**	299.1
£250.0m 2.875% class B Fixed rate bond due 2027 (b)	**247.6**	247.3
CAD 250.0m 2.875% fixed rate bond due 2024 (a), (b)	**143.2**	141.1
£350.0m 2.375% fixed rate bond due 2040 (b)	**345.9**	-
£40.0m 2.442% fixed rate bond due 2050 (b)	**39.9**	-
£84.7m 0.875% fixed rate bond due 2023 (b)	**84.6**	-
€500.0m 0.190% fixed rate bond due 2023 (a), (b)	**424.6**	-
$57.0m 2.060% fixed rate bond due 2030 (a), (b)	**41.3**	-
$40.0m 1.604% fixed rate bond due 2027 (a), (b)	**29.1**	-
Fees (f)	**(10.6)**	(9.3)
Thames Water Utilities Finance Limited total	**9,224.1**	8,468.2

Notes to the Group financial statements (continued)

18. Borrowings (continued)

Breakdown of bonds (continued):

	2021 £m	2020 £m
Thames Water (Kemble) Finance plc		
£175.0m 5.875% fixed rate bond due 2022 (b), (m)	**114.8**	174.3
£400.0m 4.625% fixed rate bond due 2026 (b)	**398.3**	-
Thames Water (Kemble) Finance plc total	**513.1**	174.3
Total bonds	**9,737.2**	8,642.5

All TWUF bonds are Class A except where highlighted.

(a) The Group has entered into cross currency swap agreements which convert this debt into sterling debt.
(b) These bonds are shown net of issuance costs.
(c) The Group has entered into swap agreements that convert this debt into £ index-linked debt.
(d) The value of the capital and interest elements of the index-linked debt is linked to movements in the Retail Price Index ("RPI").
(e) In September 2022 this Class B bond has a 'Step Up and Call' meaning the interest rate changes to 3 months LIBOR plus 7.97% at which point the issuer can exercise a call option to redeem the nominal value of the debt at par value.
(f) These fees have been shown within bonds to reflect that they relate to index linked debt issued in 2007.
(g) This is a Limited Price Index ("LPI") bond. Accretion is calculated using an adjusted UK Retail Price Index.
(h) This bond includes £nill million (2020: £0.3 million) fair value adjustments to carrying value at acquisition by Kemble Water Holdings Group.
(i) This bond includes £45.1 million (2020: £54.3 million) fair value adjustments to carrying value at acquisition by Kemble Water Holdings Group.
(j) This bond includes £38.6 million (2020: £44.5 million) fair value adjustments to carrying value at acquisition by Kemble Water Holdings Group.
(k) This bond includes £52.6 million (2020: £57.1 million) fair value adjustments to carrying value at acquisition by Kemble Water Holdings Group.
(l) This bond includes £0.2 million (2020: £8.7million) fair value adjustments to carrying value at acquisition by Kemble Water Holdings Group.
(m) In November 2020, the Group repurchased £59.9 million debt (out of the £175.0 million external debt due 2022) at a £2.7 million premium, with the tender price taking into account the above market interest rate on the bond and its trading price prior to the announcement of the tender. The £2.7 million premium was recognised as a loss on part settlement of debt.

The total carrying value of the fair value adjustment to the debt on acquisition of the Thames Water Group by Kemble Water Holdings Group is £136.5 million (2020: £166.5 million). Capitalised debt issuance costs in relation to the debt portfolio are £85.8 million (2020: £87.0 million).

Breakdown of amounts owed to group undertakings:

Kemble Water Eurobond plc	2021 £m	2020 £m
£3,100.6 fixed rate due on demand (a)	**3,100.6**	**3,100.6**
Total amounts owed to group undertakings	**3,100.6**	**3,100.6**

(a) This loan is repayable on demand, however the Directors confirm that there will be no repayment within 12 months and a letter of comfort has been obtained from the counterparty to confirm that no repayment will be sought for at least 12 months from the date of signing the financial statements. Therefore, amounts owed to group undertakings has been classified as non-current.

Notes to the Group financial statements (continued)

19. Financial instruments

Categories of financial instruments

The carrying values of the primary financial assets and liabilities are as follows:	**2021** **£m**	2020 - Restated[1] £m
Financial assets:		
Fair value through profit or loss		
Cross currency swaps	**63.5**	177.2
Interest rate swaps	**16.2**	87.7
Index-linked swaps	**83.7**	109.4
Cash and cash equivalents – money market funds[2]	**800.4**	801.1
	963.8	1,175.4
Amortised cost		
Other receivables (excluding prepayments) [1]	**51.4**	64.3
Trade and other receivables (excluding prepayments) [1]	**589.6**	458.4
Short-term investments	**-**	300.0
Cash and cash equivalents – cash at bank and in hand[2]	**6.4**	16.7
	647.4	839.4
Total	**1,611.2**	2,014.8

[1] The comparative amounts have been restated to reclassify amounts between 'Other receivables' and 'Trade and other receivables' consistent with how these balances are presented in note 15. Trade and other receivables.

[2] The comparative amounts have been restated to reclassify cash and cash equivalents – money market funds from the amortised cost section to the fair value through profit or loss section."

	2021 **£m**	2020 £m
Financial liabilities:		
Fair value through profit or loss		
Cross currency swaps	**(113.6)**	(51.3)
Interest rate swaps	**(166.6)**	(252.1)
Index-linked swaps	**(1,189.7)**	(757.5)
	(1,469.9)	(1,060.9)
Amortised cost		
Trade and other payables (excluding other taxation and social security)	**(610.2)**	(664.3)
Borrowings	**(21,338.0)**	(20,721.6)
Lease liabilities	**(60.4)**	(70.3)
	(22,008.6)	(21,456.2)
Total	**(23,478.5)**	(22,517.1)

Fair value measurements

The fair value of financial assets and liabilities represents the price that would be received to sell an asset or paid to transfer a liability between informed and willing parties, other than in a forced or liquidation sale at the measurement date. The techniques for determining the fair value of financial instruments are classified under the hierarchy defined in IFRS 13 *Fair Value Measurement* which categorises inputs to valuation techniques into levels one to three based on the degree to which the fair value is observable.

Level 1: Quoted prices in active markets for identical assets or liabilities that can be accessed
Level 2: Significant inputs other than within Level 1 that are observable for the asset or liability, either directly or indirectly
Level 3: Inputs for the assets or liabilities that are not based on observable market data and require management assumptions or inputs from unobservable markets.

Unless otherwise stated all of the Group's inputs to valuation techniques are level two – the fair value is determined from inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. The fair values of interest rate and index-linked swaps are determined, in part, from unobservable inputs but the use of these unobservable inputs does not significantly impact the result. As a result, we have concluded that it is appropriate to continue to classify the derivative instruments as level two. The table below sets out the valuation basis of financial instruments held at fair value as at 31 March 2021:

Notes to the Group financial statements (continued)

19. Financial instruments (continued)

Fair value measurements (continued)

	Level 2[1]	
	2021 **£m**	2020 £m
Financial assets - derivative financial instruments:		
Cross currency swaps	**63.5**	177.2
Interest rate swaps	**16.2**	87.7
Index-linked swaps	**83.7**	109.4
	163.4	374.3
Financial liabilities - derivative financial instruments:		
Cross currency swaps	**(113.6)**	(51.3)
Interest rate swaps	**(166.6)**	(252.1)
Index-linked swaps	**(1,189.7)**	(757.5)
	(1,469.9)	(1,060.9)
Net total	**(1,306.5)**	(686.6)

[1]The fair value of derivative financial instruments, including interest rate swaps, cross currency swaps and index-linked swaps are measured using discounted cash flows. The future cash flows are estimated based on observable forward interest rates and inflation rates and discounted at a rate that reflects the credit risk of the Group and counterparties, discounted currency cash flows are then translated at spot rate.

During the year, £37.5 million (31 March 2020: £34.9 million) was recycled from the cash flow hedge reserve to the income statement, see "statement of changes in equity" on page 38. The amount recycled of £37.5 million consisted of a £37.2m loss from the phased release of cash flow hedge reserve in relation to forward starting swaps that have already commenced and for which the related debt has been issued and a £0.3m loss due to ineffectiveness on the swaps that were restructured during the prior year. No fair value movement was recognised on the cash flow hedge reserve for the year ended 31 March 2021 (31 March 2020: loss of £4.1 million).

In November 2019, the maturity date of three index linked swaps, with a total notional of £400.0 million, were extended. These swaps are measured at fair value through the income statement. At the restructuring date the fair value of these instruments, as indicated by their fair value immediately prior to the restructuring, could not be supported by observable inputs alone. In management's view the reduction in value of £38.0 million at the restructuring date is supported by unobservable factors including the counterparty's credit, capital, funding and trading charges. Therefore, such movement was deferred on the balance sheet in compliance with IFRS 9 and is recognised in the income statement on a straight-line basis over the life of the underlying derivative instrument. As at 31 March 2021, £35.3 million (31 March 2020: £37.3 million) remained capitalised and £2.0 million had been recognised in the income statement (31 March 2020: £0.7 million).

Comparison of fair value of financial instruments with their carrying amounts

The fair values and carrying values of the Group's financial assets and financial liabilities are set out in the tables below.

	2021		2020	
	Book value £m	**Fair value £m**	Book value £m	Fair value £m
Financial assets:				
Non-current				
Trade and other receivables (excluding prepayments)	**51.4**	**51.4**	64.3	64.3
Derivative financial instruments				
Cross currency swaps	**51.2**	**51.2**	177.2	177.2
Interest rate swaps	**16.2**	**16.2**	87.7	87.7
Index-linked swaps	**83.7**	**83.7**	109.4	109.4
	202.5	**202.5**	438.6	438.6

[1] The comparative amounts have been restated to exclude prepayments.

Current				
Trade and other receivables (excluding prepayments)	**589.6**	**589.6**	458.4	458.4
Derivative financial instruments				
Short-term investments	**-**	**-**	300.0	300.0
Cash and cash equivalents	**806.8**	**806.8**	817.8	817.8
Cross currency swaps	**12.3**	**12.3**	-	-
	1,408.7	**1,408.7**	1,576.2	1,576.2
Total	**1,611.2**	**1,611.2**	2,014.8.	2,014.8

Notes to the Group financial statements (continued)

19. Financial instruments (continued)

	2021		2020[1]	
	Book value £m	**Fair value £m**	Book value £m	Fair value £m
Financial liabilities:				
Non-current				
Borrowings:				
Secured bank loans and private placements	**(4,010.8)**	**(4,423.9)**	(4,133.2)	(4,322.8)
Bonds	**(9,215.3)**	**(12,190.5)**	(8,440.9)	(10,402.1)
Amounts owed to group undertakings	**(3,100.6)**	**(3,100.6)**	(3,100.6)	(3,100.6)
Interest payable	**(3,865.2)**	**(3,865.2)**	(3,232.0)	(3,232.0)
Lease liabilities	**(52.9)**	**(52.9)**	(62.4)	(62.4)
Derivative financial instruments:				
Cross currency swaps	**(113.6)**	**(113.6)**	(51.3)	(51.3)
Interest rate swaps	**(166.6)**	**(166.6)**	(252.1)	(252.1)
Index-linked swaps	**(1,189.7)**	**(1,189.7)**	(742.5)	(742.5)
	(21,714.7)	**(25,103.0)**	(20,015.0)	(22,165.8)
Current				
Borrowings:				
Secured bank loans and private placements	**(432.2)**	**(438.6)**	(1,430.3)	(1,436.5)
Bonds	**(521.9)**	**(507.7)**	(201.6)	(200.4)
Interest payable	**(192.0)**	**(192.0)**	(183.0)	(183.0)
Trade and other payables (excluding other taxation and social security) [1]	**(610.2)**	**(610.2)**	(664.3)	(664.3)
Derivative financial instruments:				
Index-linked swaps	**-**	**-**	(15.0)	(15.0)
Lease liabilities	**(7.5)**	**(7.5)**	(7.9)	(7.9)
	(1,763.8)	**(1,756.0)**	(2,502.1)	(2,507.1)
Total	**(23,478.5)**	**(26,859.0)**	(22,517.1)	(24,672.9)

[1] The comparative amounts have been restated to include Trade and other payables (excluding other taxation and social security).

The fair value of borrowings represents the market value of the publicly traded underlying liquid bonds (level 1 inputs to valuation technique) for private placements and less liquid underlying bonds, the fair value is determined by discounting expected future cash flows using a risk-free rate plus the Group's credit spread.

The fair value of index-linked debt instruments is based on the nominal value of the debt plus accretion already accrued and accretion expected to accrue to maturity, discounted using a risk-free rate plus the Group's credit spread. Amounts owed by group undertakings includes a floating rate loan and related interest. The fair value of the entire balance is assumed to be the nominal value due to early repayment rights.

Capital risk management

Capital risk primarily relates to whether the Group is adequately capitalised and financially solvent. The Board reviews the Group's exposure to these risks and actively overseas the treasury activities, reviewing the treasury policy and approving the treasury strategy and funding plan.

The Group's key objectives in managing capital are:

- To maintain a broad portfolio of debt, diversified by source and maturity
- To retain TWUL Group's investment grade credit rating
- To provide liquidity sufficient to fund ongoing obligations for a minimum of a 15-month forward period on an ongoing basis
- To maintain customer bills at a level which is both affordable and sustainable

Derivative financial instruments are used, where appropriate to manage the risk of fluctuations in interest rates, inflation and foreign exchange rates. No open or speculative positions are taken.

The Group is part of a Whole Business Securitisation ("WBS") Group of companies. The other companies in the Securitisation Group (Thames Water Utilities Finance plc (TWUF) and TWUHL) guarantee the funding activity of TWUL, and TWUL and TWUHL guarantee the funding activity of TWUF, which raises debt finance in external debt markets through the issuance of secured bonds and the issue of loans. The Securitisation Group is required to comply with certain covenants, which include, amongst others:

- Interest cover ratios
- Gearing ratios
- An obligation to manage the maturity profile of debt arrangements
- An obligation to manage the proportion of future interest cost which is fixed and/or index-linked
- Unsecured debt ratios

Notes to the Group financial statements (continued)

19. Financial instruments (continued)

Capital risk management (continued)

The Securitisation Group complied with these ratios throughout the financial year.

The Company and its financing subsidiary (TW(K)F) are party to an Intercreditor Deed and their debt is securitised. The Company is required to comply with certain covenants, which include, amongst others:

- Interest cover ratios
- Gearing ratios

These requirements were complied with for the financial year.

The capital structure of the Group consists of net debt and equity as follows:

	2021	2020
	£m	£m
Secured bank loans and private placements	**(4,443.0)**	(5,563.5)
Bonds	**(9,737.2)**	(8,642.5)
Amounts owed to group undertakings	**(3,100.6)**	(3,100.6)
Interest payable on secured bank loans, private placements and bonds	**(192.0)**	(183.0)
Interest payable on amounts owed to group undertakings	**(3,865.2)**	(3,232.0)
Lease liability	**(60.4)**	(70.3)
	(21,398.4)	(20,791.9)
Cash and cash equivalents[1]	**804.5**	815.2
Short-term investments	**-**	300.0)
Net debt (statutory basis)	**(20,593.9)**	(19,676.7)
Amounts owed to group undertakings	**3,100.6**	3,100.6
Interest payable on secured bank loans, private placements and bonds	**192.0**	183.0
Interest payable on amounts owed to group undertakings	**3,865.2**	3,232.0
Unamortised debt issuance costs and discount	**(85.8)**	(87.0)
Relevant derivative financial liabilities (Accretion and FX)	**(293.3)**	(110.6)
Fair value adjustment on acquisition to loans	**136.5**	166.5
Unamortised IFRS 9 transition adjustment	**24.5**	25.1
Cash (not relevant)/relevant for covenant	**(20.4)**	(29.3)
Net debt (covenant basis)	**(13,674.6)**	(13,196.4)
Equity attributable to owners of the Group	**(5,051.4)**	(4,157.7)

[1] The cash and cash equivalents balance excludes £2.3m (31 March 2020: £2.6 million) which is held as security for the SUURBS defined benefit pension scheme. The use of the cash is restricted for this purpose only.

Net debt (covenant basis) excludes accrued interest, amounts owed to group undertakings, unamortised debt issuance costs and discounts, unamortised IFRS 9 adjustment, cash not relevant for covenant based on covenant definitions, fair value adjustment made to the Thames Water Group's borrowing on acquisition by Kemble Water consortium; includes relevant derivative financial liabilities related solely to accretion on index-linked swaps and the effect of movement in foreign exchange rate to cross currency swaps.

A summary of the Group's net debt (covenant basis) by different types of debt is as follows:

	2021 £m	2020 £m
Securitised Class A debt	**(11,390.1)**	(11,718.9)
Securitised Class B debt	**(1,543.3)**	(1,393.3)
Holding company level secured debt	**(1,464.9)**	(1,099.8)
Cash net of covenant cash adjustment	**784.1**	1,085.9
Lease liability	**(60.4)**	(70.3)
Net debt (covenant basis)	**(13,674.6)**	(13,196.4)

Notes to the Group financial statements (continued)

19. Financial instruments (continued)

Reconciliation of liabilities arising from financing activities

The reconciliation below between the opening and closing balances for liabilities arising from financing activities evaluates changes in liabilities including both changes arising from cash flow and non-cash changes.

	2021			2020		
	Borrowings) £m)	**Net derivative financial liabilities £m)**	**Lease liabilities**	Borrowings) £m)	Net derivative financial liabilities £m)	Lease liabilities
Opening balance	**(20,721.6)**	**(686.6)**	**(70.3)**	(19,301.2)	(1,100.1)	(72.5)
Non-current	**(18,906.7)**	**(671.6)**	**(62.4)**	(17,750.4)	(1,061.5)	(65.1)
Current	**(1,814.9)**	**(15.0)**	**(7.9)**	(1,550.8)	(38.6)	(7.4)
Cash flows						
New loans raised	**(2,071.6)**	**-**	**-**	(3,474.4)	-	-
Repayment of borrowings	**1,981.0**	**-**	**-**	2,366.5	-	-
Repayment of lease principal	**-**	**-**	**11.4**	-	-	11.0
Derivative accretion settlement[1]	**-**	**15.3**	**-**	-	123.2	-
Interest paid[2]	**445.9**	**-**	**-**	905.1	-	-
Interest received[3]	**-**	**(176.6)**	**-**	-	(48.7)	-
	355.3	**(161.3)**	**11.4**	(202.8)	74.5	11.0
Non-cash changes						
Interest accrued / Fees amortised	**(1,098.0)**	**171.8**	**-**	(1,072.7)	65.2	-
Foreign exchange movement	**145.8**	**-**	**-**	(52.1)	-	-
Accretion	**(50.2)**	**-**	**-**	(105.1)	-	-
Unamortised IFRS 9 transition adjustment	**0.7**	**-**	**-**	0.7	-	-
Lease additions	**-**	**-**	**1.9**	-	-	(5.1)
Interest accrued on IFRS 16 leases	**-**	**-**	**(3.4)**	-	-	(3.7)
Fair value changes	**-**	**(630.4)**	**-**	-	273.8	-
Fair value amortisation	**30.0**	**-**	**-**	11.6	-	-
	(971.7)	**(458.6)**	**(1.5)**	(1,217.6)	339.0	(8.8)
Closing balance	**(21,338.0)**	**(1,306.5)**	**(60.4)**	(20,721.6)	(686.6)	(70.3)
Non-current	**(20,191.9)**	**(1,318.8)**	**(52.9)**	(18,906.7)	(671.6)	(62.4)
Current	**(1,146.1)**	**12.3**	**(7.5)**	(1,814.9)	(15.0)	(7.9)

[1] Derivative accretion settlement of £15.3 million (2020: £123.2million) relates to index-linked swaps where accretion is payable periodically.
[2] Interest paid of £ 445.9 million (2020: £905.1 million) includes £69.7 million of capitalised borrowing costs (2020: £97.6 million) and excludes £0.3 million of bank charges (2020: £0.2 million).
[3] Interest received of £176.6 million (2020: £48.7 million) excludes £1.5 million interest received on bank deposits (2020: £2.3 million) and £0.7 million other interest income (2020: £5.6 million).

Financial risk management

The Group's activities expose it to a number of financial risks: market risk (including interest rate risk, exchange rate risk and inflation risk), credit risk, and liquidity risk. Details of the nature of each of these risks along with the steps the Group has taken to manage them is described below and overleaf.

(a) Market risk

Market risk relates to fluctuations in external market variables such as interest rates, inflation and foreign exchange rates that could affect the Group's income or the value of the financial instruments it holds. Below is the effective interest rate and foreign currency risk profile of the debt held by the Group after taking into account the derivative financial instruments used to manage market risk.:

As at 31 March 2021:	Total at fixed rates £m	Total at floating rates £m	Total at index linked rates £m	**Total £m**
Interest bearing loans and borrowings				
Net of corresponding swap assets				
- £ Sterling	9,116.7	684.9	7,611.6	17,413.2
Total	9,116.7	684.9	7,611.6	17,413.2

Notes to the Group financial statements (continued)

19. Financial instruments (continued)

Financial risk management (continued)

(a) Market risk

As at 31 March 2020:	Total at fixed rates) £m)	Total at floating rates) £m)	Total at index linked rates) £m)	Total) £m)
Interest bearing loans and borrowings				
Net of corresponding swap assets				
- £ Sterling	7,777.3	2,206.9	7,241.5	17,225.7
Total	7,777.3	2,206.9	7,241.5	17,225.7

The weighted average interest rates of the debt held by the Group, after taking into account the derivative financial instruments used to manage market risk, and the period until maturity for which the rate is fixed and index-linked, are given below:

	Weighted average interest rate		Weighted average period until maturity	
	2021	2020	**2021**	2020
	%	%	**Years**	Years
Fixed	**6.2**	7.2	**12.1**	13.4
Index-Linked	**2.5**	3.6	**17.5**	18.1

(i) Interest rate risk sensitivity analysis

The Group holds both fixed and floating rate borrowings. Fixed rate borrowings are exposed to a risk of change in their fair value due to changes in interest rates. Floating rate borrowings are exposed to a risk of change in interest cash flows due to changes in interest rates. The Group uses interest rate swaps which economically hedge future cash flows to protect against interest rate movements. For details of the interest rate swaps please see the Cash flow hedges section of this note on pages 88 and 89.

The table below summarises the impact, on pre-tax profits, of a 1 % increase or decrease in GBP interest rates at 31 March 2021. This analysis considers the effect on the fair value of derivative instruments and assumes that all other variables, in particular exchange rates and inflation expectations, remain constant.

	2021		2020	
	+1%	**-1%**	+1%	-1%
	£m	**£m**	£m	£m
Profit	**404.7**	**(478.7)**	294.1	(344.3)
Equity	**404.7**	**(478.7)**	294.1	(344.3)

(ii) Exchange rate risk sensitivity analysis

The Group's foreign currency risk exposure results from debt raised in currencies other than sterling. The Group uses cross currency swaps to hedge the foreign currency exposure of bonds issued in a foreign currency. All hedges are undertaken for commercial reasons with the objective of minimising the impact of exchange rate fluctuations. The Group has no material unhedged monetary assets or liabilities denominated in a currency other than sterling.

The table below summarises the impact of changes in the year end valuations of financial assets and liabilities denominated in foreign currency on pre-tax profits of a 10% strengthening or weakening of GBP (£) against the respective currencies in which the financial assets and liabilities are denominated at 31 March 2021. This analysis assumes that all other variables in the valuation remain constant.

	2021		2020	
	+10%	**-10%**	+10%	-10%
	£m	**£m**	£m	£m
Profit	**(22.2)**	**(3.9)**	(28.4)	24.5
Equity	**(22.2)**	**(3.9)**	(28.4)	24.5

Notes to the Group financial statements (continued)

19. Financial instruments (continued)

Financial risk management (continued)

(a) Market risk (continued)

(iii) Inflation risk sensitivity analysis

The Group has entered into financial instruments that are directly linked to inflation including RPI linked bonds, loans and swaps. In addition, the Group as a regulated water and wastewater Group is subject to fluctuations in its revenues due to movements in inflation. Therefore the Group's RPI linked borrowings and swaps form a partial economic hedge as the assets and liabilities partially offset.

The table below summarises the impact on pre-tax profits of a 1% increase or decrease in inflation rates at 31 March 2021. This analysis assumes that all other variables, in particular exchange rates, remain constant.

	2021		2020	
	+1%	**-1%**	+1%	-1%
	£m	**£m**	£m	£m
Profit	**(881.3)**	**768.0**	(740.1)	699.1
Equity	**(881.3)**	**768.0**	(740.1)	699.1

(b) Credit risk

Credit risk relates to the potential financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations. This arises principally from the Group's trade receivables, insurance receivables, short-term investments and cash flows receivable from counterparties to the derivative financial instruments.

The Group has a statutory obligation to provide water and wastewater services to customers within its region. Due to the large area served by the Group and the significant number of households within this area, there is considered to be no concentration of trade receivables credit risk, however, the Group's credit control policies and procedures are in place to minimise the risk of bad debt arising from its household trade receivables. Amounts provided against trade receivables and movements in the provision in the year are disclosed in note XX. For non-household customers, the Group's credit risk lies with a small number of retailers rather than the end user and exposure to retailer default would be limited due to regulatory conditions that exist within the non-household market which aim to mitigate risks in relation to wholesaler creditworthiness.

Under the terms of the WBS agreement, counterparties to the Group's short-term investments and derivative transactions have to meet minimum credit rating criteria as assigned by both Moody's and S&P. For derivative counterparties there is a mechanism for the counterparty to post collateral when the counterparty fails to meet the necessary credit rating criteria and amounts due to the Group under outstanding derivative contracts exceed a contractually agreed threshold amount.

The Group's maximum exposure to credit risk is the carrying amount of financial assets recorded in the financial statements, which is net of impairment losses, less collateral held under the terms of the whole business securitisation agreement. During the year ended 31 March 2021, no collateral was held (2020: nil).

The following table summarises amounts held on cash at bank and in hand, money market funds and short-term investments by credit rating of counterparties.

	2021	2020
	£m	£m
AAA	**800.4**	801.1
A+	**-**	150.0
A	**6.4**	166.7
Total	**806.8**	1,117.8

Notes to the Group financial statements (continued)

19. Financial instruments (continued)

Financial risk management (continued)

(b) Credit risk

The following table summarises fair value of derivative assets by credit rating of counterparties.

	2021 **£m**	2020 £m
AA-	**15.6**	93.4
A+	**139.2**	228.2
A	**8.6**	43.3
A-	**-**	9.4
Total	**163.4**	374.3

(c) Liquidity risk

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group manages long-term liquidity by maintaining continuity of funding through access to different markets and debt instruments, raising funds in the capital markets and ensuring that manageable debt maturity profiles are maintained. The Group also maintains a level of committed liquidity facilities provided by a range of financial institutions.

The maturity profile of interest-bearing loans and borrowings disclosed in the statement of financial position are given below.

	2021 **£m**	2020 £m
Within one year	**954.1**	1,632.0
Between one and two years	**327.0**	753.8
Between two and three years	**1,928.2**	468.3
Between three and four years	**794.7**	1,130.4
Between four and five years	**1,339.6**	961.3
After more than five years	**11,937.2**	12,360.8
Total	**17,280.8**	17,306.6

(i) Cash flows from non-derivative financial liabilities

The maturity profile of the anticipated future cash flows including interest in relation to the Group's non-derivative financial liabilities on an undiscounted basis (excluding non-current trade payables), which, therefore, differs from both the carrying value disclosed in the statement of financial position and fair values, is as follows:

Undiscounted amounts payable	**2021** **£m**	2020 - Restated[1] £m
Within one year	**(2,056.1)**	(2,758.3)
Between one and two years	**(794.5)**	(1,213.9)
Between two and three years	**(2,408.7)**	(898.2)
Between three and four years	**(1,229.9)**	(1,572.6)
Between four and five years	**(1,771.7)**	(1,364.3)
After more than five years	**(22,614.1)**	(21,633.4)
Total	**(30,875.0)**	(29,440.7)

[1] The comparative amounts have been restated to include lease liabilities.

Notes to the Group financial statements (continued)

19. Financial instruments (continued)

Financial risk management (continued)

(c) Liquidity risk (continued)

(ii) Cash flows from derivative financial instruments

The maturity profile of the Group's financial derivatives (which include interest rate swaps, cross currency swaps and index-linked swaps), based on undiscounted cash flows, is as follows:

Undiscounted amounts payable	**2021** **£m**	2020 £m
Within one year	**135.1**	168.0
Between one and two years	**58.5**	150.1
Between two and three years	**(45.3)**	77.8
Between three and four years	**(124.4)**	(13.8)
Between four and five years	**59.2**	(86.1)
After more than five years	**(1,584.4)**	(1,238.4)
Total	**(1,501.3)**	(942.4)

Cash flow hedges

The Group has designated a number of contracts which qualify, in accordance with IFRS 9: Financial Instruments, as cash flow hedges. The accounting policy on cash flow hedges is explained on page 52.

In mid-2014 the Group executed £2.25 billion of forward-starting floating to fixed interest rate swaps of a 5-7 year maturity with various financial institutions to fix the future interest costs of an element of the new debt to be issued from 2017 to 2020. As at 31 March 2021, all forward-starting floating to fixed interest rate swaps have commenced. As the relevant debt has been issued, cash flow hedge has been discontinued prospectively and the amount outstanding on the cash flow hedge reserve is being recycled to the income statement over the life of the hedging instrument.

During the year, £37.5 million (31 March 2020: £34.9 million) was recycled from the cash flow hedge reserve to the income statement, see "Statement of changes in equity" on page 38. The amount recycled of £37.5 million consisted of a £37.2 million loss from the phased release of cash flow hedge reserve in relation to forward starting swaps that have already commenced and related debt has been issued and a £0.3 million loss due to ineffectiveness on the swaps that were restructured during the prior year. No fair value movement was recognised on the cash flow hedge reserve for the year ended 31 March 2021 (31 March 2020: loss of £4.1 million).

The Group's cash flow hedge reserve disclosed on the statement of changes in equity on page 38 relate to forward starting interest rate swaps which have now commenced.

	£m
At 1 April 2019	**(118.0)**
Loss on cash flow hedge	**(4.1)**
Cash flow hedge transferred to income statement	**34.9**
Deferred tax including impact of deferred tax rate change	**(3.0)**
At 31 March 2020	**(90.2)**
Loss on cash flow hedge	**-**
Cash flow hedge transferred to income statement	**37.5**
Deferred tax charge on cash flow hedge gains	**(7.1)**
At 31 March 2021	**(59.8)**

Notes to the Group financial statements (continued)

19. Financial instruments (continued)

Cash flow hedges (continued)

Following are the effects of forward starting interest rate swaps which have commenced on the Group's financial position and performance:

As at 31 March	**2021 £m**	2020 £m
Quantitative		
Cash flow hedge transferred to income statement	**37.5**	34.9

As at 31 March	**2021**	2020
Qualitative		
Line item affected in income statement due to reclassification	Net (losses)/gains on financial instruments	Net (losses)/gains on financial instruments

The table below shows phasing of amounts to be reclassed to income statement from the cash flow hedge reserve, which relates to the Group's forward starting interest rate swaps which have commenced:

As at 31 March	**2021 £m**	2020 £m
Interest rate swaps		
Within one year	**(31.1)**	(37.5)
Between one and two years	**(21.1)**	(31.1)
Between two and three years	**(18.7)**	(21.1)
Between three and four years	**(2.8)**	(18.7)
Between four and five years	**-**	(2.8)
After more than five years	**-**	-
Total	**(73.7)**	(111.2)

Offsetting financial assets and financial liabilities

Financial assets and liabilities are offset and the net amount is reported in the consolidated statement of financial position where KWF Group currently has a legally enforceable right to offset the recognised amounts, and there is an intention to settle on a net basis or realise the asset and settle the liability simultaneously.

KWF Group has entered into arrangements that allow for the related amounts to be set off in certain circumstances, such as an early termination event for derivative transactions.

The following table presents the recognised financial instruments that are offset, or subject to enforceable master netting arrangements and other similar agreements but not offset in the financial statements, as at 31 March 2021 and 31 March 2020. The column 'net amount' shows the impact on the consolidated statement of financial position if circumstances arose for set-off rights to be applied.

Notes to the Group financial statements (continued)

19. Financial instruments (continued)

Offsetting financial assets and financial liabilities (continued)

	Effects of offsetting on the Consolidated statement of financial position				
As at 31 March 2021	**Gross amounts £m**	**Amounts set off £m**	**Net amounts presented on consolidated statement of financial position £m**	**Impact of master netting arrangements £m**	**Net amounts £m**
Financial assets					
Derivative financial instruments	**163.4**	**-**	**163.4**	**(131.6)**	**31.8**
	163.4	**-**	**163.4**	**(131.6)**	**31.8**
Financial liabilities					
Derivative financial instruments	**(1,469.9)**	**-**	**(1,469.9)**	**131.6**	**(1,338.3)**
	(1,469.9)	**-**	**(1,469.9)**	**131.6**	**(1,338.3)**
Total	**(1,306.5)**	**-**	**(1,306.5)**	**-**	**(1,306.5)**
As at 31 March 2020					
Financial assets					
Derivative financial instruments	374.3	-	374.3	(261.3)	113.0
	374.3	-	374.3	(261.3)	113.0
Financial liabilities					
Derivative financial instruments	(1,060.9)	-	(1,060.9)	261.3	(799.6)
	(1,060.9)	-	(1,060.9)	261.3	(799.6)
Total	(686.6)	-	(686.6)	-	(686.6)

20. Deferred tax

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

	Accelerated tax depreciation £m	Retirement benefit obligations £m	Cash flow hedge £m	Other £m	**Total £m**
At 31 March 2019	(1,144.0)	40.2	151.1	47.9	**(904.8)**
(Charge)/credit to income	(153.2)	(5.2)	(33.9)	6.3	**(186.0)**
Charge to equity	-	(27.0)	(3.0)	-	**(30.0)**
At 31 March 2020	(1,297.2)	8.0	114.2	54.2	**(1,120.8)**
(Charge)/credit to income	(22.6)	(17.4)	89.9	1.2	**51.1**
Charge to equity	-	43.2	(7.1)	-	**36.1**
At 31 March 2021	(1,319.8)	33.8	197.0	55.4	**(1,033.6)**

In the Spring Budget 2021, the Government announced that from 1 April 2023 the corporation tax rate will increase from 19% to 25%. Since the proposal to increase the rate to 25% had not been substantively enacted at the balance sheet date, its effects are not included in these financial statements. Please refer to Note 8 for details of the impact of this announcement, had it been enacted in the year. The deferred tax assets and liabilities shown above as at 31 March 2021 have therefore been calculated using the 19% tax rate, except the deferred tax liability on the pension surplus which is provided at 35%, being the tax rate which would apply if the surplus were to be refunded to the Group.

A deferred tax liability arises in respect of accelerated tax depreciation, because the rate of tax relief specified in UK tax legislation on most of our capital expenditure is quicker than the rate of accounting depreciation on that expenditure. These temporary differences unwind and affect current tax over the life of the relevant assets, but the continued high levels of capital investment within TWUL mean that the temporary differences currently tend to increase every year.

Notes to the Group financial statements (continued)

20. Deferred tax (continued)

Deferred tax assets have arisen on the following temporary differences:

- Retirement benefit obligations: A net deferred tax asset is provided on the net retirement benefit obligations booked in the accounts. The £33.8m deferred tax asset carried forward is the net of an asset of £52.6m (19% of the deficit on the TWPS pension scheme of £277.1m) less a liability of £20.2m (35% of the surplus on the MIPS pension scheme of £57.9m) and an asset of £1.4m (19% of the SUURBS deficit of £7.6m). Current tax relief will be available in the future for pension contributions paid to reduce these obligations. Deferred tax movements will also arise on any non-cash changes in the obligations, for example those arising from actuarial valuations.

- Cash flow hedge: A deferred tax asset is provided on certain fair values booked in respect of financial instruments in the accounts. Current tax relief will be available in the future as the cash flows arise over the lives of the derivatives. Deferred tax movements will also arise on any non-cash changes in the fair value of the derivatives.

- Other: A deferred tax asset is provided on the temporary differences arising on amounts for which a tax deduction is spread over a number of years in accordance with tax legislation, including certain pension contributions. Current tax relief will be available in future when tax relief is available in accordance with the legislation. A deferred tax asset is also provided on fair values on loans booked on consolidation; there will be no current tax impact in future but deferred tax charges will arise as these fair values are amortised in the accounts.

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:

	2021 **£m**	2020 £m
Deferred tax asset	**286.2**	176.4
Deferred tax liability	**(1,319.8)**	(1,297.2)
Total	**(1,033.6)**	(1,120.8)

There is an unrecognised deferred tax asset in respect of tax losses where the Group does not anticipate taxable profits in the immediate future. The amount of deferred tax asset not recognised at 19% (2020: 19%) is:

	2021 **£m**	2020 £m
Deferred tax asset not recognised in respect of tax losses	**7.2**	7.4

If the corporation tax rate increase from 19% to 25% had been substantively enacted at the balance sheet date, the deferred tax asset not recognised would have been a total of £9.6m.

21. Provisions for liabilities and charges

	Insured liabilities £m	Capital Infrastructure provision £m	Dilapidations £m	Other provisions £m	**Total** **£m**
At 1 April 2020	85.1	17.5	11.0	32.0	**145.6**
Utilised during the period	(35.9)	(3.5)	-	(25.9)	**(65.3)**
Charge/(credit) to income statement	23.3	-	0.4	43.0	**66.7**
Charge/(credit) to capital project	(1.4)	-	-	(2.7)	**(4.1)**
Transfer from current liabilities	-	2.1	-	-	**2.1**
At 31 March 2021	71.1	16.1	11.4	46.4	**145.0**

The insured liability provision arises from claims for which insurance is in place, including actual claims from third parties received by the Group and incidents incurred but without claims received. These amounts provided for represent the estimated cost of settlement. Where we have insurance cover for claims, we recognise the assessed reimbursement value from third party insurance companies net of retentions. The receivable is disclosed in note 15. Timing of settlement for these claims is uncertain and therefore amounts provided have been classified as non-current.

Notes to the Group financial statements (continued)

21. Provisions for liabilities and charges (continued)

The capital infrastructure provision is to cover various potential third party costs, including compensation claims, arising from the construction of infrastructure assets. Due to the uncertain timing of these costs, the Group considers it appropriate to classify these as non-current.

Dilapidations relate to our legal obligation to return several leased offices, industrial units and laboratories back to their pre-leased state. The estimate of this cost has been informed by our outsourced property advisor. There have been no additional sites to consider under this provision during the current financial year.

Other provisions relate to contractual claims, legal claims including environmental matters and regulatory obligations of the Group. The amount recorded represents management's best estimate of the value to settle the obligations. During the current financial year, there has been an additional charge of £43.0m recognised in other provisions, this represents a reassessment of historic provisions and new provisions recorded during the period. An out of court settlement was reached between the Group and Castle Water Limited which was partially provided for in the previous period, which has been utilised in the current period. Timing of settlement of provisions is uncertain and therefore amounts provided have been classified as non-current.

The Group needs to determine the merit of any litigation and the chances of a claim successfully being made, the likelihood and the ability to reliably estimate an outflow of economic benefits occurring and whether there is a need to disclose a contingent liability or whether a provision is required based on this assessment.

There are claims against the Group arising in the normal course of business, which are in the process of negotiation. Judgement is required in measuring and recognising provisions related to pending litigation or other outstanding claims that are subject to negotiated settlement or Court assessment. This includes evaluating the likelihood that an outstanding claim will succeed and to quantify the possible range of any financial settlement and outflow of economic benefits. There is a risk that the final outcome of legal claims could be materially different to amounts provided.

The Group has also taken the option under paragraph 92 of IAS 37 for non-disclosure of certain information relating to provisions and contingent liabilities in extremely rare cases where this can be expected to seriously prejudice the entity in a dispute.

22. Share capital and other reserves

Share capital

	2021 £m	2020 £m
Allotted, called-up and fully paid:		
1,000,001 (2020: 1,000,001) ordinary shares of £1 each	**1.0**	1.0

The Group has one class of ordinary share which carries no right to fixed income. The holders of ordinary shares are entitled to receive dividends as declared and are entitled to one vote per share at meetings of the Group.

Other reserves

	2021 £m	2020 £m
Cash flow hedge reserve	**(59.8)**	(90.2)
Retained earnings	**(4,992.6)**	(4,068.5)
Total	**(5,052.4)**	(4,158.7)

The cash flow hedge reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet occurred.

Notes to the Group financial statements (continued)

23. Retirement benefit obligations

Background

The Group operates four material pension schemes, one of which is a defined contribution scheme and the other three are defined benefit schemes.

	What are they?	How do they impact the Group's financial statements?
Defined Contribution Scheme This scheme was set up in April 2011, is managed through Standard Life, and is open to all new employees of the Group.	In a defined contribution pension scheme the benefits are linked to: • contributions paid; • the performance of the individual's chosen investments; and • the form of benefits	A charge of £15.2 million (2020: £13.1 million) was recognised in the income statement relating to the contributions payable by the Group based upon a fixed percentage of employees' pay. There were no (2020: £1.6 million) outstanding contributions at the year-end recognised in the statement of financial position. The Group has no exposure to investment or other experience risks.
Defined Benefit Schemes Defined benefit arrangements for the Group's eligible employees are provided through three defined benefit pension schemes: • Thames Water Mirror Image Pension Scheme ("TWMIPS"). Thames Water Pension Scheme ("TWPS"); • Thames Water Mirror Image Pension Scheme ("TWMIPS"); and • The SUURBS Arrangement ("SUURBS"). The SUURBS Arrangement provides retirement benefits to a previous director, and their spouse, of Thames Water Limited, a subsidiary entity in the Group. The scheme is an unfunded arrangement but is secured against assets held by Thames Water Limited Both now are career average pension schemes. Their assets are held separately from the rest of the Kemble Water Holdings Limited Group in funds in the United Kingdom which are independently administered by the pension trustees. TWMIPS has been closed to new entrants since 1989 and TWPS since April 2011. New entrants now join the defined contribution scheme. One scheme was closed to future accrual as of 31 March 2021.	In a defined benefit pension scheme the benefits: • are defined by the scheme rules • depend on a number of factors including age, years of service and pensionable pay; and • do not depend on contributions made by the members or the Group	A charge was recognised in the income statement of £ 26.5 million (2020: £33.2million) relating to the following: • service cost representing the increase in the defined benefit liability arising from pension benefits earned by active members in the current period; • administrative expenses for the pension schemes; • the net interest expense on pension scheme assets and liabilities; and • the effect of restriction in the surplus. An actuarial loss of £195.6 million (2020: gain of £168.9 million) on the value of the pension scheme was recognised in the statement of other comprehensive income. This reflects the impact of changes in financial assumptions and the demographic of the scheme members when compared with those at the start of the year, as well as the return on the schemes' assets over and above the amount included in the net interest expense. A pension asset of £57.9 million (2020: £94.5 million) is recognised in the statement of financial position for the TWMIPS scheme. A pension deficit of £ 277.1 million (2020: £209.1million) is recognised in the statement of financial position for the TWPS scheme. A pension deficit of £7.6 million (2020: deficit of £7.0 million) is recognised in the statement of financial position for the SUURBS scheme. As at 31 March 2021, the net pension deficit is £ 226.8 million (2020:£ 121.6 million). The Group is exposed to investment and other experience risks. Where it is estimated that the benefits will not be met by regular contributions, assets held or expected investment income, additional contributions are being made by the Group.

In addition to the cost of the UK Pension arrangements, the Group operates arrangements under which it augments benefits on retirement in certain cases of redundancy. These augmentations are funded by way of additional employer contributions to the schemes. In the year to 31 March 2021 these related payments amounted to £ 0.2 million (2020: £0.3 million).

Notes to the Group financial statements (continued)

23. Retirement benefit obligations (continued)

Background (continued)

The defined benefit pension schemes are subject to a full actuarial valuation every three years using assumptions agreed between the trustees of the pension schemes and the Group. The purpose of this triennial valuation is to evaluate and if necessary, modify the funding plans of the pension schemes to ensure the schemes have sufficient funds to meet future benefit payments. The most recent full actuarial valuation of the defined benefit pension scheme was carried out at 31 March 2019 on behalf of the trustees by David Gardiner of Aon, the actuary of the schemes. This resulted in a combined funding deficit across the TWMIPS and TWPS schemes of £148.9 million (2016: £364.9 million) with the market value of the assets being £2,313.3 million (2016: £1,905.5 million).

The triennial funding valuation is different from the accounting valuation presented in the financial statements due to the use of different assumptions and changes in market conditions from 31 March 2020 to 31 March 2021. The 2020 funding valuation has been updated to an accounting valuation as at 31 March 2021 by Hymans Robertson LLP, an independent and professionally qualified consulting actuary, using revised assumptions that are consistent with the requirements of IAS 19 *Employee Benefits* and shown in this note to the financial statements.

The most recent full valuation of the SUURBS Arrangement was carried out at 28 February 2018 on behalf of the pension Trustees by Hymans Robertson LLP, the independent and professionally qualified consulting actuaries to the scheme. This resulted in a funding surplus of £1.2 million.

This funding valuation is different from the accounting valuation presented in the financial statements due to the use of different assumptions and changes in market conditions from the time of the most recent valuation to 31 March 2018. The 2016 funding valuation has been updated to an accounting valuation as at 31 March 2021 by Hymans Robertson LLP, an independent and professionally qualified consulting actuary, using revised assumptions that are consistent with the requirements of IAS 19 *Employee Benefits* and shown in this note to the financial statements.

Amounts included in the financial statements

Income statement

The amounts recognised in the income statement with respect to the defined benefit pension schemes are detailed below:

		2021			2020	
	TWPS £m	**TWMIPS £m**	**SUURBS £m**	TWPS £m	TWMIPS £m	SUURBS £m
Current service cost	**19.0**	**1.5**	**-**	19.5	2.7	-
Past service cost including curtailments	**0.4**	**0.1**	**-**	-	-	-
Scheme administration expenses	**1.8**	**1.6**	**-**	3.1	1.5	-
Net interest cost/(income)	**4.1**	**(2.2)**	**0.2**	7.4	(1.2)	0.2
Total	**25.3**	**1.0**	**0.2**	30.0	3.0	0.2

The net expense is recognised in the following captions within the income statement:

		2021			2020	
	TWPS £m	**TWMIPS £m**	**SUURBS £m**	TWPS £m	TWMIPS £m	SUURBS £m
Operating expenses	**23.5**	**3.2**	**-**	22.6	4.2	-
Net finance expense/(income)	**4.1**	**(2.2)**	**0.2**	7.4	(1.2)	0.2
Total	**25.3**	**1.0**	**0.2**	30.0	3.0	0.2

Notes to the Group financial statements (continued)

23. Retirement benefit obligations (continued)

Amounts included in the financial statements (continued)

Actuarial gains and losses on the defined benefit schemes have been recognised within other comprehensive income. An analysis of the amount presented is set out below:

	2021 **£m**	2020 - Restated[1] £m
Cumulative actuarial gains recognised at 1 April	**(326.2)**	(495.1)
Actual return less expected return on pension scheme assets	**32.4**	88.4
Experience gain /(loss) arising on scheme liabilities	**100.8**	19.0
(Loss)/gain arising due to change in assumptions	**(341.8)**	145.5
Gain arising due to change in demographic assumption	**13.0**	(84.0)
Total actuarial (loss)/gain	**(195.6)**	168.9
Cumulative actuarial losses recognised at 31 March	**(521.8)**	(326.2)

[1] The cumulative actuarial losses recognised in the prior year have been restated to reflect the MIPS pension surplus that was recognised in the accounts at 31 March 2018, which improved the net pension deficit by £49.7 million. £36.7 million of this amount was previously not reflected in this cumulative actuarial loss figure. The adjustment recognised in the prior period has led to an improvement in the cumulative actuarial losses recognised of £36.7 million.

Statement of financial position

The net pension (liability)/asset recognised within the statement of financial position is as follows:

		2021			2020	
	TWPS **£m**	**TWMIPS** **£m**	**SUURBS** **£m**	TWPS £m	TWMIPS £m	SUURBS £m
Fair value of scheme assets	**1,730.9**	**770.9**	**-**	1,595.3	805.8	-
Present value of defined benefit obligations	**(2,008.0)**	**(713.0)**	**(7.6)**	(1,804.4)	(711.3)	(7.0)
(Deficit)/surplus	**(277.1)**	**57.9**	**(7.6)**	(209.1)	94.5	(7.0)
Net pension deficit			**(226.8)**			(121.6)

Reconciliation of defined benefit plan assets and liabilities

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

		2021			2020	
	TWPS **£m**	**TWMIPS** **£m**	**SUURBS** **£m**	TWPS £m	TWMIPS £m	SUURBS £m
At 1 April	**1,804.4**	**711.3**	**7.0**	1,847.0	759.4	7.7
Current service cost	**19.0**	**1.5**	**-**	19.5	2.7	-
Past service cost including curtailments	**0.4**	**0.1**	**-**	-	-	-
Interest cost	**41.8**	**16.2**	**0.2**	43.9	17.4	0.2
Contributions from scheme members	**0.1**	**-**	**-**	0.1	-	-
Benefits paid	**(56.0)**	**(45.4)**	**(0.4)**	(51.5)	(44.5)	(0.4)
Termination benefits	**0.2**	**-**	**-**	1.4	0.3	-
Actuarial gains	**198.1**	**29.3**	**0.8**	(56.0)	(24.0)	(0.5)
At 31 March	**2,008.0**	**713.0**	**7.6**	1,804.4	711.3	7.0

Notes to the Group financial statements (continued)

23. Retirement benefit obligations (continued)

Amounts included in the financial statements (continued)

Reconciliation of defined benefit plan assets and liabilities (continued)

The movements in the fair value of scheme assets were as follows:

	2021			2020		
	TWPS £m	**TWMIPS £m**	**SUURBS £m**	TWPS £m	TWMIPS £m	SUURBS £m
At 1 April	**1,595.3**	**805.8**	**-**	1,508.2	805.2	15.4
Interest income on scheme assets	**37.7**	**18.4**	**-**	36.5	18.6	-
Disposal of assets	**-**	**-**	**-**	-	-	(12.2)
Fair value loss on disposal of assets	**-**	**-**	**-**	-	-	(0.6)
Reclassification of cash[1]	**-**	**-**	**-**	-	-	(2.6)
Contributions by sponsoring employers	**114.4**	**2.3**	**-**	39.8	3.2	0.4
Contributions from scheme members	**0.1**	**-**	**-**	0.1	-	-
Administration costs paid from scheme assets	**(1.8)**	**(1.6)**	**-**	(3.1)	(1.5)	-
Benefits paid	**(56.0)**	**(45.4)**	**-**	(51.5)	(44.5)	(0.4)
Contributions for termination benefits	**0.2**	**-**	**-**	1.4	0.3	-
Gains on assets above interest	**41.0**	**(8.6)**	**-**	63.9	24.5	-
At 31 March	**1,730.9**	**770.9**	**-**	1,595.3	805.8	-

[1] £2.3 million of cash, previously held as an asset of the SUURB pension scheme in the prior year is now reclassified as restricted cash.

Analysis of assets

	2021				2020			
	Quoted £m	**Unquoted £m**	**Total £m**	**Total (%)**	Quoted £m	Unquoted £m	Total £m	Total (%)
Equities								
UK	**36.8**	**-**	**36.8**	**1.5**	29.7	-	29.7	1.2
Rest of World	**486.3**	**-**	**486.3**	**19.4**	358.3	1.1	359.4	15.0
Bonds								
Government – UK	**25.6**	**-**	**25.6**	**1.0**	16.2	-	16.2	0.7
Government – Rest of World	**92.0**	**-**	**92.0**	**3.7**	116.2	1.1	117.3	4.9
Corporates – UK	**50.3**	**0.2**	**50.5**	**2.0**	48.4	3.5	51.9	2.2
Corporates – Rest of World	**277.2**	**1.4**	**278.6**	**11.1**	166.3	1.9	168.2	7.0
Property								
UK	**7.1**	**-**	**7.1**	**0.3**	4.5	-	4.5	0.2
Rest of world	**1.1**	**-**	**1.1**	**-**	1.9	-	1.9	0.1
Alternative assets								
Liability driven instruments	**1,297.8**	**-**	**1,297.8**	**51.9**	1,433.1	-	1,433.1	59.6
Other (including derivatives)	**86.5**	**-**	**86.5**	**3.5**	109.6	3.5	113.1	4.7
Cash	**139.5**	**-**	**139.5**	**5.6**	105.8	-	105.8	4.4
Total market value of assets	**2,500.2**	**1.6**	**2,501.8**	**100.0**	2,390.0	11.1	2,401.1	100.0

The assets of the defined benefit schemes do not include any directly held shares issued by the Group or property occupied by the Group.

The Pension Trustees determine the investment strategy of the defined benefit pension schemes after taking advice from their investment advisor, Willis Towers Watson. As of 31 March 2021, Reddington have been appointed as our new advisors. 51.9% of the scheme assets are invested in Liability Driven Investment ("LDI") portfolios managed by Schroder Investment Management Limited. These use government bonds and derivative instruments such as interest rate swaps, inflation swaps and gilt repurchase transactions to hedge the impact of interest rate and inflation movements on the long-term liabilities of the schemes.

Under the LDI strategies, if interest rates fall the value of investments rises to help match the increase in actuarial liabilities arising from the resulting fall in discount rate. Similarly, if interest rates rise, the value of the LDI investments will fall, as will the liabilities, as a result of the increase in the discount rate. Interest rates and inflation risks are not fully matched by the LDI portfolios, representing the residual interest rate and inflation risk to which the schemes remain exposed.

Notes to the Group financial statements (continued)

23. Retirement benefit obligations (continued)

Amounts included in the financial statements (continued)

Analysis of assets (continued)

In the current period, Index Linked Gilts amount to £475.0 million and Fixed Interest Gilts amount to £849.0 million of the LDI total.

The credit risk arising on the derivatives held in the LDI mandate depends on whether the derivative is traded on an exchange or over the counter ("OTC"). OTC derivative contracts are not guaranteed by any regulated exchange and therefore the schemes are subject to risk of failure of the counterparty. The credit risk for OTC swaps held in the LDI portfolio is reduced by collateral arrangements and the counterparty exposure of each scheme is appropriately diversified.

IAS 19 Assumptions

The approach used to set the IAS 19 assumptions is detailed below:

	Approach to set the assumptions
Discount rate	As per IAS 19, the discount rate is determined using the market yields on high quality corporate bonds as at the reporting date with the currency and term of these bonds being consistent with the currency and term of the pension liabilities. The TWPS and TWMIPS discount rate is calculated by applying the projected cash flows of these schemes to an AA-corporate bond yield curve as at 31 March 2021.
RPI inflation	The RPI inflation assumption uses the inflation curve weighted by projected future cash flows of TWPS and TWMIPS with an adjustment made for an inflation risk premium.
CPI inflation	This CPI inflation assumption is taken at a margin below RPI factoring in market forces and third party estimates of the difference expected.
Salary increases	Both defined benefit schemes provide benefits on a Career Average ("CARE") benefit structure whereby past entitlements are linked to movements in CPI therefore an assumption for increase in salary is not required.
Pension increases	It is assumed that benefits will increase in line with the RPI and CPI inflation assumptions detailed above, based on the appropriate index for increasing benefits.
Longevity	The mortality assumptions are based on standard mortality tables and the recent actual mortality experience of members within the schemes. The assumptions also allow for future improvements to mortality rates.

The main assumptions used in the valuation of these schemes are as follows:

		2021			2020	
	TWPS	**TWMIPS**	**SUURBS**	TWPS	TWMIPS	SUURBS
Price inflation – RPI	**3.25%**	**3.30%**	**3.30%**	2.55%	2.65%	2.65%
Price inflation – CPI (Pre 2030)	**1.00%**	**1.00%**	**1.00%**	1.75%	1.85%	1.85%
Price inflation – CPI (Post 2030)	**0.10%**	**0.10%**	**0.10%**			
Rate of increase to pensions in payment – RPI	**3.25%**	**3.30%**	**3.30%**	1.75%	1.85%	1.85%
Rate of increase to pensions in payment – CPI (Pre 2030)	**1.00%**	**1.00%**	**1.00%**	2.35%	2.35%	2.35%
Rate of increase to pensions payment – CPI (Post 2030)	**0.10%**	**0.10%**	**0.10%**			
Discount rate	**2.10%**	**2.00%**	**2.00%**	2.55%	2.65%	2.65%

Both the TWPS and TWMIPS schemes provide benefits on a Career Average ("CARE") benefit structure whereby past entitlements are linked to movements in CPI therefore an assumption for increase in salary is not required.

In valuing the liabilities of the pension schemes, mortality assumptions have been made as indicated below, however in respect of the SUURBS Arrangement as mortality assumptions have been made regarding the schemes only member and their spouse they have not been disclosed. These mortality assumptions are based on standard mortality tables and the recent actual mortality experience of members within the schemes. The assumptions also allow for future improvements to mortality rates.

Notes to the Group financial statements (continued)

23. Retirement benefit obligations (continued)

IAS 19 Assumptions (continued)

	2021		2020	
	TWPS Years	**TWMIPS Years**	TWPS Years	TWMIPS Years
Life expectancy from age 60:				
Male	**27.6**	**26.8**	27.6	26.8
Female	**29.7**	**29.0**	29.7	28.9
Life expectancy from age 60 currently age 40:				
Male	**28.3**	**27.9**	28.3	27.9
Female	**30.8**	**30.2**	30.8	30.1

Actuarial risk factors

The schemes are exposed to actuarial risks including investment risk, inflation risk and longevity risk.

	Definition of risk
Investment risk	Assumptions are made about the returns expected from the schemes' investments. If the investments underperform these assumptions in the long-term then additional contributions will need to be made to the schemes in order to fund the payment of future benefits.
Discount rate risk	A fall in AA-rated corporate bond yields, which are used to set the discount rate, will increase the value of the scheme's liabilities. This may be partially offset by an increase in the value of the scheme's bond holdings.
Inflation risk	The benefits payable to the members of the schemes are linked to inflation and as such higher inflation will lead to higher liabilities. Additionally, the Company's contributions to the schemes are based on assumptions about the future levels of inflation, therefore an increase in inflation above that assumed in the actuarial calculations will create a deficit.
Longevity risk	An increase in the life expectancy of scheme members will result in benefits being paid out for longer, leading to an increase in the defined benefit schemes' liabilities.

The sensitivity of the present value of scheme liabilities to changes in the principal assumptions used is set out below:

	Reduction in liability					
	2021			2020		
	TWPS £m	**TWMIPS £m**	**SUURBS £m**	TWPS £m	TWMIPS £m	SUURBS £m
Change in discount rate (+ 1% p.a.)	**400.0**	**110.0**	**0.7**	320.0	90.0	0.7
Change in rate of inflation (-1% p.a.)	**260.0**	**80.0**	**0.7**	210.0	70.0	0.7
Change in life expectancy (-1 year)	**90.0**	**40.0**	**0.3**	70.0	40.0	0.3

Future expected cash flows

The Group made a pension deficit repair payment of £69.7 million on 30 March 2021 covering the financial periods from 2021/22 to 2024/25, which has been treated as an exceptional cash flow in the current year. We made a payment of £28.3 million on 1 April 2020 in relation to 2020/21. The average duration of the benefit obligation at the end of the year is 18 years for TWPS and 11 years for TWMIPS (2020: 19 years for TWPS and 12 years for TWMIPS).

In December 2020, the funding valuation as at 31 March 2020 was finalised and agreed with the scheme Trustees and actuaries. In order to address the combined funding deficit the Group is scheduled to make future deficit repair payments in line with the table below:

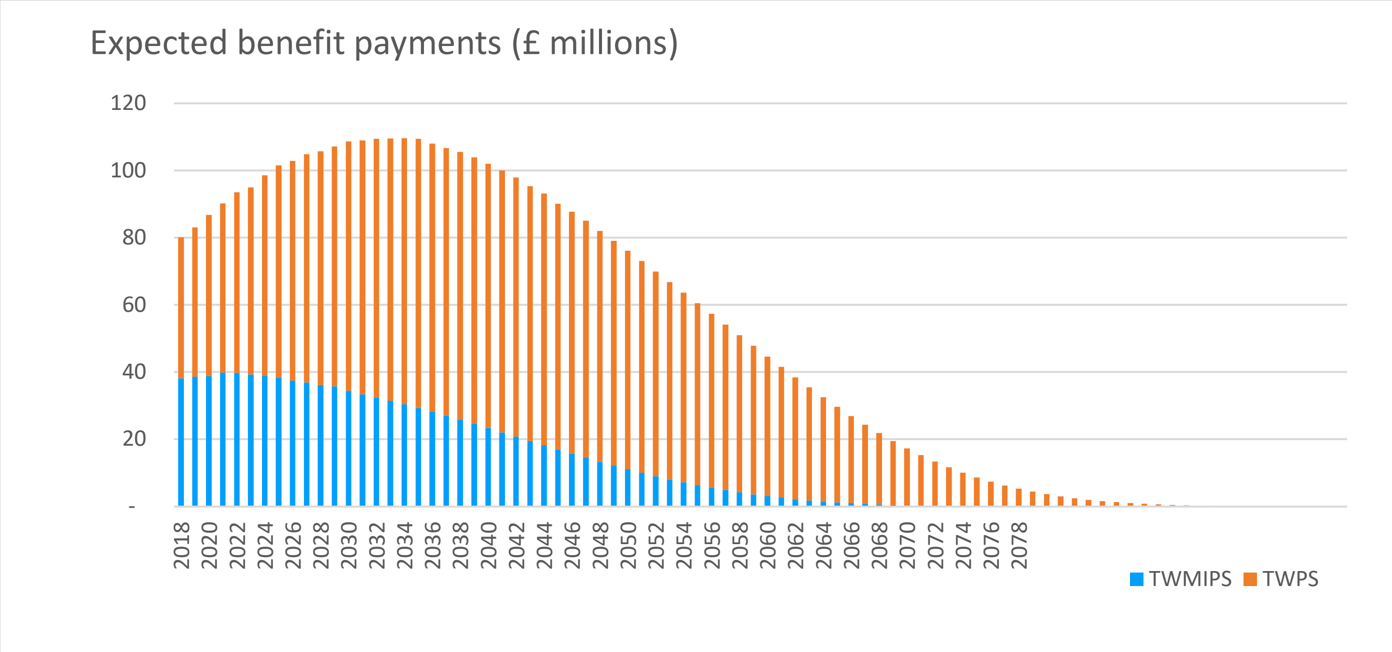
Year to 31 March	**2021**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**
Deficit contribution (£m)	69.7	-	-	-	-	17.9	17.9	17.9

The expected cash flows payable from the schemes are presented in the graph below:

Notes to the Group financial statements (continued)

23. Retirement benefit obligations (continued)

Future expected cash flows (continued)



The expected cash flows are undiscounted liability cash flows based on the funding valuation as at 31 March 2019. The future cash flows are sensitive to the assumptions used and therefore actual cash flows may differ from those expected.

24. Capital commitments

	2021 £m	2020 £m
Property, plant and equipment	**404.9**	281.7
Intangible assets	**10.0**	7.5
Contracted for but not provided	**414.9**	289.2

In addition to these commitments, the Group has long-term capital investment plans, under its business plan submitted to Ofwat, to provide for future growth and maintenance of the infrastructure network. Capital commitments have increased during the year due to the start of a new AMP and delays to commencement of capital works driven by Covid-19.

25. Contingent liabilities

Contingent liabilities represent potential future cash outflows which are either not probable or cannot be measured reliably.

The Group is currently defending five sets of court proceedings commenced by different groups of Property Search Companies (“PSCs”) seeking refunds of fees paid for property search data, including CON29DW searches, from 1 December 2013 to date. The PSCs allege that they have been overcharged for drainage and water searches and that information should have been made available to them pursuant to the Environmental Information Regulations 2004, at a lower cost than that charged. The position is replicated across all other Water & Sewerage Companies in England and Wales. We are defending these claims, as are all the other water and sewage companies in England and Wales. However, the claims are at too early a stage to provide further commentary on the merits or otherwise of them or any effect on the financial position of the Group.

As at 31 March 2021, there were ongoing commercial negotiations arising in the ordinary course of business in respect of closing out AMP6 contracts. At present the Directors consider an outflow of economic benefit is possible, however, cannot be reliably estimated. The outcome is contingent on future discussions and will only become known on conclusion of the negotiation. The outcome could result in either an economic outflow, inflow or neither. In respect of these negotiations, the Group has also taken the option under paragraph 92 of IAS 37 for non-disclosure of certain information relating to provisions and contingent liabilities in extremely rare cases where this can be expected to seriously prejudice the entity in a dispute.

Other contractual matters with suppliers incurred in the ordinary course of business, which may result in a liability that could have a material effect on the Group’s financial statements. These contractual matters are unquantifiable and subject to significant uncertainties. The Group has considered these contractual matters as a contingent liability.

Financial guarantees

The Group is part of a Whole Business Securitisation ("WBS") group as described in note 19. Companies in the WBS group raise debt in external debt markets through the issuance of secured bonds and the issue of loans. All companies in the WBS group guarantee the principal and interest payments due under the terms of the bonds. Where the Group enters into financial guarantee contracts to guarantee the indebtedness of other companies within this group, the Group considers these to be insurance arrangements and accounts for them as such. In this respect, the Group treats the guarantee contract as a contingent liability until such a time as it becomes probable that the Group will be required to make a payment under the guarantee.

26. Off-balance sheet arrangements

The Group is party to a number of contractual arrangements for the purposes of its principal activities that are not required to be included within the statement of financial position. These are:

- operating leases not in the scope of IFRS 16;
- outsourcing contracts; and
- guarantees.

In respect of outsourcing contracts, the Group has entered into various arrangements to outsource the provision of certain back-office and operational functions with third party providers. These outsourced arrangements include aspects of customer services, legal services, metering and capital delivery. These arrangements are on commercial terms and no associated penalty or termination clauses will have a material effect on the financial position of the Company.

The Group is part of a whole business securitisation group. Thames Water Utilities Holdings Limited, Thames Water Utilities Limited and its direct subsidiary, Thames Water Utilities Finance plc are Obligators under the whole business securitisation entered into in 2007. The Obligators have all entered into a Security Trust and Inter-creditor Deed. Under this document each Obligator will guarantee the obligations of each other Obligator with their future cash flows. The guaranteed debt as at 31 March 2021 was £12.9 billion (2020: £13.1 billion).

27. Guarantees

Thames Water Utilities Holdings Limited, Thames Water Utilities Limited and Thames Water Utilities Finance plc are Obligors under the whole business securitisation entered into in 2007. The Obligors have all entered into a Security Trust and Inter-creditor Deed. Under this document each Obligor will guarantee the obligations of each other Obligor with their future cash flows. The guaranteed debt at 31 March 2021 was £12.9 billion (2020: £13.1 billion).

At 31 March 2021 certain subsidiaries of the Group have secured overdrafts of other subsidiaries up to a maximum of £5.0 million (2020: £20.0 million).

Kemble Water Finance Limited and its subsidiary, Thames Water (Kemble) Finance plc (the "Kemble Financing Group") have provided security by way of a debenture over each of their assets in relation to monies owed by the Kemble Financing Group under certain financing arrangements which accede from time to time as secured debt pursuant to an intercreditor agreement. Pursuant to the intercreditor agreement, Kemble Water Finance Limited also guarantees the obligations of its subsidiary, Thames Water (Kemble) Finance plc pursuant to any secured indebtedness it may raise. The total amount outstanding at the Kemble Water Finance Limited level at 31 March 2021 amounts to £ 949.8 million (2020: £924.8 million). The total amount of guaranteed secured debt raised at the Thames Water (Kemble) Finance plc level outstanding at 31 March 2021 is £ 515.1 million (2020: £175.0 million).

In addition, there are a number of parent company guarantees in respect of subsidiary company contractual obligations that have been entered into in the normal course of business. No un-provided loss is expected to arise under these arrangements.

Notes to the Group financial statements (continued)

28. Statement of cash flows

Reconciliation of operating profit to operating cash flows

	2021 Underlying £m	2021 BTL £m	2021 Total £m	2020 Underlying £m	2020 BTL £m	2020 Total £m
(Loss)/profit for the financial year	**(831.3)**	**59.6**	**(771.7)**	(389.7)	58.0	(331.7)
Less finance income	**(174.7)**	**-**	**(174.7)**	(73.2)	-	(73.2)
Add finance expense	**1,061.6**	**-**	**1,061.6**	1,081.9	-	1,081.9
Add interest paid on lease liability	**3.4**	**-**	**3.4**	3.7	-	3.7
Less net gains/(add net losses) on fair value of financial instruments	**524.9**	**-**	**524.9**	(190.8)	-	(190.8)
Taxation on (loss)/profit on ordinary activities	**(192.8)**	**14.0**	**(178.8)**	61.2	6.1	67.3
Operating profit	**391.1**	**73.6**	**464.7**	493.1	64.1	557.2
Depreciation on property, plant and equipment	**580.8**	**-**	**580.8**	569.0	-	569.0
Depreciation on right of use assets	**8.0**	**-**	**8.0**	8.2	-	8.2
Amortisation of intangible assets	**52.0**	**-**	**52.0**	32.9	-	32.9
Write off of property, plant and equipment and intangible assets	**-**	**-**	**-**	9.9	-	9.9
Loss on sale of property, plant and equipment	**(8.3)**	**-**	**(8.3)**	4.1	-	4.1
Difference between pension charge and cash contribution	**(92.7)**		**(92.7)**	(1.8)	-	(1.8)
Increase in inventory	**(1.3)**	**-**	**(1.3)**	(0.1)	-	(0.1)
Increase in trade and other receivables	**12.3**	**(71.1)**	**(58.8)**	(46.5)	(60.2)	(106.7)
Increase in contract assets	**(4.6)**	**(4.3)**	**(8.9)**	(17.9)	(0.6)	(18.5)
Decrease in trade and other payables	**(55.4)**	**1.0**	**(54.4)**	(8.0)	(0.8)	(8.8)
Increase/(decrease) in contract liabilities	**48.1**	**1.8**	**49.9**	84.5	(3.1)	81.4
(Decrease)/increase in provisions	**(0.6)**	**-**	**(0.6)**	25.7	-	25.7
Cash generated from/(used in) operations	**929.4**	**1.0**	**930.4**	1,153.1	(0.6)	1,152.5

[1] Operating cash flows for the year ended 31 March 2021 includes £69.7 million (31 March 2020: nil) of payments that are considered to be exceptional. This exceptional outflow is related to the remaining pension deficit repayments covering AMP7 for the TWPS. Excluding this exceptional cash payment, underlying operating cash flows would be £999.1 million for the year ended 31 March 2021 (31 March 2020: £1,153.1 million).

Non-cash transactions

Assets transferred from developers and customers for nil consideration were recognised at their fair value.

Movement in cash and cash equivalents

	2021 £m	2020 £m
Unrestricted cash movement	**(12.4)**	11.2
Movement in short-term deposits	**300.0**	282.6
Total	**287.6**	293.8

The restricted cash above relates to collateral posted by derivative counterparties that have failed to meet minimum credit rating criteria assigned by Moody's.

29. Ultimate parent company and controlling party

Kemble Water Eurobond plc, a company incorporated in the United Kingdom, is the immediate parent company. The Directors consider that Kemble Water Holdings Limited, a company incorporated in the United Kingdom, is the ultimate and controlling party and the only group to consolidate these financial statements.

Copies of the accounts of the above companies may be obtained from The Company Secretary's Office, Thames Water, Clearwater Court, Vastern Road, Reading, Berkshire, RG1 8DB.

Notes to the Group financial statements (continued)

30. Related party transactions

Key management personnel

Key management personnel comprise the members of the Board of Directors and the Executive Committee of the Group's principal trading subsidiary Thames Water Utilities Limited during the year. Information regarding transactions with post-employment benefits plans is included in note 23.

	2021 £'000	2020 £'000
Short term employee benefits	**3,109.8**	9,255.0
Post-employment benefits	**159.0**	507.0
Other long-term benefits	**-**	-
Termination benefits	**591.0**	3,249.0
Other	**457.0**	124.0
Total	**4,316.8**	13,135

Company

During the year, Kemble Water Eurobond plc ("KWE"), the Company's immediate parent charged the Company interest of £633.3 million (2020: £613.2 million) in respect of the £3,100.6 million 10% fixed rate loan due on demand. As at 31 March 2021, the amount payable to KWE, including loan principal and interest thereon, was £ 6,965.8 million (2020: £6,332.5 million).

The Company pays and receives interest to and from subsidiary undertakings in the normal course of business. Total net interest expense to and from subsidiary undertakings during the year was £634.0 million (2020: £613.3 million).

As at 31 March 2021 net amounts owed by the Company to subsidiary undertakings was £6.909.1 million (2020: £6,122.4 million). As at 31 March 2021 and 31 March 2020, no related party receivables or payables were secured and no guarantees were issued. Balances will be settled in accordance with normal credit terms.

The Company's borrowings include a £100.0 million fixed rate note due 2025 with a book value of £98.6 million. The noteholder is OCM Credit Portfolio LP. OCM Credit Portfolio LP is a member of the Ontario Municipal Employees Retirement System ("OMERS") group which, via a separately managed group of companies within the OMERS group owns, indirectly, 31.8% of the Company. The terms of the notes, including the coupon payable, are the same market rates as all fixed rate notes issued by the Company in 2018 and due in 2025, a total of £310.0 million.

31. Post balance sheet events

In the Spring Budget 2021, the Government announced that from 1 April 2023 the corporation tax rate will increase to 25%. Since the proposal to increase the rate to 25% had not been substantively enacted at the balance sheet date, its effects are not included in these financial statements. The legislation was enacted on 24 May 2021 and the likely impact of this change is disclosed in Note 7 for the Group and Note 33 Company only.

In June 2021, the Group further strengthened its financing position, through Thames Water Utilities Finance Plc entering into a £180.0 million Class B loan facility due June 2026, which is currently undrawn. Since 31 March 2021, £525.0 million has been drawn under the Class A RCF, and debt repayments have been made of £214.3 million Class B RCF, £225.0 million Class A bond due April 2021 and £300.0 million Class B term loan due June 2023.

Notes to the Company financial statements

32. Investment in subsidiaries

	2021 £m	2020 £m
Cost of shares in subsidiary undertakings	**4,292.3**	4,292.3
Net book value	**4,292.3**	4,292.3

A full listing of direct and indirect subsidiary and associated undertakings has been included in note 41 to these financial statements. Investments in subsidiaries are stated at cost, less any provision for impairment. The key inputs consist of future RCV, RCV premium, future gearing and expected interest settlements. This impairment would be recognised within the Company income statement only. An impairment review is performed on an annual basis.

33. Trade and other receivables

	2021 £m	2020 £m
Other receivables	**0.5**	0.6
Amounts owed by group undertakings	**445.6**	379.1
Amounts receivable in respect of group relief	**323.5**	195.6
	769.6	575.3
Disclosed within non-current assets	**417.5**	367.0
Disclosed within current assets	**352.1**	208.3

Included within amounts owed by group undertaking are 3 intercompany loans with Thames Water Limited, including:

£249.8m with an interest rate of 5.47% repayable on demand
£50.0m with an interest rate of 5.40% repayable on demand
£32.0m with an interest rate of 5.46% repayable on demand

Separately there is an intercompany receivable owed by Thames Water Limited of which £85.1 million (2020: 116.6 million) remains at 31 March 2021 and is interest free and repayable on demand.

These loans are repayable on demand, however the Directors confirm that there will be no repayment within 12 months and letters of comfort have been obtained from the counterparty to confirm that no repayment will be sought for at least 12 months from the date of signing the financial statements. Therefore, these amounts owed to group undertakings have been classified as non-current.

34. Deferred tax asset

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

	Other timing differences £m	**Total £m**
At 1 April 2019	9.2	9.2
Charge to income	(0.8)	(0.8)
At 31 March 2020	8.4	8.4
Charge to income	(1.7)	(1.7)
At 31 March 2021	6.7	6.7

In the Spring Budget 2021, the Government announced that from 1 April 2023 the corporation tax rate will increase to 25%. Since the proposal to increase the rate to 25% had not been substantively enacted at the balance sheet date, its effects are not included in these financial statements. However, it is likely that the overall effect of the change, had it been substantively enacted by the balance sheet date, would be to increase the deferred tax asset by £1.1m, and to increase the tax credit for the period by £1.1m.

Notes to the Company financial statements (continued)

35. Cash and cash equivalents

	2021 £m	2020 £m
Cash at bank and in hand	**0.3**	0.3
Money market funds	**286.2**	28.4
Total	**286.5**	28.7

36. Trade and other payables

	2021 £m	2020 £m
Other payables	**0.3**	0.1
Amounts owed to group undertakings	**1.7**	0.3
	2.0	0.4
Disclosed within non-current liabilities	**0.3**	0.3
Disclosed within current liabilities	**1.7**	0.1

All amounts owed to group undertakings are unsecured, interest free and repayable on demand.

37. Net losses on financial instruments

	2021 £m	2020 £m
Loss on part repayment of amounts owed to group undertakings[1]	**(2.7)**	-
Total	**(2.7)**	-

[1] In November 2020, £62.6 million plus accrued interest was paid by KWF towards repayment of £59.9 million principal of the £175.0 million intercompany loan with TW(K)F. The £2.7 million premium paid on the part repayment of the £175.0 million intercompany loan has been recognised in net losses on financial instruments.

38. Borrowings

All amounts owed to group undertakings are unsecured, interest free and repayable on demand.

	2021 £m	2020 £m
Secured bank loans and private placements	**938.8**	911.1
Amounts owed to group undertakings	**3,765.0**	3,426.2
	4,703.8	4,337.3
Interest payable on secured bank loans and private placements	**14.1**	14.8
Interest payable on amounts owed to group undertakings	**3,910.2**	3,270.6
Total	**8,628.1**	7,622.7
Disclosed within current liabilities	**21.0**	17.0
Disclosed within non-current liabilities	**8,607.1**	7,605.7

Notes to the Company financial statements (continued)

38. Borrowings (continued)

Breakdown of secured bank loans and private placements

	2021 £m	2020 £m
Kemble Water Finance Limited:		
£75.0m floating rate loan due 2022 (a), (b)	**-**	74.5
£200.0m floating rate loan due 2025 (a)	**198.5**	198.1
£4.5m 5.3% fixed rate loan due 2025 (a)	**4.4**	4.4
£5.5m 5.3% fixed rate loan due 2025 (a)	**5.4**	5.4
£100.0m 5.3% fixed rate loan due 2025 (a)	**98.6**	98.3
£200.0m 5.3% fixed rate loan due 2025 (a)	**197.1**	196.6
£149.8m 5.39% fixed rate loan due 2026 (a)	**147.6**	147.2
£190.0m floating rate loan due 2024 (a)	**188.4**	186.5
£50.0m 5.26% private placement due 2027 (a)	**49.5**	-
£50.0m 5.27% private placement due 2028 (a)	**49.3**	-
Kemble Water Finance Limited total	**938.8**	911.0
Total secured bank loans and private placements	**938.8**	911.0

(a) These loans and private placements are shown net of issuance costs.
(b) During the year ended 31 March 2021, the £75.0m floating rate loan originally due in 2022 was repaid early.

Breakdown of amounts owed to group undertakings

	2021 £m	2020 £m
Thames Water (Kemble) Finance plc		
£175.0m 5.75% fixed rate bond due 2022 (a), (b)	**114.8**	174.3
£400.0m 4.625% fixed rate bond due 2026 (c)	**398.3**	-
Kemble Water Eurobond plc		
£3,100.6 10.0% fixed rate loan due on demand (e)	**3,100.6**	3,100.6
Thames Water Investments Limited		
£15.0m floating rate loan due on demand (d), (e)	**15.0**	15.0
Thames Water Limited		
£136.3m floating rate loan due on demand (d), (e)	**136.3**	136.3
Total amounts owed to group undertakings	**3,765.0**	3,426.2

(a) This bond is on-lent at equivalent interest rate to the external borrowing rate, plus an annual margin of £10,000 (2020: £10,000).
(b) In November 2020, £62.6 million plus accrued interest was paid by KWF towards repayment of £59.9 million principal of the £175.0 million intercompany loan with TW(K)F. The £2.7 million premium paid on the part repayment of the £175.0 million intercompany loan has been recognised in losses on financial instruments.
(c) This bond is on-lent at equivalent interest rate to the external borrowing rate, plus 0.10%.
(d) This loan incurs interest at Libor + 0.5%.
(e) These loans are repayable on demand, however the Directors confirm that there will be no repayment within 12 months and letters of comfort have been obtained from the counterparty to confirm that no repayment will be sought for at least 12 months from the date of signing the financial statements. Therefore, these amounts owed to group undertakings have been classified as non-current.

Details of the significant accounting policies and methods adopted (including the criteria for recognition, the basis of measurement and the basis for recognition of income and expenses) for each class of financial asset, financial liability and equity instrument are disclosed in the accounting policies. The Company does not hold any derivative financial assets or liabilities (2020: none).

Notes to the Company financial statements (continued)

39. Financial instruments

The carrying values of the financial assets and liabilities are as follows:

	2021 **£m**	2020 - Restated[1] £m
Financial assets:		
Fair value through profit or loss		
Cash and cash equivalents – money market funds[2]	**286.2**	28.4
	286.2	28.4
Amortised cost		
Other receivables (excluding prepayments)[1]	**417.5**	367.0
Trade and other receivables (excluding prepayments)[1]	**352.1**	208.3
Cash and cash equivalents – cash at bank and in hand[2]	**0.3**	0.3
	769.9	575.6
Total	**1,056.1**	604.0
Financial liabilities:		
Amortised cost		
Other payables (excluding other taxation and social security)	**(0.3)**	(0.3)
Trade and other payables (excluding other taxation and social security)	**(1.7)**	(0.1)
Borrowings	**(8,628.1)**	(7,622.7)
Total	**(8,630.1)**	(7,623.1)

[1] The comparative amounts have been restated to reclassify amounts between 'Other receivables' and 'Trade and other receivables' consistent with how these balances are presented in note 36.

[2] The comparative amounts have been restated to reclassify cash and cash equivalents – money market funds from the amortised cost section to the fair value through profit or loss section.

Fair value measurements

The fair value of financial assets and liabilities represents the price that would be received to sell an asset or paid to transfer a liability between informed and willing parties, other than in a forced or liquidation sale at the measurement date. The techniques for determining the fair value of financial instruments are classified under the hierarchy defined in IFRS 13 *Fair Value Measurement* which categorises inputs to valuation techniques into Levels 1-3 based on the degree to which the fair value is observable.

Level 1: Quoted prices in active markets for identical assets or liabilities that can be accessed
Level 2: Significant inputs other than within Level 1 that are observable for the asset or liability, either directly or indirectly
Level 3: Inputs for the assets or liabilities that are not based on observable market data and require management assumptions or inputs from unobservable markets.

Unless otherwise stated all of the Company's inputs to valuation techniques are Level 2 - the fair value is determined from inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly.

Notes to the Company financial statements (continued)

39. Financial instruments (continued)

Comparison of fair value of financial instruments with their carrying amounts

The fair values and carrying values of the Company's financial assets and financial liabilities are set out in the tables below:

	2021		2020 - Restated[1,2]	
	Book value £m	**Fair value £m**	Book value £m	Fair value £m
Financial assets:				
Non-current				
Other receivables (excluding prepayments)[1]	**417.5**	**417.5**	367.0	367.0
Current				
Trade and other receivables (excluding prepayments)[1]	**352.1**	**352.1**	208.3	208.3
Cash and cash equivalents	**286.5**	**286.5**	28.7	28.7
Total	**1,056.1**	**1,056.1**	604.0	604.0

[1] The comparative amounts have been restated to exclude prepayments.

Financial liabilities:				
Non-current				
Borrowings:				
Secured bank loans and private placements	**(938.8)**	**(980.7)**	(911.1)	(877.2)
Amounts owed to group undertakings	**(3,765.0)**	**(3,774.1)**	(3,426.2)	(3,425.0)
Interest payable	**(3,903.3)**	**(3,903.3)**	(3,268.4)	(3,268.4)
Other payables (excluding other taxation and social security)[2]	**(0.3)**	**(0.3)**	(0.3)	(0.3)
Current				
Borrowings:				
Amounts owed to group undertakings	**-**	**-**	-	-
Interest payable	**(21.0)**	**(21.0)**	(17.0)	(17.0)
Trade and other payables (excluding other taxation and social security)[2]	**(1.7)**	**(1.7)**	(0.1)	(0.1)
Total	**(8,630.1)**	**(8,681.1)**	(7,623.1)	(7,588.0)

[2] The comparative amounts have been restated to include Trade and other payables (excluding other taxation and social security).

Capital risk management

Details of the Group's capital risk management strategy can be found on pages 82 and 83. The capital structure of the Company is as follows:

	2021 £m	2020 £m
Cash and cash equivalents	**286.5**	28.7
Secured bank loans and private placements	**(938.8)**	(911.1)
Interest payable on secured bank loans and private placements	**(14.1)**	(14.8)
Amounts owed to group undertakings	**(3,765.0)**	(3,426.2)
Interest payable on amounts owed to group undertakings	**(3,910.2)**	(3,270.6)
Net debt	**(8,341.6)**	(7,594.0)
Deficit attributable to the owners of the Group	**(3,725.0)**	(2,718.4)

Notes to the Company financial statements (continued)

39. Financial instruments (continued)

Financial risk management

The Company's activities expose it to a number of financial risks: market risk (including interest rate risk), credit risk and liquidity risk. Details of the nature of each of these risks along with the steps the Company has taken to manage them is described below. The Company's activities expose it to credit and liquidity risk.

(a) Market risk

Market risk relates to fluctuations in external market variables such as interest rates that could affect the Company's value of the financial instruments it holds. Below is the effective interest rate profile of the debt held by the Company:

As at 31 March 2021:	Total at fixed rates £m	Total at floating rates £m	Total £m
Interest bearing loans and borrowings			
Net of corresponding swap assets			
- £ Sterling	4,165.7	538.1	4,703.8
Total	4,165.7	538.1	4,703.8

As at 31 March 2020:	Total at fixed rates £m	Total at floating rates £m	**Total £m**
Interest bearing loans and borrowings			
Net of corresponding swap assets			
- £ Sterling	3,726.9	610.4	4,337.3
Total	3,726.9	610.4	4,337.3

The weighted average interest rates of the debt held by the Company and the period until maturity for which the rate is fixed are given below:

	Weighted average interest rate for fixed rate and index-linked debt		Weighted average period until maturity for which rate is fixed for fixed rate and index-linked debt	
	2021 %	2020 %	**2021 Years**	2020 Years
Interest bearing loans and borrowings				
Net of corresponding swap assets				
- £ Sterling	**8.8**	9.2	**13.4**	15.3
Total	**8.8**	9.2	**13.4**	15.3

Interest rate risk sensitivity analysis

The table below summarises the impact, on pre-tax profits, of 1% increase or decrease in interest rate at 31 March 2021. This analysis considers the effect of variable interest rate instruments and assumes that all other variables, in particular exchange rates, remain constant.

	2021		2020	
	+1% £m	**-1% £m**	+1% £m	-1% £m
Profit	**(3.9)**	**3.9**	(4.7)	4.7
Equity	**(3.9)**	**3.9**	(4.7)	4.7

Notes to the Company financial statements (continued)

39. Financial instruments (continued)

Financial risk management (continued)

(b) Credit risk

The Company's maximum exposure to credit risk is the carrying amount of financial assets recorded in the financial statements, which is net of impairment losses, therefore the maximum exposure to credit risk at the year-end date was £1056.1 million (2020: £604.0 million).

(c) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company manages long-term liquidity by maintaining continuity of funding through access to different market and debt instruments, raising funds in the capital markets and ensuring that manageable debt maturity profiles are maintained. The Company also maintains a level of committed liquidity facilities provided by a range of financial institutions. Details of the Company's borrowings are disclosed in Note 38.

The maturity profile of the Company's financial liabilities disclosed in the statement of financial position are given below.

	2021 **£m**	2020 £m
Within one year	**-**	-
Between one and two years	**114.8**	-
Between two and three years	**-**	248.8
Between three and four years	**188.4**	-
Between four and five years	**504.1**	186.5
After more than five years	**3,896.5**	3,902.0
Total	**4,703.8**	4,337.3

Cash flows from non-derivative financial liabilities.

The maturity profile of the anticipated future cash flows including interest in relation to the Company's non-derivative financial liabilities on an undiscounted basis, which, therefore, differs from both the carrying value disclosed in the statement of financial position and fair values, is as follows:

Undiscounted amounts payable	**2021** **£m**	2020 - Restated[1] £m
Within one year	**74.4**	53.4
Between one and two years	**184.4**	53.2
Between two and three years	**65.9**	296.5
Between three and four years	**250.2**	39.7
Between four and five years	**563.3**	224.9
After more than five years	**3,925.5**	3,940.6
Total	**5,063.7**	4,608.3

[1] The comparative amounts have been restated to include lease liabilities.

Notes to the Company financial statements (continued)

40. Statement of cash flows

Reconciliation of operating profit to operating cash flows

	2021 **£m**	2020 £m
Loss for the financial year	**(556.6)**	(533.6)
Add finance expense	**687.3**	674.5
Less finance income	**(0.1)**	(12.7)
Decrease in intercompany receivables	**31.6**	53.9
Increase/(decrease) in intercompany payables	**1.4**	(14.6)
Taxation on loss on ordinary activities	**(130.4)**	(126.5)
Cash generated in operations	**33.2**	41.0

Notes to the Company financial statements (continued)

41. Subsidiaries, associated undertakings, and significant holdings other than subsidiary undertakings

At 31 March 2021 the Company held the following principal interests, all of which are either wholly or jointly owned either directly or indirectly through its subsidiary investments.

	Principal undertaking	Country of incorporation	Country of tax residence	Class of shares held	Proportion of voting rights and shares held
Direct					
Thames Water (Kemble) Finance plc	Finance Company	United Kingdom	United Kingdom	Ordinary	100%
Thames Water Limited	Holding Company	United Kingdom	United Kingdom	Ordinary	100%
Indirect					
Thames Water Utilities Limited	Water & wastewater	United Kingdom	United Kingdom	Ordinary	100%
Kennet Properties Limited	Property company	United Kingdom	United Kingdom	Ordinary	100%
Thames Water Utilities Finance Plc	Finance company	United Kingdom	United Kingdom	Ordinary	100%
Thames Water Commercial Ventures Finance Limited	Holding company	United Kingdom	United Kingdom	Ordinary	100%
Thames Water Commercial Services Limited	Trading Company	United Kingdom	United Kingdom	Ordinary	100%
Thames Water Utilities Holdings Limited	Holding Company	United Kingdom	United Kingdom	Ordinary	100%
Thames Water Asia Pte Limited	Legacy Investment	Singapore	Singapore	Ordinary	100%
Foudry Properties Limited	Property Company	United Kingdom	United Kingdom	Ordinary	50%
Innova Park Management Limited	Property Company	United Kingdom	United Kingdom	Ordinary	100%
Thames Water Overseas Limited	Holding Company	United Kingdom	United Kingdom	Ordinary	100%
PWT Projects Limited	Dormant Company	United Kingdom	United Kingdom	Ordinary	100%
Thames Water Products Limited	Non Trading Company	United Kingdom	United Kingdom	Ordinary	100%
Thames Water Investments Limited	Property Company	United Kingdom	United Kingdom	Ordinary	100%
Thames Water Pension Trustees (MIS) Limited	Pension Trustees	United Kingdom	United Kingdom	Ordinary	100%
Thames Water Pension Trustees Limited	Pension Trustees	United Kingdom	United Kingdom	Ordinary	100%
Thames Water Property Services Limited	Property Company	United Kingdom	United Kingdom	Ordinary	100%
Thames Water Senior Executive Pension Trustees Limited	Pension Trustees	United Kingdom	United Kingdom	Ordinary	100%

Notes to the Company financial statements (continued)

41. Subsidiaries, associated undertakings, and significant holdings other than subsidiary undertakings (continued)

Liquidations completed during the year ended 31 March 2021

Thames Water Nominees Limited	Dormant Company	United Kingdom	United Kingdom	Ordinary	100%
Thames Water International Services Limited	Dormant Company	United Kingdom	United Kingdom	Ordinary	100%
Thames Water International Service Holdings Limited	Holding Company	United Kingdom	United Kingdom	Ordinary	100%
Thames Water Developments Limited	Dormant Company	United Kingdom	United Kingdom	Ordinary	100%
Shapeshare Limited	Property Company	United Kingdom	United Kingdom	Ordinary	100%
Thames Water International (Thailand) Limited	Legacy Investment	Thailand	Thailand	Ordinary/ Preference	100%

The address of the registered office of all the above companies is Clearwater Court, Vastern Road, Reading, Berkshire, RG1 8DB with the exception of:

- Thames Water Asia Pte Limited (80 Robinson Road #02-00, Singapore, 68898)