Our approach to finance is responsible and sustainable

FINANCIAL STATEMENTS AND SHAREHOLDER INFORMATION

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Independent auditor's report to the members of Pennon Group plc

Opinion

In our opinion:

- Pennon Group plc's group financial statements and parent company financial statements (the "financial statements") give a true and fair view of the state of the group's and of the parent company's affairs as at 31 March 2018 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006, and, as regards the group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements of Pennon Group plc which comprise:

Group	Parent company
Consolidated income statement	
Consolidated statement of comprehensive income	
Consolidated balance sheet	Balance sheet
Consolidated statement of changes in equity	Statement of changes in equity
Consolidated cash flow statement	Cash flow statement
Related notes 1 to 45 to the financial statements	Related notes 1 to 45 to the financial statements

The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the Group and parent company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

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

Use of our report

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

Conclusions relating to principal risks, going concern and viability statement

We have nothing to report in respect of the following information in the annual report, in relation to which the ISAs(UK) require us to report to you whether we have anything material to add or draw attention to:

- the disclosures in the annual report set out on pages 54 to 60 that describe the principal risks and explain how they are being managed or mitigated;
- the directors' confirmation set out on page 54 in the annual report that they have carried out a robust assessment of the principal risks facing the entity, including those that would threaten its business model, future performance, solvency or liquidity;
- the directors' statement set out on page 100 in the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and their identification of any material uncertainties to the entity's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements
- whether the directors' statement in relation to going concern required under the Listing Rules in accordance with Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit; or
- the directors' explanation set out on page 61 in the annual report as to how they have assessed the prospects of the entity, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the entity will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

Overview of our audit approach

Key audit matters	• Revenue recognition across the Group's operations • Valuation of landfill related provisions (Viridor) • Valuation of the provision for doubtful debts (SWW) • Contract claims (Viridor)
Audit scope	• We performed an audit of the complete financial information of three components and audit procedures on specific balances for one component. • The components where we performed full or specific audit procedures accounted for 100% of Profit before taxation before non-underlying items, 100% of Revenue and 95% of Total assets.
Materiality	• Overall Group materiality of £12.9m which represents 5% of Profit before taxation before non-underlying items.

Key audit matters

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

Risk	Our response to the risk	Key observations communicated to the Audit Committee
Revenue recognition across the Group's operations (£1,396.2 million, PY comparative £1,353.1 million) **Risk direction** *Refer to the Audit Committee Report (page 73); Accounting policies (page 119); and Note 4 of the Consolidated Financial Statements (page 127)* The Group's material revenue streams relate to the provision of water and sewerage services by South West Water and Pennon Water Services and revenue generated from the renewable energy, recycling and waste management services provided by Viridor. ISAs (UK & Ireland) presume there is a risk of fraud relating to revenue recognition. For the Group, given targets associated with financial performance and pressures to meet market expectations, there is an incentive to overstate revenue. This risk over revenue recognition specifically arises in the following judgemental areas, where there is opportunity to overstate revenue: **South West Water and Pennon Water Services** • Income from measured water services requires an estimation of the amount of unbilled charges at the year end. This is calculated using a combination of system generated information, based on previous customer volume usage, together with management judgements as to the likely impact on usage of factors such as recent weather patterns. The accrued income balance at 31 March 2018 is £61.5 million (2017: £72.2 million) for South West Water and £20.2 million for Pennon Water Services. **Viridor** • Calculations of accrued income on waste management contracts and powergen revenue to be received involve estimation by management. The accrued income balance at 31 March 2018 is £53.4 million (2017: £42.8 million). • Accounting for revenue from long term service concession arrangements under IFRIC12 requires revenue to be recognised on construction, during service delivery and as a capital return on the asset. The determination of the margin allocated during the different phases of each service concession involves management judgement. At 31 March 2018 the Group has recognised contract receivables of £234.1 million (2017: £217.6 million) and other intangible assets of £69.2 million (2017: £61.3 million).	Our procedures include: **South West Water and Pennon Water Services** • We obtained an understanding of the process for the supply of measured services, meter reading and related billing in order to assess the completeness of adjustments to reflect the accrual or deferral of revenue • We tested key controls linked to system generated information and around the estimation process for measured revenue • We compared the accrued income to bills raised post year end for a sample of customers, and compared management's history of estimating the accrued income balance to bills raised in the subsequent year to assess the accuracy of the accrued income balance • We corroborated the key assumptions and estimates made by management in recognising revenue, by obtaining internal and external data on factors that influence demand from customers, such as weather patterns and leaks in infrastructure network • We tested whether contract terms and conditions were met and revenue recognised at the correct time in accordance with IFRS • We performed analytical procedures by comparing revenue balances for the year against expectation and obtaining support for significant variances • We tested a sample of transactions to underlying bills • In performing our journal testing, we paid increased attention to entries impacting revenue focusing on non-system postings and those raised in the last two weeks of the year. **Viridor** • We compared the key assumptions and estimates made by management in recognising accrued revenue in the current year to those applied in the prior year to identify significant changes. • We analysed revenue trends and corroborated unusual movements to assess the accuracy of the accrued income balance • We obtained customer confirmations for a sample of revenue • For material items, within accrued income, we reperformed the calculation of the income that had been earned on waste management contracts and powergen revenue to confirm the accuracy of the accrued income recorded by management • We tested the application of the IFRIC12 revenue recognised and assessed the allocation of consideration between the construction and operating services provided • We agreed whether the revenue recognition policies adopted comply with IFRS, in particular the requirements of IFRIC 12, and that the margins used to recognised revenue are appropriate through testing that costs were allocated to the correct contracts and that revenue recognised, based on those costs, is reasonable and aligned with the individual contract models. We also compared the margins to those generated in prior years and to the latest projections for future years • In performing our journal testing, we paid increased attention to entries impacting revenue, particularly those raised close to the balance sheet date. We performed full and specific scope audit procedures over this risk area for three components, which covered 100% of the risk amount.	**South West Water and Pennon Water Services** We concluded that the estimation process undertaken by management to calculate the measured income accrual reflects latest operational factors in the key assumptions and results in an acceptable income accrual. **Viridor** We concluded that accrued income has been appropriately recognised, and IFRIC 12 appropriately applied.
Valuation of landfill related provisions (Viridor) (£191.9 million, PY comparative £183.8 million) **Risk direction** *Refer to the Audit Committee Report (page 73); Accounting policies (page 119); and Note 4 of the Consolidated Financial Statements (page 127).* Landfill related provisions of £191.9 million (2017: £183.8 million) are disclosed in note 32 and consist of aftercare, restoration and remediation provisions. Calculation of the aftercare provision involves significant judgement in respect of the expected period of aftercare, the level of costs to be incurred and the discount rate to be used. Key areas of estimation for the restoration provision include the expected restoration costs, the void space to be filled and timing of site closure. Judgement over the remedial action required to comply with current environmental legislation, where breaches have been identified, is a key estimate for the remediation provision. We focused on this area given there is a risk that provisions could be misstated due to the complexity of factors to be assessed and assumptions, such as discount rates, applied by management being inappropriate, including the impact of any management bias.	Our procedures include: • We tested the aftercare, restoration and remediation provision models, and verified that the models are arithmetically accurate • We evaluated the forecast costs in the models, agreeing these to supporting evidence such as budgets and supplier cost quotations and current performance, including prices charged by contractors in current year for significant sites • We assessed the material estimates made for evidence of management bias, including agreeing anticipated cost savings to detailed plans and current performance • We benchmarked the discount and inflation rates applied, using our internal valuation experts to assist in our review of whether management's assumptions are within an acceptable range based on comparative market data • We compared the key assumptions used in the calculation of the provisions, including the discount rates, inflation rates, void space and remaining lives of the sites, to available market information • We compared the key assumptions used in the current models to those used in the prior year, and obtained evidence to corroborate that changes were appropriate. This included obtaining evidence to support the impact of future planned technological changes • We performed sensitivity analysis on these key assumptions • We tested the appropriateness of journal entries impacting landfill related provisions, particularly those raised close to the balance sheet date. We performed full scope audit procedures over this risk area at Viridor, which covered 100% of the risk amount.	We concluded that management's real risk free rate of 2.325% applied to the most significant provision (aftercare) is within an acceptable range (2.00% to 2.54%). We consider key assumptions supporting the landfill related provisions reflect management's best estimates, informed by latest external and internal data, resulting in an acceptable provision balance.

Independent auditor's report to the members of Pennon Group plc
continued

Risk	Our response to the risk	Key observations communicated to the Audit Committee
Valuation of the provision for doubtful debts (South West Water) (£88.5 million, PY comparative £90.0 million) **Risk direction** *Refer to the Audit Committee Report (page 73); Accounting policies (page 119); and include d within the total Group balance per Note 22 of the Consolidated Financial Statements (page 144)* The South West Water provision is calculated using a combination of system generated information on historic debt recovery rates and management's judgement of the future likely recovery rates. There is a risk that the assumptions used by management in calculating the bad debt provision may be susceptible to management bias and the valuation of the provision against trade receivables may be misstated. We have therefore focused on this key audit matter.	Our procedures include: • We performed a walkthrough of the process for calculating the bad debt provision and assessed the design effectiveness of key controls • We tested the operating effectiveness of key controls over the integrity of data and the report utilised to generate the ageing and categorisation of debt within South West Water's billing system • We tested historic data on collection rates and evaluated how this data was used in the preparation of the bad debt provision • We corroborated the assumptions used by management in determining the amounts provided against the different categories and age of debt, by comparing these assumptions to historic collection rates and by considering the impact of changes in the methods adopted operationally by management to collect debt, and in the external environment • We utilised collection information over the past three years, to determine a range of the likely ultimate collection of debts existing at the balance sheet date and compared this to the provision recorded by management, including assessing assumptions for evidence of management bias • We tested the appropriateness of journal entries and adjustments impacting the doubtful debt provision, particularly those raised close to the balance sheet date. We performed full scope audit procedures over this risk area at South West Water, which covered 100% of the risk amount.	We concluded that the doubtful debt provision is within an acceptable range (£80.7 million to £91.2 million) and reflects recent history of collection of outstanding debts.
Contract claims (Viridor) **Risk direction** *Refer to the Audit Committee Report (page 73); Accounting policies (page 119); and Note 4 of the Consolidated Financial Statements (page 127)* During the year, there was significant activity on two of Viridor's key contracts. Firstly, there was a reset of contracts associated with the Greater Manchester Waste Disposal Authority. This resulted in the settlement of outstanding claims and counter claims, a write down of a financial asset and recognition of an increase in share of profit after tax from joint ventures. These transactions have been presented as non-underlying items in the financial statements. We have focussed on the key judgements made by management and accounting treatment applied to this significant event. Viridor is also contracted with Glasgow City Council to construct a Recycling and Renewable Energy Centre in Glasgow. Viridor terminated the contract with the original principal contractor in November 2016 and is overseeing the remaining construction. Expenditure to complete construction is expected to exceed the original target and management has accounted for what it believes its contractual rights are. Where contract claims arise, the claims and the related accounting can be complex. We focused on this area given there is risk of challenge of the legal position taken and higher judgement involved in assessing the collectability of amounts recorded.	For the Manchester contract our procedures include: • We inspected contracts and settlement agreements and agreed the accounting treatment of settled claims • We evaluated whether the allocation of income to the various settlement arrangements was appropriate and assessed whether the timing of revenue recognition was in accordance with IFRS. • We tested the revised cash flow models over the contract life and ensured recognition of revenue and costs are in accordance with IAS 18. For the Glasgow contract our procedures include: • We obtained an understanding of the key assumptions and estimates made by management in accounting for material claims, assessing for evidence of management bias and concluding on whether we concur with accounting estimates made by management • We inspected legal advice or opinion management have obtained in relation to contract positions, quantum of costs and amounts recoverable • We inquired of management and assessed other evidence, including board minutes, to test the completeness of amounts recorded in relation to contract claims • We inspected external data, including market announcements, analyst reports and financial reports, to assess the recoverability of amounts due from contractors and whether there is a need for a reserve to reflect any credit default risk. We performed full scope audit procedures over this risk area in one location, which covered 100% of the risk amount.	For the Manchester contract, we concluded that the accounting treatment applied and judgements made by management, particularly relating to the allocation of income and timing of revenue recognition was appropriate. In relation to the Glasgow contract, we concluded that the accounting position taken by management, including the recoverability of amounts due from contractors, is appropriate and is based on supporting legal and financial analysis.

In the prior year, our auditor's report included a key audit matter in relation to completeness of provisions for uncertain tax positions and related tax disclosures. We reported that the Group had reached resolution with HMRC on a number of areas, reducing the level of uncertainty over the year end tax liability and the risk of material misstatement. In the current year we concluded this is not a key audit matter.

In the prior year, our auditor's report also included a key audit matter in relation to valuation of Viridor's non-current assets. In the current year, we concluded the likelihood of material misstatement has reduced as a further year of experience has provided management with more confidence that the financial performance in the business plan, which supports the carrying value, will be achieved. There are no indicators of impairment.

An overview of the scope of our audit

Tailoring the scope

Our assessment of audit risk, our evaluation of materiality and our allocation of performance materiality determine our audit scope for each entity within the Group. Taken together, this enables us to form an opinion on the consolidated financial statements. We take into account size, risk profile, the organisation of the group and effectiveness of group-wide controls, changes in the business environment and other factors such as recent Internal audit results when assessing the level of work to be performed at each entity.

In assessing the risk of material misstatement to the Group financial statements, and to ensure we had adequate quantitative coverage of significant accounts in the financial statements, of the six reporting components of the Group, we selected four components covering Pennon Group plc, Viridor, South West Water and Pennon Water Services, which represent the principal business units within the Group.

Of the four components selected, we performed an audit of the complete financial information of three components ("full scope components") which were selected based on their size or risk characteristics. For the remaining one component ("specific scope component"), we performed audit procedures on specific accounts within that component that we considered had the potential for the greatest impact on the significant accounts in the financial statements either because of the size of these accounts or their risk profile.

The reporting components where we performed audit procedures accounted for 100% (2017: 100%) of the Group's Profit before taxation before non-underlying items, 100% (2017: 100%) of the Group's Revenue and 95% (2017: 95%) of the Group's Total assets. For the current year, the full scope components contributed 100% (2017: 100%) of the Group's Profit before taxation before non-underlying items, 88% (2017: 100%) of the Group's Revenue and 94% (2017: 95%) of the Group's Total assets. The specific scope component contributed 0.4% (2017: 0%) of the Group's Profit before taxation before non-underlying items, 12% (2017: 0%) of the Group's Revenue and 1% (2017: 0%) of the Group's Total assets. The audit scope of these components may not have included testing of all significant accounts of the component but will have contributed to the coverage of significant accounts tested for the Group.

Of the remaining two components that together represent less than 1% of the Group's profit before taxation before non-underlying items, none are individually greater than 1% of the Group's profit before taxation before non-underlying items. For these components, we performed other procedures, including analytical review procedures, testing of consolidation journals and intercompany eliminations to respond to any potential risks of material misstatement to the Group financial statements.

Changes from the prior year

There was one change in scope from the prior year. Pennon Water Services, a new business unit, was designated as a specific scope component for the current year audit.

Involvement with component teams

In establishing our overall approach to the Group audit, we determined the type of work that needed to be undertaken at each of the components by us, as the primary audit engagement team, or by component auditors operating under our instruction. There are three key locations where we perform audit procedures for the Group and its components, being Exeter, Taunton and Bournemouth. The Pennon Group plc and South West Water accounting functions are based in Exeter and the audit teams of these components are led by the Senior Statutory Auditor. Separate teams audit full scope component, Viridor, in Taunton, and specific scope component, Pennon Water Services, in Bournemouth. Where the work was performed by component auditors, we determined the appropriate level of involvement to enable us to determine that sufficient audit evidence had been obtained as a basis for our opinion on the Group as a whole.

The primary team interacted regularly with the component teams where appropriate during various stages of the audit, reviewed key audit working papers on risk areas, attended key meetings with local management and were responsible for the scope and direction of the audit process. This, together with the additional procedures performed at Group level, gave us appropriate evidence for our opinion on the Group financial statements.

Our application of materiality

We apply the concept of materiality in planning and performing the audit, in evaluating the effect of identified misstatements on the audit and in forming our audit opinion.

Materiality

The magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures.

We determined materiality for the Group to be £12.9 million (2017: £12.5 million), which is 5% (2017: 5%) of profit before taxation before non-underlying items. We believe that profit before taxation before non-underlying items provides us with an appropriate measure of the underlying performance of the Group. We excluded non-underlying items on the basis that profit before taxation after non-underlying items is not indicative of the underlying performance of the Group. We also note that market and analyst commentary on the performance of the Group uses the same measure. We therefore, considered profit before taxation before non-underlying items to be the most relevant performance metric on which to base our materiality calculation.

We determined materiality for the Parent Company to be £7.3 million (2017: £7.1 million), which is 75% (2017: 75%) of Group performance materiality.

Starting basis	Reported profit before taxation £262.9 million (2017: £210.5 million).
Adjustments	Non-underlying items – increase basis by £4.1 million (2017: £39.5 million).
Materiality	Totals £258.8 million (2017: £250.0 million) profit before taxation before non-underlying items. Materiality of £12.9 million (5% of profit before taxation before non-underlying items).

Performance materiality

The application of materiality at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.

On the basis of our risk assessments, together with our assessment of the Group's overall control environment, our judgement was that performance materiality was 75% (2017: 75%) of our planning materiality, namely £9.7m (2017: £9.4m). We have set performance materiality at this percentage based on our assessment of the Group's internal control environment and the extent and nature of audit findings identified in the prior period. This basis is consistent with the prior year.

Independent auditor's report to the members of Pennon Group plc
continued

Audit work at component locations for the purpose of obtaining audit coverage over significant financial statement accounts is undertaken based on a percentage of total performance materiality. The performance materiality set for each component is based on the relative scale and risk of the component to the Group as a whole and our assessment of the risk of misstatement at that component. In the current year, the range of performance materiality allocated to components was £2.9m to £9.0m (2017: £4.4m to £8.4m).

Reporting threshold
An amount below which identified misstatements are considered as being clearly trivial.

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £0.7m (2017: £0.6m), which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

Other information

The other information comprises the information included in the annual report set out on pages 1 to 101, other than the financial statements and our auditor's report thereon. The directors are responsible for the other information.

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

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

In this context, we also have nothing to report in regard to our responsibility to specifically address the following items in the other information and to report as uncorrected material misstatements of the other information where we conclude that those items meet the following conditions:

- **Fair, balanced and understandable set out on page 101** – the statement given by the directors that they consider the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the group's performance, business model and strategy, is materially inconsistent with our knowledge obtained in the audit; or
- **Audit committee reporting set out on pages 73 to 76** – the section describing the work of the audit committee does not appropriately address matters communicated by us to the audit committee; or
- **Directors' statement of compliance with the UK Corporate Governance Code set out on page 6** – the parts of the directors' statement required under the Listing Rules relating to the company's compliance with the UK Corporate Governance Code containing provisions specified for review by the auditor in accordance with Listing Rule 9.8.10R(2) do not properly disclose a departure from a relevant provision of the UK Corporate Governance Code.

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, the part of the directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006.

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

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements and those reports have been prepared in accordance with applicable legal requirements;
- the information about internal control and risk management systems in relation to financial reporting processes and about share capital structures, given in compliance with rules 7.2.5 and 7.2.6 in the Disclosure Rules and Transparency Rules sourcebook made by the Financial Conduct Authority (the FCA Rules), is consistent with the financial statements and has been prepared in accordance with applicable legal requirements; and
- information about the company's corporate governance code and practices and about its administrative, management and supervisory bodies and their committees complies with rules 7.2.2, 7.2.3 and 7.2.7 of the FCA Rules.

Matters on which we are required to report by exception

In the light of the knowledge and understanding of the group and the parent company and its environment obtained in the course of the audit, we have not identified material misstatements in:

- the strategic report or the directors' report; or
- the information about internal control and risk management systems in relation to financial reporting processes and about share capital structures, given in compliance with rules 7.2.5 and 7.2.6 of the FCA Rules.

We have nothing to report in respect of the following matters in relation to which the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit
- a Corporate Governance Statement has not been prepared by the company.

Responsibilities of directors

As explained more fully in the directors' responsibilities statement set out on page 101, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the group and parent 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 parent company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

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

Explanation as to what extent the audit was considered capable of detecting irregularities, including fraud

The objectives of our audit, in respect to fraud, are; to identify and assess the risks of material misstatement of the financial statements due to fraud; to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and to respond appropriately to fraud or suspected fraud identified during the audit. However, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management.

Our approach was as follows:

- We obtained an understanding of the legal and regulatory frameworks that are applicable to the group and determined that the most significant are:
  - Companies Act 2006
  - Financial Reporting Council (FRC) and the UK Corporate Governance Code
  - Tax legislation (governed by HM Revenue & Customs)
  - Health and Safety legislation
  - Environment Agency environmental permits
  - Ofwat regulations
  - UK listing rules
- We understood how Pennon Group plc is complying with those frameworks by reading internal policies and codes of conduct and assessing the entity level control environment, including the level of oversight of those charged with governance. We made enquiries of the Group's legal counsel, regulatory team and internal audit of known instances of non-compliance or suspected non-compliance with laws and regulations. We corroborated our enquiries through review of correspondence with regulatory bodies. We designed our audit procedures to identify non-compliance with such laws and regulations identified in the paragraph above. As well as enquiry and attendance at meetings, our procedures involved a review of the reporting to the above committees and a review of board meetings and other committee minutes to identify any non-compliance with laws and regulations. Our procedures also involved journal entry testing, with a focus on journals meeting our defined risk criteria based on our understanding of the business.
- We assessed the susceptibility of the group's financial statements to material misstatement, including how fraud might occur by making enquiries of senior management, including the Chief Executive Officer, Chief Financial Officer, Head of Internal Audit and Audit Committee Chairman. We planned our audit to identify risks of management override, tested higher risk journal entries and performed audit procedures to address the potential for management bias, particularly over areas involving significant estimation and judgement Further discussion of our approach to address the identified risks of management override are set out in the key audit matters section of our report.
- Based on this understanding we designed our audit procedures to identify non-compliance with such laws and regulations. Our procedures involved making enquiries of key management and legal counsel, reviewing key policies, inspecting legal registers and correspondence with regulators and reading key management meeting minutes. We also completed procedures to conclude on the compliance of significant disclosures in the Annual Report and Accounts with the requirements of the relevant accounting standards, UK legislation and the UK Corporate Governance Code.
- We communicated regularly with the component teams and attended key meetings with the component teams, management and legal counsel in order to identify and communicate any instances of non compliance with laws and regulations.
- The Group operates in the water and waste sectors which are highly regulated environments. As such the Senior Statutory Auditor reviewed the experience and expertise of the engagement team to ensure that the team had the appropriate competence and capabilities, which included the use of an expert where appropriate.

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

Other matters we are required to address

- We were appointed by the company at its annual general meeting on 31 July 2014 to audit the financial statements for the year ending 31 March 2015 and subsequent financial periods.
- The period of total uninterrupted engagement including previous renewals and reappointments is 4 years, covering the years ending 31 March 2015 to 31 March 2018.
- The non-audit services prohibited by the FRC's Ethical Standard were not provided to the group or the parent company and we remain independent of the group and the parent company in conducting the audit.
- The audit opinion is consistent with the additional report to the audit committee.

Debbie O'Hanlon
Senior statutory auditor
for and on behalf of Ernst & Young LLP, Statutory Auditor
Reading

24 May 2018

Notes:

(1) The maintenance and integrity of the Pennon Group plc web site is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site.

(2) Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Consolidated income statement
For the year ended 31 March 2018

	Notes	Before non-underlying items 2018 £m	Non-underlying items (note 6) 2018 £m	Total 2018 £m	Before non-underlying items 2017 £m	Non-underlying items (note 6) 2017 £m	Total 2017 £m
Revenue	5	**1,393.0**	**3.2**	**1,396.2**	1,353.1	–	1,353.1
Operating costs	7						
Employment costs		**(192.9)**	**–**	**(192.9)**	(179.7)	(1.1)	(180.8)
Raw materials and consumables used		**(108.7)**	**–**	**(108.7)**	(115.8)	–	(115.8)
Other operating expenses		**(581.8)**	**–**	**(581.8)**	(571.6)	(9.6)	(581.2)
Earnings before interest, tax, depreciation and amortisation	5	**509.6**	**3.2**	**512.8**	486.0	(10.7)	475.3
Depreciation and amortisation	7	**(185.7)**	**–**	**(185.7)**	(181.4)	–	(181.4)
Operating profit	5	**323.9**	**3.2**	**327.1**	304.6	(10.7)	293.9
Finance income	8	**24.2**	**–**	**24.2**	36.3	16.0	52.3
Finance costs	8	**(98.7)**	**(21.6)**	**(120.3)**	(95.1)	(44.8)	(139.9)
Net finance costs	8	**(74.5)**	**(21.6)**	**(96.1)**	(58.8)	(28.8)	(87.6)
Share of post-tax profit from joint ventures	20	**9.4**	**22.5**	**31.9**	4.2	–	4.2
Profit before tax	5	**258.8**	**4.1**	**262.9**	250.0	(39.5)	210.5
Taxation (charge)/credit	9	**(44.4)**	**3.4**	**(41.0)**	(58.4)	28.4	(30.0)
Profit for the year		**214.4**	**7.5**	**221.9**	191.6	(11.1)	180.5
Attributable to:							
Ordinary shareholders of the parent		**193.1**	**7.5**	**200.6**	175.4	(11.1)	164.3
Non-controlling interests		**(0.2)**	**–**	**(0.2)**	–	–	–
Perpetual capital security holders		**21.5**	**–**	**21.5**	16.2	–	16.2
Earnings per ordinary share (pence per share)	11						
– Basic				**48.0**			39.8
– Diluted				**47.8**			39.6

Consolidated statement of comprehensive income
For the year ended 31 March 2018

	Notes	Before non-underlying items 2018 £m	Non-underlying items (note 6) 2018 £m	Total 2018 £m	Before non-underlying items 2017 £m	Non-underlying items (note 6) 2017 £m	Total 2017 £m
Profit for the year		**214.4**	**7.5**	**221.9**	191.6	(11.1)	180.5
Other comprehensive (loss)/ income							
Items that will not be reclassified to profit or loss							
Remeasurement of defined benefit obligations	30	**24.5**	**–**	**24.5**	(23.6)	–	(23.6)
Income tax on items that will not be reclassified	9, 31	**(4.2)**	**–**	**(4.2)**	4.7	(1.4)	3.3
Total items that will not be reclassified to profit or loss		**20.3**	**–**	**20.3**	(18.9)	(1.4)	(20.3)
Items that may be reclassified subsequently to profit or loss							
Share of other comprehensive (loss)/income from joint ventures	20	**(2.7)**	**–**	**(2.7)**	0.3	–	0.3
Cash flow hedges		**20.5**	**–**	**20.5**	4.9	–	4.9
Income tax on items that may be reclassified	9, 31	**(3.5)**	**–**	**(3.5)**	(1.0)	(0.3)	(1.3)
Total items that may be reclassified subsequently to profit or loss		**14.3**	**–**	**14.3**	4.2	(0.3)	3.9
Other comprehensive income/(loss) for the year net of tax	36	**34.6**	**–**	**34.6**	(14.7)	(1.7)	(16.4)
Total comprehensive income for the year		**249.0**	**7.5**	**256.5**	176.9	(12.8)	164.1
Total comprehensive income attributable to:							
Ordinary shareholders of the parent		**227.7**	**7.5**	**235.2**	160.7	(12.8)	147.9
Non-controlling interests		**(0.2)**	**–**	**(0.2)**	–	–	–
Perpetual capital security holders		**21.5**	**–**	**21.5**	16.2	–	16.2

The notes on pages 119 to 168 form part of these financial statements.

Balance sheets
At 31 March 2018

		Group		Company	
	Notes	**2018 £m**	2017 £m	**2018 £m**	2017 £m
Assets					
Non-current assets					
Goodwill	15	**385.0**	385.0	**–**	–
Other intangible assets	16	**72.6**	67.1	**–**	–
Property, plant and equipment	17	**4,310.6**	4,103.2	**0.2**	0.2
Other non-current assets	19	**263.5**	308.0	**846.0**	1,011.6
Deferred tax assets	31	**–**	–	**1.6**	2.3
Derivative financial instruments	23	**70.5**	73.6	**4.2**	3.1
Investments in subsidiary undertakings	20	**–**	–	**1,980.8**	1,624.2
Investments in joint ventures	20	**22.8**	0.1	**–**	–
		5,125.0	4,937.0	**2,832.8**	2,641.4
Current assets					
Inventories	21	**24.6**	21.3	**–**	–
Trade and other receivables	22	**416.0**	340.8	**42.7**	127.3
Derivative financial instruments	23	**12.9**	14.1	**6.4**	1.1
Cash and cash deposits	25	**585.3**	598.1	**303.3**	372.5
		1,038.8	974.3	**352.4**	500.9
Liabilities					
Current liabilities					
Borrowings	28	**(209.8)**	(146.5)	**(433.2)**	(357.8)
Financial liabilities at fair value through profit	24	**(2.6)**	(2.4)	**(0.4)**	–
Derivative financial instruments	23	**(9.4)**	(17.3)	**(2.7)**	(2.1)
Trade and other payables	26	**(342.0)**	(286.5)	**(57.1)**	(6.3)
Current tax liabilities	27	**(24.4)**	(26.8)	**(23.9)**	(37.9)
Provisions	32	**(38.0)**	(40.4)	**–**	–
		(626.2)	(519.9)	**(517.3)**	(404.1)
Net current assets		**412.6**	454.4	**(164.9)**	96.8
Non-current liabilities					
Borrowings	28	**(3,177.0)**	(3,116.5)	**(711.7)**	(848.2)
Other non-current liabilities	29	**(140.1)**	(180.7)	**(8.7)**	(53.0)
Financial liabilities at fair value through profit	24	**(46.6)**	(48.4)	**(1.7)**	(1.4)
Derivative financial instruments	23	**(8.2)**	(25.2)	**(0.9)**	(1.3)
Retirement benefit obligations	30	**(49.5)**	(68.0)	**(3.3)**	(4.1)
Deferred tax liabilities	31	**(295.6)**	(269.6)	**–**	–
Provisions	32	**(181.5)**	(173.8)	**–**	–
		(3,898.5)	(3,882.2)	**(726.3)**	(908.0)
Net assets		**1,639.1**	1,509.2	**1,941.6**	1,830.2
Shareholders' Equity					
Share capital	33	**170.8**	168.4	**170.8**	168.4
Share premium account	34	**218.8**	217.4	**218.8**	217.4
Capital redemption reserve	35	**144.2**	144.2	**144.2**	144.2
Retained earnings and other reserves	36	**807.1**	684.4	**1,111.1**	1,005.4
Total shareholders' equity		**1,340.9**	1,214.4	**1,644.9**	1,535.4
Non-controlling interests		**1.5**	–	**–**	–
Perpetual capital securities	37	**296.7**	294.8	**296.7**	294.8
Total equity		**1,639.1**	1,509.2	**1,941.6**	1,830.2

The profit for the year attributable to ordinary shareholders' equity dealt within the accounts of the parent Company is £215.1 million (2017 £162.9 million).

The notes on pages 119 to 168 form part of these financial statements.
The financial statements on pages 114 to 168 were approved by the Board of Directors and authorised for issue on 24 May 2018 and were signed on its behalf by:

Chris Loughlin, Chief Executive Officer Pennon Group plc

Registered Office: Peninsula House, Rydon Lane, Exeter, Devon, England EX2 7HR. Registered in England Number 2366640.

Statements of changes in equity
For the year ended 31 March 2018

	Share capital (note 33) £m	Share premium account (note 34) £m	Capital redemption reserve (note 35) £m	Retained earnings and other reserves (note 36) £m	Non-controlling interests £m	Perpetual capital securities (note 37) £m	Total equity £m
Group							
At 1 April 2016	167.8	213.3	144.2	667.5	–	294.8	1,487.6
Profit for the year	–	–	–	164.3	–	16.2	180.5
Other comprehensive loss for the year	–	–	–	(16.4)	–	–	(16.4)
Total comprehensive income for the year	–	–	–	147.9	–	16.2	164.1
Transactions with equity shareholders:							
Dividends paid	–	–	–	(138.5)	–	–	(138.5)
Adjustment for shares issued under the Scrip Dividend Alternative	0.3	(0.3)	–	6.9	–	–	6.9
Adjustment in respect of share-based payments (net of tax)	–	–	–	3.2	–	–	3.2
Distributions to perpetual capital security holders	–	–	–	–	–	(20.3)	(20.3)
Current tax relief on distributions to perpetual capital security holders	–	–	–	–	–	4.1	4.1
Own shares acquired by the Pennon Employee Share Trust in respect of share options granted	0.1	1.2	–	(2.6)	–	–	(1.3)
Proceeds from shares issued under the Executive Share Option Scheme	–	0.2	–	–	–	–	0.2
Proceeds from shares issued under the Sharesave Scheme	0.2	3.0	–	–	–	–	3.2
Total transactions with equity shareholders	0.6	4.1	–	(131.0)	–	(16.2)	(142.5)
At 31 March 2017	168.4	217.4	144.2	684.4	–	294.8	1,509.2
Profit for the year	–	–	–	200.6	(0.2)	21.5	221.9
Other comprehensive income for the year	–	–	–	34.6	–	–	34.6
Total comprehensive income for the year	–	–	–	235.2	(0.2)	21.5	256.5
Transactions with equity shareholders:							
Dividends paid	–	–	–	(149.5)	–	–	(149.5)
Adjustment for shares issued under the Scrip Dividend Alternative	2.1	(2.1)	–	41.7	–	–	41.7
Adjustment in respect of share-based payments (net of tax)	–	–	–	2.2	–	–	2.2
Issuance of perpetual capital securities	–	–	–	–	–	296.7	296.7
Redemption of perpetual capital securities	–	–	–	(5.2)	–	(294.8)	(300.0)
Distributions to perpetual capital security holders	–	–	–	–	–	(25.3)	(25.3)
Current tax relief on distributions to perpetual capital security holders	–	–	–	–	–	3.8	3.8
Own shares acquired by the Pennon Employee Share Trust in respect of share options granted	0.1	0.4	–	(1.7)	–	–	(1.2)
Proceeds from shares issued under the Executive Share Option Scheme	–	–	–	–	–	–	–
Proceeds from shares issued under the Sharesave Scheme	0.2	3.1	–	–	–	–	3.3
Non-controlling interests	–	–	–	–	1.7	–	1.7
Total transactions with equity shareholders	2.4	1.4	–	(112.5)	1.7	(19.6)	(126.6)
At 31 March 2018	**170.8**	**218.8**	**144.2**	**807.1**	**1.5**	**296.7**	**1,639.1**

The notes on pages 119 to 168 form part of these financial statements.

	Share capital (note 33) £m	Share premium account (note 34) £m	Capital redemption reserve (note 35) £m	Retained earnings and other reserves (note 36) £m	Perpetual capital securities (note 37) £m	Total equity £m
Company						
At 1 April 2016	167.8	213.3	144.2	976.1	294.8	1,796.2
Profit for the year (note 10)	–	–	–	162.9	16.2	179.1
Other comprehensive loss for the year	–	–	–	(1.1)	–	(1.1)
Total comprehensive income for the year	–	–	–	161.8	16.2	178.0
Transactions with equity shareholders:						
Dividends paid	–	–	–	(138.5)	–	(138.5)
Adjustment for shares issued under the Scrip Dividend Alternative	0.3	(0.3)	–	6.9	–	6.9
Distributions to perpetual capital security holders	–	–	–	–	(20.3)	(20.3)
Current tax relief on distributions to perpetual capital security holders	–	–	–	–	4.1	4.1
Adjustment in respect of share-based payments (net of tax)	–	–	–	1.2	–	1.2
Charge in respect of share options vesting	–	–	–	(2.1)	–	(2.1)
Own shares acquired by the Pennon Employee Share Trust in respect of share options granted	–	0.2	–	–	–	0.2
Proceeds from shares issued under the Executive Share Option Scheme	0.1	1.2	–	–	–	1.3
Proceeds from shares issued under the Sharesave Scheme	0.2	3.0	–	–	–	3.2
Total transactions with equity shareholders	0.6	4.1	–	(132.5)	(16.2)	(144.0)
At 31 March 2017	168.4	217.4	144.2	1,005.4	294.8	1,830.2
Profit for the year (note 10)	–	–	–	215.1	21.5	236.6
Other comprehensive income for the year	–	–	–	3.6	–	3.6
Total comprehensive income for the year	–	–	–	218.7	21.5	240.2
Transactions with equity shareholders:						
Dividends paid				(149.5)	–	(149.5)
Adjustment for shares issued under the Scrip Dividend Alternative	2.1	(2.1)	–	41.7	–	41.7
Issuance of perpetual capital securities	–	–	–	–	296.7	296.7
Redemption of perpetual capital securities	–	–	–	(5.2)	(294.8)	(300.0)
Distributions to perpetual capital security holders	–	–	–	–	(25.3)	(25.3)
Current tax relief on distributions to perpetual capital security holders	–	–	–	–	3.8	3.8
Adjustment in respect of share-based payments (net of tax)	–	–	–	0.8	–	0.8
Own shares acquired by the Pennon Employee Share Trust in respect of share options granted	0.1	0.4	–	(0.8)	–	(0.3)
Proceeds from shares issued under the Executive Share Option Scheme	–	–	–	–	–	–
Proceeds from shares issued under the Sharesave Scheme	0.2	3.1	–	–	–	3.3
Total transactions with equity shareholders	2.4	1.4	–	(113.0)	(19.6)	(128.8)
At 31 March 2018	**170.8**	**218.8**	**144.2**	**1,111.1**	**296.7**	**1,941.6**

The notes on pages 119 to 168 form part of these financial statements.

Cash flow statements
For the year ended 31 March 2018

		Group		Company	
	Notes	**2018 £m**	2017 £m	**2018 £m**	2017 £m
Cash flows from operating activities					
Cash generated/(outflow) from operations	38	**443.5**	431.5	**249.4**	(159.0)
Interest paid	38	**(69.6)**	(76.4)	**(32.5)**	(39.1)
Tax (paid)/received		**(21.7)**	(36.4)	**17.9**	(8.4)
Net cash generated/(outflow) from operating activities		**352.2**	318.7	**234.8**	(206.5)
Cash flows from investing activities					
Interest received		**8.3**	14.5	**41.2**	49.6
Dividends received	45	**6.5**	4.5	**202.3**	247.0
Investments in subsidiary undertakings		**–**	–	**(356.6)**	–
Loan repayments received from joint ventures		**33.3**	0.3	**–**	–
Return of restricted deposits		**42.3**	–	**–**	–
Purchase of property, plant and equipment		**(390.6)**	(354.1)	**(0.2)**	(0.2)
Purchase of intangible assets		**(1.0)**	–	**–**	–
Acquisition of subsidiary undertakings	44	**(8.4)**	–	**–**	–
Proceeds from sale of property, plant and equipment		**10.6**	4.1	**–**	0.1
Net cash (used in)/received from investing activities		**(299.0)**	(330.7)	**(113.3)**	296.5
Cash flows from financing activities					
Proceeds from issuance of ordinary shares		**3.9**	4.7	**3.9**	4.7
Proceeds from the issuance of perpetual capital securities		**296.7**	–	**296.7**	–
Redemption of 2013 perpetual capital securities		**(300.0)**	–	**(300.0)**	–
Purchase of ordinary shares by the Pennon Employee Share Trust		**(1.8)**	(2.6)	**–**	–
Return of restricted funds		**–**	2.7	**–**	9.7
Proceeds from new borrowing		**106.9**	130.0	**–**	–
Repayment of borrowings		**(116.0)**	(39.0)	**(63.9)**	–
Finance lease sale and lease back		**140.1**	60.7	**–**	–
Finance lease principal repayments		**(28.6)**	(24.0)	**–**	–
Disposal of non-controlling interest	44	**1.7**	–	**–**	–
Dividends paid		**(107.8)**	(131.6)	**(107.8)**	(131.6)
Perpetual capital securities periodic return	37	**(19.6)**	(20.3)	**(19.6)**	(20.3)
Net cash used in financing activities		**(24.5)**	(19.4)	**(190.7)**	(137.5)
Net increase/(decrease) in cash and cash equivalents		**28.7**	(31.4)	**(69.2)**	(47.5)
Cash and cash equivalents at beginning of the year	25	**374.3**	405.7	**372.5**	420.0
Cash and cash equivalents at end of the year	25	**403.0**	374.3	**303.3**	372.5

The notes on pages 119 to 168 form part of these financial statements.

Notes to the financial statements

1. General information

Pennon Group plc is a company registered in the United Kingdom under the Companies Act 2006. The address of the registered office is given on page 115. Pennon Group's business is operated through two main subsidiaries. South West Water Limited includes the merged water companies of South West Water and Bournemouth Water, providing water and wastewater services in Devon, Cornwall and parts of Dorset and Somerset and water only services in parts of Dorset, Hampshire and Wiltshire. Viridor Limited's business is recycling, energy recovery and waste management. Pennon Group is also the majority shareholder of Pennon Water Services Limited, a company providing water and wastewater retail services to non-household customer accounts across Great Britain.

2. Principal accounting policies

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to the years presented.

(a) Basis of preparation

These financial statements have been prepared on the historical cost accounting basis (except for fair value items, principally acquisitions, transfers of assets from customers and certain financial instruments as described in accounting policy notes (b), (w) and (o) respectively) and in accordance with International Financial Reporting Standards (IFRS) and interpretations of the IFRS Interpretations Committee as adopted by the European Union, and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS. A summary of the principal accounting policies is set out below, together with an explanation where changes have been made to previous policies on the adoption of new accounting standards and interpretations in the year.

The going concern basis has been adopted in preparing these financial statements as stated by the Directors on page 104.

The new standards or interpretations which were mandatory for the first time in the year beginning 1 April 2017 did not have a material impact on the net assets or results of the Group.

- IFRS 15 'Revenue from contracts with customers' relates to revenue recognition and establishes principles for reporting useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. The standard will replace IAS 18 'Revenue' and IAS 11 'Construction contracts' and related interpretations. The standard is effective for annual periods beginning on or after 1 January 2018.

  The Directors anticipate that the adoption of IFRS 15 on 1 April 2018 will not materially impact reported revenues or net assets. It is anticipated that additional information on the analysis of contract assets and contract liabilities will be disclosed.
- IFRS 16 'Leases' no longer distinguishes between an on the balance sheet finance lease and an off the balance sheet operating lease. Instead, for virtually all lease contracts, the lessee recognises a lease liability reflecting future lease payments and a 'right-of-use' asset. The standard is effective for annual periods beginning on or after 1 January 2019.

  The Directors anticipate that the adoption of IFRS 16 on 1 April 2019 will affect primarily the accounting for the Group's operating leases. As at the reporting date, the Group has non-cancellable operating lease commitments of £163 million, see note 41. These predominantly relate to leases of properties occupied by the Group in the course of carrying out its businesses. If the standard had been adopted in the current year (assuming application of the modified retrospective transitional approach permitted by the standard) it is estimated this would have resulted in the Group recognising an asset in use and corresponding lease liability figure in the region of £115 million. This would have resulted in a minimal impact on profit before tax but an estimated increase of around £7 million EBITDA which would be replaced by increased charges for depreciation and finance costs. These impacts are not considered to be material to the Group's net assets or results. Existing borrowing covenants are not impacted by changes in accounting standards.

Other new standards or interpretations in issue, but not yet effective, including IFRS 9 'Financial instruments' are not expected to have a material impact on the Group's net assets or results.

(b) Basis of consolidation

The Group financial statements include the results of Pennon Group plc and its subsidiaries, joint ventures and associate undertakings.

The results of subsidiaries, joint ventures and associate undertakings are included from the date of acquisition or incorporation, and excluded from the date of disposal. The results of subsidiaries are consolidated where the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The results of joint ventures and associate undertakings are accounted for on an equity basis.

Intra-group trading, loan balances and transactions are eliminated on consolidation.

The acquisition method of accounting is used to account for the purchase of subsidiaries. The excess of the value transferred to the seller in return for control of the acquired business, together with the fair value of any previously held equity interest in that business over the Group's share of the fair value of the identifiable net assets, is recorded as goodwill.

Notes to the financial statements
continued

2. Principal accounting policies continued

(c) Revenue recognition

Revenue represents the fair value of consideration receivable in the ordinary course of business for the provision of goods and services to customers, and is recognised to the extent that it can be reliably measured and that it is probable that economic benefits will flow to the Group.

Revenue excludes value added tax, trade discounts and revenue arising from transactions between Group companies. Revenue includes landfill tax.

In respect of ongoing, continuous services to customers, such as the provision of drinking water and wastewater services, revenue is recognised in line with customer usage of those services. Where applicable, this includes both billed amounts for estimated usage and an estimation of the amount of unbilled usage at the period end.

Revenue in respect of construction services on long-term contracts, including the provision of service concession arrangements, is recognised based on the fair value of work performed during the year with reference to the total sales value and the stage of completion of those services.

Where a contract with a customer includes more than one service, such as a long-term service concession arrangement, revenue for each service is recognised in proportion to a fair value assessment of the total contract value split across the services provided.

Revenue in respect of goods, such as recyclate, is recognised when the significant risks and rewards of ownership have been transferred to the customer. For other services, encompassing waste management services, revenue is recognised once the services have been provided to the customer.

Revenue from the sale of electricity from our generating assets is measured based upon metered output delivered at rates specified under contract terms or prevailing market rates as applicable.

Payments received in advance of services provided are held within liabilities.

(d) Landfill tax

Landfill tax is recognised in both revenue and operating costs at the point waste is disposed of at a licensed landfill site.

(e) Segmental reporting

Each of the Group's business segments provides services which are subject to risks and returns which are different from those of the other business segments. The Group's internal organisation and management structure and its system of internal financial reporting are based primarily on business segments. The water business comprises the regulated water and wastewater services undertaken by South West Water. The waste management business is the recycling, energy recovery and waste management services provided by Viridor. The non-household retail business is a new segment created this period reflecting the services provided by Pennon Water Services following the opening of the non-household water and wastewater retail market to competition on 1 April 2017. Segmental revenue and results include transactions between businesses. Inter-segmental transactions are eliminated on consolidation.

(f) Goodwill

Goodwill arising on consolidation from the acquisition of subsidiary undertakings represents the excess of the purchase consideration over the fair value of net assets acquired, less any subsequent impairment charges.

Goodwill is recognised as an asset and reviewed for impairment at least annually. Any impairment is recognised immediately in the income statement and is not subsequently reversed. For the purpose of impairment testing, goodwill acquired in a business combination is allocated to each of the cash generating units or group of cash generating units, that is expected to benefit from the synergies of the combination. Each unit or group of units to which goodwill is allocated represents the lowest level within the entity at which the goodwill is monitored for internal reporting purposes. Goodwill is allocated and monitored at the reportable operating segment level. Further details are contained in accounting policy (j).

When a subsidiary undertaking is sold, the profit or loss on disposal is determined after including the attributable amount of unamortised goodwill.

(g) Other intangible assets

Other intangible assets are recognised in relation to long-term service concessions contracts to the extent that future amounts to be received are not contracted.

Other intangible assets include assets acquired in a business combination and are capitalised at fair value at the date of acquisition. Following initial recognition, finite life intangible assets are amortised on a straight-line basis over their estimated useful lives, with the expense charged to the income statement through operating costs.

(h) Property, plant and equipment

i) Infrastructure assets (being water mains and sewers, impounding and pumped raw water storage reservoirs, dams, pipelines and sea outfalls)

Infrastructure assets were included at fair value on transition to IFRS, and subsequent additions are recorded at cost less accumulated depreciation and impairment charges. Expenditure to increase capacity or enhance infrastructure assets is capitalised where it can be reliably measured, and it is probable that incremental future economic benefits will flow to the Group. The cost of day-to-day servicing of infrastructure components is recognised in the income statement as it arises.

2. Principal accounting policies continued

Infrastructure assets are depreciated evenly over their useful economic lives, and are principally:

Dams and impounding reservoirs	200 years
Water mains	40 – 120 years
Sewers	40 – 120 years

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

ii) Landfill sites
Landfill sites are included within land and buildings at cost less accumulated depreciation. Cost includes acquisition and development expenses. The cost of a landfill site is depreciated to its residual value (which is linked to gas production at the site post-closure) over its estimated operational life taking account of the usage of void space.

iii) Landfill restoration
Where the obligation to restore a landfill site is an integral part of its future economic benefits, a non-current asset within property, plant and equipment is recognised. The asset recognised is depreciated based on the usage of void space.

iv) Other assets (including energy recovery facilities, property, overground plant and equipment)
Other assets are included at cost less accumulated depreciation.

Freehold land is not depreciated. Other assets are depreciated evenly to their residual value over their estimated economic lives, and are principally:

Land and buildings – freehold buildings	30 – 60 years
Land and buildings – leasehold buildings	Over the estimated economic lives or the finance lease period, whichever is the shorter
Operational properties	40 – 80 years
Energy recovery facilities (including major refurbishments)	25 – 40 years
Fixed plant	20 – 40 years
Vehicles, mobile plant and computers	3 – 10 years

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

The cost of assets includes directly attributable labour and overhead costs which are incremental to the Group. Borrowing costs directly attributable to the construction of a qualifying asset (an asset necessarily taking a substantial period of time to be prepared for its intended use) are capitalised as part of the asset. Assets transferred from customers are recognised at fair value as set out in accounting policy (w).

The assets' residual values and useful lives are reviewed annually.

Gains and losses on disposal are determined by comparing sale proceeds with carrying amounts. These are included in the income statement.

(i) Leased assets
Assets held under finance leases are included as property, plant and equipment at the lower of their fair value at commencement or the present value of the minimum lease payments, and are depreciated over their estimated economic lives or the finance lease period, whichever is the shorter. The corresponding liability is recorded as borrowings. The interest element of the rental costs is charged against profits using the actuarial method over the period of the lease. Rental costs arising under operating leases are charged against profits on a straight-line basis over the life of the lease.

(j) Impairment of non-financial assets
Assets with an indefinite useful life are not subject to amortisation and are tested annually for impairment, or whenever events or changes in circumstance indicate that the carrying amount may not be recoverable.

Assets subject to amortisation or depreciation are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

An impairment loss is recognised for the amount by which an asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value, less costs to sell, and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash generating units). Value in use represents the present value of projected future cash flows expected to be derived from a cash generating unit, discounted using a pre-tax discount rate which reflects an assessment of the market cost of capital of the cash generating unit. Impairments are charged to the income statement in the year in which they arise.

Non-financial assets other than goodwill that have been impaired are reviewed for possible reversal of the impairment at each reporting date.

Where a previously impaired asset or cash generating unit's recoverable amount is in excess of its carrying amount, previous impairments are reversed to the carrying value that would have expected to be recognised had the original impairment not occurred.

(k) Investment in subsidiary undertakings
Investments in subsidiary undertakings are initially recorded at cost, being the fair value of the consideration paid. Subsequently investments are reviewed for impairment on an individual basis annually or if events or changes in circumstances indicate that the carrying value may not be fully recoverable.

(l) Investment in joint ventures
Joint ventures are entities over which the Group exercises joint control. Investments in joint ventures are accounted for using the equity method of accounting. Any excess of the cost of acquisition over the Group's share of the fair values of the identifiable net assets of the joint venture at the date of acquisition is recognised as goodwill and is included in the carrying value of the investment in the joint venture.

The carrying value of the Group's investment is adjusted for the Group's share of post-acquisition profits or losses recognised in the income statement and statement of comprehensive income. Losses of a joint venture in excess of the Group's interest are not recognised unless the Group has a legal or constructive obligation to fund those losses.

Notes to the financial statements
continued

2. Principal accounting policies continued

(m) Inventories

Inventories are stated at the lower of cost and net realisable value. The cost of finished goods and work in progress includes raw materials and the cost of bringing stocks to their present location and condition. It excludes borrowing costs. Net realisable value is the estimated selling price less cost to sell.

(n) Cash and cash deposits

Cash and cash deposits comprise cash in hand and short-term deposits held at banks. Bank overdrafts are shown within current borrowings.

(o) Derivatives and other financial instruments

The Group classifies its financial instruments in the following categories:

i) Loans and receivables

All loans and borrowings are initially recognised at fair value, net of transaction costs incurred. Following initial recognition, interest-bearing loans and borrowings are subsequently stated at amortised cost using the effective interest method. Gains and losses are recognised in the income statement when instruments are derecognised or impaired. Premia, discounts and other costs and fees are recognised in the income statement through amortisation.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

ii) Trade receivables

Trade receivables do not carry any interest receivable and are recognised initially at fair value and subsequently at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of trade receivables is established when there is objective evidence that the Group will not be able to collect all amounts due in accordance with the original terms of the receivables.

iii) Trade payables

Trade payables are not interest-bearing and are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

iv) Financial assets arising from service concession arrangements

Where the provision of waste management services is performed through a contract with a public sector entity which controls a significant residual interest in asset infrastructure at the end of the contract, then consideration is treated as contract receivables, split between profit on the construction of assets, operation of the service and the provision of finance which is recognised in notional interest within finance income.

v) Derivative financial instruments and hedging activities

The Group uses derivative financial instruments, principally interest rate swaps, foreign exchange forward contracts and cross-currency interest rate swaps to hedge risks associated with interest rate and exchange rate fluctuations. Derivative instruments are initially recognised at fair value on the date the derivative contract is entered into and subsequently remeasured at fair value for the reported balance sheet.

The Group designates certain hedging derivatives as either:

- a hedge of a highly probable forecast transaction or change in the cash flows of a recognised asset or liability (a cash flow hedge); or
- a hedge of the exposure to change in the fair value of a recognised asset or liability (a fair value hedge).

The gain or loss on remeasurement is recognised in the income statement except for cash flow hedges which meet the conditions for hedge accounting, when the portion of the gain or loss on the hedging instrument which is determined to be an effective hedge is recognised directly in equity, and the ineffective portion in the income statement. The gains or losses deferred in equity in this way are subsequently recognised in the income statement in the same period in which the hedged underlying transaction or firm commitment is recognised in the income statement.

In order to qualify for hedge accounting, the Group is required to document in advance the relationship between the item being hedged and the hedging instrument. The Group is also required to document and demonstrate an assessment of the relationship between the hedged item and the hedging instrument which shows that the hedge will be highly effective on an ongoing basis. This effectiveness testing is reperformed at the end of each reporting period to ensure that the hedge remains highly effective.

Where a non-derivative transaction or series of transactions with the same counterparty has the aggregate effect in substance of a derivative instrument, the transaction or series of transactions shall be recognised as a single derivative instrument at fair value with associated movements recorded in the income statement.

The full fair value of a hedging derivative is apportioned on a straight-line basis between non-current and current assets and liabilities based on the remaining maturity of the hedging derivative.

Derivative financial instruments deemed held for trading, which are not subject to hedge accounting, are classified as a current asset or liability with any change in fair value recognised immediately in the income statement.

The Group uses cross-currency swaps for some of its foreign currency denominated private placement borrowings. The swaps either have the effect of (i) converting variable rate foreign currency borrowings into fixed rate sterling borrowings, (ii) converting fixed rate foreign currency borrowings into fixed rate sterling borrowings, or (iii) converting fixed rate foreign currency borrowings into floating rate sterling borrowings.

vi) Financial instruments at fair value through profit

Financial instruments at fair value through profit reflect the fair value movement of the hedged risk on a hedged item through a fair value hedging relationship. The fair values of these financial instruments are initially recognised on the date the hedging relationship is entered into and thereafter remeasured at each subsequent balance sheet date. The gain or loss on remeasurement for the period is recognised in the income statement.

2. Principal accounting policies continued

(p) Taxation including deferred tax

The tax charge for the year comprises current and deferred tax. Tax is recognised in the income statement, except to the extent that it relates to items recognised in the statement of comprehensive income or directly in equity. In this case the tax is also recognised in the statement of comprehensive income or directly in equity as appropriate.

Current tax is calculated on the basis of tax laws enacted or substantively enacted at the balance sheet date. Management periodically evaluates tax items subject to interpretation and establishes provisions on individual tax items, where in the judgement of management, the position is uncertain.

The Group includes a number of companies, including the parent company, which are part of a tax group for certain aspects of the tax legislation. One of these aspects relates to group relief whereby current tax liabilities can be offset by current tax losses arising in other companies within the same tax group. Payments for group relief are included within the current tax disclosures.

Deferred tax is provided in full on temporary differences between the carrying amount of assets and liabilities in the financial statements and the tax base, except where they arise from initial recognition of an asset or liability in a transaction, other than a business combination, that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred tax assets are recognised only to the extent that it is probable that future taxable profits will be available against which the assets can be realised. Deferred tax is determined using the tax rates enacted or substantively enacted at the balance sheet date, and expected to apply when the deferred tax liability is settled or the deferred tax asset is realised.

(q) Provisions

Provisions are made where there is a present legal or constructive obligation as a result of a past event and it is probable that there will be an outflow of economic benefits to settle this obligation and a reliable estimate of this amount can be made. Where the effect of the time value of money is material the current amount of a provision is the present value of the expenditures expected to be required to settle obligations. The unwinding of the discount to present value is included as notional interest within finance costs.

The Group's policies on specific provisions are:

i) Landfill restoration costs

Provisions for the cost of restoring landfill sites are made when the obligation arises. Where the obligation recognised as a provision gives access to future economic benefits, an asset in property, plant and equipment is recognised. Provisions are otherwise charged against profits based on the usage of void space.

ii) Environmental control and aftercare costs

Environmental control and aftercare costs are incurred during the operational life of each landfill site and for a considerable period thereafter. Provision for all such costs is made over the operational life of the site and charged to the income statement on the basis of the usage of void space at the site. Further provisions required after the operational life of a site are recognised immediately in the income statement.

iii) Underperforming contracts

Where the unavoidable costs of meeting a contract's obligations exceed the economic benefits derived from that contract, the unavoidable costs, less revenue anticipated under the terms of the contract, are recognised as a provision and charged to the income statement. An impairment loss on any assets dedicated to that contract is also recognised as described in accounting policy (j).

(r) Share capital and treasury shares

Ordinary shares are classified as equity.

Where the Company purchases the Company's equity share capital (treasury shares) the consideration paid, including any directly attributable costs, is deducted from equity until the shares are cancelled or reissued. Where such shares are subsequently reissued, any consideration received, net of any directly attributable transaction costs, is included in equity.

The Group balance sheet includes the shares held by the Pennon Employee Share Trust, relating to employee share-based payments, which have not vested at the balance sheet date. These are shown as a deduction from shareholders' equity until such time as they vest.

(s) Dividend distributions

Dividend distributions are recognised as a liability in the financial statements in the period in which the dividends are approved by the Company's shareholders. Interim dividends are recognised when paid; final dividends when approved by shareholders at the Annual General Meeting.

(t) Employee benefits

i) Retirement benefit obligations

The Group operates defined benefit and defined contribution pension schemes.

Defined benefit pension schemes

The liability recognised in the balance sheet in respect of defined benefit pension plans is the present value of the defined benefit obligation at the end of the year less the fair value of plan assets. If the value of a plan's assets exceeds the present value of its obligations, the resulting surplus is only recognised if the Group has an unconditional right to that surplus.

The defined benefit obligation is calculated by independent actuaries who advise on the selection of Directors' best estimates, using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high quality corporate bonds, and that have terms to maturity approximating to the terms of the related pension obligation. The increase in liabilities of the Group's defined benefit pension schemes, expected to arise from employee service in the year, is charged against operating profit.

Changes in benefits granted by the employer are recognised immediately as past service cost in the income statement.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to equity in the statement of comprehensive income in the period in which they arise.

Defined contribution scheme

Costs of the defined contribution pension scheme are charged to the income statement in the year in which they arise. The Group has no further payment obligations once the contributions have been paid.

Notes to the financial statements
continued

2. Principal accounting policies continued

ii) Share-based payment

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

Fair values are calculated using an appropriate pricing model. Non-market-based vesting conditions are adjusted for in assumptions as to the number of shares which are expected to vest.

(u) Pre-contract and development costs

Pre-contract and development costs, including bid costs are expensed as incurred, except where it is probable that the contract will be awarded or the development completed, in which case they are recognised as an asset which is amortised to the income statement over the life of the contract.

(v) Fair values

The fair value of interest rate swaps is based on the market price to transfer the asset or liability at the balance sheet date in an ordinary transaction between market participants.

The fair values of short-term deposits, loans and overdrafts with a maturity of less than one year are assumed to approximate to their book values. In the case of non-current bank loans and other loans, the fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate available to the Group for similar financial instruments.

(w) Transfers of assets from customers

Where an item of property, plant and equipment that must be used to connect customers to the network is received from a customer, or where cash is received from a customer for the acquisition or construction of such an item, that asset is recorded and measured on initial recognition at its fair value. The credit created by the recognition of the asset is recognised in the income statement. The period over which the credit is recognised depends upon the nature of the service provided, as determined by the agreement with the customer. Where the service provided is solely a connection to the network, the credit is recognised at the point of connection. If the agreement does not specify a period, revenue is recognised over a period no longer than the economic life of the transferred asset used to provide the ongoing service.

The fair value of assets on transfer from customers is determined using a cost valuation approach allowing for depreciation.

(x) Foreign exchange

Transactions denominated in foreign currencies are translated at the exchange rate at the date of the transaction. Monetary assets and liabilities denominated in a foreign currency are translated at the closing balance sheet rate. The resulting gain or loss is recognised in the income statement.

(y) Perpetual capital securities

Perpetual capital securities are issued securities that qualify for recognition as equity. Accordingly any periodic returns are accounted for as dividends and recognised directly in equity and as a liability at the time the Company becomes obligated to pay the periodic return. This reflects the nature of the periodic returns and repayment of principal being only made at the Company's discretion. Any associated tax impacts are recognised directly in equity.

(z) Non-underlying items

Non-underlying items are those that in the Directors' view are required to be separately disclosed by virtue of their size, nature or incidence to enable a full understanding of the Group's financial performance.

3. Financial risk management

(a) Financial risk factors

The Group's activities expose it to a variety of financial risks: liquidity risk, market risk (interest rate and foreign currency risk) and credit risk.

The Group's treasury function seeks to ensure that sufficient funding is available to meet foreseeable needs and to maintain reasonable headroom for contingencies, and manages inflation and interest rate risk.

The principal financial risks faced by the Group relate to liquidity, interest rate and credit counterparty risk.

These risks and treasury operations are managed by the Chief Financial Officer in accordance with policies established by the Board. Major transactions are individually approved by the Board. Treasury activities are reported to the Board and are subject to review by internal audit.

Financial instruments are used to raise finance, manage risk, optimise the use of surplus funds and manage overall interest rate performance. The Group does not engage in speculative activity.

i) Liquidity risk

The Group actively maintains a mixture of long-term and short-term committed facilities which are designed to ensure the Group has sufficient available funds for operations and planned expansions equivalent to at least one year's forecast requirements at all times. Details of undrawn committed facilities and short-term facilities are provided in note 28.

Refinancing risk is managed under a Group policy that requires that no more than 20% of Group net borrowings should mature in any financial year.

The Group and Water Business have entered into covenants with lenders. While terms vary, these typically provide for limits on gearing (primarily based on the Water Business's Regulatory Capital Value and Viridor Limited's EBITDA plus interest receivable on service concession arrangements) and interest cover. Existing covenants are not impacted by subsequent changes to accounting standards.

3. Financial risk management continued

Contractual undiscounted cash flows, including interest payments, at the balance sheet date were:

	Due within 1 year £m	Due between 1 and 2 years £m	Due between 2 and 5 years £m	Over 5 years £m	Total £m
Group					
31 March 2018					
Non-derivative financial liabilities					
Borrowings excluding finance lease liabilities	**181.5**	**129.1**	**426.2**	**1,144.9**	**1,881.7**
Interest payments on borrowings	**57.5**	**53.7**	**147.9**	**689.1**	**948.2**
Finance lease liabilities including interest	**52.1**	**87.1**	**223.7**	**2,121.7**	**2,484.6**
Trade and other payables	**342.0**	**–**	**–**	**–**	**342.0**
Guarantees	**185.1**	**–**	**–**	**–**	**185.1**
Derivative financial liabilities					
Derivative contracts – net payments/(receipts)	**4.1**	**2.4**	**(11.3)**	**(71.1)**	**(75.9)**
31 March 2017					
Non-derivative financial liabilities					
Borrowings excluding finance lease liabilities	116.0	181.5	258.5	1,322.7	1,878.7
Interest payments on borrowings	49.5	49.3	131.4	679.5	909.7
Finance lease liabilities including interest	44.3	43.0	202.3	2,021.3	2,310.9
Trade and other payables	286.5	44.3	–	–	330.8
Guarantees	187.5	–	–	–	187.5
Derivative financial liabilities					
Derivative contracts – net payments/(receipts)	8.6	7.0	(4.1)	(74.8)	(63.3)
Company					
31 March 2018					
Non-derivative financial liabilities					
Borrowings excluding intercompany borrowings	**149.6**	**102.1**	**260.6**	**349.0**	**861.3**
Interest payments on borrowings	**31.4**	**27.4**	**69.8**	**76.8**	**205.4**
Trade and other payables	**57.1**	**–**	**–**	**–**	**57.1**
Guarantees	**734.9**	**–**	**–**	**–**	**734.9**
Derivative financial liabilities					
Derivative contracts – net payments	**0.7**	**–**	**–**	**–**	**0.7**
31 March 2017					
Non-derivative financial liabilities					
Borrowings excluding intercompany borrowings	74.9	149.5	148.1	511.5	884.0
Intercompany borrowings	282.9	39.1	–	–	322.0
Interest payments on borrowings	29.2	28.8	70.6	94.0	222.6
Trade and other payables	6.3	44.3	–	–	50.6
Guarantees	743.4	–	–	–	743.4
Derivative financial liabilities					
Derivative contracts – net payments	1.3	1.1	–	–	2.4

No liability is expected to arise in respect of the guarantees noted above. Guarantees are analysed in note 42.

ii) Market risk

The Group has a policy of maintaining at least 50% of interest-bearing liabilities at fixed rates. The Group uses a combination of fixed rate and index-linked borrowings and fixed rate interest swaps as cash flow hedges of future variable interest payments to achieve this policy. At the year-end 62% (2017 69%) of Group net borrowings were at fixed rates (including at least 50% of South West Water's borrowings) after the impact of financial derivatives. The notional principal amounts of the interest rate swaps are used to determine settlement under those swaps and are not therefore an exposure for the Group. These instruments are analysed in note 23.

20% (2017 20%) of the Group's net borrowings are RPI index-linked. The interest rate for index-linked debt is based upon an RPI measure, which is also used in determining the amount of income from customers in South West Water.

The Group has no significant interest-bearing assets upon which the net return fluctuates from market risk. Deposit interest receivable is expected to fluctuate in line with interest payable on floating rate borrowings. Consequently the Group's income and cash generated from operations (note 38) are independent of changes in market interest rates.

For 2018 if interest rates on variable net borrowings had been on average 0.5% higher/lower with all other variables held constant, post-tax profit for the year and equity would have increased/decreased by £1.3 million (2017 £0.3 million), for the equity sensitivity fair value, with derivative impacts excluded.

For 2018 if RPI on index-linked borrowings had been on average 0.5% higher/lower with all other variables held constant, post-tax profit for the year and equity would have decreased/increased by £2.0 million (2017 £1.9 million).

Foreign currency risk occurs at transactional and translation level from borrowings and transactions in foreign currencies. These risks are managed through forward contracts, which provide certainty over foreign currency risk.

Notes to the financial statements
continued

3. Financial risk management continued

iii) Credit risk

Credit counterparty risk arises from cash and cash deposits, derivative financial instruments and exposure to customers, including outstanding receivables. Further information on the credit risk relating to trade receivables is given in notes 19 and 22.

Counterparty risk arises from the investment of surplus funds and from the use of derivative financial instruments. The Board has agreed a policy for managing such risk which is controlled through credit limits, counterparty approvals, and rigorous monitoring procedures.

The Group has no other significant concentration of credit risk. The Group's surplus funds are managed by the Group's treasury function and are usually placed in short-term fixed interest deposits or the overnight money markets. Deposit counterparties must meet board approved minimum criteria based on their short-term credit ratings and therefore of good credit quality.

(b) Capital risk management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to minimise the cost of capital.

The Group's policy is to have a minimum of 12 months pre-funding of projected capital expenditure. At 31 March 2018 the Group had cash and facilities, including restricted funds, of £1.2 billion, meeting this objective.

In order to maintain or adjust the capital structure, the Group seeks to maintain a balance of returns to shareholders through dividends and an appropriate capital structure of debt and equity for each business segment and the Group.

The Group monitors capital on the basis of the gearing ratio. This ratio is calculated as net borrowings divided by total capital. Net borrowings are analysed in note 39 and calculated as total borrowings less cash and cash deposits. Total capital is calculated as total shareholders' equity plus net borrowings.

The gearing ratios at the balance sheet date were:

	2018 £m	2017 £m
Net borrowings (note 39)	**2,801.5**	2,664.9
Total equity	**1,639.1**	1,509.2
Total capital	**4,440.6**	4,174.1
Gearing ratio	**63.1%**	63.8%

The Water segment is also monitored on the basis of the ratio of its net borrowings to Regulatory Capital Value (RCV). Ofwat's optimum gearing for the K6 (2015-2020) regulatory period is set at 62.5%.

	Water Business	
	2018 £m	2017 £m
Regulatory Capital Value	**3,431.2**	3,290.6
Net borrowings	**2,068.1**	2,033.8
Net borrowings/Regulatory Capital Value	**60.3%**	61.8%

The Group has entered into covenants with lenders and, while terms vary, these typically provide for limits on gearing and interest cover. The Group has been in compliance with its covenants during the year.

(c) Determination of fair values

The Group uses the following hierarchy for determining the fair value of financial instruments by valuation technique:

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (level 1)
- Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (level 2)
- Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (level 3).

The Group's financial instruments are valued principally using level 2 measures as analysed in note 23.

The fair value of financial instruments not traded in an active market (for example over-the-counter derivatives) is determined by using valuation techniques. A variety of methods and assumptions are used based on market conditions existing at each balance sheet date. Quoted market prices or dealer quotes for similar instruments are used for long-term debt. Other techniques, such as estimated discounted cash flows, are used to determine fair value for the remaining financial instruments. The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows.

The carrying values, less impairment provision, of trade receivables and payables are assumed to approximate to their fair values. The fair value of financial liabilities, principally environmental provisions, is calculated as the present value of the estimated future cash flows.

4. Critical accounting judgements and estimates

The Group's principal accounting policies are set out in note 2. Management is required to exercise significant judgement and make use of estimates and assumptions in the application of these policies. Estimates are based on factors including historical experience and expectations of future events that management believe to be reasonable. However, given the judgemental nature of such estimates, actual results could be different from the assumptions used.

Estimates

Environmental and landfill restoration provisions

Environmental control and aftercare costs are incurred during the operational life of each landfill site and for a considerable period thereafter. The period of aftercare post-closure and the level of costs expected are uncertain and can vary significantly from site to site. Key factors are the type of waste, the speed at which it decomposes, the volume of leachate requiring treatment and regulatory requirements specific to the site. The amounts expected to be incurred are based on landfill site operating lives, taking account of the anticipated decline in landfill activity.

The provisions are based on latest assumptions reflecting recent historic data and future cost estimates.

The aftercare provision is particularly sensitive to the estimated volumes of leachate and their associated cost, together with the discount rate used to establish the provision.

The provisions are recognised in the financial statements at the net present value of the estimated future expenditure required to settle the Group's obligations. A discount rate is applied to recognise the time value of money and is unwound over the life of the provision. This is included in the income statement as a financial item within finance costs.

Viridor assume an aftercare period of 60 years in calculating provision values. This is considered reasonable by management, is comparable to peers in the waste business and is consistent with Environment Agency bond periods.

The impact of a 0.1% change in discount rate is estimated to be in the region of £3 million.

As at 31 March 2018 the Group's environmental and landfill restoration provisions were £191.9 million (2017 £183.8 million) (note 32).

Where a restoration provision gives access to future economic benefits, an asset is recognised and depreciated in accordance with the Group's depreciation policy. As at 31 March 2018 these assets had a net book value of £18.4 million (2017 £14.3 million) (note 17).

Retirement benefit obligations

The Group operates defined benefit pension schemes for which actuarial valuations are carried out as determined by the trustees at intervals of not more than three years. The last such valuation of the main scheme was as at 31 March 2016.

The pension cost and liabilities under IAS 19 are assessed in accordance with Directors' best estimates using the advice of an independent qualified actuary and assumptions in the latest actuarial valuation. The assumptions are based on member data supplied to the actuary and market observations for interest rates and inflation, supplemented by discussions between the actuary and management. The mortality assumption uses a scheme-specific calculation based on CMI 2016 actuarial tables with an allowance for future longevity improvement. The principal assumptions used to measure schemes' liabilities, sensitivities to changes in those assumptions and future funding obligations are set out in note 30.

Taxation

The Group's current tax provision of £24.4 million, reduced from £26.8 million in 2016/17, includes £12.6 million related to prior year tax items.

The Group continues to have a small number of ongoing uncertain tax items primarily relating to the interpretation of tax legislation regarding different tax aspects of its energy recovery facilities. This is part of the normal course of business and the Group has paid in full the tax HMRC interpret as due, and therefore would benefit by a cash refund of up to £18 million (2016/17 £20 million) should these tax items be concluded in the Group's favour. The Group is working towards resolution of these matters with HMRC.

Service concession arrangements

Consideration from public sector entities for the operation of waste management service concessions is treated as contract receivables or other intangible assets, depending upon the right to receive cash from the asset. At the balance sheet date the Group recognised contract receivables of £234.1 million (2017 £217.6 million) and other intangible assets of £69.2 million (2017 £61.3 million) in relation to its service concession arrangements.

Consideration relating to contract receivables is split between profit on the construction of assets, operation of the service and provision of finance recognised as interest receivable. Management's judgement is used in the allocation between these three elements, this assessment reflects external market conditions according to the type of service provided and project specific cash flow expectations, including the recovery of costs from the original contractor on our Glasgow concession.

Revenue recognition

The Group recognises revenue at the time of delivery of services. Payments received in advance of services delivered are recorded as liabilities.

South West Water raises bills and recognises revenue in accordance with its entitlement to receive revenue in line with the limits established by the Periodic Review price-setting process. Pennon Water Services raises bills and recognises revenue in accordance with its contracts with customers and in line with the limits established for the non-household periodic price-setting process where applicable. For water and wastewater customers with water meters, revenue recognised is dependent upon the volume supplied including an estimate of the sales value of units supplied between the date of the last meter reading and the year-end. Estimated usage is based on historic data, judgement and assumptions. The accrued income balance in this area at the balance sheet date was £61.5 million (2017 £77.7 million) for South West Water and £20.2 million for Pennon Water Services. Each year a review of the actual amounts billed in comparison with the metered accrual recognised at the previous year end is undertaken to ensure that the methodology continues to be supported by historic experience.

Viridor estimates income from certain contractual revenue streams based on tonnages, cost and historic data which are dependent on agreement with the customer after the delivery of the service. Revenue is accrued from the sale of electricity from our generating assets based upon metered output delivered at rates specified under contract terms or prevailing market rates as applicable. The total accrued income balance in relation to these areas at the balance sheet date was £53.4 million (2017 £42.8 million).

Notes to the financial statements
continued

4. Critical accounting judgements and estimates continued

Provision for doubtful debts
At the balance sheet date each subsidiary evaluates the collectability of trade receivables and records provisions for doubtful debts based on experience including comparisons of the relative age of accounts and consideration of actual write-off history.

The actual level of debt collected may differ from the estimated levels of recovery. As at 31 March 2018 the Group's current trade receivables were £325.0 million (2017 £321.6 million), against which £104.3 million (2017 £98.1 million) had been provided for impairment (note 22).

Judgements

Impairment of non-financial assets
In order to determine whether impairments, or reversals of previous impairments, are required for non-financial assets, the Group assesses whether there are any indicators for further impairment or reversal during the year. The assessment includes a review of changes in markets and discount rates over the year, together with a review of CGU business performance against expectations. The 2017/18 review concluded there were no indicators of further impairment or reversal.

Non-underlying items
In establishing which items are disclosed separately as non-underlying, to enable a full understanding of the Group's financial performance, the Directors exercise their judgement in assessing the size, nature or incidence of specific items. See note 6 for further details.

Greater Manchester contract reset
Following the renegotiation of the Greater Manchester contract and sale of the joint venture Viridor Laing Greater Manchester to the Greater Manchester Waste Disposal Authority (see notes 6 and 20) judgement has been required to ensure all the various economic aspects of the reset have been fully considered in concluding the appropriate accounting treatment. In particular in arriving at the amount of profit to be recognised in respect of the retained TPSCo joint venture (a non-underlying profit of £22.5 million, as described in note 6), it was necessary for management to consider fair values attributed to all aspects of the transaction.

Glasgow Recycling and Renewable Energy Centre (GRECC)
Completion of the construction of this facility has required a higher level of remediation expenditure than originally envisaged. Cumulative spend of £238 million has been incurred to 31 March 2018 which is higher than the original target of £155 million. Viridor is contractually entitled to recover incremental costs from the original principal contractor, Interserve, under certain circumstances. The Group believes these circumstances have been met and discussions with Interserve are ongoing with regard to the contractual settlement. At 31 March 2018 a receivable of £68.7 million has been recognised. In accordance with IFRIC 12 service concession arrangements, a financial asset of £140.6 million and an intangible asset of £67.6 million have been recognised (including rolled up finance income and capitalised interest), with no operating profit on construction having been taken to date. While there are further possible recoveries that are contingent on future events, these are not currently recognised. The ultimate agreement of the contractual amount due to the Group from the original principal contractor, including the nature of the receipts and the recoverability of such agreed amounts under the contract, could result in revisions to the receivable and the amounts recorded for the financial asset and intangible assets, including the allocation between the two amounts, which could then impact the margins recognised on this contract over the life of the project to 2043. Internal assessments have been corroborated by legal advice in arriving at appropriate amounts to be recognised on the balance sheet.

5. Segmental information

Operating segments are reported in a manner consistent with internal reporting provided to the Chief Operating Decision-Maker, which has been identified as the Pennon Group plc Board. The earnings measures below are used by the Board in making decisions.

The water business comprises the regulated water and wastewater services undertaken by South West Water. The waste management business is the recycling, energy recovery and waste management services provided by Viridor. The non-household retail business is a new segment created this year reflecting the services provided by Pennon Water Services following the opening of the non-household water and wastewater retail market to competition on 1 April 2017. Segment assets include goodwill and other intangible assets, property, plant and equipment, inventories, trade and other receivables and cash and cash deposits. Segment liabilities comprise operating liabilities and borrowings and exclude taxation. The other segment liabilities include the Company's financing arrangements and Group taxation liabilities. Capital expenditure comprises additions to property, plant and equipment, including additions resulting from acquisitions through business combinations.

Comparative information has been re-presented during the year to reflect the opening of the non-household water and wastewater retail market to competition. Comparative results for the non-household retail segment were previously recognised in the water segment.

5. Segmental information continued

	2018 £m	2017 £m
Revenue		
Water	**571.3**	555.3
Waste management	**788.9**	793.5
Non-household retail	**165.9**	128.6
Other	**13.8**	12.8
Less intra-segment trading*	**(143.7)**	(137.1)
	1,396.2	1,353.1
Segment result		
Operating profit before depreciation, amortisation and non-underlying items (EBITDA)		
Water	**360.9**	347.6
Waste management	**150.2**	138.3
Non-household retail	**1.0**	1.5
Other	**(2.5)**	(1.4)
	509.6	486.0
Operating profit before non-underlying items		
Water	**247.8**	233.9
Waste management	**78.6**	71.1
Non-household retail	**0.4**	1.5
Other	**(2.9)**	(1.9)
	323.9	304.6
Profit before tax and non-underlying items		
Water	**180.5**	172.4
Waste management	**70.8**	60.4
Non-household retail	**(1.1)**	1.5
Other	**8.6**	15.7
	258.8	250.0
Profit before tax		
Water	**178.1**	185.9
Waste management	**77.3**	50.2
Non-household retail	**(1.1)**	1.5
Other	**8.6**	(27.1)
	262.9	210.5

* Intra-segment transactions between and to different segments is under normal market based commercial terms and conditions. Intra-segment revenue of the other segment is at cost.

	Water £m	Waste management £m	Non-household retail £m	Other £m	Eliminations £m	Group £m
Balance sheet						
31 March 2018						
Assets (excluding investments in joint ventures)	**3,513.2**	**2,254.2**	**66.6**	**1,506.9**	**(1,199.3)**	**6,141.6**
Investments in joint ventures	**–**	**22.8**	**–**	**–**	**–**	**22.8**
Total assets	**3,513.2**	**2,277.0**	**66.6**	**1,506.9**	**(1,199.3)**	**6,164.4**
Liabilities	**(2,721.9)**	**(1,512.4)**	**(59.1)**	**(1,431.2)**	**1,199.3**	**(4,525.3)**
Net assets	**791.3**	**764.6**	**7.5**	**75.7**	**–**	**1,639.1**
31 March 2017						
Assets (excluding investments in joint ventures)	3,461.4	2,099.9	33.6	1,856.8	(1,540.5)	5,911.2
Investments in joint ventures	–	0.1	–	–	–	0.1
Total assets	3,461.4	2,100.0	33.6	1,856.8	(1,540.5)	5,911.3
Liabilities	(2,641.6)	(1,697.4)	(25.6)	(1,578.0)	1,540.5	(4,402.1)
Net assets	819.8	402.6	8.0	278.8	–	1,509.2

Segment liabilities of the water and waste management segments comprise of operating liabilities and borrowings. The other segment includes company only assets and liabilities as well as Group taxation liabilities and should be considered in conjunction with the eliminations column.

Notes to the financial statements continued

5. Segmental information continued

	Notes	Water £m	Non-household retail £m	Waste management £m	Other £m	Group £m
Other information						
31 March 2018						
Amortisation of other intangible assets	7	**0.5**	**0.1**	**3.0**	**–**	**3.6**
Capital expenditure	17	**181.6**	**3.5**	**203.7**	**0.2**	**389.0**
Depreciation	7	**112.9**	**0.6**	**68.6**	**0.4**	**182.5**
Finance income (before non-underlying items)	8	**1.2**	**–**	**21.8**	**1.2**	**24.2**
Finance costs (before non-underlying items)	8	**68.4**	**1.5**	**14.8**	**14.0**	**98.7**
31 March 2017						
Amortisation of other intangible assets	7	0.5	–	2.7	–	3.2
Capital expenditure	17	190.9	–	186.5	0.1	377.5
Depreciation	7	113.5	–	64.6	0.1	178.2
Finance income (before non-underlying items)	8	1.5	–	26.3	8.5	36.3
Finance costs	8	62.3	–	12.3	20.5	95.1

	2018 £m	2017 £m
Revenue		
United Kingdom	**1,338.0**	1,287.6
Rest of European Union	**12.3**	10.3
China	**31.0**	45.1
Rest of World	**11.7**	10.1
	1,393.0	1,353.1

The Group's country of domicile is the United Kingdom and is the country in which it generates the majority of its revenue. The Group's non-current assets are all located in the United Kingdom.

6. Non-underlying items

Non-underlying items are those that in the Directors' view are required to be separately disclosed by virtue of their size, nature or incidence to enable a full understanding of the Group's financial performance in the year and business trends over time. The presentation of results is consistent with internal performance monitoring.

	Notes	2018 £m	2017 £m
Revenue			
Construction contract settlement(1a)	20	**3.2**	–
Operating costs			
Restructuring costs(2)	17, 32	**–**	(10.7)
Earnings before interest, tax, depreciation and amortisation		**3.2**	(10.7)
Remeasurement of fair value movement in derivatives(3)	8	**(2.4)**	16.0
Write-down of joint venture shareholder loans(1b)	20	**(19.2)**	–
Refinancing of joint venture arrangement(1c)	20	**22.5**	–
Unwind of synthetic derivative(4)		**–**	(44.8)
Deferred tax change in rate(5)		**–**	21.3
Tax credit arising on non-underlying items	9	**3.4**	7.1
Net non-underlying credit/(charge)		**7.5**	(11.1)

(1) On reset of the contracts associated with the Greater Manchester Waste Disposal Authority (GMWDA) an overall net credit before tax of £6.5 million has been recognised as follows:

(a) A net amount of £3.2 million has been recognised in revenue following the settlement of all outstanding claims relating to the construction of assets.

(b) On reset of the contracts associated with GMWDA ownership of Viridor Laing Holdings Limited passed to the GMWDA. On transfer £23.5 million of Viridor's shareholder loans were repaid, resulting in the write down of the remaining financial asset of £19.2 million.

(c) On reset of the contracts associated with GMWDA repayment of external bank debt in our joint venture, Ineos Runcorn TPSCo Limited, was financed by GMWDA. This change in cash flows resulted in the recognition of income in this joint venture, with an amount deferred relating to a lower ongoing gate fee. The overall share of profit after tax related to the reset is £22.5 million, which has contributed to an increase in investments in joint ventures recognised on the balance sheet to £22.8 million (31 March 2017 £0.1 million).

These items are considered non-underlying due to their size and non-recurring nature.

6. Non-underlying items continued

(2) In the prior year a one-off charge of £10.7 million was made relating to restructuring costs associated with a Group-wide Shared Services Review. The £10.7 million charge consisted of a £9.5 million non-cash charge to other operating expenses relating to a rationalisation of systems leading to an asset de-recognition, and a £1.1 million charge to manpower costs and a £0.1 million charge to other operating costs in relation to restructuring provisions. The charge was considered non-underlying due to its size and non-recurring nature.

(3) In the year a charge of £2.4 million was recognised relating to non-cash derivative fair value movements associated with derivatives that are not designated as being party to an accounting hedge relationship. These movements are non-underlying due to the nature of the item being market dependant and potentially can be significant in value (size).

(4) This relates to the unwind of a synthetic derivative in place from 2011 until it was unwound in February 2017 (the Peninsula MB derivative as set out in Note 6 of the Annual Report and Accounts 2017).

(5) Last year rate of corporation tax reduced from 18% to 17% from April 2020, resulting in a one-off credit of £21.3 million being recognised. In addition, a charge of £3.8 million was recognised in the statement of comprehensive income and a charge of £0.1 million was recognised directly in equity. These movements were non-underlying due to being dependent on UK tax law and due to their size.

7. Operating costs

	Notes	2018 £m	2017 £m
Employment costs before non-underlying items	13	**192.9**	179.7
Raw materials and consumables		**108.7**	115.8
Other operating expenses before non-underlying items include:			
Profit on disposal of property, plant and equipment		**(2.5)**	(7.5)
Operating lease rentals payable:			
– Plant and machinery		**17.2**	17.2
– Property		**8.9**	8.8
Research and development expenditure		**0.1**	0.2
Trade receivables impairment	22	**7.5**	7.4
Depreciation of property, plant and equipment:			
– Owned assets		**139.4**	136.5
– Under finance leases		**43.1**	41.7
Amortisation of other intangible assets	16	**3.6**	3.2

Operating costs in the prior year include a charge of £10.7 million relating to non-underlying items, as detailed in note 6.

Fees payable to the Company's auditors in the year were:

	2018 £000	2017 £000
Fees payable to the Company's auditors and its associates for the audit of parent Company and consolidated financial statements	**91**	91
Fees payable to the Company's auditors and its associates for other services:		
The audit of Company's subsidiaries	**632**	583
Audit related assurance services	**50**	50
Other non-audit services	**111**	77
Total fees	**884**	801
Fees payable to the Company's auditors in respect of Pennon Group pension schemes:		
Audit	**37**	32

Expenses reimbursed to the auditors in relation to the audit of the Group were £57,000 (2017 £51,000).

A description of the work of the Audit Committee is set out in its report on pages 73 to 76 which includes an explanation of how the auditors' objectivity and independence are safeguarded when non-audit services are provided by the auditors' firm.

Notes to the financial statements
continued

8. Net finance costs

	Notes	2018 Finance cost £m	2018 Finance income £m	2018 Total £m	2017 Finance cost £m	2017 Finance income £m	2017 Total £m
Cost of servicing debt							
Bank borrowing and overdrafts		**(48.6)**	**–**	**(48.6)**	(49.4)	–	(49.4)
Interest element of finance lease rentals		**(34.4)**	**–**	**(34.4)**	(31.9)	–	(31.9)
Other finance costs		**(3.9)**	**–**	**(3.9)**	(3.5)	–	(3.5)
Interest receivable		**–**	**2.5**	**2.5**	–	3.2	3.2
Interest receivable on shareholder loans to joint ventures		**–**	**7.9**	**7.9**	–	10.2	10.2
		(86.9)	**10.4**	**(76.5)**	(84.8)	13.4	(71.4)
Notional interest							
Interest receivable on service concession arrangements		**–**	**13.8**	**13.8**	–	16.1	16.1
Retirement benefit obligations	30	**(1.6)**	**–**	**(1.6)**	(1.2)	–	(1.2)
Unwinding of discounts in provisions	32	**(10.2)**	**–**	**(10.2)**	(9.1)	–	(9.1)
		(11.8)	**13.8**	**2.0**	(10.3)	16.1	5.8
Net gains on derivative financial instruments arising from the combination of non-derivative instruments		**–**	**–**	**–**	–	6.8	6.8
Net finance cost before non-underlying items		**(98.7)**	**24.2**	**(74.5)**	(95.1)	36.3	(58.8)
Non-underlying items							
Fair value remeasurement of non-designated derivative financial instruments providing commercial hedges		**(2.4)**	**–**	**(2.4)**	–	16.0	16.0
Write-down of joint venture shareholder loans	6	**(19.2)**	**–**	**(19.2)**	–	–	–
Unwind of synthetic derivative	6	**–**	**–**	**–**	(44.8)	–	(44.8)
Net finance cost after non-underlying items		**(120.3)**	**24.2**	**(96.1)**	(139.9)	52.3	(87.6)

In addition to the above, finance costs of £17.0 million (2017 £12.9 million) have been capitalised on qualifying assets included in property, plant and equipment and other intangible assets.

9. Taxation

	Notes	Before non-underlying items 2018 £m	Non-underlying items (note 6) 2018 £m	Total 2018 £m	Before non-underlying items 2017 £m	Non-underlying items (note 6) 2017 £m	Total 2017 £m
Analysis of charge in year							
Current tax charge		**26.1**	**(3.0)**	**23.1**	39.5	(9.4)	30.1
Deferred tax – other		**18.3**	**(0.4)**	**17.9**	18.9	2.3	21.2
Deferred tax arising on change of rate of corporation tax		**–**	**–**	**–**	–	(21.3)	(21.3)
Total deferred tax charge/ (credit)	31	**18.3**	**(0.4)**	**17.9**	18.9	(19.0)	(0.1)
Tax charge for year		**44.4**	**(3.4)**	**41.0**	58.4	(28.4)	30.0

UK corporation tax is calculated at 19% (2017 20%) of the estimated assessable profit for the year.

UK corporation tax is stated after a credit relating to prior year current tax of £3.6 million (2017 credit of £1.8 million) and a prior year deferred tax credit of £2.4 million (2017 charge of £1.1 million).

The 2017 deferred tax credit includes a credit of £21.3 million reflecting a reduction in the rate of UK corporation tax.

9. Taxation continued

The tax for the year differs from the theoretical amount which would arise using the standard rate of corporation tax in the UK of 19% (2017 20%) as follows:

	2018 £m	2017 £m
Reconciliation of total tax charge		
Profit before tax	**262.9**	210.5
Profit before tax multiplied by the standard rate of UK corporation tax of 19% (2017 20%)	**49.9**	42.1
Effects of:		
Expenses not deductible for tax purposes	**0.3**	(1.3)
Financial transaction deemed ineligible	**–**	10.7
Joint ventures profits not taxed	**(6.1)**	(0.9)
Change in rate of corporation tax	**–**	(21.3)
Adjustments to tax charge in respect of prior years	**(6.0)**	(0.7)
Depreciation charged on non-qualifying assets	**1.5**	1.9
Other	**1.4**	(0.5)
Tax charge for year	**41.0**	30.0

	2018 £m	2017 £m
Reconciliation of current tax charge		
Profit before tax	**262.9**	210.5
Profit before tax multiplied by the standard rate of UK corporation tax of 19% (2017 20%)	**49.9**	42.1
Relief for capital allowances in place of depreciation	**(49.5)**	(48.5)
Disallowance of depreciation charged in the accounts	**31.2**	31.6
Financial transactions deemed ineligible	**–**	10.7
Other timing differences	**1.6**	(3.1)
Adjustments to tax charge in respect of prior years	**(3.6)**	(1.8)
Joint venture profits not taxed	**(6.1)**	(0.9)
Expenses not deductible for tax purposes	**0.3**	(1.3)
Depreciation charged on non-qualifying assets	**1.5**	1.9
Relief for capitalised interest and foreign exchange gains/losses	**(2.2)**	(0.5)
Research and Development Expenditure credit	**–**	(0.1)
Current tax charge for year	**23.1**	30.1

The Group's current tax charge is lower than the UK headline tax rate of 19%, primarily due to the availability of capital allowances. Capital allowances provide tax relief when a business incurs expenditure on qualifying capital items such as plant and machinery used by the business. As an infrastructure business, these allowances help the Group to plan major investment and consequentially to maintain lower customers bills, as corporation tax relief is given against the investments made. As noted in the deferred tax note (note 31), the rate of UK corporation tax will reduce to 17% from April 2020.

Joint Venture profits are not subject to any additional tax within the Group as these are included on a post tax basis already, as the Joint Venture entity is subject to tax itself.

In addition to the amounts recognised in the income statement the following tax charges and credits were also recognised:

	2018 £m	2017 £m
Amounts recognised directly in other comprehensive income		
Deferred tax charge/(credit) on defined benefit pension schemes	**4.2**	(3.3)
Deferred tax charge on cash flow hedges	**3.4**	1.3
Amounts recognised directly in equity		
Deferred tax charge/(credit) on share-based payments	**0.4**	(0.3)
Current tax credit on perpetual capital securities periodic return	**(3.8)**	(4.1)

10. Profit of the Parent Company

	2018 £m	2017 £m
Profit attributable to ordinary shareholders' equity dealt within the accounts of the parent company	**215.1**	162.9

As permitted by Section 408 of the Companies Act 2006 no income statement or statement of comprehensive income is presented for the Company.

Notes to the financial statements
continued

11. Earnings per share

Basic earnings per share are calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the year, excluding those held in the employee share trust (note 36), which are treated as cancelled.

For diluted earnings per share, the weighted average number of ordinary shares in issue is adjusted to include all dilutive potential ordinary shares. The Group has two types of dilutive potential ordinary shares – those share options granted to employees where the exercise price is less than the average market price of the Company's ordinary shares during the year; and the contingently issuable shares under the Group's Performance and Co-investment Plan, the Long-term Incentive Plan and the deferred shares element of the Annual Incentive Bonus Plan, based on performance criteria for the vesting of the awards.

The weighted average number of shares and earnings used in the calculations were:

	2018	2017
Number of shares (millions)		
For basic earnings per share	**417.9**	413.0
Effect of dilutive potential ordinary shares from share options	**1.5**	1.9
For diluted earnings per share	**419.4**	414.9

Basic and diluted earnings per ordinary share

Earnings per ordinary share before non-underlying items and deferred tax are presented as the Directors believe that this measure provides a more useful comparison on business trends and performance, since deferred tax reflects distortive effects of changes in corporation tax rates and the level of long-term capital investment. Perpetual capital returns are proportionately adjusted to allow a more useful comparison in the year as the full return is accrued at 31 March 2018 but not payable until May. Earnings per share have been calculated as follows:

	2018			2017		
	Profit after tax £m	**Earnings per share Basic p**	**Diluted p**	Profit after tax £m	Earnings per share Basic p	Diluted p
Statutory earnings	**200.6**	**48.0**	**47.8**	164.3	39.8	39.6
Deferred tax charge before non-underlying items	**18.3**	**4.4**	**4.4**	18.9	4.5	4.6
Non-underlying items (net of tax)	**(7.5)**	**(1.8)**	**(1.8)**	11.1	2.7	2.6
Proportional adjustment on Perpetual capital returns	**1.3**	**0.3**	**0.3**	–	–	–
Adjusted earnings	**212.7**	**50.9**	**50.7**	194.3	47.0	46.8

12. Dividends

	2018 £m	2017 £m
Amounts recognised as distributions to ordinary equity holders in the year		
Interim dividend paid for the year ended 31 March 2017: 11.09p (2016 10.46p) per share	**45.9**	43.1
Final dividend paid for the year ended 31 March 2017: 24.87p (2016 23.12p) per share	**103.6**	95.4
	149.5	138.5
Proposed dividends		
Proposed interim dividend for the year ended 31 March 2018: 11.97p per share	**50.2**	
Proposed final dividend for the year ended 31 March 2018: 26.62p per share	**111.8**	
	162.0	

The proposed interim and final dividends have not been included as liabilities in these financial statements.

The proposed interim dividend for 2018 was paid on 4 April 2018 and the proposed final dividend is subject to approval by shareholders at the Annual General Meeting.

13. Employment costs

	Notes	2018 £m	2017 £m
Wages and salaries		**170.6**	157.1
Social security costs		**17.4**	16.6
Pension costs	30	**20.7**	18.8
Share-based payments	33	**2.8**	2.9
Non-underlying items	6, 30	**–**	1.1
Total employment costs		**211.5**	196.5
Charged:			
Employment costs (excluding non-underlying items) – consolidated income statement		**192.9**	179.7
Non-underlying items – consolidated income statement	6	**–**	1.1
Capital schemes – property, plant and equipment		**18.6**	15.7
Total employment costs		**211.5**	196.5

Details of Directors' emoluments are set out in note 14. There are no personnel, other than Directors, who as key management exercise authority and responsibility for planning, directing and controlling the activities of the Group.

	2018	2017
Employees (average full time equivalent number)		
The average monthly number of employees (including Executive Directors) was:		
Water	**1,575**	1,589
Waste management	**3,285**	3,153
Non-household retail	**81**	–
Other	**73**	57
Group totals	**5,014**	4,799

The total number of employees at 31 March 2018 was 5,190 (2017 4,788).

14. Directors' emoluments

	2018 £000	2017 £000
Executive Directors:		
Salary	**914**	1,205
Performance-related bonus paid or payable	**398**	381
Share-based payments	**667**	421
Other emoluments, including payments in lieu of pension provision	**298**	312
Non-Executive Directors	**477**	471
	2,754	2,790

The cost of share-based payments represents the amount charged to the income statement, as described in note 33. The aggregate gains on vesting of Directors' share-based awards amounted to a total of £nil (2017 £102,000). Total gains made by Directors on the exercise of share options were £nil (2017 £17,000).

Total emoluments include £nil (2017 £476,000) payable to Directors for services as directors of subsidiary undertakings.

At 31 March 2018 one Director (2017 one) is accruing retirement benefits under defined benefit pension schemes in respect of which the Group contributed £28,000 (2017 £35,000).

At 31 March 2018 no Director (2017 no) is a member of the Group's defined contribution pension scheme in respect of which the Group contributed £nil (2017 £40,000).

At 31 March 2018 two Directors received payments in lieu of pension provision (2017 two).

More detailed information concerning Directors' emoluments (including pensions and the highest paid Director) and share interests is shown in the Directors' remuneration report on pages 84 to 101.

Notes to the financial statements
continued

15. Goodwill

	£m
Cost:	
At 1 April 2016	385.0
At 31 March 2017	385.0
At 31 March 2018	385.0
Carrying amount:	
At 1 April 2016	385.0
At 31 March 2017	385.0
At 31 March 2018	**385.0**

Goodwill acquired in a business combination is allocated at acquisition to the cash generating unit (CGU) expected to benefit from that business combination. £342.7 million of the goodwill balance is allocated to the waste management business, with the remaining £42.3 million allocated to the water business, representing the lowest levels at which goodwill is monitored and tested.

Impairment testing of goodwill

The Group tests goodwill for impairment annually, or more frequently if there are any indications that impairment may have arisen.

The recoverable amount of the water business segment, for which goodwill was recognised on acquisition of Bournemouth Water in 2015, is assessed using level 2 fair value hierarchy techniques, with reference to the market value of the merged water business, using a market based observable premium to Regulated Capital Value.

The recoverable amount of the waste management segment, to which the majority of goodwill is allocated, is determined based on value-in-use calculations which, under IAS 36 'Impairment of Assets', require the use of base cash flow projections that reflect reasonable and supportable assumptions with specific restrictions on the estimates to be used. These include limitations on reflecting cash flows to take account of future cost restructuring, or improvement or enhancement of asset performance. Uncommitted projects are excluded. Discount rates are required to be derived independently of the Group's capital structure and those used reflect management's prudent estimate of a rate that investors would require if they were to choose a similar investment ranging from 7-10% across the CGUs business activities.

The base cash flow projections have been derived from the Group's detailed budget and strategic plan projections. These cover a period of seven years and are prepared as part of the annual planning cycle. This period is believed to lead to a more realistic estimate of future cash flows than five years. Long-term growth rates of 3%, based on forecast of growth in waste management markets and the UK economy, are applied to cash flows beyond the seven year period.

These plans are based on detailed market-by-market forecasts of projected volumes, prices and costs for each business activity. These forecasts reflect, on an individual operational site basis, numerous assumptions and estimates. The key assumptions include anticipated changes in market size and volumes; recyclate prices; energy selling prices; gate fees; the level of future landfill tax; and cost inflation. Management has determined the value assigned to each assumption based on historical experience, market surveys, industry analysis and current legislation. For business activities with an indefinite life a terminal growth rate has been used.

The results of tests performed during the year demonstrate significant headroom in all CGUs, and it is judged that no reasonable change in the key assumptions would cause the carrying amount of the CGUs to exceed the recoverable amount.

16. Other intangible assets

	Service concession arrangements £m	Customer contracts £m	Patents £m	Other £m	Total £m
Acquired intangible assets					
Cost:					
At 1 April 2016	55.0	34.3	0.2	2.6	92.1
Additions	6.5	–	–	–	6.5
At 31 March 2017	61.5	34.3	0.2	2.6	98.6
Additions	8.1	–	–	1.0	9.1
At 31 March 2018	69.6	34.3	0.2	3.6	107.7
Accumulated amortisation:					
At 1 April 2016	–	27.5	0.2	0.6	28.3
Charge for year	0.2	2.4	–	0.6	3.2
At 31 March 2017	0.2	29.9	0.2	1.2	31.5
Charge for year	0.2	2.8	–	0.6	3.6
At 31 March 2018	0.4	32.7	0.2	1.8	35.1
Carrying amount:					
At 1 April 2016	55.0	6.8	–	2.0	63.8
At 31 March 2017	61.3	4.4	–	1.4	67.1
At 31 March 2018	**69.2**	**1.6**	**–**	**1.8**	**72.6**

Service concession arrangements, once available for use, are amortised over the useful life of each contract. The average remaining life is 22 years (2017 23 years).

Customer contracts are amortised over the useful life of each contract which at acquisition ranged between two and 15 years. The weighted average remaining life is one year (2017 two years).

Patents are amortised over their estimated useful lives which at acquisition was 13 years. The average remaining life is nil years (2017 nil years).

Other, including computer software, is amortised over the useful life of the assets which at acquisition was five years. The average remaining life is five years (2017 two years).

The carrying values of other intangible assets are reviewed annually or when events or changes in circumstance indicate that the carrying amounts may not be fully recoverable.

During the year borrowing costs of £2.3 million (2017 £2.1 million) have been capitalised on qualifying assets, at an average borrowing rate of 3.7% (2017 3.5%).

Notes to the financial statements
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17. Property, plant and equipment

	Land and buildings £m	Infrastructure assets £m	Operational properties £m	Fixed and mobile plant, vehicles and computers £m	Landfill restoration £m	Construction in progress £m	Total £m
Group							
Cost:							
At 1 April 2016	524.4	1,824.9	693.5	2,629.9	64.6	166.1	5,903.4
Additions	9.8	12.7	1.2	47.0	7.1	299.7	377.5
Assets adopted at fair value	–	5.4	14.1	5.1	–	–	24.6
Grants and contributions	–	(1.6)	–	–	–	–	(1.6)
Disposals	(3.5)	(1.2)	(0.2)	(10.7)	–	(9.5)	(25.1)
Transfers/reclassifications	8.7	14.6	(2.2)	62.9	–	(84.0)	–
At 31 March 2017	539.4	1,854.8	706.4	2,734.2	71.7	372.3	6,278.8
Additions	12.3	13.2	1.8	45.4	11.1	305.2	389.0
Assets adopted at fair value	–	8.0	–	–	–	–	8.0
Grants and contributions	–	(2.2)	–	–	–	–	(2.2)
Disposals	(0.4)	(1.2)	–	(9.9)	–	–	(11.5)
Transfers/reclassifications	3.7	21.9	11.1	85.4	–	(122.1)	–
At 31 March 2018	555.0	1,894.5	719.3	2,855.1	82.8	555.4	6,662.1
Accumulated depreciation:							
At 1 April 2016	372.2	223.7	227.4	1,129.9	52.9	–	2,006.1
Charge for year	13.5	24.4	12.8	126.1	4.5	–	181.3
Disposals	(1.0)	(1.3)	(0.2)	(9.3)	–	–	(11.8)
At 31 March 2017	384.7	246.8	240.0	1,246.7	57.4	–	2,175.6
Charge for year	17.2	23.0	13.4	125.3	7.0	–	185.9
Disposals	(0.2)	(1.2)	–	(8.6)	–	–	(10.0)
At 31 March 2018	401.7	268.6	253.4	1,363.4	64.4	–	2,351.5
Net book value:							
At 1 April 2016	152.2	1,601.2	466.1	1,500.0	11.7	166.1	3,897.3
At 31 March 2017	154.7	1,608.0	466.4	1,487.5	14.3	372.3	4,103.2
At 31 March 2018	**153.3**	**1,625.9**	**465.9**	**1,491.7**	**18.4**	**555.4**	**4,310.6**

Of the total depreciation charge of £185.9 million (2017 £181.3 million), £1.5 million (2017 £1.6 million) has been charged to capital projects, £1.9 million (2017 £1.5 million) has been offset by deferred income and £182.5 million (2017 £178.2 million) has been charged against profits. Asset lives and residual values are reviewed annually. During the year borrowing costs of £14.7 million (2017 £10.8 million) have been capitalised on qualifying assets, at an average borrowing rate of 3.7% (2017 3.5%).

Groups of assets forming cash generating units are reviewed for indicators of impairment. No indicators of impairment were identified during the year.

Asset lives are reviewed annually. No significant changes were required in 2017/18.

17. Property, plant and equipment continued

Assets held under finance leases included above were:

	Infrastructure assets £m	Operational properties £m	Fixed and mobile plant, vehicles and computers £m	Construction in progress £m	Total £m
Cost:					
At 31 March 2017	409.0	436.7	574.8	0.2	1,420.7
At 31 March 2018	416.9	463.7	673.7	0.2	1,554.5
Accumulated depreciation:					
At 31 March 2017	58.2	111.6	276.0	–	445.8
At 31 March 2018	63.3	119.4	305.3	–	488.0
Net book amount:					
At 31 March 2017	350.8	325.1	298.8	0.2	974.9
At 31 March 2018	**353.6**	**344.3**	**368.4**	**0.2**	**1,066.5**

	Fixed and mobile plant, vehicles and computers £m
Company	
Cost:	
At 1 April 2016	0.3
Additions	0.2
Disposals	(0.2)
At 31 March 2017	0.3
Additions	0.1
At 31 March 2018	0.4
Accumulated depreciation:	
At 1 April 2016	0.2
Charge for year	–
Disposals	(0.1)
At 31 March 2017	0.1
Charge for year	0.1
At 31 March 2018	0.2
Net book value:	
At 1 April 2016	0.1
At 31 March 2017	0.2
At 31 March 2018	**0.2**

Asset lives and residual values are reviewed annually.

Notes to the financial statements
continued

18. Financial instruments by category

The accounting policies for financial instruments that have been applied to line items are:

	Notes	Fair value			Amortised cost		
		Derivatives used for fair value hedging £m	Derivatives used for cash flow hedging £m	Derivatives not in a hedge accounting relationship £m	Loans and receivables £m	Trade receivables and trade payables £m	Total £m
Group							
31 March 2018							
Financial assets							
Trade receivables	22	–	–	–	–	220.7	220.7
Other receivables	19,22	–	–	–	266.6	–	266.6
Derivative financial instruments	23	4.1	7.0	72.3	–	–	83.4
Cash and cash deposits	25	–	–	–	585.3	–	585.3
Total		4.1	7.0	72.3	851.9	220.7	1,156.0
Financial liabilities							
Borrowings	28	–	–	–	(3,386.8)	–	(3,386.8)
Derivative financial instruments	23	–	(16.7)	(0.9)	–	–	(17.6)
Trade payables	26	–	–	–	–	(98.2)	(98.2)
Other payables	26,29	–	–	–	–	(48.0)	(48.0)
Total		–	(16.7)	(0.9)	(3,386.8)	(146.2)	(3,550.6)
31 March 2017							
Financial assets:							
Trade receivables	22	–	–	–	–	223.5	223.5
Other receivables	19,22	–	–	–	314.3	–	314.3
Derivative financial instruments	23	2.8	6.2	78.7	–	–	87.7
Cash and cash deposits	25	–	–	–	598.1	–	598.1
Total		2.8	6.2	78.7	912.4	223.5	1,223.6
Financial liabilities:							
Borrowings	28	–	–	–	(3,263.0)	–	(3,263.0)
Derivative financial instruments	23	–	(40.0)	(2.5)	–	–	(42.5)
Trade payables	26	–	–	–	–	(107.4)	(107.4)
Other payables	26/29	–	–	–	–	(48.5)	(48.5)
Total		–	(40.0)	(2.5)	(3,263.0)	(155.9)	(3,461.4)
Company							
31 March 2018							
Financial assets							
Amounts owed by subsidiaries	19,22	–	–	–	886.9	–	886.9
Other receivables	22	–	–	–	0.3	–	0.3
Derivative financial instruments	23	4.1	6.5	–	–	–	10.6
Cash and cash deposits	25	–	–	–	303.3	–	303.3
Total		4.1	6.5	–	1,190.5	–	1,201.1
Financial liabilities							
Amounts due to subsidiaries	26	–	–	–	(5.7)	–	(5.7)
Borrowings	28	–	–	–	(1,144.9)	–	(1,144.9)
Derivative financial instruments	23	–	(3.6)	–	–	–	(3.6)
Trade payables	26	–	–	–	–	(0.1)	(0.1)
Other payables	26	–	–	–	–	(44.3)	(44.3)
Total		–	(3.6)	–	(1,150.6)	(44.4)	(1,198.6)
31 March 2017							
Financial assets:							
Amounts owed by subsidiaries	19,22	–	–	–	1,137.7	–	1,137.7
Other receivables	22	–	–	–	0.4	–	0.4
Derivative financial instruments	23	2.9	1.3	–	–	–	4.2
Cash and cash deposits	25	–	–	–	372.5	–	372.5
Total		2.9	1.3	–	1,510.6	–	1,514.8
Financial liabilities:							
Amounts due to subsidiaries	26	–	–	–	(0.8)	–	(0.8)
Borrowings	28	–	–	–	(1,206.0)	–	(1,206.0)
Derivative financial instruments	23	–	(3.4)	–	–	–	(3.4)
Trade payables	26	–	–	–	–	(0.2)	(0.2)
Other payables	29					(44.3)	(44.3)
Total		–	(3.4)	–	(1,206.8)	(44.5)	(1,254.7)

19. Other non-current assets

Non-current receivables

	Group		Company	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Amounts owed by subsidiary undertakings	**–**	–	**846.0**	1,011.6
Amounts owed by related parties (note 45)	**39.4**	87.2	**–**	–
Service concession arrangements	**222.9**	210.1	**–**	–
Other receivables	**1.2**	10.7	**–**	–
	263.5	308.0	**846.0**	1,011.6

Non-current receivables were due:

	Group		Company	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Between 1 and 2 years	**12.9**	19.4	**35.5**	85.8
Over 2 years and less than 5 years	**34.9**	23.7	**108.1**	269.9
Over 5 years	**215.7**	264.9	**702.4**	655.9
	263.5	308.0	**846.0**	1,011.6

The fair values of non-current receivables were:

	Group		Company	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Amounts owed by subsidiary undertakings	**–**	–	**909.5**	1,115.7
Amounts owed by related parties	**70.6**	156.9	**–**	–
Service concession arrangements	**222.9**	210.1	**–**	–
Other receivables	**1.2**	10.7	**–**	–
	294.7	377.7	**909.5**	1,115.7

The Group has a number of service concession arrangements with local authority clients in the waste management sector to build and operate recycling assets and energy recovery facilities. The terms of the contracts, including pricing and performance obligations, are established at the outset and the contracts are typically for a duration of 24 years. The assets revert to the local authority at the end of the contract. At 31 March 2018 the average remaining duration of the service concession arrangements was 22 years.

The fair value of amounts owed by related parties is based on cash flows using a rate based on the borrowings rate of 2.5% (2017 2.25%). The discount rate is equal to London Interbank Offered Rate plus an allowance to reflect an appropriate credit margin.

The effective interest rate on amounts owed by related parties was 12.6% (2017 12.5%).

Other receivables include site development and pre-contract costs of £0.7 million (2017 £4.1 million).

A significant proportion of the non-current asset balances are due from local government authorities or joint venture companies which principally operate under long-term local government authority contracts.

20. Investments

Subsidiary undertakings

	£m
Company	
At 1 April 2016	1,628.3
Additions	100.0
Disposals	(104.1)
At 31 March 2017	1,624.2
Additions	356.7
Disposals	(0.1)
At 31 March 2018	**1,980.8**

On 1 April 2017 the Company acquired 2,799,900 ordinary shares of £1 in Pennon Water Services Limited at par, having previously acquired 100 ordinary shares of £1 in 2015 . On the same date Pennon Water Services Limited issued 700,000 shares to South Staffordshire Water Plc, resulting in the Company becoming 80% majority shareholder in Pennon Water Services Limited. On 29 March 2018 the Company acquired an additional 3,917,436 ordinary shares of £1 at par, with South Staffordshire Water Plc acquiring a further 979,359 ordinary shares of £1.

On 29 March 2018, in settlement of intercompany loan balances owed by Viridor Limited to the Company, the Company subscribed for an additional £350 million of new share capital in Viridor Limited.

The disposal during the year is related to the unwind of the PMB synthetic derivative in the prior year (described in full in note 6 in the 2017 Annual Report and Accounts). Peninsula MB Limited was put into liquidation during the year.

Notes to the financial statements
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20. Investments continued

Joint ventures

	Shares £m
Group	
At 1 April 2016	0.1
Share of post–tax profit	4.2
Share of other comprehensive profit	0.3
Dividends received	(4.5)
At 31 March 2017	0.1
Share of post–tax profit – underlying	9.4
Share of post-tax profit – non-underlying	22.5
Share of other comprehensive charges	(2.7)
Disposals	–
Dividends received	(6.5)
At 31 March 2018	**22.8**

The recoverable amount of investments is determined based on value-in-use calculations, which are set out in note 15.

Details of the Group's principal subsidiary, joint venture and associate undertakings are set out in note 40.

As part of the reset of the contracts associated with the Greater Manchester Disposal Authority (GMWDA) the Group disposed of its interest in Viridor Laing (Greater Manchester) Holdings Limited during the year. Full details of the transaction are given in Note 6.

The Group's joint venture and associate listed below all have share capital consisting solely of ordinary shares which is held directly by the Group.

Name of Entity	Place of business/ country of incorporation	% of ownership	Measurement method
Lakeside Energy from Waste Holdings Limited(1)	England	50	Equity
INEOS Runcorn (TPS) Holdings Limited(2)	England	20	Equity

(1) Lakeside Energy from Waste Holdings Limited provides energy recovery facility services.
(2) INEOS Runcorn (TPS) Holdings Limited provides energy recovery facilities. The Group's economic interest is 37.5% as set out in note 40.

The Group's joint ventures and associate are all private companies and there are no quoted market prices available for their shares.

Summarised financial information for the Group's joint venture and associate:

Summarised balance sheet

	2018		2017		
	Lakeside Energy from Waste Holdings Limited £m	**INEOS Runcorn (TPS) Holdings Limited £m**	Lakeside Energy from Waste Holdings Limited £m	Viridor Laing (Greater Manchester) Holdings Limited £m	INEOS Runcorn (TPS) Holdings Limited £m
Current					
Cash and cash equivalents	**16.1**	**15.5**	13.5	63.2	40.0
Other current assets	**8.6**	**10.0**	10.5	4.2	6.7
Total current assets	**24.7**	**25.5**	24.0	67.4	46.7
Borrowings	**–**	**–**	–	–	–
Other current liabilities	**(6.5)**	**(8.6)**	(4.6)	(35.9)	(13.8)
Total current liabilities	**(6.5)**	**(8.6)**	(4.6)	(35.9)	(13.8)
Non-current					
Assets	**109.8**	**270.3**	117.7	303.9	283.5
Borrowings	**(95.5)**	**(86.9)**	(105.5)	(321.9)	(319.7)
Other liabilities	**(28.4)**	**(145.1)**	(32.9)	(48.4)	(44.2)
Total non-current liabilities	**(123.9)**	**(232.0)**	(138.4)	(370.3)	(363.9)
Net assets/(liabilities)	**4.1**	**55.2**	(1.3)	(34.9)	(47.5)
Net debt	**(79.4)**	**(71.4)**	(92.0)	(258.7)	(279.7)
Associated shareholder loans	**16.3**	**86.9**	17.1	80.3	100.9
Net (debt)/funds (excluding shareholder loans)	**(63.1)**	**15.5**	(74.9)	(178.4)	(178.8)

20. Investments continued

Summarised statement of comprehensive income

	2018			2017		
	Lakeside Energy from Waste Holdings Limited £m	Viridor Laing (Greater Manchester) Holdings Limited £m	INEOS Runcorn (TPS) Holdings Limited £m	Lakeside Energy from Waste Holdings Limited £m	Viridor Laing (Greater Manchester) Holdings Limited £m	INEOS Runcorn (TPS) Holdings Limited £m
Revenue	49.2	85.3	53.7	46.8	145.5	59.4
EBITDA	33.7	3.6	38.7	29.4	6.3	40.2
Depreciation and amortisation	(7.9)	(0.6)	(12.1)	(8.1)	(1.3)	(12.4)
Non-underlying credit (see note 6)	–	–	60.0	–	–	–
Interest receivable on service concessions	–	11.3	–	–	22.5	–
Other net interest charge	(7.5)	(14.5)	(20.3)	(8.2)	(27.5)	(29.7)
Pre-tax profit/(loss)	18.3	(0.2)	66.3	13.1	–	(1.9)
Income tax (expense)/income	(3.8)	0.1	(0.3)	(2.2)	(2.5)	1.9
Post-tax profit/(loss)	14.5	(0.1)	66.0	10.9	(2.5)	–
Other comprehensive income	3.9	–	36.7	6.0	8.0	8.1
Total comprehensive income	18.4	(0.1)	102.7	16.9	5.5	8.1
Dividends paid by joint venture	(13.0)	–	–	(9.0)	–	–

The information above reflects the amounts presented in the financial statements of the joint ventures and associate adjusted for differences in accounting policies between the Group and the joint ventures and associate. The information reflects 100% of the joint ventures and associate results and net liabilities. The current year information for Viridor Laing (Greater Manchester) Holdings Limited covers the period from the start of the year to date of disposal.

Reconciliation of summarised financial information

Reconciliation of the summarised financial information presented to the carrying amount of its interest in the joint venture/associate.

	2018			2017		
	Lakeside Energy from Waste Holdings Limited £m	Viridor Laing (Greater Manchester) Holdings Limited £m	INEOS Runcorn (TPS) Holdings Limited £m	Lakeside Energy from Waste Holdings Limited £m	Viridor Laing (Greater Manchester) Holdings Limited £m	INEOS Runcorn (TPS) Holdings Limited £m
Opening net liabilities 1 April	(1.3)	(34.9)	(47.5)	(9.2)	(40.4)	(55.6)
Profit/(loss) for the year	14.5	–	66.0	10.9	(2.5)	–
Other comprehensive income/(loss)	3.9	–	36.7	6.0	8.0	8.1
Dividends paid	(13.0)	–	–	(9.0)	–	–
Disposal	–	34.9	–	–	–	–
Closing net assets	4.1	–	55.2	(1.3)	(34.9)	(47.5)
Interest in joint venture	2.1	–	20.7	(0.7)	(17.4)	(17.8)
Share of net liabilities not recognised	–	–	–	0.8	17.4	17.8
Carrying value	2.1	–	20.7	0.1	–	–

Net liabilities in excess of the Group's interest are not recognised unless the Group has a legal or constructive obligation to fund those liabilities.

21. Inventories

	Group		Company	
	2018 £m	2017 £m	2018 £m	2017 £m
Raw materials and consumables	24.6	21.3	–	–

Notes to the financial statements
continued

22. Trade and other receivables – current

	Group		Company	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Trade receivables	**325.0**	321.6	**–**	–
Less: provision for impairment of receivables	**(104.3)**	(98.1)	**–**	–
Net trade receivables	**220.7**	223.5	**–**	–
Amounts owed by related parties (note 45)	**4.3**	17.0	**–**	–
Amounts owed by subsidiary undertakings	**–**	–	**41.0**	126.1
Other receivables	**4.1**	15.6	**0.3**	0.4
Prepayments and accrued income	**186.9**	84.7	**1.4**	0.8
	416.0	340.8	**42.7**	127.3

Trade receivables include accrued income relating to customers with water budget plans.

In the current year prepayments and accrued income include contractual compensation amounts due totalling £68.7 million related to additional costs incurred in the construction of the Glasgow Recycling and Renewable Energy Centre. A full credit risk appraisal has been carried out on this receivable.

The Directors consider that the carrying amounts of trade and other receivables approximate to their fair value.

There is no concentration of credit risk in trade receivables. The Group has a large number of customers who are dispersed and there is no significant loss on trade receivables expected that has not been provided for. The Group has created IAS 39 portfolio provisions, but cannot practicably identify which receivables specifically are the ones impaired. It is Group policy to consider a receivable in a portfolio to which an impairment has been allocated on a collective basis as not being impaired for the purposes of IFRS 7 disclosures until the loss can be specifically identified with the receivable.

The ageing of trade receivables which are past due but not specifically impaired was:

	2018 £m	2017 £m
Group		
Past due 1 – 30 days	**55.6**	34.1
Past due 31 – 120 days	**27.8**	26.6
More than 120 days	**161.3**	148.2

The aged trade receivables above are taken directly from aged sales ledger records before deduction of credit balances and other adjustments.

The Group's operating businesses specifically review separate categories of debt to identify an appropriate provision for impairment. South West Water Limited has a duty under legislation to continue to provide domestic customers with services regardless of payment.

The movement in the allowance for impairment in respect of trade receivables was:

	2018 £m	2017 £m
At 1 April	**98.1**	95.6
Associated with acquisition of trade receivables (non-household market)	**3.0**	–
Provision for receivables impairment	**7.5**	7.4
Receivables written off during the year as uncollectable	**(4.3)**	(4.9)
At 31 March	**104.3**	98.1

23. Derivative financial instruments

	Group		Company	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Derivatives used for cash flow hedging				
Non-current assets	**3.4**	1.4	**3.4**	0.9
Current assets	**3.6**	4.8	**3.1**	0.4
Current liabilities	**(8.9)**	(16.0)	**(2.7)**	(2.1)
Non-current liabilities	**(7.8)**	(24.0)	**(0.9)**	(1.3)
Derivatives used for fair value hedging				
Non-current assets	**3.3**	2.2	**0.8**	2.2
Current assets	**0.8**	0.6	**3.3**	0.7
Derivatives not in a hedge accounting relationship				
Non-current assets	**63.8**	70.0	**–**	–
Current assets	**8.5**	8.7	**–**	–
Current liabilities	**(0.5)**	(1.3)	**–**	–
Non-current liabilities	**(0.4)**	(1.2)	**–**	–

The fair value of derivatives is split between current and non-current assets or liabilities based on the maturity of the cash flows. The ineffective portion recognised in the income statement arising from hedging relationships was £nil (2017 £nil).

During the year a £15.6 million charge (2017 £10.8 million) was recognised in profit and loss relating to cash flow hedges previously recognised through other comprehensive income and recorded in the hedging reserve.

Interest rate swaps, primarily cash flow hedges, and fixed rate borrowings are used to manage the mix of fixed and floating rates to ensure at least 50% of Group net borrowings are at fixed rate. At 31 March 2018 62% of Group net borrowings were at fixed rate (2017 69%).

At 31 March 2018 the Group had interest rate swaps to swap from floating to fixed rate and hedge financial liabilities with a notional value of £978 million and a weighted average maturity of 2.1 years (2017 £1,078.0 million, with 2.9 years). The weighted average interest rate of the swaps for their nominal amount was 2.0% (2017 2.0%).

The periods for which cash flow hedges are expected to affect future profit or loss are as follows:

	Due within 1 year £m	Due between 1 and 2 years £m	Due between 2 and 5 years £m	Due over 5 years £m	Total £m
Group					
31 March 2018					
Assets	**2.8**	**2.2**	**1.8**	**0.2**	**7.0**
Liabilities	**(8.9)**	**(7.8)**	**–**	**–**	**(16.7)**
31 March 2017					
Assets	0.4	0.4	0.4	0.1	1.3
Liabilities	(16.0)	(12.1)	(11.3)	(0.6)	(40.0)
Company					
31 March 2018					
Assets	**2.2**	**2.2**	**1.9**	**0.2**	**6.5**
Liabilities	**(2.0)**	**(0.8)**	**(0.8)**	**–**	**(3.6)**
31 March 2017					
Assets	0.4	0.4	0.4	0.1	1.3
Liabilities	(2.1)	(1.3)	–	–	(3.4)

In addition, the Group has cash flow hedges that are expected to affect future amounts recognised in property, plant and equipment, amounting to assets of £3.0 million (2017 £4.9 million).

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23. Derivative financial instruments continued

Valuation hierarchy

The Group uses the following hierarchy for determining the fair value of financial instruments by valuation technique:

- quoted prices (unadjusted) in active markets for identical assets or liabilities (level 1)
- inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (level 2)
- inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (level 3).

The fair value of financial instruments not traded in an active market (level 2, for example over-the-counter derivatives) is determined by using valuation techniques. A variety of methods and assumptions are used based on market conditions existing at each balance sheet date. Quoted market prices or dealer quotes for similar instruments are used for long-term debt. Other techniques, such as estimated discounted cash flows, are used to determine fair value for the remaining financial instruments. The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows.

The Group's financial instruments are valued principally using level 2 measures:

	Group		Company	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Assets				
Derivatives used for cash flow hedging	**7.1**	6.2	**6.5**	1.3
Derivatives used for fair value hedging	**4.0**	2.8	**4.1**	2.9
Derivatives not in a hedge accounting relationship	**72.3**	78.7	**–**	–
Total assets	**83.4**	87.7	**10.6**	4.2
Liabilities				
Derivatives used for cash flow hedging	**16.7**	40.0	**3.5**	3.4
Derivatives not in a hedge accounting relationship	**0.9**	2.5	**–**	–
Total liabilities	**17.6**	42.5	**3.5**	3.4

Financial instruments valued using level 3 measures are valued by the counterparty using cash flows discounted at prevailing mid-market rates. The fair value of such financial instruments is not significantly sensitive to unobservable inputs.

The following table presents the changes in level 3 financial instruments for the year:

	Group		Company	
Level 3 inputs	**2018 £m**	2017 £m	**2018 £m**	2017 £m
At 1 April	**–**	(4.2)	**–**	(4.2)
Gains recognised in net finance costs	**–**	6.8	**–**	6.8
Unwind loss on financial instrument (note 6)	**–**	(44.8)	**–**	(83.5)
Amounts to be settled post unwind of financial instrument (notes 6 and 29)	**–**	44.3	**–**	44.3
Amounts settled during the year	**–**	(2.1)	**–**	36.6
At 31 March	**–**	–	**–**	–

24. Financial instruments at fair value through profit

	Group		Company	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Current liabilities	**(2.6)**	(2.4)	**(0.4)**	–
Non-current liabilities	**(46.6)**	(48.4)	**(1.7)**	(1.4)

Financial instruments at fair value through profit reflect the fair value movement of the hedged risk on a hedged item which had been designated in a fair value hedging relationship.

25. Cash and cash deposits

	Group		Company	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Cash at bank and in hand	**114.9**	101.2	**15.2**	99.4
Short-term bank deposits	**113.0**	78.0	**113.0**	78.0
Other deposits	**357.4**	418.9	**175.1**	195.1
Total cash and cash deposits	**585.3**	598.1	**303.3**	372.5

Group short-term deposits have an average maturity of 1 day.

Group other deposits have an average maturity of 58 days.

Group other deposits include restricted funds of £182.3 million (2017 £223.8 million) to settle long-term lease liabilities (note 28). Restricted funds are available for access, subject to being replaced by an equivalent valued security.

For the purposes of the cash flow statement cash and cash equivalents comprise:

	Group		Company	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Cash and cash deposits as above	**585.3**	598.1	**303.3**	372.5
Less: deposits with a maturity of three months or more (restricted funds)	**(182.3)**	(223.8)	**–**	–
	403.0	374.3	**303.3**	372.5

26. Trade and other payables – current

	Group		Company	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Trade payables	**98.2**	107.4	**0.1**	0.2
Amounts owed to subsidiary undertakings	**–**	–	**5.7**	0.8
Amounts owed to joint ventures (note 45)	**3.7**	4.2	**–**	–
Other tax and social security	**48.4**	50.6	**0.6**	0.3
Accruals and other payables	**191.7**	124.3	**50.7**	5.0
	342.0	286.5	**57.1**	6.3

The Directors consider that the carrying amount of trade and other payables approximates to their fair value.

At 31 March 2018 Accruals and other payables includes an amount of £44.3 million due to Nomura Structured Holdings plc on unwind of a synthetic derivative (see note 6) which was included in non-current liabilities at 31 March 2017.

27. Current tax liabilities

	Group		Company	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Current year creditor	**11.8**	8.2	**(1.7)**	–
Prior year tax items	**12.6**	18.6	**25.6**	37.9
	24.4	26.8	**23.9**	37.9

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28. Borrowings

	Group		Company	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Current				
Short-term loans	**149.6**	74.9	**149.6**	74.9
European Investment Bank	**32.0**	41.1	**–**	–
Amounts owed to subsidiary undertakings (note 45)	**–**	–	**283.6**	282.9
	181.6	116.0	**433.2**	357.8
Obligations under finance leases	**28.2**	30.5	**–**	–
Total current borrowings	**209.8**	146.5	**433.2**	357.8
Non-current				
Bank and other loans	**229.0**	328.8	**149.1**	248.6
Private placements	**619.6**	560.5	**562.6**	560.5
Bond 2040	**133.9**	133.6	**–**	–
RPI index-linked bonds	**426.3**	416.4	**–**	–
European Investment Bank	**291.4**	323.4	**–**	–
Amounts owed to subsidiary undertakings (note 45)	**–**	–	**–**	39.1
	1,700.2	1,762.7	**711.7**	848.2
Obligations under finance leases	**1,476.8**	1,353.8	**–**	–
Total non-current borrowings	**3,177.0**	3,116.5	**711.7**	848.2
Total borrowings	**3,386.8**	3,263.0	**1,144.9**	1,206.0

The Company issued a £100 million private placement in July 2007 maturing in 2022. Interest is payable at a fixed rate of 3.3%.

South West Water Finance Plc issued a £200 million RPI index-linked bond in July 2008 maturing in 2057 with a cash coupon of 1.99%. South West Water Finance Plc issued a £150 million bond in July 2010 maturing in 2040 with a cash coupon of 5.875%.

Bournemouth Water Limited issued a £65 million RPI index-linked bond in April 2005 maturing in 2033 with a cash coupon of 3.084%. This instrument was transferred to South West Water Limited in April 2017.

The fair values of non-current borrowings, valued using level 2 measures (as set out in note 23) were:

	2018		2017	
	Book value £m	**Fair value £m**	Book value £m	Fair value £m
Group				
Bank and other loans	**229.0**	**232.8**	328.8	336.4
Private placements	**619.6**	**652.3**	560.5	614.0
Bond 2040	**133.9**	**197.5**	133.6	198.7
RPI index-linked bond	**426.3**	**495.5**	416.4	496.2
European Investment Bank	**291.4**	**251.5**	323.4	282.3
	1,700.2	**1,829.6**	1,762.7	1,927.6
Obligations under finance leases	**1,476.8**	**1,350.0**	1,353.8	1,217.3
	3, 177.0	**3,179.6**	3,116.5	3,144.9
Company				
Bank and other loans	**149.1**	**152.4**	248.6	256.4
Private placements	**562.6**	**595.4**	560.5	614.0
Amounts owed to subsidiary undertakings (note 45)	**–**	**–**	39.1	39.1
	711.7	**747.8**	848.2	909.5

Where market values are not available, fair values of borrowings have been calculated by discounting expected future cash flows at prevailing interest rates.

The maturity of non-current borrowings was:

	Group		Company	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Between 1 and 2 years	**190.6**	207.7	**102.0**	188.6
Over 2 year and less than 5 years	**574.3**	408.3	**260.6**	148.1
Over 5 years	**2,412.1**	2,500.5	**349.1**	511.5
	3,177.0	3,116.5	**711.7**	848.2

The weighted average maturity of non-current borrowings was 19 years (2017 22 years).

28. Borrowings continued

Finance lease liabilities – minimum lease payments were:

	Group		Company	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Within 1 year	**52.1**	44.3	**–**	–
Over 1 year and less than 5 years	**310.8**	245.3	**–**	–
Over 5 years	**2,121.7**	2,021.3	**–**	–
	2,484.6	2,310.9	**–**	–
Less: future finance charges	**(979.6)**	(926.6)	**–**	–
Present value of finance lease liabilities	**1,505.0**	1,384.3	**–**	–

The maturity of finance lease liabilities was:

	Group		Company	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Within 1 year	**28.2**	30.5	**–**	–
Over 1 year and less than 5 years	**209.7**	175.4	**–**	–
Over 5 years	**1,267.1**	1,178.4	**–**	–
	1,505.0	1,384.3	**–**	–

Included above are accrued finance charges arising on obligations under finance leases totalling £155.7 million (2017 £146.3 million), of which £3.4 million (2017 £2.0 million) is repayable within one year.

The period for repayment of certain leases includes an agreement to deposit with the lessor group amounts equal to the difference between the original and revised payments due. The accumulated deposits, £87.9 million at 31 March 2018 (2017 £79.3 million), are currently being held to settle the lease liability, subject to rights to release by negotiation with the lessor. The deposits are subject to a registered charge given as security to the lessor for the balance outstanding.

The period for repayment of certain other existing leases includes an agreement to deposit with the lessor group amounts equal to the difference between the original and revised payments due. The accumulated deposits, £92.5 million at 31 March 2018 (2017 £142.4 million), are currently being held to settle the lease liability, subject to rights to release by negotiation with the lessor. The deposits are subject to a registered charge given as security to the lessor for the outstanding balance.

Undrawn committed borrowing facilities at the balance sheet date were:

	Group		Company	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Floating rate:				
Expiring within 1 year	**180.0**	60.0	**100.0**	60.0
Expiring after 1 year	**405.9**	725.0	**125.0**	180.0
	585.9	785.0	**225.0**	240.0

In addition at 31 March 2018 the Group had undrawn uncommitted short-term bank facilities of £30.0 million (2017 £15.0 million) available to the Company.

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29. Other non-current liabilities

	Group		Company	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Amounts owed to subsidiary undertakings	**–**	–	**8.7**	8.7
Deferred income	**118.5**	114.5	**–**	–
Other payables	**21.6**	66.2	**–**	44.3
	140.1	180.7	**8.7**	53.0

Deferred income includes amounts relating to the adoption at fair value of assets transferred from customers in the water segment.

In the prior year, other payables included an amount of £44.3 million due to Nomura Structured Holdings plc on unwind of a synthetic derivative (see note 6) which this year is included within current liabilities.

Included in other payables are amounts provided by the Group in relation to claims received which are considered by the Directors and the management of the Group to be the best estimate of the amounts that might be finally settled. Further disclosures have not been provided in accordance with IAS 37 paragraph 92.

30. Retirement benefit obligations

During the year the Group operated a number of defined benefit pension schemes and also a defined contribution section within the main scheme. The principal plan within the Group is the Pennon Group Pension Scheme, which is a funded defined benefit, final salary pension scheme in the UK. The Group's pension schemes are established under trust law and comply with all relevant UK legislation.

The assets of the Group's pension schemes are held in separate trustee administered funds. The trustees of the funds are required to act in the best interest of the funds' beneficiaries. The appointment of schemes' trustees is determined by the schemes' trust documentation. The Group has a policy for the main fund that one-half of all trustees, other than the Chairman, are nominated by members of the schemes, including pensioners.

Defined contribution schemes

Pension costs for defined contribution schemes were £6.1 million (2017 £5.3 million).

Defined benefit schemes

Assumptions

The principal actuarial assumptions at 31 March were:

	2018 %	2017 %	2016 %
Rate of increase in pensionable pay	**3.2**	3.2	2.9
Rate of increase for current and future pensions	**3.0**	2.0	2.9
Rate used to discount schemes' liabilities and expected return on schemes' assets	**2.70**	2.55	3.30
Inflation	**3.2**	3.2	2.9

Mortality

Assumptions regarding future mortality experience are set based on actuarial advice in accordance with published statistics and experience. The mortality assumption uses a scheme-specific calculation based on CMI 2016 actuarial tables with an allowance for future longevity improvement.

The average life expectancy in years of a member having retired at age 62 on the balance sheet date is projected as:

	2018	2017	2016
Male	**24.9**	24.8	25.1
Female	**27.3**	27.2	27.3

The average life expectancy in years of a future pensioner retiring at age 62, 20 years after the balance sheet date, is projected as:

	2018	2017	2016
Male	**26.3**	26.2	26.5
Female	**29.6**	29.5	29.6

30. Retirement benefit obligations continued

The sensitivities regarding the principal assumptions used to measure the schemes' liabilities are:

	Change in assumption	Impact on schemes' liabilities
Rate of increase in pensionable pay	+/– 0.5%	+/– 0.6%
Rate of increase in current and future pensions	+/– 0.5%	+/– 6.3%
Rate used to discount schemes' liabilities	+/– 0.5%	+/– 9.3%
Inflation	+/– 0.5%	+/– 6.8%
Life expectancy	+/– 1 year	+/– 4.6%

The sensitivity analysis shows the effect of changes in the principal assumptions used for the measurement of the pension liability. The method used to calculate the sensitivities is approximate and has been determined taking into account the duration of the liabilities and the overall profile of each scheme's membership. This is the same approach as has been adopted in previous years.

The amounts recognised in the balance sheet were:

	Group		Company	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Present value of financial obligations	**(931.2)**	(956.0)	**(56.5)**	(58.0)
Fair value of plan assets	**898.5**	903.4	**53.2**	53.9
Deficit of funded plans	**(32.7)**	(52.6)	**(3.3)**	(4.1)
Impact of minimum funding asset ceiling	**(16.8)**	(15.4)	**–**	–
Net liability recognised in the balance sheet	**(49.5)**	(68.0)	**(3.3)**	(4.1)

The movement in the net defined benefit obligation over the accounting period is as follows:

	2018			2017		
	Present value of obligation £m	**Fair value of plan assets £m**	**Total £m**	Present value of obligation £m	Fair value of plan assets £m	Total £m
At 1 April	**(971.4)**	**903.4**	**(68.0)**	(833.6)	792.7	(40.9)
Current service cost	**(13.9)**	**–**	**(13.9)**	(12.0)	–	(12.0)
Past service cost and gains and losses on settlements	**(0.7)**	**–**	**(0.7)**	(1.5)	–	(1.5)
Interest (expense)/income	**(24.1)**	**22.5**	**(1.6)**	(27.4)	26.2	(1.2)
	(38.7)	**22.5**	**(16.2)**	(40.9)	26.2	(14.7)
Remeasurements:						
Return/ (loss) on plan on assets excluding amounts included in interest expense	**–**	**(5.7)**	**(5.7)**	–	106.0	106.0
Gain from change in demographic assumptions	**1.0**	**–**	**1.0**	12.2	–	12.2
(Loss)/ gain from change in financial assumptions	**30.6**	**–**	**30.6**	(133.1)	–	(133.1)
Experience losses	**(1.4)**	**–**	**(1.4)**	(8.7)	–	(8.7)
	30.2	**(5.7)**	**24.5**	(129.6)	106.0	(23.6)
Contributions:						
Employers	**–**	**10.2**	**10.2**	–	11.2	11.2
Plan participants	**(1.0)**	**1.0**	**–**	(1.1)	1.1	–
Payments from plans:						
Benefit payments	**32.9**	**(32.9)**	**–**	33.8	(33.8)	–
	31.9	**(21.7)**	**10.2**	32.7	(21.5)	11.2
At 31 March	**(948.0)**	**898.5**	**(49.5)**	(971.4)	903.4	(68.0)

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30. Retirement benefit obligations continued

The movement in the Company's net defined benefit obligation over the accounting period is as follows:

	2018			2017		
	Present value of obligation £m	**Fair value of plan assets £m**	**Total £m**	Present value of obligation £m	Fair value of plan assets £m	Total £m
1 April	**(58.0)**	**53.9**	**(4.1)**	(50.7)	47.7	(3.0)
Current service cost	**(0.3)**	**–**	**(0.3)**	(0.2)	–	(0.2)
Interest (expense)/income	**(1.5)**	**1.3**	**(0.2)**	(1.8)	1.7	(0.1)
	(1.8)	**1.3**	**(0.5)**	(2.0)	1.7	(0.3)
Remeasurements:						
(Loss)/return on plan on assets excluding amounts included in interest expense	**–**	**(0.1)**	**(0.1)**	–	6.0	6.0
Gain from change in demographic assumptions	**–**	**–**	**–**	1.0	–	1.0
Gain/(loss) from change in financial assumptions	**1.8**	**–**	**1.8**	(9.0)	–	(9.0)
Experience gains	**(0.6)**	**–**	**(0.6)**	0.5	–	0.5
	1.2	**(0.1)**	**1.1**	(7.5)	6.0	(1.5)
Contributions:						
Employers	**–**	**0.2**	**0.2**	–	0.7	0.7
Payments from plans:						
Benefit payments	**2.1**	**(2.1)**	**–**	2.2	(2.2)	–
	2.1	**(1.9)**	**0.2**	2.2	(1.5)	0.7
31 March	**(56.5)**	**53.2**	**(3.3)**	(58.0)	53.9	(4.1)

Changes in the effect of the asset ceiling during the year were:

	Group		Company	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Irrecoverable asset at start of the year	**15.8**	7.6	**–**	–
Interest on irrecoverable surplus	**0.4**	0.2	**–**	–
Actuarial gains	**1.1**	8.0	**–**	–

The Group has two smaller pension schemes which are in surplus. One of these surpluses is deemed to have irrecoverable assets in accordance with IFRIC 14 'The Limit on Defined Benefit Asset, Minimum Funding Requirements and their Interaction'.

The schemes' assets were:

	2018			2017		
	Quoted prices in active market £m	**Prices not quoted in active market £m**	**Fund %**	Quoted prices in active market £m	Prices not quoted in active market £m	Fund %
Equities	**208.3**	**–**	**23**	243.7	1.9	27
Government bonds	**170.2**	**–**	**19**	168.8	–	19
Other bonds	**211.9**	**–**	**24**	170.0	–	19
Diversified growth	**182.3**	**7.9**	**21**	96.8	–	11
Property	**57.4**	**9.9**	**7**	52.1	8.8	7
Insurance linked security	**41.8**	**–**	**5**	47.2	–	5
Other (including cash funds)	**8.8**	**–**	**1**	100.2	13.9	12
	880.7	**17.8**	**100**	878.8	24.6	100

30. Retirement benefit obligations continued

Other assets at 31 March 2018 represented principally cash contributions received from the Group towards the year end which were invested during the subsequent financial year.

The Company's share of the schemes' assets at the balance sheet date was:

	2018			2017		
	Quoted prices in active market £m	Prices not quoted in active market £m	Fund %	Quoted prices in active market £m	Prices not quoted in active market £m	Fund %
Equities	10.5	–	20	13.0	–	24
Government bonds	10.7	–	20	10.5	–	19
Other bonds	13.3	–	24	10.1	–	19
Diversified growth	10.4	–	20	6.2	–	12
Property	4.7	–	9	4.2	–	8
Insurance linked security	3.3	–	6	3.8	–	7
Other	0.3	–	1	6.1	–	11
	53.2	–	100	53.9	–	100

Through its defined benefit pension plan, the Group is exposed to a number of risks, the most significant of which are detailed below:

Asset volatility	The liabilities are calculated using a discount rate set with reference to corporate bond yields; if assets underperform this yield, this will create a deficit. The schemes hold a significant proportion of growth assets (equities and diversified growth funds) which are expected to outperform corporate bonds in the long-term, but can give rise to volatility and risk in the short-term. The allocation to growth assets is monitored such that it is suitable with the schemes' long-term objectives.
Changes in bond yields	A decrease in corporate bond yields will increase the schemes' liabilities, although this will be partially offset by an increase in the value of the schemes' bond holdings.
Inflation risk	The majority of the schemes' benefit obligations are linked to inflation, and higher inflation will lead to higher liabilities (although, in most cases, caps on the level of inflationary increases are in place to protect against extreme inflation). The majority of the assets are either unaffected by or loosely correlated with inflation, meaning that an increase in inflation will also increase the deficit.
Life expectancy	The majority of the schemes' obligations are to provide benefits for the life of the member, so increases in life expectancy will result in an increase in the liabilities.

In conjunction with its investment advisers, the trustees have structured the schemes' investments with the objective of balancing investment returns and levels of risk. The asset allocation for the main scheme has three principal elements:

- Holding of cash funds and bonds which are expected to be less volatile than most other asset classes and reflects market movements in the schemes' liabilities
- A proportion of equities, with fund managers having freedom in making investment decisions to maximise returns
- Investment of a proportion of the schemes' assets in alternative asset classes which give the potential for diversification (currently property and diversified growth).

The liabilities of the defined benefit schemes are measured by using the projected unit credit method which is an accrued benefits valuation method in which the scheme liabilities make allowance for projected increases in pensionable pay.

The future cash flows arising from the payment of the defined benefits are expected to be settled primarily in the period between 15 and 40 years from the balance sheet date.

The 2016 triennial actuarial valuation of the principal defined benefit scheme has been agreed, with the actuarial valuation deficit and schedule of contributions being in line with the 2013 triennial actuarial valuation, requiring deficit recovery contributions of c.£13 million per annum rising with inflation from 2019 to 2022. The Group's deficit recovery contribution to the main scheme for 2018 has been paid in earlier periods (2017 £0.5 million). The Group monitors funding levels on an annual basis and expects to pay total contributions of around £27 million during the year ended 31 March 2019.

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31. Deferred tax

Deferred tax is provided in full on temporary differences under the liability method using enacted tax rates.

Movements on deferred tax were:

	Group		Company	
	2018 £m	2017 £m	2018 £m	2017 £m
Liabilities/(assets) at 1 April	**269.6**	272.0	**(2.3)**	(2.2)
Charged/(credited) to the income statement	**18.3**	18.9	**(0.2)**	–
Charged/(credited) to equity	**8.1**	(2.3)	**0.9**	–
Change of rate in income statement – non-underlying	**–**	(21.3)	**–**	(0.1)
Other non-underlying charges in the income statement	**(0.4)**	2.3	**–**	–
Liabilities/(assets) at 31 March	**295.6**	269.6	**(1.6)**	(2.3)

Deferred tax assets have been recognised in respect of all temporary differences giving rise to deferred tax assets because it is probable that these assets will be recovered.

The majority of the Group's deferred tax liability is expected to be recovered over more than one year. The majority of the Company's deferred tax asset is expected to be recovered over more than one year. All deferred tax assets and liabilities within the same jurisdiction are offset.

In the prior year the deferred tax balance was reduced by a credit of £19.7 million to recognise the change in the rate of corporation tax enacted on 15 September 2016 to reduce the rate at 1 April 2020 from 18% to 17%. This credit included a credit of £21.3 million recognised in the income statement and a debit of £1.6 million recognised in equity.

The movements in deferred tax assets and liabilities were:

Group

Deferred tax liabilities

	Accelerated tax depreciation £m	Fair value adjustments £m	Revenue on service concession arrangements £m	Derivatives £m	Other £m	Total £m
At 1 April 2016	243.7	24.6	39.7	–	0.9	308.9
Charged/(credited) to the income statement	15.8	(1.9)	4.8	–	(0.4)	18.3
Non-underlying credit to the income statement	(17.6)	(0.6)	(2.8)	–	(0.1)	(21.1)
Reclassifications	(0.1)	–	–	–	–	(0.1)
At 31 March 2017	241.8	22.1	41.7	–	0.4	306.0
Charged/(credited) to the income statement	18.1	(1.5)	2.0	–	(0.4)	18.2
Transfer from deferred tax assets	–	–	–	0.7	–	0.7
At 31 March 2018	**259.9**	**20.6**	**43.7**	**0.7**	**–**	**324.9**

Deferred tax assets

	Long term liabilities including provisions £m	Retirement benefit obligations £m	Derivatives £m	Share based payments £m	Tax losses £m	Fair value adjustment £m	Other £m	Total £m
At 1 April 2016	(4.9)	(7.4)	(7.2)	(1.3)	(1.9)	(11.0)	(3.2)	(36.9)
(Credited)/charged to the income statement	(1.2)	(0.6)	–	–	0.1	0.5	1.8	0.6
Non-underlying charge/(credit) to the income statement	(0.1)	(0.2)	2.6	–	0.1	0.5	(0.8)	2.1
(Credited)/charged to equity	–	(4.7)	1.0	(0.2)	–	–	–	(3.9)
Non-underlying charge to equity	–	1.4	0.3	(0.1)	–	–	–	1.6
Reclassifications	(0.2)	–	0.9	–	–	–	(0.6)	0.1
At 31 March 2017	(6.4)	(11.5)	(2.4)	(1.6)	(1.7)	(10.0)	(2.8)	(36.4)
(Credited)/charged to the income statement	1.0	(1.1)	–	0.4	–	0.1	(0.3)	0.1
Non-underlying (credit)/charge to the income statement	–	–	(0.4)	–	–	–	–	(0.4)
Charged to equity	–	4.2	3.5	0.4	–	–	–	8.1
Transfer to deferred tax liabilities	–	–	(0.7)	–	–	–	–	(0.7)
At 31 March 2018	**(5.4)**	**(8.4)**	**–**	**(0.8)**	**(1.7)**	**(9.9)**	**(3.1)**	**(29.3)**
Net liability:								
At 31 March 2017								269.6
At 31 March 2018								**295.6**

31. Deferred tax continued

Company

Deferred tax assets

	Retirement benefit obligations £m	Derivatives £m	Share based payments £m	Other £m	Total £m
At 1 April 2016	(0.5)	(1.3)	(0.2)	(0.2)	(2.2)
(Credited)/charged to the income statement	–	–	(0.1)	0.1	–
Non-underlying credit to income statement	(0.1)	–	–	–	(0.1)
(Credited)/charged to equity	(0.3)	0.1	(0.1)	–	(0.3)
Non-underlying charge to equity	0.2	0.1	–	–	0.3
At 31 March 2017	(0.7)	(1.1)	(0.4)	(0.1)	(2.3)
(Credited)/ charged to the income statement	(0.1)	–	0.1	(0.2)	(0.2)
Charged to equity	0.2	0.6	0.1	–	0.9
At 31 March 2018	**(0.6)**	**(0.5)**	**(0.2)**	**(0.3)**	**(1.6)**

Deferred tax (charged)/credited to equity during the year was:

	Group		Company	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Remeasurement of defined benefit obligations	**(4.2)**	3.3	**(0.2)**	0.1
Cash flow hedges	**(3.5)**	(1.3)	**(0.6)**	(0.2)
Deferred tax on other comprehensive loss/(gain)	**(7.7)**	2.0	**(0.8)**	(0.1)
Share-based payments	**(0.4)**	0.3	**(0.1)**	0.1
	(8.1)	2.3	**(0.9)**	–

32. Provisions

	Environmental and landfill restoration £m	Restructuring £m	Other provisions £m	Total £m
Group				
At 1 April 2017	183.8	6.5	23.9	214.2
Charged to the income statement	6.7	–	0.9	7.6
Capitalised	11.1	–	–	11.1
Utilised	(9.7)	(3.1)	(0.6)	(13.4)
At 31 March 2018	**191.9**	**3.4**	**24.2**	**219.5**

The amount charged to the income statement includes £10.2 million (2017 £9.1 million) charged to finance costs as the unwinding of discounts in provisions.

The analysis of provisions between current and non-current is:

	2018 £m	2017 £m
Current	**38.0**	40.4
Non-current	**181.5**	173.8
	219.5	214.2

Environmental and landfill restoration provisions are incurred during the operational life of each landfill site and for a considerable period thereafter. The period of aftercare post-closure and the level of costs expected are uncertain and can vary significantly from site to site. Key factors are the type of waste, the speed at which it decomposes, the volume of leachate requiring treatment and regulatory requirements specific to the site. Environmental and landfill restoration provisions are expected to be substantially utilised throughout the operational life of a site and for landfill sites within 60 years of closure. The provisions have been established assuming current waste management technology based upon estimated costs at future prices which have been discounted to present value. The Group has applied a discount rate of 4.825% (2017 4.75%) and an inflation rate of 2.5% (2017 2.5%) to its aftercare provision and a discount rate of 3.8% (2017 4.75%) and an inflation rate of 2.5% (2017 2.5%) to its restoration provision.

The restructuring provision relates principally to severance costs and will be utilised within one year.

Other provisions include underperforming contracts of £11.0 million (2017 £11.1 million), which are provided for at the net present value of the operating losses of the underperforming contracts and are to be utilised over the remaining period of the contract to which they relate. The weighted average contract life of underperforming contracts is 6 years.

Notes to the financial statements
continued

33. Share capital

Allotted, called-up and fully paid

	Number of shares		
	Treasury shares	Ordinary shares	£m
Group and Company			
At 1 April 2016 ordinary shares of 40.7p each	10,356	412,340,597	167.8
Shares issued under the Scrip Dividend Alternative	–	771,563	0.3
For consideration of £1.3 million, shares issued to the Pennon Employee Share Trust	–	143,479	0.1
For consideration of £0.2 million, shares issued under the Executive Share Option Scheme	–	24,457	–
For consideration of £0.0 million, shares reissued under the Executive Share Option Scheme	(1,913)	1,913	–
For consideration of £3.2 million, shares issued under the Company's Sharesave Scheme	–	611,284	0.2
At 31 March 2017 ordinary shares of 40.7p each	8,443	413,893,293	168.4
Shares issued under the Scrip Dividend Alternative	–	5,223,293	2.1
For consideration of £0.5 million, shares issued to the Pennon Employee Share Trust	–	46,205	0.1
For consideration of £3.4 million, shares issued under the Company's Sharesave Scheme	–	580,392	0.2
At 31 March 2018 ordinary shares of 40.7p each	**8,443**	**419,743,183**	**170.8**

Shares held as treasury shares may be sold or reissued for any of the Company's share schemes, or cancelled.

Employee share schemes

The Group operates a number of equity-settled share plans for the benefit of employees. Details of each plan are:

i) Sharesave Scheme

An all-employee savings related plan is operated that enables employees, including Executive Directors, to invest up to a maximum of £500 per month for three or five years. These savings can then be used to buy ordinary shares, at a price set at a 17% discount to the market value at the start of the savings period, at the third or fifth year anniversary of the option being granted. Options expire six months following the exercise date and, except for certain specific circumstances such as redundancy, lapse if the employee leaves the Group before the option exercise period commences.

Outstanding options to subscribe for ordinary shares of 40.7p each under the Company's share option schemes are:

Date granted and	subscription price fully paid	Period when options normally exercisable	Thousands of shares in respect of which options outstanding at 31 March 2018	2017
28 June 2010	431p	2013 – 2017	**–**	41
29 June 2011	536p	2014 – 2017	**26**	29
29 June 2012	588p	2015 – 2017	**2**	91
3 July 2013	538p	2016 – 2017	**94**	103
14 July 2014	611p	2017 – 2018	**159**	609
24 June 2015	683p	2017 – 2020	**933**	1,132
29 June 2016	709p	2019 – 2021	**605**	748
28 June 2017	767p	2020 – 2022	**671**	–
			2,490	2,753

33. Share capital continued

The number and weighted average exercise price of Sharesave options are:

	2018		2017	
	Number of ordinary shares (thousands)	Weighted average exercise price per share (p)	Number of ordinary shares (thousands)	Weighted average exercise price per share (p)
At 1 April	**2,753**	**660**	2,856	619
Granted	**775**	**767**	798	709
Forfeited	**(411)**	**707**	(205)	661
Exercised	**(570)**	**597**	(610)	533
Expired	**(57)**	**667**	(86)	639
At 31 March	**2,490**	**700**	2,753	660

The weighted average price of the Company's shares at the date of exercise of Sharesave options during the year was 798p (2017 878p). The options outstanding at 31 March 2018 had a weighted average exercise price of 700p (2017 660p) and a weighted average remaining contractual life of 1.6 years (2017 1.9 years).

The aggregate fair value of Sharesave options granted during the year was £0.9 million (2017 £0.9 million), determined using the Black-Scholes valuation model. The significant inputs into the valuation model at the date of issue of the options were:

	2018	2017
Weighted average share price	**848**	854
Weighted average exercise price	**767**	709
Expected volatility	**19.0%**	18.0%
Expected life	**3.4 years**	3.4 years
Risk-free rate	**0.3%**	0.3%
Expected dividend yield	**4.5%**	4.2%

Expected volatility was determined by calculating the historical volatility of the Group's share price over the previous three years.

ii) Performance and Co-investment Plan

Executive Directors and senior management receive a conditional award of ordinary shares in the Company and are also required to hold a substantial personal shareholding in the Company. The eventual number of shares, if any, which vest is dependent upon the achievement of conditions of the plan over the restricted period, being not less than three years. From 2017/18, no further awards are made under this Plan as it has been superseded by a Long-term Incentive Plan (see iii) below).

The number and price of shares in the Performance and Co-investment Plan are:

	2018		2017	
	Number of ordinary shares (thousands)	Weighted average exercise price per share (p)	Number of ordinary shares (thousands)	Weighted average exercise price per share (p)
At 1 April	**1,021**	**850**	1,198	761
Granted	**–**	**–**	378	920
Vested	**(50)**	**799**	(128)	653
Lapsed	**(400)**	**852**	(427)	721
At 31 March	**571**	**865**	1,021	850

The awards outstanding at 31 March 2018 had a weighted exercise price of 865p (2017 850p) and a weighted average remaining contractual life of 0.7 years (2017 1.3 years).

The aggregate fair value of awards granted in the prior year was £1.7 million determined using a Monte-Carlo simulation model. The significant inputs into the valuation model at the date of the share awards were:

	2017
Weighted average share price	920p
Expected volatility	18.0%
Risk-free rate	0.3%

Expected volatility was determined by calculating the historical volatility of the Group's share price over the previous three years.

Notes to the financial statements
continued

33. Share capital continued

iii) Long-term Incentive Plan (LTIP)

Executive Directors and senior management receive an annual grant of conditional shares. Share awards vest subject to the achievement of specific performance conditions measured over a performance period of not less than three years.

The number and price of shares in the LTIP are:

	2018	
	Number of ordinary shares (thousands)	**Weighted average exercise price per share (p)**
At 1 April	–	–
Granted	**537**	**803**
Lapsed	**(27)**	**803**
At 31 March	**510**	**803**

The awards outstanding at 31 March 2018 had a weighted exercise price of 803p and a weighted average remaining contractual life of 2.4 years.

The aggregate fair value of awards granted during the year was £1.0 million, determined from market value. No option pricing methodology is applied is applied since the vesting of the shares depend on non-market performance vesting conditions.

iv) Annual Incentive Bonus Plan – deferred shares

Awards under the plan to Executive Directors and senior management involve the release of ordinary shares in the Company to participants. There is no performance condition since vesting is conditional upon continuous service with the Group for a period of three years from the award. The number and weighted average price of shares in the Annual Incentive Bonus Plan are:

	2018		2017	
	Number of ordinary shares (thousands)	**Weighted average exercise price per share (p)**	Number of ordinary shares (thousands)	Weighted average exercise price per share (p)
At 1 April	**325**	**848**	307	759
Granted	**172**	**809**	146	944
Vested	**(51)**	**821**	(122)	745
Lapsed	**(41)**	**815**	(6)	701
At 31 March	**405**	**843**	325	848

The awards outstanding at 31 March 2018 had a weighted average exercise price of 843p (2017 848p) and a weighted average remaining contractual life of 1.5 years (2017 1.4 years). The Company's share price at the date of the awards ranged from 791p to 950p.

The aggregate fair value of awards granted during the year was £0.9 million (2017 £1.3 million), determined from market value. No option pricing methodology is applied since dividends paid on the shares are receivable by the participants in the scheme.

Further details of the plans and options granted to Directors, included above, are shown in the Directors' remuneration report.

34. Share premium account

	£m
Group and Company	
At 1 April 2016	213.3
Adjustment for shares issued under the Scrip Dividend Alternative	(0.3)
Shares issued under the Sharesave Scheme	3.0
Shares issued to the Pennon Employee Share Trust	1.2
Shares issued under the Executive Share Option Scheme	0.2
At 31 March 2017	217.4
Adjustment for shares issued under the Scrip Dividend Alternative	(2.1)
Shares issued under the Sharesave Scheme	3.1
Shares issued to the Pennon Employee Share Trust	0.4
At 31 March 2018	**218.8**

35. Capital redemption reserve

The capital redemption reserve represents the redemption of B shares and cancellation of deferred shares arising from a capital return to shareholders undertaken during 2006.

	£m
Group and Company	
At 1 April 2016	144.2
At 31 March 2017	144.2
At 31 March 2018	**144.2**

36. Retained earnings and other reserves

	Own shares £m	Hedging reserve £m	Retained earnings £m	Total £m
Group				
At 1 April 2016	(2.1)	(31.8)	701.4	667.5
Profit for the year	–	–	164.3	164.3
Other comprehensive loss for the year	–	5.1	(20.0)	(14.9)
Transfer from hedging reserve to property, plant and equipment	–	(1.5)	–	(1.5)
Dividends paid relating to 2016	–	–	(138.5)	(138.5)
Adjustment for shares issued under the Scrip Dividend Alternative	–	–	6.9	6.9
Credit to equity in respect of share-based payments (net of tax)	–	–	3.2	3.2
Charge in respect of share options vesting	2.1	–	(2.1)	–
Own shares acquired by the Pennon Employee Share Trust in respect of share options granted	(2.6)	–	–	(2.6)
At 31 March 2017	(2.6)	(28.2)	715.2	684.4
Profit for the year	–	–	200.6	200.6
Other comprehensive income for the year	–	17.1	17.5	34.6
Redemption of perpetual capital securities (see note 37)	–	–	(5.2)	(5.2)
Dividends paid relating to 2017	–	–	(149.5)	(149.5)
Adjustment for shares issued under the Scrip Dividend Alternative	–	–	41.7	41.7
Credit to equity in respect of share-based payments (net of tax)	–	–	2.2	2.2
Charge in respect of share options vesting	0.8	–	(0.8)	–
Own shares acquired by the Pennon Employee Share Trust in respect of share options granted	(1.7)	–	–	(1.7)
At 31 March 2018	**(3.5)**	**(11.1)**	**821.7**	**807.1**

The own shares reserve represents the cost of ordinary shares in Pennon Group plc issued to or purchased in the market and held by the Pennon Employee Share Trust to satisfy awards under the Group's Annual Incentive Bonus Plan.

The market value of the 440,000 ordinary shares (2017 330,000 ordinary shares) held by the Trust at 31 March 2018 was £2.8 million (2017 £2.9 million).

Notes to the financial statements continued

36. Retained earnings and other reserves continued

	Hedging reserve £m	Retained earnings £m	Total £m
Company			
At 1 April 2016	(5.0)	981.1	976.1
Profit for the year	–	162.9	162.9
Other comprehensive loss for the year	0.3	(1.4)	(1.1)
Dividends paid relating to 2016	–	(138.5)	(138.5)
Adjustment for shares issued under the Scrip Dividend Alternative	–	6.9	6.9
Credit to equity in respect of share-based payments (net of tax)	–	1.2	1.2
Charge in respect of share options vesting	–	(2.1)	(2.1)
At 31 March 2017	(4.7)	1,010.1	1,005.4
Profit for the year	–	215.1	215.1
Other comprehensive loss for the year	2.7	0.9	3.6
Dividends paid relating to 2017	–	(149.5)	(149.5)
Adjustment for shares issued under the Scrip Dividend Alternative	–	41.7	41.7
Redemption of perpetual capital securities (see note 37)	–	(5.2)	(5.2)
Credit to equity in respect of share-based payments (net of tax)	–	0.8	0.8
Charge in respect of share options vesting	–	(0.8)	(0.8)
At 31 March 2018	**(2.0)**	**1,113.1**	**1,111.1**

In making decisions about the level of dividends to be proposed the Directors take steps to check that retained earnings reflect realised profits and are therefore distributable within the requirements of the Companies Act 2006.

37. Perpetual capital securities

	£m
Group and Company	
At 1 April 2016	294.8
Distributions to perpetual capital security holders	(20.3)
Current tax relief on distributions to perpetual capital security holders	4.1
Profit for the year attributable to perpetual capital security holders	16.2
At 31 March 2017	294.8
Issuance of perpetual capital securities	296.7
Redemption of perpetual capital securities	(294.8)
Distributions to perpetual capital security holders	(25.3)
Current tax relief on distributions to perpetual capital security holders	3.8
Profit for the year attributable to perpetual capital security holders	21.5
At 31 March 2018	**296.7**

On 8 March 2013 the Company issued £300 million perpetual capital securities. Costs directly associated with the issue of £5.2 million are set off against the value of the issuance. They had no fixed redemption date but the Company could at its sole discretion, redeem all, but not part, of these securities at their principal amount on 8 March 2018 or any subsequent periodic return payment date after this. In the event the Company acquired 80% or more of the securities it could then redeem the remainder at its sole discretion.

On 22 September 2017 the Company purchased £285.8 million in principal amount of the capital securities and settled accrued periodic returns totalling £19.0 million for a total of £304.8 million. On 10 October 2017 the Company exercised its option to redeem all of the remaining £14.2 million capital securities at their principal amount and accrued periodic returns totalling £0.6 million.

On 22 September 2017 the Company issued £300 million perpetual capital securities. Costs directly associated with the issue of £3.3 million were set off against the value of the issuance. They have no fixed redemption date but the Company can at its sole discretion redeem all, but not part, of these securities at their principal amount on 22 May 2020 or any subsequent periodic return payment date after this.

The Company has the option to defer periodic returns on any relevant payment date, as long as a dividend on the ordinary shares has not been paid or declared in the previous 12 months. Deferred periodic returns shall be satisfied only on redemption or payment of dividend on ordinary shares, all of which only occur at the sole discretion of the Company.

As the Company paid a dividend in the 12 months prior to the periodic return date of 22 May 2018, a periodic return of £5.8 million has been recognised as a financial liability at the year end.

Profits for the year attributable to perpetual capital security holders of £21.5 million reflect £19.6 million of distributions noted above on the March 2013 perpetual capital securities, £3.8 million of associated corporation tax relief and £5.8 million for periodic returns due on 2017 perpetual capital securities. (The newly issued securities do not qualify for corporation tax relief).

38. Analysis of cash flows given in the statement of cash flows

Reconciliation of profit for the year to cash generated from operations:

Cash generated from operations

	Group		Company	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Continuing operations				
Profit for the year	**221.9**	180.5	**236.6**	179.1
Adjustments for:				
Share-based payments	**2.5**	2.9	**0.9**	1.1
Profit on disposal of property, plant and equipment	**(2.5)**	(7.5)	**–**	–
Depreciation charge	**182.5**	178.2	**0.1**	0.1
Amortisation of intangible assets	**3.6**	3.2	**–**	–
Non-underlying provision charge	**–**	10.7	**–**	–
Non-underlying JV loan write off and credit	**(6.5)**	–	**–**	–
Non-underlying remeasurement of fair value movement in derivatives	**2.4**	(16.0)	**–**	–
Non-underlying unwind of synthetic derivative	**–**	44.8	**–**	83.5
Share of post-tax profit from joint ventures	**(9.4)**	(4.2)	**–**	–
Finance income (before non-underlying items)	**(24.2)**	(36.3)	**(42.5)**	(51.1)
Finance costs (before non-underlying items)	**98.7**	95.1	**34.6**	37.1
Dividends receivable	**–**	–	**(202.3)**	(247.0)
Taxation charge/(credit)	**41.0**	30.0	**(28.4)**	(3.3)
Changes in working capital:				
Increase in inventories	**(5.2)**	(0.7)	**–**	–
(Increase)/decrease in trade and other receivables	**(36.9)**	(13.1)	**250.6**	(158.1)
Increase in service concession arrangements receivable	**(15.2)**	(22.2)	**–**	–
Increase in trade and other payables	**2.2**	8.5	**0.1**	0.1
Increase/(decrease) in retirement benefit obligations from contributions	**4.5**	2.3	**(0.3)**	(0.5)
Decrease in provisions	**(15.9)**	(24.7)	**–**	–
Cash generated/(outflow) from operations	**443.5**	431.5	**249.4**	(159.0)

Reconciliation of total interest paid:

	Group		Company	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Interest paid in operating activities	**69.6**	76.4	**32.5**	39.1
Interest paid in investing activities	**17.0**	12.9	**–**	–
Total interest paid	**86.6**	89.3	**32.5**	39.1

Notes to the financial statements
continued

39. Net borrowings

	Group 2018 £m	Group 2017 £m	Company 2018 £m	Company 2017 £m
Cash and cash deposits	**585.3**	598.1	**303.3**	372.5
Borrowings – current				
Bank and other loans	**(149.6)**	(74.9)	**(149.6)**	(74.9)
Other current borrowings	**(32.0)**	(41.1)	**–**	–
Finance lease obligations	**(28.2)**	(30.5)	**–**	–
Amounts owed to subsidiary undertakings	**–**	–	**(283.6)**	(282.9)
Total current borrowings	**(209.8)**	(146.5)	**(433.2)**	(357.8)
Borrowings – non-current				
Bank and other loans	**(1,408.8)**	(1,439.3)	**(711.7)**	(848.2)
Other non-current borrowings	**(291.4)**	(323.4)	**–**	–
Finance lease obligations	**(1,476.8)**	(1,353.8)	**–**	–
Total non-current borrowings	**(3,177.0)**	(3,116.5)	**(711.7)**	(848.2)
Total net borrowings	**(2,801.5)**	(2,664.9)	**(841.6)**	(833.5)

The movements in net borrowings during the periods presented were as follows:

Group	Net borrowings at 1 April 2016 £m	Cash flows – other £m	Foreign exchanged adjustments £m	Other non-cash movements £m	Net borrowings at 31 March 2017 £m
Cash and cash deposits	632.2	(34.1)	–	–	598.1
Bank and other loans due within one year	–	–	–	(74.9)	(74.9)
Other current borrowings	(39.0)	39.0	–	(41.1)	(41.1)
Finance leases due within one year	(26.0)	26.0	–	(30.5)	(30.5)
Bank and other loans due after one year	(1,502.5)	(0.5)	(2.3)	66.0	(1,439.3)
Other non-current borrowings	(234.5)	(130.0)	–	41.1	(323.4)
Finance leases due after one year	(1,314.6)	(12.1)	–	(27.1)	(1,353.8)
	(2,484.4)	(111.7)	(2.3)	(66.5)	(2,664.9)

	Net borrowings at 1 April 2017 £m	**Cash flows – other £m**	**Foreign exchanged adjustments £m**	**Other non-cash movements £m**	**Net borrowings at 31 March 2018 £m**
Cash and cash deposits	**598.1**	**(12.8)**	**–**	**–**	**585.3**
Bank and other loans due within one year	**(74.9)**	**74.9**	**–**	**(149.6)**	**(149.6)**
Other current borrowings	**(41.1)**	**41.1**	**–**	**(32.0)**	**(32.0)**
Finance leases due within one year	**(30.5)**	**30.5**	**–**	**(28.2)**	**(28.2)**
Bank and other loans due after one year	**(1,439.3)**	**(106.9)**	**(2.3)**	**139.7**	**(1,408.8)**
Other non-current borrowings	**(323.4)**	**–**	**–**	**32.0**	**(291.4)**
Finance leases due after one year	**(1,353.8)**	**(117.1)**	**–**	**(5.9)**	**(1,476.8)**
	(2,664.9)	**(90.3)**	**(2.3)**	**(44.0)**	**(2,801.5)**

Company	Net borrowings at 1 April 2016 £m	Cash flows – other £m	Foreign exchanged adjustments £m	Other non-cash movements £m	Net borrowings at 31 March 2017 £m
Cash and cash deposits	429.7	(57.2)	–	–	372.5
Bank and other loans due within one year	–	–	–	(74.9)	(74.9)
Amounts due to subsidiary undertakings	(287.2)	–	–	4.3	(282.9)
Bank and other loans due after one year	(877.1)	–	–	28.9	(848.2)
	(734.6)	(57.2)	–	(41.7)	(833.5)

	Net borrowings at 1 April 2017 £m	**Cash flows – other £m**	**Foreign exchanged adjustments £m**	**Other non-cash movements £m**	**Net borrowings at 31 March 2018 £m**
Cash and cash deposits	**372.5**	**(69.2)**	**–**	**–**	**303.3**
Bank and other loans due within one year	**(74.9)**	**25.0**	**–**	**(99.7)**	**(149.6)**
Amounts due to subsidiary undertakings	**(282.9)**	**(0.7)**	**–**	**–**	**(283.6)**
Bank and other loans due after one year	**(848.2)**	**–**	**–**	**136.5**	**(711.7)**
	(833.5)	**(44.9)**	**–**	**36.8**	**(841.6)**

The increase in the value of Financial liabilities at fair value through profit in the year of £0.4m for the Group and £0.7m for the Company is attributable to Other non-cash movements.

40. Subsidiary, joint venture and associate undertakings at 31 March 2018

Principal subsidiary companies	Registered office address	Country of incorporation, registration and principal operations
Water		
South West Water Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
South West Water Finance Plc	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Source Contact Management Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Waste management		
Viridor Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste Exeter Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste Suffolk Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (West Sussex) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste Management Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor EnviroScot Limited	1 Exchange Crescent, Conference Square, Edinburgh, EH3 8UL	Scotland
Viridor Resource Management Limited	First Floor Offices, Riverside House, Sir Thomas Longley Road, Medway City, Rochester, ME2 4FN	England
Viridor Waste Kent Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Oxfordshire Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor EfW (Runcorn) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Landfill Restoration) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Somerset) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Thames) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Greater Manchester) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Polymer Recycling Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Trident Park Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor (Glasgow) Limited	1 Exchange Crescent, Conference Square, Edinburgh, EH3 8UL	Scotland
Viridor (Lancashire) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Peterborough Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor South London Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Clyde Valley Limited	1 Exchange Crescent, Conference Square, Edinburgh, EH3 8UL	Scotland
Non-household retail		
Pennon Water Services Limited(1)	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Other		
Peninsula Insurance Limited*(2)	Level 5, Mill Court, La Charroterie, St Peter Port, GY1 1EJ	Guernsey

(1) 80% of share capital owned by Pennon Group plc. All shares in issue are ordinary shares.
(2) Captive insurance company established with the specific objective of financing risks emanating from within the Group.

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40. Subsidiary, joint venture and associate undertakings at 31 March 2018 continued

Other trading companies	Registered office address	Country of incorporation
Dragon Waste Limited (81%)	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Peninsula Leasing Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Peninsula Properties (Exeter) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Peninsula Trustees Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Pennon Defined Contribution Pension Trustee Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Pennon Pension Trustees Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Pennon Share Plans (Guernsey) Limited*	Albert House, South Esplanade, St Peter Port, GY1 1AW	Guernsey
Pennon Share Schemes Trustees Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Pennon Trustee Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Raikes Lane Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Source Collections Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Source for Business Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
SSWB Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Somerset) Pension Scheme & Life Assurance Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England

Other dormant companies	Registered office address	Country of incorporation
A.A. Best & Sons Limited	1 Exchange Crescent, Conference Square, Edinburgh, EH3 8UL	Scotland
Acetip	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Albion Water (Shotton) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Alderney Water Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Analaq Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Aquacare (BWH) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Astley Minerals Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Avon Valley Water Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Basecall Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Bournemouth Water Investments Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Bournemouth Water Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
BWH Enterprises Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Cambridge Water Business Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Centre for Environmental Research Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
City Reclamation Services Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Corby Skip Hire Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
DMP (Holdings) Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
ELE Datasystems	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Exe Continental	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Greater Manchester Sites Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Greenhill Environmental Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Handside Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Haul Waste Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Hodgejoy Recycling Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Industrial Waste Disposals (Sheffield) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Lavelle & Sons Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Mac-Glass Recycling Limited	1 Exchange Crescent, Conference Square, Edinburgh, EH3 8UL	Scotland
Oakley Recycling Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Oakley Skip Hire Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Parkwood Environmental Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Parkwood Group Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Parkwood Recycling Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Pearsons Group Holdings Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Peninsula	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Peninsula MB Limited* (in liquidation)	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Peninsula Water Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England

40. Subsidiary, joint venture and associate undertakings at 31 March 2018 continued

Other dormant companies	Registered office address	Country of incorporation
Pennon Power Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Pennon South West Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Pennon Waste Management Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
pHOX Systems Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Pilsworth Forest (1996) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Pilsworth Forest Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Roseland Plant Co. Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Rydon Properties Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Seal Security Systems Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Sheffield Waste Disposal Company Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Shore Recycling (Ozone) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
South Staffordshire Water Business Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
SWW Pension Trustees Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Thames Incineration and Recycling Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HT	England
Thames Incineration Services Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Thames Tankering Services Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Thames Waste Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
The Metropolitan Water Company Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Tokenmarch Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor (Cheshire) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor (Community Recycling MK) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor (Community Recycling MKH) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor (Erith) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor (Martock) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor (Winsford) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Contracting Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Electrical Recycling (Holdings) Limited	1 Exchange Crescent, Conference Square, Edinburgh, EH3 8UL	Scotland
Viridor Electrical Recycling Limited	1 Exchange Crescent, Conference Square, Edinburgh, EH3 8UL	Scotland
Viridor Enterprises Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Glass Recycling Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor London Recycling Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor New England (EfW) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Resource (Peterborough) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Resource Transport Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor South Lanarkshire Limited	1 Exchange Crescent, Conference Square, Edinburgh, EH3 8UL	Scotland
Viridor South West Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Adapt) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Allwaste Disposal) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Atherton) Holdings Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Atherton) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Bristol Holdings) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Bristol) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Bury) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Corby) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Earls Barton) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (East Anglia) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Medway Holdings) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Medway) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Sheffield) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Thetford) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Wastenot Recycling) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste 2 Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste Disposal Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste Hampshire Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste Wootton Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
VWM (Scotland) Limited	1 Exchange Crescent, Conference Square, Edinburgh, EH3 8UL	Scotland
Waste Treatment Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Water West Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
West Hampshire Water Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England

* Indicates the shares are held directly by Pennon Group plc, the Company.

The subsidiary undertakings are wholly owned unless stated otherwise and all shares in issue are ordinary shares. All companies above are consolidated in the Group financial statements.

Notes to the financial statements
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40. Subsidiary, joint venture and associate undertakings at 31 March 2018 continued

Joint ventures and associate

All joint ventures, the associate and the subsidiary undertakings of Lakeside Energy from Waste Holdings Limited, INEOS Runcorn (TPS) Holdings Limited and Shelford Composting Limited are incorporated and registered in England which is also their country of operation. The registered office of Lakeside Energy from Waste Holdings Limited and Lakeside Energy from Waste Limited is Thames House, Oxford Road, Wallingford OX10 6LX. The registered office of Shelford Composting Limited is 900 Pavilion Drive, Northampton NN4 7RG.

	Share capital in issue	Percentage held	Principal activity
Joint ventures			
Lakeside Energy from Waste Holdings Limited	1,000,000 A ordinary shares	–	
	1,000,000 B ordinary shares	100%	
Lakeside Energy from Waste Limited			Waste management
Shares in Lakeside Energy from Waste Holdings Limited are held by Viridor Waste Management Limited			
Shelford Composting Limited	50 A ordinary shares	–	
	50 B ordinary shares	100%	Waste management
Associate			
INEOS Runcorn (TPS) Holdings Limited	1,000 A ordinary shares	20%	
	186,750 B1 ordinary shares	50%	
	62,250 B2 ordinary shares	–	
INEOS Runcorn (TPS) Limited			Waste management

Shares in INEOS Runcorn (TPS) Holdings Limited are held by Viridor Waste Management Limited.

The Group's economic interest in INEOS Runcorn (TPS) Holdings Limited is 37.5%, as returns from the investment are based on holdings of B1 and B2 ordinary shares.

41. Operating lease commitments

	Group 2018 £m	Group 2017 £m	Company 2018 £m	Company 2017 £m
The future aggregate minimum lease payments under non-cancellable operating leases are:				
Within 1 year	**10.8**	10.6	**–**	–
Over 1 year and less than 5 years	**29.1**	28.2	**–**	–
Over 5 years	**123.0**	104.5	**–**	–
	162.9	143.3	**–**	–

The Group leases various offices, depots and workshops under non-cancellable operating lease agreements. The leases have various terms, escalation clauses and renewal rights. Property leases are negotiated for an average term of 33 years and rentals are reviewed on average at five-yearly intervals.

The Group also leases plant and machinery under non-cancellable operating lease agreements.

42. Contingencies

Contingent liabilities

	Group 2018 £m	Group 2017 £m	Company 2018 £m	Company 2017 £m
Guarantees:				
Borrowing facilities of subsidiary undertakings	**–**	–	**549.6**	555.9
Performance bonds	**185.1**	187.5	**185.1**	187.5
	185.1	187.5	**734.7**	743.4

Guarantees in respect of performance bonds are entered into in the normal course of business. No liability is expected to arise in respect of the guarantees.

In connection with the application of the audit exemption under Section 479A of the Companies Act 2006 the Company has guaranteed all the outstanding liabilities as at 31 March 2018 of certain subsidiaries: Peninsula Leasing Limited and Viridor Waste 2 Limited since these companies qualify for the exemption.

Other contractual and litigation uncertainties

The Group establishes provisions in connection with contracts and litigation where it has a present legal or constructive obligation as a result of past events and where it is more likely than not an outflow of resources will be required to settle the obligation and the amount can be reliably estimated. Matters where it is uncertain that these conditions are met include a potential prosecution by the Health and Safety Executive.

42. Contingencies continued

Contingent assets

In addition to contractual receivables related to our construction contracts in respect of Glasgow Recycling and Renewable Energy Centre that are reflected in the financial statements, there are further possible recoveries that are contingent on events in the future that are not wholly within the Group's control. These contingent assets have not been recognised as at 31 March 2018.

43. Capital commitments

	Group		Company	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Contracted but not provided	**287.7**	401.1	**–**	–

44. Acquisition

On 1 April 2017 Pennon Water Services Limited, a wholly owned subsidiary of Pennon Group plc (Pennon) at the start of the year, acquired 100% of the issued share capital of SSWB Limited, including its two dormant subsidiary companies, South Staffordshire Water Business (SSWB) Limited and Cambridge Water Business Limited, for a total consideration of £8.4 million.

The acquisition was part of the formation of a non-household retail venture with South Staffordshire plc (SS), incorporating South Staffs and Cambridge Water, to participate in the non-household retail market which commenced 1 April 2017.

On the same date Pennon Water Services also purchased assets, primarily trade receivables from South West Water Limited, a fellow subsidiary of Pennon, for a total consideration of £33.6 million.

The acquisition of SSWB Limited has been accounted for using the acquisition method. No goodwill has arisen as the book value of the net assets of SSWB Limited at the point of acquisition equated to their fair value.

The consideration was financed by the issuance to SS of new equity share capital in Pennon Water Services of £1.7 million and the issuance of a loan from SS to Pennon Water Services of £6.7 million. Initial placements of equity and debt were made on 1 April 2017 for £0.7 million and £6.3 million respectively with final placements of £1.0 million and £0.4 million on 29 March 2018 upon final agreement of asset values within SSWB Limited.

As a result of these transactions Pennon now holds a majority 80% equity share in Pennon Water Services, with SS holding the remaining 20% non-controlling interest.

Directly attributable costs included in other operating expenses were £0.4 million.

Fair values on acquisition of SSWB Limited	£m	£m
Intangible assets		0.5
Trade and other receivables		7.9
Total consideration		8.4
Satisfied by cash payment, which was financed by:		
Issuance of equity share capital in Pennon Water Services	1.7	
Issuance of loan from SS to Pennon Water Services	6.7	
		8.4

The fair value of trade and other receivables in SSWB Limited on acquisition was £7.9 million. This included gross contracted amounts receivable of £10.9 million, of which £3.0 million were not expected to be collected.

Revenue and costs associated with the assets acquired are all included in the Consolidated Income Statement for the full year ended 31 March 2018.

45. Related party transactions

During the year Group companies entered into the following transactions with joint ventures and associate related parties who are not members of the Group:

	2018 £m	2017 £m
Sales of goods and services		
Viridor Laing (Greater Manchester) Limited	**38.4**	80.1
INEOS Runcorn (TPS) Limited	**15.9**	15.8
Purchase of goods and services		
Lakeside Energy from Waste Limited	**12.0**	10.4
INEOS Runcorn (TPS) Limited	**6.0**	6.6
Dividends received		
Lakeside Energy from Waste Holdings Limited	**6.5**	4.5

Notes to the financial statements
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45. Related party transactions continued

Year-end balances

	2018 £m	2017 £m
Receivables due from related parties		
Viridor Laing (Greater Manchester) Limited (loan balance)	–	40.2
Lakeside Energy from Waste Limited (loan balance)	8.2	8.6
INEOS Runcorn (TPS) Limited (loan balance)	32.5	37.8
	40.7	86.6
Viridor Laing (Greater Manchester) Limited (trading balance)	–	15.3
Lakeside Energy from Waste Limited (trading balance)	1.0	1.0
INEOS Runcorn (TPS) Limited (trading balance)	2.0	1.3
	3.0	17.6
Payables due to related parties		
Lakeside Energy for Waste Limited (trading balance)	1.2	2.7
INEOS Runcorn (TPS) Limited (trading balance)	2.5	1.5
	3.7	4.2

The £40.8 million (2017 £86.6 million) receivable relates to loans to related parties included within receivables and due for repayment in instalments between 2017 and 2033. Interest is charged at an average of 13.0% (2017 13.0%).

Company

The following transactions with subsidiary undertakings occurred in the year:

	2018 £m	2017 £m
Sales of goods and services (management fees)	12.2	11.2
Purchase of goods and services (support services)	1.5	0.5
Interest receivable	39.9	39.6
Interest payable	0.1	0.1
Dividends received	202.3	247.0

Sales of goods and services to subsidiary undertakings are at cost. Purchases of goods and services from subsidiary undertakings are under normal commercial terms and conditions which would also be available to unrelated third parties.

Year-end balances

	2018 £m	2017 £m
Receivables due from subsidiary undertakings		
Loans	870.8	1,124.3
Trading balances	16.2	13.4

Interest on £425.3 million of the loans has been charged at a fixed rate of 5.0%, and on £20.3 million at a fixed rate of 6.0% (2017 £70.0 million at 4.5%, £428.0 million nil at 5.0% and £28.0 million at 6.0%). Interest on £411.8 million of the loans is charged at 12 month LIBOR +1.0% (2017 £497.8 million) and on £13.4 million at 12 month LIBOR +3.0% (2017 nil). These loans are due for repayment in instalments over the period 2018 to 2056.

Loans of £100.0 million at 1 month LIBOR + 1.0% and £0.5 million at base rate +1.0% were repaid during the year.

During the year there were no provisions (2017 nil) in respect of loans to subsidiaries not expected to be repaid.

	2018 £m	2017 £m
Payables due to subsidiary undertakings		
Loans	283.6	322.0
Trading balances	14.4	9.5

The loans from subsidiary undertakings are unsecured and interest-free without any terms for repayment.

Five-year financial summary

	2018 £m	2017 £m	2016 £m	2015 £m	2014 £m
Income statement					
Revenue before non-underlying items	**1,393.0**	1,353.1	1,352.3	1,357.2	1,321.2
Operating profit before non-underlying items	**323.9**	304.6	261.8	246.6	257.5
Net finance costs before non-underlying items	**(74.5)**	(58.8)	(54.1)	(40.8)	(53.9)
Share of profit in joint ventures	**9.4**	4.2	3.6	4.9	3.7
Profit before tax and non-underlying items	**258.8**	250.0	211.3	210.7	207.3
Net non-underlying items before tax	**4.1**	(39.5)	(5.0)	(13.7)	(48.6)
Taxation charge	**(41.0)**	(30.0)	(38.0)	(54.7)	(0.6)
Profit for the year	**221.9**	180.5	168.3	142.3	158.1
Attributable to:					
Ordinary shareholders of the parent	**200.6**	164.3	152.1	126.3	142.5
Perpetual capital security holders	**21.5**	16.2	16.2	16.0	15.6
Non-controlling interests	**(0.2)**	–	–	–	–
Dividends proposed/declared	**162.0**	149.5	138.5	129.5	117.0
Earnings per ordinary share (basic):					
From continuing operations					
Earnings per share	**48.0p**	39.8p	37.0p	32.3p	38.8p
Deferred tax before non-underlying items	**4.4p**	4.5p	9.5p	4.7p	(7.0)p
Non-underlying items (net of tax)	**(1.8)p**	2.7p	(7.0)p	2.8p	10.8p
Proportional adjustment on Perpetual capital returns	**0.3p**	–	–	–	–
Earnings per share before non-underlying and deferred tax	**50.9p**	47.0p	39.5p	39.8p	42.6p
Declared dividends per share	**38.59p**	35.96p	33.58p	31.80p	30.31p

	2018 £m	2017 £m	2016 £m	2015 £m	2014 £m
Capital expenditure					
Acquisitions	**8.4**	–	91.0	–	–
Property, plant and equipment	**389.0**	377.5	284.2	301.4	360.8
Balance sheet					
Non-current assets	**5,125.0**	4,937.0	4,676.7	4,325.9	4,076.6
Net current assets	**412.6**	454.4	549.1	586.0	241.9
Non-current liabilities	**(3,898.5)**	(3,882.2)	(3,738.2)	(3,557.8)	(3,120.9)
Net assets	**1,639.1**	1,509.2	1,487.6	1,354.1	1,197.6
Number of employees (average for year)					
Water	**1,575**	1,589	1,706	1,408	1,356
Waste management	**3,285**	3,153	3,230	3,101	3,044
Non-household retail	**81**				
Other businesses	**73**	57	51	49	51
	5,014	4,799	4,987	4,558	4,451

Shareholder information

Financial calendar

Financial year end	31 March
29th Annual General Meeting	5 July 2018
Ex-dividend date for 2018 final dividend	5 July 2018*
Record date for 2018 final dividend	6 July 2018*
2018 final dividend payable	4 September 2018*
2018/19 half-yearly results announcement	27 November 2018
2019 interim dividend payable	April 2019
2018/19 final results announcement	21 May 2019
30th Annual General Meeting	4 July 2019
2019 final dividend payable	September 2019

Dividend Reinvestment Plan (DRIP) alternative*

Ordinary shares quoted ex-dividend	5 July 2018
Record date for final dividend	6 July 2018
Final date for receipt of DRIP applications	13 August 2018
Posting of dividend cheques	3 September 2018
Final dividend payment date	4 September 2018

* Subject to obtaining shareholder approval at the 2018 Annual General Meeting to the payment of a final dividend for the year ended 31 March 2018.

Shareholder analysis at 31 March 2018

Holding of shares	Number of shareholders	% of total shareholders	% of ordinary shares
1-100	2,429	12.41	0.03
101-1,000	8,235	42.09	1.03
1,001-5,000	7,404	37.84	3.89
5,001-50,000	1,129	5.77	3.11
50,001-100,000	84	0.45	1.42
100,001+	283	1.44	90.51
	19,564		

	Number of accounts	% of total accounts	% of total shares
Individuals	17,151	87.66	6.42
Companies	128	0.66	0.31
Trust companies (pension funds etc.)	8	0.04	0.01
Banks and nominees	2,277	11.64	93.25
	19,564		

Major shareholdings

The net position on 31 March 2018 of investors who have notified interests in the issued share capital of the Company pursuant to the Financial Conduct Authority's Disclosure and Transparency Rules is as follows:

	Number of voting rights (direct and indirect)	% of voting rights
Lazard Asset Management LLC	41,575,771	9.91%
Pictet Asset Management SA	25,599,217	6.10%
BlackRock, Inc.	21,700,561	5.17%
Ameriprise Financial, Inc.	20,328,154	4.84%
The Capital Group Companies, Inc.	20,106,888	4.79%
RARE Infrastructure Limited	19,366,782	4.61%
AXA Investment Managers SA	18,088,394	4.31%
Invesco Limited	17,212,959	4.10%
UBS Investment Bank	16,610,004	3.96%

No changes to interests in the Company's issued share capital have been disclosed to the Company between 31 March 2018 and 23 May 2018 (being a date not more than one month prior to the date of the Company's Notice of Annual General Meeting).

Registrar

All enquiries concerning shareholdings including notification of change of address, loss of a share certificate or dividend payments should be made to the Company's registrar, Link Asset Services, who can be contacted as follows:

Link Asset Services
Pennon Group Share Register
The Registry
34 Beckenham Road
Beckenham
Kent BR3 4TU

Telephone: **0371 664 9234** (calls are charged at standard geographic rate and will vary by provider.).

Lines are open 8.30am-5.30pm Monday-Friday, excluding public holidays in England and Wales.

Overseas telephone: **+44 371 664 9234** (calls outside the United Kingdom will be charged at the applicable international rate).

Email: **pennon@linkgroup.co.uk**

Website: **signalshares.com**

ShareGift service

Through ShareGift, an independent charity share donation scheme, shareholders who only have a small number of shares with a value that makes it uneconomical to sell them can donate such shares to charity. Donations can be made by completion of a simple share transfer form which is available from the Company's registrar, Link Asset Services, or by contacting ShareGift on 020 7930 3737 (**www.sharegift.org.uk**).

Individual savings accounts

Shareholders may gain tax advantages by holding their shares in the Company in an Individual Savings Account (ISA).

Dividend Reinvestment Plan (DRIP)

Subject to obtaining shareholder approval at the 2018 Annual General Meeting for the payment of a final dividend for the year ended 31 March 2018, full details of the DRIP and how to participate will be published on the Company's website at **www.pennon-group.co.uk/dividends/dividend-reinvestment-plan-drip**. The full timetable for offering the DRIP is given on page 170.

The DRIP provides shareholders with an opportunity to invest the cash dividend they receive on their Pennon Group plc shares to buy further shares in the Company at preferable dealing rates.

Online portfolio service

The online portfolio service provided by Link Asset Services gives shareholders access to more information on their investments. Details of the portfolio service are available online at **www.signalshares.com**.

Electronic communications

The Company has passed a resolution which allows it to communicate with its shareholders by means of its website.

Shareholders currently receiving a printed copy of the annual report who now wish to sign up to receive all future shareholder communications electronically can do so by registering with Link Asset Services' share portal. Go to **www.signalshares.com** to register, select 'Account Registration' and then follow the on-screen instructions by inputting your surname, your Investor Code (which can be found on your proxy form) and your postcode, as well as entering an email address and selecting a password.

By registering to receive your shareholder communications electronically, you will also automatically receive your dividend confirmations electronically.

Electronic proxy voting

Shareholders also have the opportunity to register the appointment of a proxy for any general meeting of the Company once notice of the meeting has been given and may do so via **www.signalshares.com**. Shareholders who register an email preference will not receive a paper proxy form. Instead, they will receive an email alert advising them of general meetings of the Company, with links to the notices of meetings and annual reports.

Pennon's website

www.pennon-group.co.uk provides news and details of the Company's activities plus links to its subsidiaries' websites.

The Investor Information section contains up-to-date information for shareholders including detailed share price information, financial results, dividend payment dates and amounts, and stock exchange announcements. There is also a comprehensive shareholder services section which includes information on buying, selling and transferring shares, and how to notify a change in personal circumstances, for example, a change of address.

Shareholder information
continued

Beware of share fraud

The following is taken from the ScamSmart section of the Financial Conduct Authority's website (**www.fca.org.uk/scamsmart**).

Fraudsters use persuasive and high-pressure tactics to lure investors into scams. They may offer to sell shares that turn out to be worthless or non-existent, or to buy shares at an inflated price in return for an upfront payment.

While high profits are promised, if you buy or sell shares in this way you will probably lose your money.

How to avoid share fraud

1. Keep in mind that firms authorised by the Financial Conduct Authority (FCA) are unlikely to contact you out of the blue with an offer to buy or sell shares.
2. Do not get into a conversation; note the name of the person and firm contacting you and then end the call.
3. Check the Financial Services Register from **www.fca.org.uk** to see if the person and firm contacting you is authorised by the FCA.
4. Beware of fraudsters claiming to be from an authorised firm, copying its website or giving you false contact details.
5. Use the firm's contact details listed on the Register if you want to call it back.
6. Call the FCA on **0800 111 6768** if the firm does not have contact details on the Register or you are told they are out of date.
7. Search the FCA Warning List of unauthorised firms at **www.fca.org.uk/scamsmart**. Consider that if you buy or sell shares from an unauthorised firm you will not have access to the Financial Ombudsman Service or Financial Services Compensation Scheme. Seek impartial advice from a financial adviser before you make an investment.
8. Remember: if it sounds too good to be true, it probably is!

5,000 people contact the Financial Conduct Authority about share fraud each year, with victims losing an average of £20,000

Report a scam

If you are approached by fraudsters, please tell the FCA using the share fraud reporting form at **www.fca.org.uk/scams** where you can find out more about investment scams.

You can also call the FCA Consumer Helpline on 0800 111 6768. If you have already paid money to share fraudsters, you should contact Action Fraud on 0300 123 2040.

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