Dŵr Cymru
Welsh Water

Annual Performance Report 2020/21

Part 1 – Regulatory financial reporting

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Foreword

References to “the Company”, “Dŵr Cymru” and “Welsh Water” in the Annual Performance Report Parts 1 to 9 inclusive relate to Dŵr Cymru Cyfyngedig, the sole operating company in the whole business securitisation formed by the Glas Cymru Anghyfyngedig group. References to “Glas Cymru” and “the Group” refer, respectively, to Glas Cymru Holdings Limited and the group of which it is the parent.

Statement of Directors’ responsibilities for regulatory information

The following confirmations from our Directors are provided to comply with the requirements of Condition F of our Licence, which requires that accounting statements are prepared in accordance with the Regulatory Accounting Guidelines issued by Ofwat. In particular, Regulatory Accounting Guideline 3.12 issued in February 2021 requires the following statements to be made by our Directors:

- statement of Directors’ pay and standards of performance;
- statement on disclosure of information to auditors;
- statement on dividend policy;
- accounting policy note for price control segments;
- a note on revenue recognition;
- a note on capitalisation policy;
- a note on bad debt policy;
- statement on sufficiency of non-financial resources;
- ring fencing certificate or certificate of adequacy;
- tax strategy note;
- statement on differences between statutory and RAG definitions;
- statement on long term viability;
- statement explaining out/under performance of the return on regulatory equity (RORE);
- statement on variance between revenue and costs arising from providing infrastructure network reinforcement; and
- statement on innovation competition.

Statement of Directors' responsibilities for regulatory information (continued)

Statement on Directors' pay and standards of performance

The Company is required under s35A of the Water Industry Act 1991 to provide a statement that the remuneration paid to Executive Directors is linked to standards of performance. This Statement is provided within the Directors' Remuneration Report which can be found within part 4 to 9 of this Annual Performance Report and also in the Group's 2021 Annual Report and Accounts which are available at www.dwrcymru.com.

Statement on disclosure of information to auditors

In the case of each of the persons who are Directors at the time when the Annual Performance Report is approved under Section 418 of the Companies Act 2006 the following applies:

a) so far as the Director is aware, there is no relevant audit information of which the Company's auditors are unaware; and

b) he/she has taken all the steps that he/she ought to have taken as a Director in order to make himself/herself aware of any relevant audit information and to establish that the Company's auditors are aware of the information.

Statement on dividend policy

Paragraph 29 to Licence Condition P requires that dividends can only be declared or paid in accordance with a dividend policy which, in the written opinion of Ofwat, will not impair the ability of the Appointee to finance the Appointed Business. In addition, the disclosure requirements are set out in either licence conditions P8 or I12 'Putting the sector in balance' position statement published in July 2018, PR19 final determination: Aligning risk and return technical appendix and Ofwat's Board leadership, transparency and governance principles statement and requires that companies provide detailed explanation of their approach to the dividend policy.

Dŵr Cymru's ultimate parent undertaking is Glas Cymru Holdings Cyfyngedig. As a Company limited by guarantee, and having no shareholders, all financial surpluses are reinvested for the benefit of customers. The reserves built up from retained profits help to insulate Dŵr Cymru and its customers from any unexpected costs and also to improve credit quality to keep the cost of finance as low as possible. A new dividend policy was approved by Ofwat in December 2015 and formally adopted by the Board in the June 2016 Board meeting. No monies are transferred out of the Glas Cymru group of companies under this policy and all financial surpluses are retained for the benefit of customers. Our dividend policy expressly provides that dividends will not be paid unless the Directors are satisfied that this would not impair Dŵr Cymru's ability to finance its regulated activities.

During the year to 31 March 2021 no dividends were paid or received by the Company (2020: none).

Statement of Directors' responsibilities for regulatory information (continued)

Accounting policy note for price control segments

The financial statements have been drawn up in accordance with RAG2 – Guidance for classification of costs across the price control. An accounting policy note for price control units is disclosed in part 2 of this Annual Performance Report. The tables presented in parts 2 and 4 to 9 inclusive have been prepared in accordance with our Accounting Methodology Statement which can be found at www.dwrcymru.com.

Revenue recognition note

The revenue recognition note is included in the accounting policies note in appendix 6 of parts 4 to 9.

Capitalisation policy note

The capitalisation policy note is included in the accounting policies note in appendix 6 of parts 4 to 9.

Bad debt policy note

The bad debt policy note is included in the accounting policies note in appendix 6 of parts 4 to 9.

Statement on sufficiency of non-financial resources

Under paragraph 4.2 of Condition P of the Licence, the Company is at all times required to ensure, so far as is reasonably practicable, that if a special administration order were made, the Company would have available to it sufficient rights and assets (other than financial resources) to enable the special administrator to manage the affairs, business and property of the Company.

Going concern

The financial statements have been prepared on the going concern basis as the Directors have a reasonable expectation that the Company has adequate resources for a period of at least 12 months from the date of their approval and that there are no material uncertainties to disclose.

In assessing the appropriateness of the going concern basis of accounting the Directors have reviewed the resources available to the Company in the form of cash and committed bank facilities as well as consideration of the Company's capital adequacy, along with a baseline plan which reflects a view of the estimated impact of the Covid-19 pandemic on the Company.

Statement of Directors' responsibilities for regulatory information (continued)

Going concern (continued)

This baseline plan assumes that the lifting of restrictions continues to follow the Government's 22 February Roadmap, which would ease restrictions in June, with elements of social distancing continuing into the foreseeable future. Unemployment is assumed to peak around 6.5% at the end of 2021, recovering slowly to pre-pandemic levels by 2025; CPIH falls to an average of 1.5% during 2021 and recovers to the government's long-term target of 2% in 2022/23. The worst-case scenario impact on turnover is considered to be behind us, with 2020/21 seeing a circa £21m reduction in non-household revenues (12%, demand-driven), with a further circa £5m of revenue voluntarily abated, offset by an increase in household revenues of circa £9m. However under regulatory mechanisms lost revenues are recoverable in future years.

This baseline plan has then been subject to a furthermore extreme downside stress scenario, which assumes an additional drop in CPIH to -2%, recovering to 3% by March 2023 and unemployment at around 6.5%. Consequential impacts on the Group's cost base are greater pressure on bad debts (circa £4m per annum through to 2022/23), as well as further reductions in revenues.

Reduced cash flows would impact on key financial metrics, in particular interest cover ratios. In the extreme downside scenario, gearing and interest covers retain significant headroom within the trigger levels specified in borrowing covenants; and whilst the reduced cash flows weaken financial metrics, they remain within rating agencies' guidance for current ratings.

Having considered these matters, the Directors do not believe there are any material uncertainties to disclose in relation to the Company's ability to continue as a going concern

Further details are provided in the long-term viability statement in part 4 to 9 of this Annual Performance Report

Statement on ring fencing certificate

The Directors have resolved that a Certificate required under Condition P9 be issued to the Water Services Regulation Authority confirming that in the opinion of the Directors:

a) the Company will have available to it sufficient financial resources and facilities to enable it to carry out, for at least the next 12 months, the regulated activities (including the investment programme necessary to fulfil the Company's obligations under the Instrument of Appointment); and

b) the Company will, for at least the next 12 months, have available to it management resources and systems of planning and internal control which are sufficient to enable it to carry out those functions.

Statement of Directors' responsibilities for regulatory information (continued)

Statement on sufficiency of financial resources and facilities

In providing this Certificate, the Directors have taken into account:

a) the Company's Licence, which is in place on a rolling 25-year basis;

b) the certainty on customer tariffs to March 2022 provided by the 2019 Final Determination of prices by Ofwat, following its acceptance by the Board;

c) the financial strength of the Company and the management and other resources available to the Company as recorded in the financial statements for the year ended 31 March 2021;

d) the bond programme of financing implemented by Dŵr Cymru (Financing) UK Plc, an associate Company, inter alia, to provide future financing for the Company (including the investment programme necessary to fulfil the Company's obligations under the Instrument of Appointment);

e) the strong credit rating of the Company's bonds;

f) the results from the ongoing monitoring of financial, operational and compliance controls and the risk management process reported to the Board via five formal committees: the Audit Committee; the Remuneration Committee; the Nominations Committee; the Quality and Environment Committee; and the Technology Committee. The Group's internal audit function has carried out a programme of work, which incorporates a review of the control environment;

g) the annual review of the effectiveness of internal controls in compliance with the requirements of the UK Corporate Governance Code;

h) the Company's formal risk and governance arrangements which are monitored by the Audit Committee and Board;

i) the Company's employment policies and strategy;

j) the Company's plans for the AMP7 regulatory period; and

k) the undertaking that Glas Cymru Cyfyngedig ("Glas Cymru") has given following the acquisition of the Company, in which Glas Cymru confirms that it (and each of its subsidiaries other than the Company) will:

- provide the Company with all such information as may be necessary to enable the Company to comply with the requirements of the conditions of Appointments, or such additional information as the Director may reasonably require about their activities and the financing of them;
- refrain from any action which would or may cause the Company to breach any of its obligations under the Act or conditions of Appointments;
- ensure that at all times the Board of the Company contains a majority of Non-Executive Directors;

Statement of Directors’ responsibilities for regulatory information (continued)

Statement on sufficiency of financial resources and facilities (continued)

- comply with the Principles of Good Governance outlined in the current UK Corporate Governance Code published by the Financial Reporting Council (or any successor document having a similar purpose or intent) as may from time to time be appended to or approved for the purposes of the Listing Rules of the UK Listing Authority; and
- not make any changes to their respective Memorandum and Articles of Association without the consent of Ofwat.

This Directors’ Certificate also confirms that in the opinion of the Directors all contracts entered into with any associated company include all necessary provisions and requirements concerning the standard of service to the Company, to ensure that it is able to meet all its obligations as a water and sewerage undertaker.

Section P35 of Licence Condition P requires our independent auditors to produce a report that sets out:

- any inconsistencies between the Director’s Certificate and either the statements under licence conditions F6.1 or any information which were obtained in the course of their work as the Company’s auditors.

The independent auditors’ report can be found on page 11.

Licence Condition P26 – maintaining an investment grade rating

The Directors confirm that throughout 2020/21 the Company, or an associated company as issuer of debt on its behalf, has ensured that it has maintained at all times an issuer credit rating which is an investment grade rating. Dŵr Cymru has amongst the strongest credit ratings in the water sector, reflecting the Company’s high level of creditworthiness. The ratings of the Company’s Class A and B debt at 31 March 2021 were A-, A3 and A (all with stable outlook) from Standard and Poor, Moody’s and Fitch Ratings.

Tax strategy note

As required by RAG 3.12 the tax strategy note is included within this Annual Performance Report, in the accounting policies note in appendix 6 of part 4 to 9, and covers the following key areas:

- the Company’s approach to risk management and governance arrangements;
- the Company’s attitude towards tax planning;
- the level of risk that the Group is prepared to accept; and
- the Company’s approach towards its dealings with HMRC.

Statement of Directors' responsibilities for regulatory information (continued)

Statement on differences between statutory and RAG definitions

Tables 1A, 1B, 1C and 1D all have a column to report any resulting differences between statutory and regulatory definitions on a line by line basis. An analysis of the differences is shown at the end of each table with a narrative explanation of any material movements included in appendix 6 of part 4 to 9. A reconciliation between total borrowings included in the statutory financial statements and borrowings in the regulatory accounts is provided alongside table 1C.

Long term viability statement

Our customers need to know they can rely on the services we provide over the long term. Ensuring the long-term resilience of our business, including financial resilience, is therefore a key area of focus for us. Ofwat expects companies to confirm that they are financially viable over the longer term. Our approach to doing this complies with Provision 31 of the UK Corporate Governance Code.

As a result of our assessment, the Directors have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period to March 2030. The Long Term Viability Statement is provided at the end of appendix 6 – Additional Regulatory information of parts 4 to 9 of this Annual Performance Report and also in the 2021 Glas Cymru Annual Report and Accounts which are available at www.dwrcymru.com.

Statement explaining out/under performance of the return on regulated equity (RORE)

The movement in RORE compared to the base RORE set at the last price review is reported in appendix 6 of parts 4 to 9. This identifies and quantifies the key components of the out/under performance as required by RAG 3.12.

Statement on variance between revenue and costs arising from providing infrastructure network reinforcement

This statement applies to English Companies where revenue from infrastructure charges is aligned to costs over a period of time. These rules do not apply in Wales as the infrastructure charges which are set in accordance with the terms of our licence are not directly aligned to costs; as a result we have not shown any variance in table 2K.

Statement on innovation competition

There was no innovation competition spend in this report year. The revenue received from customers in 2020/21 for the purposes of innovation competition will not be used for business as usual activities funded through totex. The breakdown of the cash balance between the innovation competition and other appointed activities is shown alongside table 1C.

Statement of Directors' responsibilities for regulatory information (continued)

Licence Condition P19 – trading with associate companies at arm's length

We have an obligation to ensure that every transaction between the appointed business and any associated company is at arm's length so neither gives to nor receives from the other any cross-subsidy. There were no material transactions with associated companies except for:

- the Directors of Dŵr Cymru Cyfyngedig (DCC) are also directors of other companies within the Glas Cymru Group. However, the emoluments of the Directors are paid in full by DCC as their activities are predominantly related to the regulated water and sewerage business. During the year the Directors' emoluments amounted to £1,968,528 (2020: £2,320,031);
- no dividends were paid or received by the Company during the year;
- Welsh Water Infrastructure Limited (WWIL) intercompany balance at 31.03.2021 was £nil (2020: £2,400) ; £2,400 was repaid to the Company during the year;
- Welsh Water Organic Energy (Cardiff) Limited (WOEC) intercompany balance at 31.03.2021 was £320,559 (2020: £149,259); the net increase of £171,300 relates to costs recharged to WOEC that have not yet been reimbursed. This value has been included in the Company's balance sheet as an intercompany balance;
- Welsh Water Organic Energy Limited (WWOE) intercompany balance at 31.03.2021 was £nil (2020: £9,675); £9,675 was repaid to the Company during the year;
- Welsh Water Organic Waste Limited (WWOW) intercompany balance at 31.03.2021 was £147,563 (2020: £277,127); the net decrease of £129,564 relates to reimbursement of costs recharged to WWOW. This value has been included in the Company's balance sheet as an intercompany balance;
- £18,901 (2020: £18,901) of Glas Cymru Holdings Cyfyngedig (CGHC) costs remain outstanding. This value has been included in the Company's balance sheet as an intercompany balance;
- £8,481 (2020: £8,481) of Glas Cymru Anghyfyngedig costs remain outstanding. This value has been included in the Company's balance sheet as an intercompany balance;
- Cambrian Utilities Limited intercompany balance at 31.03.2021 was £10,879 (2020: £4,265); costs amounting to £6,614 were paid by the Company on its behalf. This value has been included in the Company's balance sheet as an intercompany balance;
- £1,971,000 (2020: £1,971,000) from Glas Cymru Anghyfyngedig remains outstanding and is included in the Company's balance sheet as an intercompany balance;
- an intercompany loan of £2,812,458 (2020: £2,812,458) from Dŵr Cymru Holdings Limited remains outstanding and is included in the Company's balance sheet as an intercompany loan;

Statement of Directors' responsibilities for regulatory information (continued)

Licence Condition P19 – trading with associate companies at arm's length (continued)

- intercompany interest payable to the Group's financing company Dŵr Cymru (Financing) UK Plc (DCF), totalled £107,550,000 (2020: £141,866,998). As at 31 March 2020 the balance outstanding on the intercompany loan from DCF stood at £2,744,327,596 (2020: £3,075,771,969). All borrowings raised by DCF are immediately on-lent to DCC on an arm's length basis. The intercompany loan agreement is subject to the terms and conditions of the whole business securitisation structure of Glas Cymru Anghyfyngedig and its subsidiaries. DCC, in its capacity as debtor, repays such principal and interest as is due on each borrowing on the due date plus a margin of 0.01%;
- recharge of costs paid on behalf of Welsh Water Organic Energy (Cardiff) Limited and Welsh Water Organic Waste Limited of £1,167,000 and £285,000 respectively;
- services provided by the associated companies to the Company was £587,000 for supply of power from Welsh Water Organic Energy (Cardiff) Limited ; the contract was at arms length; and
- the Company received rent of £52,000 for two sites at Nash and Eign from Welsh Water Organic Waste Limited; the contract was at arms length.

For a complete list please see the accounting policies note in appendix 6 of parts 4 to 9.

Independent auditors' report to the Water Services Regulation Authority (the WSRA) and the Directors of Dŵr Cymru Cyfyngedig

Opinion

We have audited the sections of Dwr Cymru Cyfyngedig's Annual Performance Report for the year ended 31 March 2021 ("the Regulatory Accounting Statements") which comprise:

- the regulatory financial reporting tables comprising the income statement (table 1A), the statement of comprehensive income (table 1B), the statement of financial position (table 1C), the statement of cash flows (table 1D), the net debt analysis (table 1E), the financial flows (table 1F) and the related notes; and
- the regulatory price review and other segmental reporting tables comprising the segmental income statement (table 2A), the totex analysis for wholesale water and wastewater (table 2B), the operating cost analysis for retail (table 2C), the historical cost analysis of fixed assets for wholesale and retail (table 2D), the analysis of grants and contributions and land sales for wholesale (table 2E), the household water revenues by customer type (table 2F), the non-household water revenues by customer type (table 2G), the non-household wastewater revenues by customer type (table 2H), the revenue analysis & wholesale control reconciliation (table 2I), the infrastructure network reinforcement costs (table 2J), the infrastructure charges reconciliation (table 2K), the analysis of land sales (table 2L), the revenue reconciliation for wholesale (table 2M), residential retail social tariffs (table 2N) and historical cost analysis of intangible assets (table 2O) and the related notes.

We have not audited the outcome performance table (tables 3A to 3I) and the additional regulatory information in tables 4A to 4R, 5A to 5B, 6A to 6D, 7A to 7E, 8A to 8D and 9A.

In our opinion, the Company's Regulatory Accounting Statements have been prepared, in all material aspects, in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA (RAG 1.09, RAG 2.08, RAG 3.12, RAG 4.09 and RAG 5.07) and the accounting policies (including the Company's published accounting methodology statement(s), as defined in RAG 3.12, appendix 2), set out on page 92.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)"), including ISA (UK) 800, and applicable law, except as stated in the section on Auditors' responsibilities for the audit of the Regulatory Accounting Statements below, and having regard to the guidance contained in ICAEW Technical Release Tech 02/16 AAF 'Reporting to Regulators on Regulatory Accounts' issued by the Institute of Chartered Accountants in England & Wales.

Independent auditors' report to the Water Services Regulation Authority (the WSRA) and the Directors of Dŵr Cymru Cyfyngedig (continued)

Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the Regulatory Accounting Statements within the Annual Performance Report section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit, including the Financial Reporting Council's (FRC's) Ethical Standard as applied to public interest entities, and we have fulfilled our 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.

Emphasis of matter – special purpose basis of preparation

We draw attention to the fact that the Regulatory Accounting Statements have been prepared in accordance with a special purpose framework, Condition F, the Regulatory Accounting Guidelines, the accounting policies (including the Company's published accounting methodology statement(s), as defined in RAG 3.12, appendix 2) set out in the statement of accounting policies and under the historical cost convention. The nature, form and content of the Regulatory Accounting Statements are determined by the WSRA. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the WSRA's purposes. Accordingly, we make no such assessment. In addition, we are not required to assess whether the methods of cost allocation set out in the accounting methodology statement are appropriate to the circumstances of the Company or whether they meet the requirements of the WSRA.

The Regulatory Accounting Statements are separate from the statutory financial statements of the Company and have not been prepared under the basis of international accounting standards in conformity with the requirements of the Companies Act 2006 ("IAS"). Financial information other than that prepared on the basis of IAS does not necessarily represent a true and fair view of the financial performance or financial position of a Company as shown in statutory financial statements prepared in accordance with the Companies Act 2006.

The Regulatory Accounting Statements in parts 1 and 2 have been drawn up in accordance with Regulatory Accounting Guidelines with a number of departures from IASs. A summary of the effect of these departures in the Company's statutory financial statements is included in the tables within part 1.

Our opinion is not modified in respect of this matter.

Conclusions relating to going concern

The directors have prepared the Regulatory Accounting Statements on the going concern basis as they do not intend to liquidate the Company or to cease its operations, and as they have concluded that the Company's financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over its ability to continue as a going concern for at least a year from the date of approval of the Regulatory Accounting Statements ("the going concern period").

Independent auditors' report to the Water Services Regulation Authority (the WSRA) and the Directors of Dŵr Cymru Cyfyngedig (continued)

We used our knowledge of the Company, its industry, and the general economic environment to identify the inherent risks to its business model and analysed how those risks might affect the Company's financial resources or ability to continue operations over the going concern period. The risks that we considered most likely to adversely affect the Company's available financial resources and the interest cover and regulated asset ratios relevant to debt covenants over this period was the impact of a reduction in customer collections as a result of Covid-19.

We considered whether these risks could plausibly affect the liquidity or covenant compliance in the going concern period by assessing the degree of downside assumption that, individually and collectively, could result in a liquidity issue, taking into account the current and projected cash and facilities (a reverse stress test).

Our conclusions based on this work:

- we consider that the directors' use of the going concern basis of accounting in the preparation of the Regulatory Accounting Statements is appropriate;
- we have not identified, and concur with the directors' assessment that there is not, a material uncertainty related to events or conditions that, individually or collectively, may cast significant doubt on the Company's ability to continue as a going concern for the going concern period; and
- we found the going concern disclosure in the Regulatory Accounting Statements to be acceptable.

However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the above conclusions are not a guarantee that the Company will continue in operation.

Other information

The other information comprises all of the information in the Annual Performance Report other than the Regulatory Accounting Statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the Regulatory Accounting Statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the Regulatory Accounting Statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the Regulatory Accounting Statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the Regulatory Accounting 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 based on these responsibilities.

Independent auditors' report to the Water Services Regulation Authority (the WSRA) and the Directors of Dŵr Cymru Cyfyngedig (continued)

Responsibilities of the Directors for the Annual Performance Report

As explained more fully in the Statement of Directors' responsibilities for regulatory information set out above, the directors are responsible for the preparation of the Annual Performance Report in accordance with the Regulatory Accounting Guidelines issued by the WSRA and the Company's accounting policies (including the Company's published accounting methodology statement(s), as defined in RAG 3.12, appendix 2).

The directors are also responsible for such internal control as they determine is necessary to enable the preparation of the Annual Performance Report that is free from material misstatement, whether due to fraud or error.

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

Auditors' responsibilities for the Audit of the Regulatory Accounting Statements within the Annual Performance Report

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

Fraud and breaches of laws and regulations – ability to detect

Identifying and responding to risks of material misstatement due to fraud

To identify risks of material misstatement due to fraud ("fraud risks") we assessed events or conditions that could indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud. Our risk assessment procedures included:

- Enquiring of directors, the audit committee, internal audit and inspection of policy documentation as to the Company's high-level policies and procedures to prevent and detect fraud, including the internal audit function, and the Company's channel for "whistleblowing", as well as whether they have knowledge of any actual, suspected or alleged fraud.
- Reading Board/audit committee minutes.

Independent auditors' report to the Water Services Regulation Authority (the WSRA) and the Directors of Dŵr Cymru Cyfyngedig (continued)

- Considering remuneration incentive schemes and performance targets for management/ directors including the AVPS and LTVPS target for management remuneration.
- Using analytical procedures to identify any unusual or unexpected relationships.

We communicated identified fraud risks throughout the audit team and remained alert to any indications of fraud throughout the audit.

As required by auditing standards, we perform procedures to address the risk of management override of controls, in particular the risk that Company management may be in a position to make inappropriate accounting entries. On this audit we do not believe there is a fraud risk related to revenue recognition because of the regulated nature of the revenues recognized and limited opportunity or incentive for management to manipulate these revenues.

We performed procedures including:

- Identifying journal entries and other adjustments to test based on risk criteria and comparing the identified entries to supporting documentation. These included fixed asset, and cash entries made to unrelated accounts.
- Assessing significant accounting estimates for bias.

Identifying and responding to risks of material misstatement due to non-compliance with laws and regulations

We identified areas of laws and regulations that could reasonably be expected to have a material effect on the Regulatory Accounting Statements from our general commercial and sector experience, through discussion with the directors and other management (as required by auditing standards), and from inspection of the Company's regulatory and legal correspondence and discussed with the directors and other management the policies and procedures regarding compliance with laws and regulations.

We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit.

The potential effect of these laws and regulations on the Regulatory Accounting Statements varies considerably.

Firstly, the Company is subject to laws and regulations that directly affect the Regulatory Accounting Statements including regulatory reporting guidelines, distributable profits legislation, taxation legislation, pension legislation and we assessed the extent of compliance with these laws and regulations as part of our procedures on the related Regulatory Accounting Statements items.

Independent auditors' report to the Water Services Regulation Authority (the WSRA) and the Directors of Dŵr Cymru Cyfyngedig (continued)

Secondly, the Company is subject to many other laws and regulations where the consequences of non-compliance could have a material effect on amounts or disclosures in the Regulatory Accounting Statements, for instance through the imposition of fines or litigation or the loss of the Company's license to operate. We identified the following areas as those most likely to have such an effect: compliance with OFWAT regulatory legislation, environmental legislation, water quality, health and safety and employment law recognising the financial and regulated nature of the Company's activities and its legal form. Auditing standards limit the required audit procedures to identify non-compliance with these laws and regulations to enquiry of the directors and other management and inspection of regulatory and legal correspondence, if any. Therefore if a breach of operational regulations is not disclosed to us or evident from relevant correspondence, an audit will not detect that breach.

Context of the ability of the audit to detect fraud or breaches of law or regulation

Owing to the inherent limitations of an audit, there is an unavoidable risk that we may not have detected some material misstatements in the Regulatory Accounting Statements, even though we have properly planned and performed our audit in accordance with auditing standards. For example, the further removed non-compliance with laws and regulations is from the events and transactions reflected in the Regulatory Accounting Statements, the less likely the inherently limited procedures required by auditing standards would identify it.

In addition, as with any audit, there remained a higher risk of non-detection of fraud, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls. Our audit procedures are designed to detect material misstatement. We are not responsible for preventing non-compliance or fraud and cannot be expected to detect non-compliance with all laws and regulations.

A further description of our responsibilities for the audit of the Regulatory Accounting Statements is located on the Financial Reporting Council's website at www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report, except for the following:

The nature, form and content of the Regulatory Accounting Statements are determined by the WSRA. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the WSRA's purposes. Accordingly we make no such assessment. In addition, the Company has presented the allocation of operating costs and assets in accordance with the accounting policy for price control segments as set out alongside table 2A and its accounting methodology statement. We are not required to assess whether the methods of cost allocation set out in the accounting methodology statement are appropriate to the circumstances of the Company or whether they meet the requirements of the WSRA, which would have been required if we were to express an audit opinion under ISAs (UK).

Independent auditors' report to the Water Services Regulation Authority (the WSRA) and the Directors of Dŵr Cymru Cyfyngedig (continued)

We have not assessed whether the accounting policies are appropriate to the circumstances of the Company where these are laid down by Condition F. Where Condition F does not give specific guidance on the accounting policies to be followed, our audit includes an assessment of whether the accounting policies adopted in respect of the transactions and balances required to be included in the Annual Performance Report are consistent with those used in the preparation of the statutory financial statements of the Company.

Use of this report

This report is made, on terms that have been agreed, solely to the Company and the WSRA in order to meet the requirements of Condition F of the Instrument of Appointment granted by the Secretary of State for the Environment to the Company as a water and sewage undertaker under the Water Industry Act 1991 ("Condition F"). Our audit work has been undertaken so that we might state to the Company and the WSRA those matters that we have agreed to state to them in our report, in order (a) to assist the Company to meet its obligation under Condition F to procure such a report and (b) to facilitate the carrying out by the WSRA of its regulatory functions, 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 WSRA, for our audit work, for this report or for the opinions we have formed.

Our opinion on the Regulatory Accounting Statements is separate from our opinion on the statutory financial statements of the Company for the year ended 31 March 2021 on which we reported on 4 June 2021, which are prepared for a different purpose. Our audit report in relation to the statutory financial statements of the Company (our "Statutory audit") was made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our Statutory audit work was undertaken so that we might state to the Company's members those matters we are required to state to them in a statutory audit report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume responsibility for any other purpose or to any other person to whom our Statutory audit report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

James Ledward
For and on behalf of KPMG LLP
Chartered Accountants
3 Assembly Square
Britannia Quay
Cardiff CF10 4AX
9 July 2021

1A – Income statement for the year ended 31 March 2021

	Ref	Statutory £m	Adjustments: RAG differences[1] £m	Adjustments: Non-appointed[2] £m	Adjustments: Total adjustment £m	Total appointed £m
Revenue	2A	**776.158**	(5.834)	4.145	**(9.979)**	**766.179**
Operating costs	2A	**(768.618)**	(5.493)	(6.327)	**0.834**	**(767.784)**
Other operating income	2A	**0.096**	-	-	-	**0.096**
Operating profit	1D, 2A	**7.636**	(11.327)	(2.182)	**(9.145)**	**(1.509)**
Other income		-	17.102	-	**17.102**	**17.102**
Interest income		**4.801**	-	0.151	**(0.151)**	**4.650**
Interest expense[3]		**(138.955)**	(9.312)	-	**(9.312)**	**(148.267)**
Other interest expense[4]		-	(1.988)	-	**(1.988)**	**(1.988)**
Loss before tax and fair value movements		**(126.518)**	(5.525)	(2.031)	**(3.494)**	**(130.012)**
Fair value gains on financial instruments		**39.381**	-	-	-	**39.381**
Loss before tax		**(87.137)**	(5.525)	(2.031)	**(3.494)**	**(90.631)**
UK corporation tax		**0.292**	-	-	-	**0.292**
Deferred tax		**13.589**	1.050	0.386	**0.664**	**14.253**
Loss for the year	1B	**(73.256)**	(4.475)	(1.645)	**(2.830)**	**(76.086)**
Dividends		-	-	-	-	-

[1] Differences arising from statutory IFRS and RAG definitions are shown in the table on page 20.

[2] See accounting policies note in appendix 6 of parts 4 to 9 (appointed and non-appointed business) for a description of the Company's non-appointed activities.

[3] Interest expense consists of interest payable on:

	£m
External borrowings	(8.240)
Intra group borrowings	(125.616)
Amortisation of:	
Debt issuance cost	(1.320)
Debt premiums	0.723
Lease liabilities	(11.602)
Other loans	(2.212)
	(148.267)

[4]Other interest expense relates to interest paid on pension scheme liabilities.

1A – Income statement for the year ended 31 March 2021 (continued)

Tax analysis

	Statutory £m	Adjustments: RAG differences[1] £m	Adjustments: Non-appointed[2] £m	Adjustments: Total adjustments £m	Total appointed £m
Current year	**0.171**	-	-	**-**	**0.171**
Adjustments in respect of prior years	**(0.463)**	-	-	**-**	**(0.463)**
UK Corporation tax	**(0.292)**	-	-	-	**(0.292)**

[1] Differences arising from statutory IFRS and RAG definitions are shown in the table on page 20.

[2] See accounting policies note in parts 4 to 9 (appointed and non-appointed business) for a description of the Company's non-appointed activities.

Analysis of non-appointed revenue

	Non-appointed[2] £m
Imported sludge	-
Tankered waste	1.605
Other non-appointed revenue	2.540
Revenue	**4.145**

1A – Income statement for the year ended 31 March 2021 (continued)

The differences arising from statutory IFRS and RAG definitions are summarised below:

	Revenue recognition - measured income accrual adjustment £m	Removal of interest capitalisation and related depreciation £m	Deferred income release moved from depreciation to other income £m	Infrastructure renewal income moved from operating costs to other income £m	New connection income moved from revenue to other income £m	Searches income moved from revenue to other income £m	Pension interest moved from interest expense to other interest £m	Innovation fund accrual removed from operating expenditure £m	Tax charge relating to measured income accrual and capitalisation of interest £m	Total £m
Revenue	0.2	-	-	-	(5.3)	(0.7)	-	-	-	(5.8)
Operating costs	-	3.1	(9.1)	(2.0)	-	-	-	2.5	-	(5.5)
Other income	-	-	9.1	2.0	5.3	0.7	-	-	-	17.1
Interest expense	-	(11.3)	-	-	-	-	2.0	-	-	(9.3)
Other interest expense	-	-	-	-	-	-	(2.0)	-	-	(2.0)
Deferred tax	-	-	-	-	-	-	-	-	1.0	1.0
Loss for the year	0.2	(8.2)	-	-	-	-	-	2.5	1.0	(4.5)

1B – Statement of comprehensive income for the year ended 31 March 2021

			Adjustments			
		Statutory	RAG differences[1]	Non-appointed[2]	**Total adjustments**	**Total appointed**
	Ref	**£m**	£m	£m	**£m**	**£m**
Loss for the year	1A	**(73.256)**	(4.475)	(1.645)	**(2.830)**	**(76.086)**
Actuarial losses on post-employment plans		**(1.080)**	**-**	-	**-**	**(1.080)**
Other comprehensive income[3]		**23.166**	-	-	**-**	**23.166**
Total comprehensive loss for the year		**(51.170)**	**(4.475)**	**(1.645)**	**(2.830)**	**(54.000)**

[1] Differences in the loss for the year arising from statutory IFRS and RAG definitions are shown in the table on page 20.

[2] See accounting policies note in appendix 6 in parts 4 to 9 (appointed and non-appointed business) for a description of the Company's non-appointed activities.

[3] Further details are provided in the statement of changes in equity; in the accounting policies note in appendix 6 in parts 4 to 9.

1C – Statement of financial position as at 31 March 2021

	Ref	Statutory £m	Adjustments: RAG differences[1] £m	Adjustments: Non-appointed[2] £m	Adjustments: Total adjustments £m	Total appointed activities £m
Non-current assets						
Fixed assets	2D	**5,808.790**	(85.037)	-	**(85.037)**	**5,723.753**
Intangible assets		**203.600**	(9.300)	-	**(9.300)**	**194.300**
Financial instruments		**3.300**	-	-	**-**	**3.300**
Total non-current assets		**6,015.690**	(94.337)	-	**(94.337)**	**5,921.353**
Current assets						
Inventories		**4.325**	-	-	**-**	**4.325**
Trade and other receivables		**569.135**	5.544	-	**5.544**	**574.679**
Financial instruments		**4.500**	-	-	**-**	**4.500**
Cash and cash equivalents[4]	1E	**208.809**	-	43.449	**(43.449)**	**165.360**
Total current assets		**786.769**	5.544	43.449	**(37.905)**	**748.864**
Current liabilities						
Trade and other payables		**(524.539)**	3.952	-	**3.952**	**(520.587)**
Capex creditor		**(17.985)**	-	-	**-**	**(17.985)**
Borrowings[3]		**(77.667)**	7.633	-	**7.633**	**(70.034)**
Financial instruments		**(32.554)**	-	-	**-**	**(32.554)**
Provisions		**(8.500)**	(9.085)	-	**(9.085)**	**(17.585)**
Total		**(661.245)**	2.500	-	**2.500**	**(658.745)**
Net current assets		**125.524**	8.044	43.449	**(35.405)**	**90.119**

[1] Differences arising from statutory IFRS and RAG definitions are shown in the table on page 24.

[2] See accounting policies note in appendix 6 of parts 4 to 9 (appointed and non-appointed business) for a description of the Company's non-appointed activities.

[3] A reconciliation between borrowings in statutory accounts and regulatory accounts is shown on page 24.

[4]Cash and cash equivalent value for total appointed activities of £165.360m consists of £2.588m cash balances for innovation competition and £162.772m cash balances for other appointed activities.

1C – Statement of financial position as at 31 March 2021 (continued)

	Statutory	RAG differences[1]	Non-appointed[2]	Total adjustments	Total appointed activities
		Adjustments			
	£m	£m	£m	£m	£m
Non-current liabilities					
Trade and other payables	**(401.898)**	361.051	-	**361.051**	**(40.847)**
Borrowings[3]	**(3,743.987)**	40.847	-	**40.847**	**(3,703.140)**
Financial instruments	**(237.703)**	-	-	**-**	**(237.703)**
Retirement benefit obligations	**(89.880)**	-	-	**-**	**(89.880)**
Provisions	**(7.787)**	-	-	**-**	**(7.787)**
Deferred income – grants and contributions	**-**	0.002	-	-	**0.002**
Deferred income – adopted assets	-	(401.900)	-	**(401.900)**	**(401.900)**
Deferred tax	**(472.993)**	16.814	0.386	**16.428**	**(456.565)**
Total non-current liabilities	**(4,954.248)**	16.814	0.386	**16.428**	**(4,937.820)**
Net assets	**1,186.966**	(69.479)	43.835	**(113.314)**	**1,073.652**
Equity					
Called-up share capital	**309.900**	-	-	**-**	**309.900**
Retained earnings and other reserves	**877.066**	(69.479)	43.835	**(113.314)**	**763.752**
Total equity[4]	**1,186.966**	(69.479)	43.835	**(113.314)**	**1,073.652**

[1] Differences arising from statutory IFRS and RAG definitions are shown in the table on page 24.

[2] See accounting policies note in parts 4 to 9 (appointed and non-appointed business) for a description of the Company's non-appointed activities.

[3] A reconciliation between borrowings in statutory accounts and regulatory accounts is shown on page 24.

[4] A statement of changes in equity has been provided in the accounting policy note in appendix 6 of parts 4 to 9 to enable reconciliation between tables 1B and 1C.

1C – Statement of financial position as at 31 March 2021 (continued)

The differences arising from statutory IFRS and RAG definitions are summarised below:

	Revenue recognition - measured income accrual adjustment £m	Accrued interest moved from borrowings to trade payables £m	Deferred income £m	Capitalisation of interest removed £m	Tax charge relating to changes £m	Removal of innovation fund provision £m	Total £m
Fixed assets	-	-	-	(85.0)	-	-	**(85.0)**
Intangible assets	-	-	-	(9.3)	-	-	**(9.3)**
Current assets							
Trade and other receivables	5.5	-	-	-	-	-	**5.5**
Current liabilities							
Trade and other payables	-	(7.6)	9.1	-	-	2.5	**4.0**
Borrowings	-	7.6	-	-	-	-	**7.6**
Provisions	-	-	(9.1)	-	-	-	**(9.1)**
Non-current liabilities							
Trade and other payables	-	(40.8)	401.9	-	-	-	**361.1**
Borrowings	-	40.8	-	-	-	-	**40.8**
Deferred income - adopted assets	-	-	(401.9)	-	-	-	**(401.9)**
Deferred tax	-	-	-	-	16.8	-	**16.8**
Net assets	**5.5**	**-**	**-**	**(94.3)**	**16.8**	**2.5**	**(69.5)**
Equity							
Retained earnings	5.5	-	-	(94.3)	16.8	2.5	**(69.5)**
Total equity	**5.5**	**-**	**-**	**(94.3)**	**16.8**	**2.5**	**(69.5)**

Reconciliation between total borrowings in Statutory Accounts and Regulatory Accounting Statements

	£m
Borrowings per Statutory Financial Statements	**3,821.7**
Accrued interest reclassified as trade and other payables	(48.5)
Borrowings per Regulatory Accounting Statements	**3,773.2**

1D – Statement of cash flows for the year ended 31 March 2021

Statement of cash flows	Ref	Statutory £m	Adjustments: RAG differences[1] £m	Adjustments: Non-appointed £m	Adjustments: Total adjustments £m	Total appointed £m
Operating profit	**1A**	**7.636**	(11.327)	(2.182)	**(9.145)**	**(1.509)**
Other income		**-**	7.985	-	**7.985**	**7.985**
Depreciation[2]	**2D**	**342.217**	(3.100)	-	**(3.100)**	**339.117**
Amortisation – grants and contributions	**2O**	**(9.117)**	9.117	-	**9.117**	**-**
Changes in working capital		**7.434**	(2.675)	-	**(2.675)**	**4.759**
Movement in provisions		**(0.513)**	-	-	**-**	**(0.513)**
Profit on sale of fixed assets		**(0.096)**	-	-	**-**	**(0.096)**
Cash generated from operations		**347.561**	-	(2.182)	**2.182**	**349.743**
Net interest paid		**(105.589)**	-	0.151	**(0.151)**	**(105.740)**
Tax rebate		**2.498**	-	-	**-**	**2.498**
Net cash generated from operating activities		**244.470**	**-**	(2.031)	**2.031**	**246.501**
Investing activities						
Capital expenditure		**(322.416)**	-	-	**-**	**(322.416)**
Grants and contributions		**18.200**	-	-	**-**	**18.200**
Disposal of fixed assets		**0.196**	-	-	**-**	**0.196**
Net cash used in investing activities		**(304.020)**	-	-	**-**	**(304.020)**
Net cash flow before financing activities		**(59.550)**	-	(2.031)	**2.031**	**(57.519)**
Cash flows from financing activities						
Net loans repaid		**(390.303)**	-	-	**-**	**(390.303)**
Net cash flow from financing activities		**(390.303)**	**-**	**-**	**-**	**(390.303)**
Decrease in net cash		**(449.853)**	-	(2.031)	**2.031**	**(447.822)**

[1] Differences arising from statutory IFRS and RAG definitions; for further details see table on page 26.

[2] **Reconciliation to table 2A:**

Depreciation of:	**£m**
Tangible fixed assets (2D)	306.992
Intangible fixed assets (2O)	32.125
	339.117

1D – Statement of cash flows for the year ended 31 March 2021 (continued)

The differences arising from statutory IFRS and RAG definitions are summarised below:

	Revenue recognition: measured income accrual adjustment	Reversal of interest capitalisation	Deferred income	IRE income moved from operating costs to other income	New connections income moved from revenue to other income	Searches income moved from revenue to other income	Removal of innovation fund provision	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Operating profit	0.2	3.1	(9.1)	(2.0)	(5.3)	(0.7)	2.5	(11.3)
Other income	-	-	-	2.0	5.3	0.7	-	8.0
Depreciation	-	(3.1)	-	-	-	-	-	(3.1)
Amortisation – grants and contributions	-	-	9.1	-	-	-	-	9.1
Changes in working capital	(0.2)	-	-	-	-	-	(2.5)	(2.7)
Decrease in net cash	-	-	-	-	-	-	-	-

1E – Net debt analysis (appointed activities) as at 31 March 2021

	Interest rate risk profile			
	Fixed rate £m	Floating rate £m	Index-linked £m	Total appointed £m
Borrowings (excluding preference shares)	495.567	265.837	3,020.936	3,782.340
Preference share capital				-
Total borrowings[2]				**3,782.340**
Cash				(85.805)
Short term deposits				(79.555)
Cash and cash equivalents[1]				**(165.360)**
Net debt				**3,616.980**
Gearing				60.18%
Adjusted gearing[1]				60.27%
Full year equivalent nominal interest cost	19.752	2.799	94.651	117.202
Full year equivalent cash interest payment	19.752	2.799	57.905	80.456
Indicative interest rates				
Indicative weighted average nominal interest rate	3.99%	1.05%	3.13%	3.10%
Indicative weighted average cash interest rate	3.99%	1.05%	1.92%	2.13%
Weighted average years to maturity	11.100	1.538	11.376	11.259

[1] The gearing ratio used by the Company includes accrued interest as well as all cash held within the whole business securitisation structure.

The Ofwat measure of gearing excludes accrued interest and uses cash allocated to the appointed business only:

	Net debt £m	RCV £m	Gearing %
Gearing	3,617	6,010	60.18%
Accrued interest	51		
Loan from parent	(3)		
Non-appointed cash	(43)		
	5		
Adjusted gearing	3,622	6,010	60.27%

[2] Reconciliation between total borrowings in 1C to 1E:

	Net debt £m
Borrowings per Statement of Financial Position– 1C	3,773.2
Bond issue premium	9.1
Total borrowings per net debt analysis – 1E	3,782.3

1F – Financial Flows

	Year ended 31 March 2021[1]					
	Notional returns and notional regulatory equity	**Actual returns and notional regulatory equity**	**Actual returns and actual regulatory equity**	**Notional returns and notional regulatory equity**	**Actual returns and notional regulatory equity**	**Actual returns and actual regulatory equity**
	%	**%**	**%**	**£m**	**£m**	**£m**
Return on regulatory equity						
Return on regulatory equity	3.78%	3.80%	3.78%	86.020	86.427	86.427
Regulatory equity	2,275.659	2,275.659	2,286.435			
Financing						
Gearing		(0.02%)	(0.02%)		(0.068)	(0.068)
Gearing benefits sharing		0.00%	0.00%		0.000	0.000
Variance in corporation tax		0.04%	0.04%		0.890	0.890
Group relief		0.00%	0.00%		0.000	0.000
Cost of debt		(0.07%)	(0.07%)		(1.561)	(1.532)
Hedging instruments		(0.79%)	(0.78%)		(17.896)	(17.896)
Return on regulatory equity including financing adjustments	3.78%	2.96%	2.97%	86.020	67.792	67.821
Operational performance						
Totex underperformance		(0.48%)	(0.48%)		(10.896)	(10.896)
ODI underperformance		(0.32%)	(0.32%)		(7.285)	(7.285)
C-Mex out/(under)performance		0.00%	0.00%		0.000	0.000
D-Mex out/(under)performance		0.00%	0.00%		0.000	0.000
Retail underperformance		(1.30%)	(1.30%)		(29.640)	(29.640)
Other exceptional items		0.00%	0.00%		0.000	0.000
Operational performance total		(2.1%)	(2.09%)		(47.821)	(47.821)
RoRE	**3.78%**	**0.86%**	**0.87%**	**86.020**	**19.971**	**20.000**
Actual performance adjustment 2015-20	(0.11%)	(0.11%)	(0.11%)	(2.609)	(2.609)	(2.609)
Total earnings	3.67%	0.75%	0.76%	83.411	17.362	17.391
RCV growth from RPI inflation	1.01%	1.01%	1.01%	22.984	22.984	23.093
Voluntary sharing arrangements		0.49%	0.49%		11.198	11.198
Total shareholder return	4.68%	2.25%	2.26%	106.395	51.544	51.682
Gross dividend	4.00%	0.00%	0.00%	91.026	0.000	0.000
Interest received on intercompany loans	0.00%	0.00%	0.00%	0.000	0.000	0.000
Retained value	0.68%	2.25%	2.26%	15.369	51.544	51.682

[1]Actual for 12 months ended 31 March 2021 and average 2020-25 are the same values in this report year.

1F – Financial flows for the year ended 31 March 2021: commentary

EXECUTIVE SUMMARY: WHAT DOES THE TABLE TELL US?

During the year to 31 March 2021 the returns to equity for Welsh Water totalled 2.26%, after inflation; lower than the 4.68% assumed by Ofwat. The principal factors contributing to this lower return are the financial impact of our response to the Covid-19 pandemic (which has impacted on our totex and retail performance), our cautious financing structure and slight overall ODI underperformance against our PR19 Final Determination (FD19) targets.

Gearing and cost of debt

Our gearing is marginally lower than Ofwat's assumed 60% for a notional company. This reduces our return on regulatory equity as there is therefore more equity in the business than assumed in FD14 for a notional company. In practice, of course, the Glas group does not have shareholders and all returns are reinvested into the business or returned to customers. Our cost of debt, excluding the impact of hedging instruments, slightly underperforms the FD19 assumptions. The impact of our hedging instruments, while providing cost certainty and stability, has further increased our cost of debt. Overall our cost of debt has been higher than the FD19 assumptions, reducing the returns to equity.

Cost and operational performance

Our AMP7 investment programme has been delivered broadly in line with plan during 2020-21 despite the pandemic, however the costs associated with ensuring that we were able to continue to safely deliver our capital schemes and provide our operational services have resulted in totex underperformance. In addition and against as a consequence of the pandemic, we have reported a significantly higher bad debt charge within retail costs than was allowed in FD19, hence retail has also underperformed. Our ODI profile reflects slight underperformance during the year.

Dividends

No dividends were declared or paid during the year. Dividends paid by Welsh Water do not represent payments to shareholders in the traditional sense. Our group structure is based on a not-for-shareholder business model and Glas Cymru Holdings Cyfyngedig, the ultimate parent Company, has no shareholders. All retained earnings are used for the benefit of customers; in recent years we have used these to reduce the bills of vulnerable customers, to improve service to customers and to bring down the level of gearing to reduce the cost of new debt.

1F – Financial flows for the year ended 31 March: commentary (continued)

DETAILED TABLE PREPARATION COMMENTARY

Introduction

Welsh Water shares Ofwat's vision for the water sector in England and Wales: one where customers, the environment and wider society have trust and confidence in vital public water and wastewater services. Ofwat intends table 1F to improve the transparency concerning financial flows to investors, providing a comparison in the annual performance reports (APR) between the financial flows to investors on the basis of the actual capital structures of water companies and what they would have been under a notional structure.

In order to support the goal of providing clarity and comparability, we have set out below details of the calculations underpinning each input as well as narrative to explain variances against the PR19 Final Determination.

Line 1 – Return on regulatory equity

This line reports the allowed equity return per Ofwat's Financial Flows Data Source model.

Line 2 – Regulatory equity

This line reports notional regulatory equity per Ofwat's Regulatory Capital Values publication.

Actual regulatory equity is calculated as the average of the opening and closing RCV, less average net debt (using the opening and closing balance for the reporting period as reported in table 1E).

1F – Financial flows for the year ended 31 March: commentary (continued)

Actual regulatory equity			**2020/21**
Average of the opening and closing RCV (in 2017/18 year average CPIH prices)			
Opening RCV			
Opening RCV per Ofwat's Regulatory Capital Values (2020/21 year-end prices)			5,967.031
2020/21 year-end CPIH			109.700
2017/18 year-average CPIH			104.217
Opening RCV deflated			5,668.770
Closing RCV			
Closing RCV per Ofwat's Regulatory Capital Values (2020/21 year-end prices)			6,009.929
2020/21 year-end CPIH			109.700
2017/18 year-average CPIH			104.217
Closing RCV deflated			5,709.524
Average RCV			**5,689.147**
Less: average net debt (using opening and closing values in table 1E, in 2017/18 year average CPIH prices)			
Opening net debt			
Table 1E 2019/20 outturn			3,510.947
Outturn CPIH			108.600
2017/18 year-average CPIH			104.217
Table 1E 2019/20 deflated			3,369.238
Closing net debt			
Table 1E 2020/21 outturn			3,616.980
Outturn CPIH			109.700
2017/18 year-average CPIH			104.217
Table 1E 2020/21 deflated			3,436.186
Average net debt			**3,402.712**
Actual regulatory equity	**£m**	**3DP**	**2,286.435**

Line 3 – Gearing

1F – Financial flows for the year ended 31 March: commentary (continued)

This line reports the impact of having a different level of gearing from that assumed in Ofwat's notional company structure. Our gearing is marginally lower than Ofwat's notional company level of 60% hence, as we would expect, "shareholder returns" are also marginally lower than allowed in the PR19 Final Determination, although in practice, of course, the Glas group does not have shareholders and all returns are invested back into the business or returned to customers.

Gearing			**2020/21**
a)			
Notional gearing			60.00%
Actual average gearing			
Table 1E 2019/20 (opening)			59.64%
Table 1E 2020/21 (closing)			60.18%
Actual average gearing			59.91%
Difference			(0.09%)
b)			
Allowed return on regulatory equity - base (Line 1 calculation)			3.78%
Allowed cost of debt per Ofwat's Financial Flows Data Source model			2.42%
			1.36%
c)			
a) multiplied by b)			(0.00%)
d)			
Average RCV (Line 2 calculation)			5,689.147
Gearing	**£m**	**3DP**	**(0.068)**

Line 4 – Gearing benefits sharing

The value reported on this line is zero as actual gearing is lower than that for the notional company (see Line 3 calculation, above) and therefore there is no outperformance to share.

1F – Financial flows for the year ended 31 March: commentary (continued)

Line 5 – Variance in corporation tax

The variance in corporation tax is the difference between the level of corporation tax allowed in the Final Determination and actual corporation tax. The guidance states that we should deduct from the Determination allowance *"the tax payable at the standard rate of corporation tax of the profit/(loss) on appointed activities only and before fair value adjustments, plus or minus any adjustment for accelerated or deferred capital allowances, plus or minus any amounts for prior year adjustments plus or minus other Final Determination adjustments to accounting profit"*. We have reflected this guidance in the table below, the data having been drawn from the tax calculations underpinning the corporation tax value reported in table 1A.

Compared to the PR19 corporation tax allowance, the table reports a positive variance in 2020/21 (i.e. our tax charge was lower than the allowance).

Variance in corporation tax			**2020/21**
Corporation tax allowance per Ofwat's Financial Flows Data Source model			1.384
Less: tax payable at the standard rate of corporation tax on the profit/(loss) on appointed activities only, before any fair value adjustments:			
Loss on appointed activities before tax and fair value movements (table 1A)			(130.012)
Standard rate of corporation tax			19.00%
Corporation tax credit			(24.702)
Plus or minus: any adjustment for accelerated or deferred capital allowances			25.672
Plus or minus any amounts for prior year adjustments			(0.453)
Plus or minus other final determination adjustments to accounting profit			-
Total corporation tax - outturn prices			0.517
2020/21 year-average CPIH			109.108
2017/18 year-average CPIH			104.217
Total corporation tax - 2017/18 prices			0.494
Variance in corporation tax	**£m**	**3DP**	**0.890**

Line 6 – Group relief

The value reported on this line is zero as no group relief has been utilised during the reporting period.

Line 7 – Cost of debt

1F – Financial flows for the year ended 31 March: commentary (continued)

Our cost of debt, excluding the impact of hedging instruments, is higher than the allowance in Ofwat's PR19 Final Determination. We still hold a significant proportion of debt which was raised in 2001 (on Welsh Water's acquisition by Glas Cymru) when rates were higher than their equivalents today. If interest rates remain low, our cost of debt will fall as the older debt matures and we are able to secure refinancing at a lower cost.

Cost of debt	**2020/21**
a) Net actual interest paid per income statement (table 1A)	
Interest income	(4.650)
Interest expense	148.267
Net interest	143.617
b) Divided by average net debt	
Opening net debt	
Table 1E 2019/20 outturn	3,510.947
Closing net debt	
Table 1E 2020/21 outturn	3,616.980
Average net debt	3,563.964
Divided by b)	4.03%
c) Less:	
Movement in CPIH for the reporting period	
CPIH at 2020/21 year-end	109.700
CPIH at 2019/20 year-end	108.600
Movement in CPIH for the reporting period	1.01%
Use Fisher equation to remove CPIH movement	2.99%
Less: allowed cost of debt per Ofwat's Financial Flows Source Data model	2.42%
Cost of debt underperformance	(0.57%)

Line 7 – Cost of debt (continued)

	Actual/ notional	**Actual/ actual**
d) Multiplying c) by the average RCV for the period		
Average RCV (Line 2 calculation)	5,689.147	5,689.147
c) multiplied by average RCV	(32.428)	(32.428)
e) Multiplying d) by the notional gearing ratio		

1F – Financial flows for the year ended 31 March: commentary (continued)

Notional/actual gearing ratio			60.00%	59.91%
Cost of debt including impact of hedging instruments			(19.457)	(19.428)
Exclude hedging instruments (Line 8 calculation)			17.896	17.896
Cost of debt - unadjusted for hedging instruments			(1.561)	(1.532)
Cost of debt	**£m**	**3DP**	**(1.561)**	**(1.532)**

Line 8 – Hedging instruments

We have determined the £ impact of the hedging instruments as the report year cash cost (within income statement interest) of those instruments. As in prior years, we have excluded from this line the effect of instruments held in our financing Company, Dŵr Cymru (Financing) UK Plc, which swap floating rate bond liabilities to an RPI indexed rate. The reason for their exclusion is that the bonds and related swaps are on-lent to the appointee as a single instrument; their impact is therefore taken into account in Line 7, Cost of debt. The swap payment data has been taken from our internal management accounts.

Hedging instruments			**2020/21**
Floating to RPI swaps			(8.245)
Floating to fixed swap			(10.492)
Total - outturn prices			(18.736)
2020/21 year-average CPIH			109.108
2017/18 year-average CPIH			104.217
Total - 2017/18 prices	**£m**	**3DP**	**(17.896)**

Line 10 – Totex out/(under)performance

This line reports the difference between actual totex performance and the amount allowed in the published Final Determination for the reporting period, adjusted for timing differences and the company sharing ratio with customers.

The values reported on this line are taken from table 4C, Line 21 and converted from outturn prices into 2017/18 CPIH prices. During the year to 31 March 2021 we incurred significant additional expenditure as a result of the Covid-19 pandemic in order to maintain our operational services and investment programme. Please refer to that table for a full breakdown of the elements of the overall totex overspend.

1F – Financial flows for the year ended 31 March: commentary (continued)

Totex out/(under)performance			**2020/21**
Company share of totex out/(under)performance (table 4c Line 21)			
Water resources			(2.414)
Water network plus			(3.894)
Wastewater network plus			(5.189)
Bioresources			0.089
Additional Control			-
Total - outturn prices			(11.408)
2020/21 year-average CPIH			109.108
2017/18 year-average CPIH			104.217
Total - 2017/18 prices	**£m**	**3DP**	**(10.896)**

Line 11 – ODI out/(under) performance

This line reports the overall financial value of the ODI out/(under)performance in respect of the reporting period.

The data feeding into this line have been taken from table 3A, wherein a full commentary can be found.

ODI out/(under)performance	**2020/21**
Table 3A	
Water quality compliance (CRI)	**(1.059)**
Water supply interruptions	**(2.796)**
Leakage	**0.114**

1F – Financial flows for the year ended 31 March: commentary (continued)

Per capita consumption			**(1.310)**
Mains repairs			**(0.133)**
Unplanned outage			**-**
Acceptability of drinking water			**(1.107)**
Lead pipes replaced			**-**
Business customer satisfaction			**(0.125)**
Unbilled properties			**(0.340)**
Visitors to recreational facilities			**(0.530)**
Delivery of our reservoirs enhancement programme			**-**
Delivery of our water network improvement programme			**-**
Delivery of our South Wales Grid water supply resilience scheme			**-**
Delivery of our new visitor centre			**-**
Cwm Taf Water Supply Strategy Scheme (Underperformance)			**-**
Cwm Taf Water Supply Strategy Scheme (Outperformance)			**-**
Total - 2017/18 prices			**(7.285)**
Total - 2017/18 prices	**£m**	**3DP**	**(7.285)**

Line 14 – Retail out/(underperformance)

This line reports the difference between the FD19 allowed retail operating costs (excluding margin) compared to the actual costs reported in table 2C.

During 2020/21 we incurred additional expenditure as a consequence of the Covid-19 pandemic in order to maintain our services, as well as a significantly higher bad debt charge than had been allowed at FD19. Further details are provided in the commentary to table 2C.

Retail out/(under)performance	**2020/21**
Allowed retail operating costs per Ofwat's Financial Flows Data Source model	38.218
Actual retail operating costs (table 2C, line 21) - outturn prices	71.043
2020/21 year-average CPIH	109.108
2017/18 year-average CPIH	104.217

1F – Financial flows for the year ended 31 March: commentary (continued)

Actual retail operating costs - 2017/18 prices			67.858
Retail out/(under)performance	**£m**	**3DP**	**(29.640)**

Line 15 – Other exceptional items

A zero value has been reported on this line as all exceptional (Covid-related) and atypical (weather-related) expenditure has been included within totex and to report on this line would be duplication. There have been no proceeds from land sales during the reporting year.

Line 18 – Actual performance adjustment 2015-20

The values on this line relate to the total PR14 out/(under)performance adjustments which are published in Ofwat's Financial Flows Data Source model. Our adjustment reflects a small level of underperformance for the period.

			Notional/ notional	Actual/ notional	Actual/ actual
PR14 underperformance adjustment (Ofwat's Financial Flows Data Source model)			(2.609)	(2.609)	(2.609)
Notional returns and notional regulatory equity					
Notional regulatory equity (line 2 calculation)			2,275.659	2,275.659	2,286.435
Actual performance adjustment 2015-20	**%**	**2DP**	**(0.11%)**	**(0.11%)**	**(0.11%)**

1F – Financial flows for the year ended 31 March: commentary (continued)

Actual performance adjustment 2015-20	**£m**	**3DP**	**(2.609)**	**(2.609)**	**(2.609)**

Line 20 – RCV growth from inflation

The values used in this calculation are included in Ofwat's published Regulatory Capital Values.

RCV growth from inflation			**2020/21**
Data from Ofwat's Regulatory Capital Values			
Total: RCV at 31 March 2020 expressed in March 2020 prices			5,905.241
Total: Indexation roll forward in 2021 update			59.814
Actual performance adjustment 2015-20	**%**	**2DP**	**1.01%**

Line 21 – Voluntary sharing arrangements

This line reports the value of any payment associated with voluntary sharing arrangements or similar schemes as set out in Ofwat's published document, PR19 final determination: aligning risk and return technical appendix. In the case of Welsh Water, our voluntary sharing relates to the company's contribution to the cost of providing more affordable social tariffs during 2020/21 (we incur this 'cost' by billing less than Ofwat allows us to and so our total revenues are lower).

Voluntary sharing arrangements			**2020/21**
Company contribution to social tariffs			11.724
2020/21 year-average CPIH			109.108
2017/18 year-average CPIH			104.217
Voluntary sharing arrangements	**£m**	**3DP**	**11.198**

1F – Financial flows for the year ended 31 March: commentary (continued)

Line 23 – Gross dividend

This line reports the total amount of dividends paid during the period for the appointee business only

			2020/21
Notional			
We have used 4% as the notional gross dividend as confirmed by Ofwat in their query log			
Gross dividend	**%**	**2DP**	**4.00%**
Actual			
Gross dividend	**%**	**2DP**	**-%**