

Registered N<sup>o</sup>: 3975719

## Glas Cymru Anghyfyngedig

Annual report and financial statements  
for the year ended 31 March 2021

Registered office

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## Foreword

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These financial statements for Glas Cymru Anghyfyngedig (the Company) cover the year to 31 March 2021.

Glas Cymru Anghyfyngedig (Glas Cymru) is the parent company of the group of companies funded under a whole Business Securitisation Common Terms Agreement (the Group).

The Company's immediate parent and holding company is Glas Cymru Holdings Cyfyngedig (GCHC); a company limited by guarantee and registered in England & Wales.

The Company's group structure consists of:

- Glas Cymru (Securities) Cyfyngedig, the holding company of Dŵr Cymru (Holdings) Ltd and its subsidiaries;
- Dŵr Cymru (Holdings) Ltd, an intermediate holding company of Dŵr Cymru Cyfyngedig and Dŵr Cymru (Financing) UK plc;
- Dŵr Cymru Financing Ltd was placed into voluntary liquidation on 9 September 2019 and was dissolved on 22 March 2021. This company was previously the 'issuer' company for the group's bonds. Dŵr Cymru (Financing) Ltd was incorporated in the Cayman Islands but managed, controlled and was resident in the UK for tax purposes. The company previously on-lent the proceeds of any bonds issued to Dŵr Cymru Cyfyngedig;
- Dŵr Cymru (Financing) UK plc is a public limited company incorporated in the UK on 16 April 2019. This company replaces Dŵr Cymru Financing Ltd as the 'issuer' company for the group's bonds, which are listed on the Luxembourg Bourse. The company on-lends the proceeds of any bonds issued to Dŵr Cymru Cyfyngedig; and
- Dŵr Cymru Cyfyngedig, the Group's principal trading company (referred to as both Dŵr Cymru and Welsh Water). Its principal activity is the supply of water and treatment and disposal of wastewater under the Instrument of Appointment made by the Secretary of State for Wales under the Water Act 1989.

## Directors and advisers

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### Directors

Chris Jones (resigned 15 May 2020)  
Peter Perry  
Peter Mike Davis  
Roger Morgan (appointed 1 January 2021 as alternative to P M Davis)

### Company Secretary

Nicola Williams

### Independent auditor

KPMG LLP  
Assembly Square  
3 Britannia Quay  
Cardiff  
CF10 4AX

### Solicitor

Linklaters LLP  
One Silk St  
London  
EC2Y 8HQ

### Principal banker

National Westminster Bank Plc  
27 High St  
Brecon  
LD3 7LF

# Strategic report

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The Directors present the Strategic report of Glas Cymru Anghyfyngedig for the year ended 31 March 2021.

## Principal activities

The principal activities of the Group are the supply of water and the treatment and disposal of wastewater under the Instrument of Appointment made by the Secretary of State for Wales under the Water Act 1989.

The principal activity of Glas Cymru Anghyfyngedig is a holding company, with references to the Board referring to the joint Board of GCHC and Dŵr Cymru Cyfyngedig (DCC).

## Business review

The Group is in a strong financial position as at 31 March 2021; gearing remains low at 60% (2020: 60%) and our credit ratings remain amongst the highest in the UK water sector.

**Revenue:** Glas Cymru's turnover in the year to 31 March 2021 was broadly in line with the prior year at £776 million (2020: £777 million); growth and price increases have been offset mainly by the impact of COVID-19 (although we continue to assume for planning purposes that our allowed revenue shortfall will be recoverable in 2022/23 under Ofwat's regulatory mechanism).

**Operational items:** Glas Cymru incurred total operational costs (excluding exceptional items, infrastructure renewals expenditure on maintaining our underground pipe network, and depreciation) of £328 million (2020: £324 million). This represents broadly stable performance, excluding the impact of COVID-19 related costs which have been reported as exceptional in the year, reflecting general inflationary cost pressures partially offset by savings from ongoing efficiency initiatives. In addition, many of the new ways of working introduced in response to the pandemic have delivered sustainable cost savings.

All water and sewerage companies use a lot of power for treatment and pumping processes and the undulating topography across Wales makes this a particular challenge for us. Power costs during 2020-21 were £46 million (2020: £47 million). We strive to generate our own power where possible, with an increase in revenue by £2m on last year (2021: £12 million, 2020: £10 million): our gas-to-grid facility at Five Fords treatment works now incorporates a fully operational advanced digestion facility. Future power prices are uncertain and to help ensure that our operations remain financeable we have forward purchased the estimated power requirements of the business for the current AMP through to 2025.

Water and sewerage companies are not permitted to disconnect supplies to non-paying domestic customers and, as a result, cash collection will always be challenging. The ongoing high priority attached to debt recovery in the Group's retail business has resulted in very little deterioration in overall cash collection rates, exceeding expectations given the COVID-19 pandemic, and our underlying bad debt charge (excluding the impact of COVID-19 on both years) was broadly in line with last year. We hold around 7,000 charging orders, secured on property owned by customers, providing security over £12 million of our customer debt as at 31 March 2021. We expect collections to deteriorate as a result of the economic impact of the COVID-19 pandemic and we have factored this into our year-end provision for overall bad debts, this forming part of the exceptional item described below.

**Exceptional item:** in the year to 31 March 2021 we have recognised an exceptional item totalling £34 million. These represent additional costs incurred as a result of the COVID-19 pandemic: due to their size and nature these have been disclosed separately on the face of the income statement. The costs include additional bad debt charges (£13 million), personal protective equipment (£8 million), additional National Grid charges (£3 million) and the incremental cost of putting in place increased hygiene measures and deep cleaning (£6 million). A further restructuring cost following a reassessment of the level of the restructuring provision has been disclosed as exceptional (£4 million). An exceptional charge of £11 million in the year to 31 March 2020 related to the establishment of a restructuring provision associated with a headcount reduction of some 200 over the period to 31 March 2025.

**Operating profit:** operating profit is lower than the prior year at £8 million (2020: £31 million), principally reflecting the exceptional item noted above. An £18 million increase in the depreciation charge on our operational fixed assets has been offset by a £22 million reduction in infrastructure renewals expenditure (IRE). The depreciation charge is higher than the prior year as the asset base is revalued at each balance sheet date to the Group's regulatory asset value as set by Ofwat and which rises in line with CPIH inflation. IRE has fallen by around 20% as a result of a different mix of activity in our capital programme.

**Financing costs:** net interest payable of £121 million (excluding accounting gains and losses on derivatives noted below) was £37 million lower than the previous year, primarily as a result of lower Retail Prices Index inflation. The Group has a number of derivative swap contracts which were entered into when Dŵr Cymru was highly geared and which fix or inflation-link the cost of debt. While these are effective commercial hedges, they do not qualify for hedge accounting under IFRS 9. Changes in market values create volatility in the income statement and net fair value losses in 2020-21 amounted to £7 million (2019-20: net losses of £48 million). There is, however, no impact on cash flows: the Group intends to hold its remaining swaps to the maturity of the underlying debt and, over the life of the swaps, such gains and losses will revert to zero.

## Strategic report (continued)

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On 31 March 2021 we repaid £325 million of Class B1 bonds with a fixed coupon of 6.907% which reached maturity as at that date. Following Board approval on 4 March 2021 and investor roadshows held in late March, shortly after the financial year end we successfully priced £300 million of subordinated (junior) bonds at a fixed rate of 2.375%. Formal issuance and cash drawdown took place on 9 April 2021. In line with the Group's AMP7 financing plans, on 6 April 2021 we also entered into contracts to swap the new bond debt to RPI with effect from the drawdown. This new issue effectively and efficiently ensures that the Group is fully funded to the end of the current regulatory period in 2025 and strengthens an already robust liquidity position to enable us to react to ongoing uncertainty in the short-to-medium term. In addition, during 2020-21 we also renegotiated our revolving credit facilities, each for two years with a one-year extension option. Three of the four facilities have been increased by £10 million, increasing the total available from £170 million to £200 million: all currently remain undrawn.

**Loss before tax:** the consolidated income statement shows a loss before taxation of £120 million (2020: loss of £175 million) which takes into account the variances discussed above, including depreciation and fair value movements.

**Taxation:** the Group has no shareholders and is run solely for the benefit of our customers. The surpluses the Group generates help keep water bills down and are also reinvested to improve the quality of our services, rather than being paid to shareholders as dividends. This reinvestment may be in the form of capital expenditure, for example improving our treatment works and network of pipes and pumping stations. By investing heavily in capital expenditure, we are able to benefit from capital allowances, a Government tax relief which aims to stimulate this type of investment. Capital allowances can be deducted in calculating the Group's taxable profits in place of accounting depreciation. In the years following investment, capital allowances are typically higher than the accounting depreciation, reducing our taxable profits. This delays corporation tax payments to future periods. The high level of capital investment planned for AMP7 (£1.8 billion over the period 2020 – 2025) means that the group does not expect to pay corporation tax until AMP8 (2025 – 2030) at the earliest.

The Group seeks to utilise available tax reliefs and incentives put in place by the Government in order to maximise funds available to benefit our customers. The Group has claimed a tax credit of £0.9 million (2020: £1.3 million) under the Government's Research & Development Expenditure Credit initiative, which has been included within operating expenditure (see Note 3 to the financial statements).

The total tax credit in the income statement is £21.9 million (2020: £6.9 million credit). The credit for the year ended 31 March 2020 was lower as it included a charge of £23.3 million as a result of deferred tax being recalculated at 19% (previously 17%) following the increase to the corporation tax rate announced in the 2020 Budget. A reconciliation is provided in Note 5.

**Group tax strategy:** the Group is committed to acting in an open and transparent way in respect of its tax affairs. The Group pays a range of taxes, including business rates, employer's National Insurance and environmental taxes. The Group does not enter into artificial tax arrangements, use tax havens or take an aggressive stance in the interpretation of tax legislation. Full details of the Group's Tax Strategy are published annually on our website at [dwrcymru.com/AR2021-TaxStrategy](http://dwrcymru.com/AR2021-TaxStrategy). The Group has complied with the Tax Strategy for the year ended 31 March 2021.

**Pension funding:** the statement of comprehensive income reports a defined benefit pension scheme actuarial loss of £1 million (2020: loss of £1 million) and the balance sheet liability as at 31 March 2021 was £90 million (2020: £87 million). This valuation is on an IAS19 basis for accounting purposes and is not consistent with the actuarial valuation of the scheme for funding purposes. The latest such valuation of the scheme was completed as at 31 March 2019 and projected a deficit which was subsequently mitigated by recovery payments totalling £12 million made during the year ended 31 March 2020. Exposure to any significant additional future liabilities has been mitigated by the closure of the majority of sections of the scheme with effect from 1 April 2017.

**Net asset position:** the consolidated balance sheet shows net assets of £1,041 million at 31 March 2021 (2020: £1,117 million). The net book value of property, plant and equipment has risen by £60 million (1%), a consequence of revaluing the Group's asset base to Dŵr Cymru's regulatory capital value. Cash balances are £450 million (68%) lower than the prior year, reflecting net operating cash outflows and financing activity. The net deferred tax liability has decreased by £17 million (3%) principally as a result of the revaluation of fixed assets as noted above (with £300m of additional financing drawn shortly after the year-end, on 9 April). Excluding non-cash fair value adjustments for derivative financial instruments, referred to above, the Group has net assets of £1,522 million (2020: assets of £1,591 million).

**Going concern:** the Directors are satisfied that the business has adequate resources to continue in business for the foreseeable future. Accordingly, the financial statements for the year ended 31 March 2021 have been prepared on the going concern basis. (Full details are provided under "basis of preparation" in note 1 to the financial statements.)

## Strategic report (continued)

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**Capital investment:** Glas Cymru's strong financial position has been built up over the last 20 years and provides a stable base from which we can respond positively to the challenges of economic uncertainty and drive forward our large, long-term capital programme. This was never demonstrated better than during 2020-21. Glas Cymru works with an alliance of contracting partners to deliver the capital investment programme at the best value for money for customers. Total net capital expenditure during the year (including infrastructure renewals expenditure) was £353 million (2020: £456 million).

**Liquidity and financial reserves:** Glas Cymru aims to offer a secure, low-risk investment to debt investors. By building and maintaining a strong financial position, we intend to keep our borrowing costs low, enabling us to finance future investment efficiently. On Glas Cymru's acquisition of Welsh Water in May 2001, gearing (net debt/RCV) stood at 93%. Since then, the financial position has improved steadily. Gearing to RCV had fallen to 60.3% by 31 March 2021 (2020: 59.7%) and "customer reserves" (RCV less net debt) were £2.4 billion (2020: £2.4 billion). As at 31 March 2021, the Group had available total liquidity of £409 million, including cash balances of £209 million; this was increased by £300 million on 9 April 2021 following the drawdown of the recent junior debt issue.

**Credit rating and interest rate management:** Glas Cymru's credit ratings are amongst the strongest in the UK water sector, reflecting the Group's high level of creditworthiness. All three credit rating agencies have issued rating updates following Ofwat's publication in December 2019 of the challenging Final Determination for the AMP7 price control and also following the Group's exposure to the COVID-19 pandemic (which they note is not material to Glas Cymru's creditworthiness). On 5 March 2021 S&P reaffirmed the ratings of the senior bonds as A- and the junior bonds as BBB. On 26 January 2021 Fitch confirmed the rating of the Group's senior bonds as A and of the junior bonds as BBB+. On 2 March 2021 Moody's confirmed Dŵr Cymru Cyfyngedig's corporate family rating as A3 and the rating of the junior bonds as Baa2. All rating outlooks are stable. The class A bonds (which are subject to a financial guarantee from Assured Guaranty UK Ltd) are unaffected by these recent rating updates, which are in line with our expectations and do not materially affect our overall credit quality. As at 31 March 2021, around 70% of gross debt was index-linked via bonds and derivatives (2020: 70%), with the remainder at fixed interest rates. The expected maturity of the outstanding fixed-rate and index-linked bonds ranges from 2026 to 2057, with not more than 20% falling due in any two-year period, in accordance with our refinancing policy.

**Gearing policy:** Glas Cymru's gearing to Regulatory Capital Value (RCV) policy is to target gearing at or around 60% and interest cover ratios commensurate with maintaining our sector leading "A" grade credit ratings. This should help us to maintain our low-risk profile giving the Group access to low-cost financing throughout AMP7 and beyond.

**Events after the financial year end:** Aside from the financing activity and the rise in corporation tax announced in the 2021 Budget, both referred to above, no material transactions or events have occurred post year-end which impact the Group's financial statements for the year ended 31 March 2021. We have taken into account the estimated impact of the COVID-19 pandemic on the valuation of the Group's balance sheet as at 31 March 2021 and discuss the impact on our operations and performance on page 55 in the Annual Report and Accounts of GCHC. We have set out in our long-term viability statement on page 74 its estimated impact on our financial forecasts. These are discussed in the 2020-21 Annual Report and Accounts of (available on the Group's website at [http://www.dwrcymru.com/en/Reading\\_Room\\_Library/Company-Reports.aspx](http://www.dwrcymru.com/en/Reading_Room_Library/Company-Reports.aspx)).

### Financial key performance indicators

The Group is part of a larger group controlled by GCHC. The Directors of Glas Cymru Anghyfyngedig use group-wide key performance measures as indicators to the development, performance and position of the Group. These are discussed in the 2020-21 Annual Report and Accounts of GCHC which does not form part of this report.

Customers are at the heart of everything we do. We measure our performance via eight "Outcomes" which are based on broad groupings of targets set by Ofwat at the last price review – "Outcome Delivery Incentives" (ODIs). The groupings represent the key elements of the essential services we provide to our customers across our supply area.

The regulatory targets are supplemented by our internal business and financial planning processes. Every year targets are discussed and agreed by the Board of Directors. The Executive team is held to account by our Non-Executive Directors to ensure that the targets are sufficiently challenging and to monitor performance in accordance with those targets.

Our vision to Earn the Trust of our Customers Every Day underpins our approach to delivering services, and the Board is conscious of the need to set targets which maintain and build on that trust.

The Board also takes the opportunity to understand the views expressed by customers and other stakeholders in the extensive engagement exercises undertaken as part of establishing Welsh Water 2050, and in the context of setting the Group's five year business plans for 2020-25.

## Strategic report (continued)

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### Future developments

Working on our Welsh Water 2050 Strategy for the next 30 year period has allowed us to examine the role we play in the communities we serve and to have a meaningful dialogue with our customers about how we will meet the external challenges over time.

Our detailed business plan for the next five year period, 2020-25 seeks to balance ensuring the affordability of the essential services we provide with the investment needed to maintain a resilient infrastructure. All gains eventually go to our customers, so that the interests of the Group and of customers are aligned, and the strategic direction of the Group takes this into account.

As well as delivering excellent service for customers, we need to manage costs carefully to keep bills as affordable as possible. The Board sets the Executive Remuneration policy which includes a significant element of variable pay, dependent on the Executive Directors delivering strong and consistent performance which achieves improved services for customers.

This is reinforced by a focus on transparency and honesty in all communications with our Members, customers and regulators, acknowledging those areas where we can still do better, and building on the progress we have made to deliver better service to customers.

### Principal risks and uncertainties

From the perspective of the Group, the principal risks and uncertainties are integrated with the principal risks of the GCHC group and are not managed separately and are discussed in the 2020-21 Annual Report and Accounts of GCHC. These include:

- health, safety and wellbeing (serious injury);
- loss of trust from our customers or key stakeholder groups;
- performance and cost targets;
- information, security, cyber and IT loss;
- resilience and business continuity (both generally and in response to planning for COVID-19 and EU exit situations);
- impact of severe recession (COVID-19 and Brexit);
- climate change;
- changes in environmental regulation

Emerging risks which could affect the Group's ability to achieve its 2020-25 business plan or longer-term strategic goals are also closely monitored. The current such risks identified include:

- occupational health issues
- public health (micropollutants in drinking water); and
- public concern about environmental issues.
- approach to agile working

The above emerging risks are also discussed in the 2020-21 Annual Report and Accounts of GCHC.

### S172(1) statement

This section sets out the Group's Section 172 Statement and should be read in conjunction with the Strategic Report on pages 3 to 7 and the Directors' Report on pages 8 to 14 of this annual report and financial statements. Reference to the Board means the joint Board of Directors of GCHC and Dŵr Cymru Cyfyngedig.

Section 172 of the Companies Act 2006 requires Directors to take into consideration the interests of stakeholders in their decision-making. The Directors continue to have regard to the interests of the Group's employees and other stakeholders, including the impact of its activities on the community, the environment and the Group's reputation, when making decisions.

### The Board's obligation to promote the long-term success of the Group

The Board is mindful of the purpose and vision of the Group and is focused on promoting the long-term success of the Group, in particular given its role as the custodians of assets over the long term to enable the delivery of essential services to customers. While the requirement to give due consideration to the Group's stakeholders is not new, this statement has been included in the Annual Report and Financial Statements in order to provide more detail on how the Board engages with our stakeholders.

As part of its involvement in the PR19 price review process, the Board focused on understanding the views of the Group's key stakeholders over the five year period 2020–25 and the longer term. This price review process allowed the Board to reflect on how the Group engages with its stakeholders and opportunities for enhancement in the future.

### Engagement with stakeholders

On pages 39 to 43 of the Strategic Report in the 2021-20 Annual Report and Accounts of GCHC, a copy of which is available to view on our website at [http://www.dwrcymru.com/en/Reading\\_Room\\_Library/Company-Reports.aspx](http://www.dwrcymru.com/en/Reading_Room_Library/Company-Reports.aspx), we set out details of our principal stakeholders, how and why we engage and the outcomes of those engagement processes. The relevance of each



## Strategic report (continued)

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stakeholder group may increase or decrease depending on the matter or issue in question, so the Board seeks to consider the needs and priorities of each stakeholder group during its discussions and as part of its decision-making.

The Board regularly hears directly from our principal stakeholders, including representatives of Government, our regulators and customers, and about how we engage with them. The stakeholder voice is brought into the Boardroom throughout the annual cycle through information provided by management, and also by direct engagement with stakeholders themselves. In the case of regulators, this can be through their attendance at Board meetings.

In the case of customers, during 2020-21 there have been opportunities for Board members to listen in to calls in our contact and operations call centre, and to review the results of customer engagement exercises. The potential impact of the Board's decisions on our communities and customers is a key factor taken into account in decision-making, and views of stakeholders are highlighted in Board papers seeking approval.

### Engagement with the workforce

The Board continues to enhance its methods of engagement with the wider workforce. The Chair and Non-Executive Directors regularly have opportunities to take part in informal meetings with managers and engagement champions across the business, without the Executive team being present, and the Executive Directors also participate in employee engagement sessions with the Executive team. These sessions are split between discussions on a pre-allocated topic of relevant to the Board in a future Board meeting, and more general discussions intended as an opportunity for those attending to raise any concerns or issues. During 2020-21 we held the first engagement session with the Chair and some Non-Executive Directors with a specific focus on discussing the role of the Remuneration Committee and the link between pay and performance across the business.

### Engagement with suppliers

We work with over 2,000 suppliers and contractors, and we have dedicated Framework Agreements and close relationships with suppliers in many areas of our business. We are continuing to enhance our contract and supplier management process, which has helped to formalise our relationships with other key suppliers. We take our Anti-Slavery obligations very seriously – during the year key members of our Procurement and Legal team attended further training to highlight the risks in this area and the further steps we can look to take to ensure that unfair working practices are not a risk for our organisation.

### Engagement with members of Glas Cymru Holdings Cyfyngedig

Glas Members fulfil an essential corporate governance role. Members receive no financial recompense for their involvement in the Group and are drawn from a wide-range of background and experiences, from across our supply area in Wales and England. During 2020-21 our two formal meetings in July and December 2020 were held remotely, and we also held a number of workshops on strategic issues, which were held remotely and were well intended by Members. Given our AGM was held remotely, we offered Members the opportunity to vote by proxy before the meeting, but we also enabled them to change their votes on all Resolutions before the meeting once they had heard from members of the Executive team on performance, and from the Chair of the Remuneration Committee on performance and pay.

### Engagement with investors

The Board is directly involved in engaging with the views of our investors. Formal communications with our bondholders are subject to Board approval, and members of the Board attend the annual investor meeting held in July every year, where investors have the opportunity to ask questions of the Chief Financial Officer and other members of the Board. During 2020-21 we held meetings with investors via video conference.

### The role of the executive team

The Dŵr Cymru Executive team is responsible, with the Chief Executive and Chief Financial Officer, for the day to day management of the Group, and is designated as senior management for the purpose of the Code but not for the purposes of section 414C(8) of the Companies Act 2006. The team comprises the senior functional management roles and, together, is comprised of those with responsibility for interacting with the Group's principal stakeholders. The Board continues to oversee measures to ensure that stakeholder interests are always taken into account. Papers prepared by management for Board approval highlight relevant stakeholder considerations to be considered as part of the debate when making decisions, in order to ensure that sufficient consideration is given to stakeholder issues, and that the interests of all stakeholders and differences within these stakeholder groups (for example, the interests of our various customer groups) can be properly balanced.

By order of the Board.



N Williams  
Company Secretary  
4 June 2021

## Directors' report

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The Board has prepared a Strategic report (pages 3 to 7) which provides a summary of the development and performance of the Group's business in the year ended 31 March 2021 and comments on likely future developments. Full details and analysis of the operational performance of Glas Cymru Anghyfyngedig during the year to 31 March 2021 are included in the published 2020-21 Annual Report and Accounts of GCHC.

The Directors have pleasure in presenting their annual report, together with the audited financial statements for the year ended 31 March 2021 on pages 20 to 63.

### Directors and employees

The Directors who held office during the year and up to the date of signing the financial statements are listed on page 2.

At 31 March 2021, the Group had 3,602 employees (2020: 3,514). Our success is fundamentally dependent upon our highly engaged and motivated people and we are committed to developing our people to meet the challenges of operating our business in the future and to encourage a diverse workforce that fully reflects the communities that we serve (see "Corporate social responsibility" below).

### Health and safety

Our health and safety performance for the year is encouraging and reflects the extensive efforts throughout the Group to instil a culture of proactive reporting and a safety-first mindset for every role in the Group. The number of RIDDORs (Reporting of Injuries, Diseases and Dangerous Occurrences Regulations 2013) – injuries that need to be reported to the Health and Safety Executive (HSE) – is 6 which is lower than the record low reported last year (2020: 8). However, we consider any serious injury as one too many – and will continue our efforts to reach our ultimate aim of zero lost time injuries.

### Engagement with stakeholders

Details of how the Directors have had regard to the need to foster the Group's business relationships with suppliers, customers and others, and the effect of that regard, including on the principal decisions taken by the Group during the year ended 31 March 2021 are set out within the Strategic Report on pages 6 and 7.

### Corporate governance

At Glas Cymru, we view corporate governance as a core discipline which generates value for our stakeholders and allows us to deliver an essential public service. Our governance processes are in pursuit of the Group's Purpose and are based on transparency and fairness, underpinned by the values of the Group.

Owat's Principles of Leadership, Transparency and Governance and the UK Corporate Governance Code 2018 (the "Code") are the standards against which we measure our governance practices. We have applied the Code's principles and complied with its provisions during the financial year. Our Annual Report for 2019-20 noted that we had not fully complied with Provision 41 of the Code, as regards engaging with the workforce to explain how executive remuneration aligns with wider company pay policy. This year (2020-21) some of our Non-Executive Directors held a specific employee engagement session with workforce representatives to discuss the principles of executive remuneration and the role of the Remuneration Committee, as part of the regular Employee Engagement sessions that take place with both the Executive team and our Non-Executive Directors. These engagement sessions provide a forum for employee queries to be discussed, by way of elected representatives, across a broad range of topics.

For further information on how we have complied with the above, please refer to pages 105 to 129 contained in the Corporate Governance section of the 2020-21 Annual Report and Accounts of GCHC. A copy of the report is available to view at [http://www.dwrcymru.com/en/Reading\\_Room\\_Library/Company-Reports.aspx](http://www.dwrcymru.com/en/Reading_Room_Library/Company-Reports.aspx) or by emailing the Company Secretary at [company.secretary@dwrcymru.com](mailto:company.secretary@dwrcymru.com).

Also within the 2020-21 GCHC Annual Report and Accounts, is the Directors' Remuneration Report, which contains the new disclosure of the CEO pay ratio to UK employees, and the Report of the Nomination Committee which includes details on the Group's Diversity Policy.

### Innovation

Innovation is central to our work to reduce our environmental impact and develop more sustainable outcomes, helping to reduce our carbon footprint and our impact on rivers or the sea, and to realise the positive contributions we can make, such as in relation to the biodiversity of our land holdings, and those of our partners. Over the past year we have been focusing our efforts on supporting the development of innovative nature-based solutions, as these can reduce our carbon footprint, resolve specific water quality issues, and enhance biodiversity all at the same time. We expect to support the Wye and Usk Foundation in the construction of two wetlands on the River Lugg with the aim of offsetting the impact of development on the river and improving local biodiversity. Similarly, we are supporting Herefordshire Council on preliminary work on eight additional sites in the same waterbody. Regulators, local developers and landowners are also partners in these projects and we report progress to the Herefordshire led Wye Nutrient Management Board.

## Directors' report (continued)

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### Innovation (continued)

This is an example of a major change away from the sorts of carbon-hungry investments of the past which did not improve biodiversity and increased our carbon footprint, and marks a move to a way of working aligned with methodology set out in the Wellbeing of Future Generations Act, where partnerships and the sharing of resources are recognised as central to providing solutions to the environmental challenges we face. We are also focused on our 'first line of defence' catchment scale improvements to the environments around our water sources, and we are optimistic that these approaches will be supported by the new land management approaches driven by the regulatory changes Welsh Government is currently making in a post-Common Agricultural Policy, post-Brexit world. We plan to double the innovation investment for 2020-25 (£39 million in 2015-20) which will include developing a number of 'disruptive' technologies and working jointly with government and other stakeholders, to co-design and co-deliver truly sustainable solutions. Our AMP7 proposals for innovation include our catchments work, our Sustainable Management of Natural Resources (SMNR) investments, and monitoring our environment to help shape Welsh Government policy and our investment portfolio for PR24. As well as investing in driving innovative change, we continue to work closely with our Independent Environmental Advisory Panel (made up of regulators, academics and environmental stakeholders) who advise the business on the science and research we undertake. The Panel continues to support the Group through the expertise and resources available in such bodies and to build our relationships with them, in order to leverage funding and expertise into our science and research work. More generally, we continue to drive elements of the national research agenda through our strategic relationship with the National Environmental Research Council (NERC) and UK Research Institute (UKRI), and by participation in water industry research initiatives, most notably through membership of the UK Water Industry Research partnership (UKWIR) which manages and coordinates the common research interests of UK water companies. Our 2020 Innovation Conference welcomed over 1000 guests, albeit virtually, from all over the globe, where we were able to showcase our innovation needs.

### Greenhouse gas emissions

Due to our commitment to transparent and best practice reporting, we have included our streamlined energy and carbon reporting (SECR) disclosures in the 2020-21 Annual Report and Accounts of GCHC in the Responsibility section of this report alongside our annual GHG (greenhouse gas) emissions footprint and an intensity ratio appropriate for our business, which fulfil the requirements of the Companies Act 2006 (Strategic and Directors' Report) Regulations 2013. This report is available on the Group's website at [http://www.dwrcymru.com/en/Reading\\_Room\\_Library/Company-Reports.aspx](http://www.dwrcymru.com/en/Reading_Room_Library/Company-Reports.aspx).

### Corporate social responsibility

We see ourselves as more than just a water company providing drinking water and taking away wastewater – we are at the heart of the communities we serve and want to play a positive role to improve the world around us. We are committed to playing our part in ensuring we benefit not just the customers we have now – but also our future customers.

### Education

Our extensive education programme for primary schools includes school assemblies, workshops and visits to our Discovery Centres and usually attracts more than 65,000 school children a year. We recognise the importance of education in helping build customer trust and wider understanding of our work, as well as in influencing the behaviour of customers by educating future customers about the water cycle. This is why we want to increase the number of children reached each year through the education programme to 75,000 every year between 2020 and 2025. However, the closure of schools for extended periods and the temporary closure of our Discovery Centres in 2020-21 had a significant impact on our education programme. When pupils returned to schools in September, we offered live school sessions, utilising Microsoft Teams to engage directly with pupils and school staff. Pupils were given access to a bespoke 360° imagery platform, complete with 'hotspots' to promote learning. This will serve as a long-term alternative to face-to-face sessions, allowing rural schools within our operational area to benefit from additional services. Despite our efforts to amend our content and delivery platforms, school closures, reduced attendance and restrictions on face-to-face delivery has resulted in us only reaching 5,834 school children in 2020-21. Nonetheless, we remain committed to supporting future generations and educating young people about how they can make a difference to their environment.

### Community fund

During 2020-21 we contributed £90,000 to community projects and supporting our employees in their fundraising and volunteering. The Fund particularly aims to support projects that are closely related to our environmental, educational and other activities, and also communities which are heavily impacted by our investment programmes. We also contributed a further £176,000, in recognition of the additional demands faced by third sector organisations caused by COVID-19.

## Directors' report (continued)

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### Communities

We want to play a positive role to improve the communities we serve and the world around us. We are committed to playing our part in ensuring we provide a benefit to future customers as well as current ones. In 2020, the impact of the COVID pandemic led us to reconfigure the Fund and provide additional funding to key organisations who were helping support our most vulnerable customers and communities. We contributed £40,000 to Business in the Community Wales, £30,000 to Community Foundation Wales, Hereford and Cheshire and £106,000 to the Trussell Trust to support each of 106 local foodbanks. We also wanted to involve colleagues and offered them the opportunity to apply for up to £200 to help support their local organisations and charities in the fight against the pandemic.

### Water resilient communities

Our innovative Water Resilient Communities projects aim to build a lasting legacy in the areas where we are carrying out major work. Following the completion of our successful pilot project in Rhondda Fach, we launched two further projects in Rhyl (north Wales) and Rhymney-Bargoed (south east Wales) in 2020. The projects challenge the business to work with and involve customers in a way not done before - to co-create and co-deliver more resilient services within the area. From helping people struggling with their bills, providing water-saving devices, heading to schools with fun lessons and supporting local community projects, we target sections of the community to deliver real and tangible value.

### Stakeholder

The Board continues to oversee measures to ensure that stakeholder interests are always taken into account. Papers prepared by management for Board approval highlight relevant stakeholder considerations to be considered as part of the debate when making decisions, in order to ensure that sufficient consideration is given to stakeholder issues, and that the interests of all stakeholders and differences within these stakeholder groups (for example, the interests of our various customer groups) can be properly balanced.

### WaterAid

The Board continues to oversee measures to ensure that stakeholder interests are always taken into account. Papers prepared by management for Board approval highlight relevant stakeholder considerations to be considered as part of the debate when making decisions, in order to ensure that sufficient consideration is given to stakeholder issues, and that the interests of all stakeholders and differences within these stakeholder groups (for example, the interests of our various customer groups) can be properly balanced. Ball. We continued to carry out smaller scale, socially-distanced fundraising activities, while for our partners in Uganda the impact has been even more profound, and their focus has shifted to increased campaigning around hygiene and hand washing. To celebrate World Water Day 2021 (22nd March), we undertook a number of fundraising activities during the same week to help raise money to fund some key WaterAid projects. Colleagues also enjoyed a live video link with our friends in Uganda who are benefiting from the money raised.

### Prince's Trust Cymru

We have also continued our support of the Prince's Trust Cymru, a charity which helps vulnerable young people get their lives back on track. It supports 11–30 year olds who are unemployed, and those struggling at school and at risk of exclusion. This partnership has included fundraising by colleagues through "Million Makers" – and our team of graduates didn't let COVID stop them raising £13,400 through several fundraising activities. Our Community Fund also pledges to match funds raised by colleagues for WaterAid and Prince's Trust to the value of £15,000 each per year, while individual employees can claim up to £200 match funding for their own charity efforts. We are supporting the Government's Kickstart scheme, and will be offering 16–24-year-olds a six month work experience placement across the business to help train and support young people to get a job in the future or join an apprenticeship scheme. The COVID-19 pandemic has limited the opportunities for colleagues to undertake usual fundraising activities to support our two strategic partners (WaterAid and the Prince's Trust). However, we donated £15,000 to each organisation during 2020-21 to help support their work. We continue to carry out smaller, socially distanced fundraising activities, in line with COVID guidelines, as well as the WaterAid lottery continuing to support the WaterAid lottery which is open to all colleagues to join through payroll. We are really grateful that many of our customers have chosen to respond to opportunities to support WaterAid highlighted in the leaflet we enclose with our annual bills. Since our partnership with WaterAid began in 2008, colleagues and customers have together raised over £1 million for WaterAid.

### Community access to our sites

Prior to the pandemic, more than one million visitors a year were coming to our sites, and we continue to invest and progress visitor centre sites to benefit local users and communities:

**Swiss Valley Reservoirs, Llanelli:** Our first ever community adoption was launched in November thanks to an innovative partnership between Welsh Water and Llanelli Rural Council. Working in partnership with the Council, Natural Resources Wales and Canoe Wales, we secured an Access to Water grant from the Welsh Government. This has enabled the fast tracking of plans to open up the Lower Lleidi for a range of paddle sports. A ramp and pontoon that allows easy access to water for people of all abilities has been installed together with a boat wash for biosecurity; and the toilet facilities have been refurbished and brought back into use. Bank angling has also been enabled through the creation of recreational zones. Local stakeholders are currently working to develop a programme of environmental enhancements, to provide volunteering opportunities for local people.

## Directors' report (continued)

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### Community access to our sites (continued)

**Lliw Reservoir, Swansea:** Working in partnership with Natural Resources Wales, Swansea Council and Canoe Wales, we secured a £103,000 'Access to Water' grant from Welsh Government in November. The grant has enabled visitor improvements at the site and access to water for a range of paddle sports, including stand-up paddleboarding and paddleboarding, canoeing and kayaking. Other improvements include the creation of a circular walking route around the reservoir and upgrading of other trails to improve wheelchair and bicycle access. New interpretation and a nature trail with wood carvings have been installed for visitors to enjoy the nature around the reservoir.

**Llys-y-Frân, Pembrokeshire:** Our major redevelopment at this location has been delayed as a result of the pandemic restrictions. Llys-y-Fran will reopen in Spring 2021 and benefit from a £4 million redevelopment (supported by £1.7 million of European Regional Development Funds through the Welsh Government). We aim to create a first-class tourism destination, to include a new Outdoor Activity Centre and waterside cabin enabling a range of watersports on the lake. The path around the reservoir has been upgraded and extended to create over 14km of mountain bike trails to explore.

**Lisvane & Llanishen Reservoirs, Cardiff:** We launched our proposals for this site in late 2020, including a new visitor hub with a watersports centre and restaurant, circular paths and recreation, learning and conservation zones. We received nearly 2,000 responses to our public consultation with more than 86% approving the plans. This is a unique natural resource of significant ecological value - designated as a Site of Scientific Interest (SSSI) for overwintering birds and for waxcap fungi, so we need to balance the needs of visitors with protecting the site's ecology. Through the Enabling Natural Resources and Well-being (ENRaW) Scheme and our partnership with the Reservoir Action Group (RAG), Cardiff Council and Cardiff and Vale University Health Board, a community engagement programme has been developed.

**Open Water Swimming:** Open water swimming is one of the fastest growing water sports in the UK and we have been working with partners to explore how we can safely allow access to water at designated reservoirs for organised activities. Last summer, we worked on a pilot at Llandegfedd reservoir in partnership with Welsh Triathlon and Swim Wales which involved over 700 open water swimmers from four clubs participating in 34 organised swimming sessions. We plan to roll out open water swimming to other staffed sites at Llyn Brenig in Denbighshire and Llys-y-Fran in 2021.

### Biodiversity

In 2020 we refreshed our 2018 plan – Making Time for Nature – highlighting both the good progress we are making in complying with our duty to enhance biodiversity and ecosystem resilience across our supply area, and also setting out our proposals to enhance and maintain biodiversity further over the next few years. Our focus on biodiversity in 2020 was impacted by COVID-19 which forced many of our partners to furlough their staff and so we have not been able to progress any third party projects. However we have continued to progress our own projects, including the River Lugg wetlands creation project and the restoration project at Lower Neuadd reservoir.

### Our People

As one of the biggest employers in Wales and serving 3.1 million people across our supply area in Wales and England, we are very aware of our responsibility to our employees and to the wider community. Our success is fundamentally dependent upon our highly engaged and motivated people, and we are committed to developing them to meet the challenges of operating our business in the future and to encourage a diverse workforce that fully reflects the communities that we serve.

### Equality, diversity and inclusivity

Our people are our greatest asset and we are passionate about creating a workforce that reflects the diversity of the communities we serve. We are committed to recognising and promoting equality, diversity and inclusivity and treating others with dignity and respect at all times. To meet our commitment to work to increase the diversity of our workforce and to attract individuals who may otherwise feel that there are significant barriers to employment, we continue to work with charities and organisations such as WISE, Stonewall, Chwarae Teg, Education and Engineering Scheme Wales, Business Disability Forum and the Prince's Trust. Welsh Water's commitment to a gender diverse workforce is supported by our work with WISE, a campaign for gender balance in science, technology and engineering. Following their 10-step model and attending events such as the STEM Women Careers Fair, means making the right cultural changes that can in turn have a significant impact on attraction, recruitment and retention. We have sought to ensure that greater numbers of women in senior positions take leading roles as mentors and as role models in the business, including taking part in our International Women's Day and International Women in Engineering Day events. We have signed up and are committed to the Social Mobility Pledge in partnership with the rest of the water industry —we continue to work and partner with schools and colleges providing coaching, mentoring, structured work experience, and apprenticeship opportunities. This year we made sure that the pandemic didn't halt our apprenticeship opportunities and 21 apprentices joined us during the year. We have pledged to open up employee recruitment practices, to promote a level playing field for people from disadvantaged backgrounds or circumstances, and to promote Welsh Water as a supportive environment for colleagues from all backgrounds, beliefs and ethnicities. Last year we were delighted to have achieved our Disability Employer status and since then we have continued to make changes to create a culture and environment where all colleagues are comfortable and can be themselves. This has resulted in successfully achieving our "Disability Confident Leader" award – we join only 20 other companies in Wales that have achieved this level of award.

## Directors' report (continued)

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### Equality, diversity and inclusivity (continued)

We are continuing our membership of the Equality and Human Rights Commission's "Working Forward" initiative – a network committed to making workplaces the best they can be for pregnant women and new parents. Our team of "Inclusivity Ambassadors", made up of colleagues across each of the Protected Characteristics defined by the Equality Act, have been examining the Group's equality, diversity and inclusivity strategy and working through an action plan together. The ambassadors have created a film, which we share on our careers site and have worked with colleagues across the business to set up employee led network groups, such as LGBT+ and Allies, BAME+, Women at Welsh Water and a Disability network. During the year we also set up a task and finish Re:Think Group to provide a forum for individuals from across the business to be inspired by external speakers to promote inclusivity, and to seek to promote Welsh Water externally as a diverse and inclusive organisation. To ensure we attract and retain a truly diverse workforce we will continue to:

- engage with relevant organisations and communities that we know are underrepresented in our organisation;
- seek relevant ideas and initiatives from our current workforce; and
- offer candidates from under-represented groups a guaranteed interview for any Welsh Water job they apply for, provided they meet the basic criteria for the role

### Career Paths

We offer a number of different development routes to those choosing to join our business for graduates, degree apprenticeships, various other apprenticeships, and internships and work experience.

### Supporting our colleagues

During 2020-21 we continued to focus on wellbeing issues across our colleague base, and during the year we appointed a further 11 Wellbeing Champions. We have enhanced the training we offer to managers in relation to mental health and have introduced i-act training and developed a Talking Toolkit. We continue to work alongside mental health charity, Mind Cymru, to help us stay focused on reducing the stigma surrounding mental health and we have spoken at events at NRW and Public Health Wales about the work we have done in supporting colleagues who need assistance. The focus on mental health wellbeing has been brought into sharp relief with the additional pressures on colleagues as a result of the COVID pandemic. We have been acutely aware of the pressures faced by colleagues working remotely and the anxiety felt by colleagues working in the community as they have had to adapt to new ways of working. Our internal communications campaign "Am I ok?" was the culmination of a focus on mental health wellbeing-related events held throughout the year, and we have held regular "pulse" surveys which have provided snapshots of how our colleagues were feeling and have allowed us to tailor support accordingly.

### Supporting our supply chain

During the COVID-19 pandemic we have taken steps to ensure the safety of our capital and operations contractors and to continue to promote fair work practices across our supply chain, despite changes in working practices. We have adopted COVID-19 safe working construction practices, as set out by the Construction Leadership Council, and have re-planned work to enable social distancing, wherever possible, and the use of appropriate PPE. At the start of the pandemic we amended our payment cycle so that invoices were paid within 10 days of approval.

### Human rights

We are committed to respecting human rights in relation to colleagues, and our supply chain. Our internal Code of Conduct was relaunched in December 2020. The Code is supported by several Group policies, including:

#### Anti-bullying and harassment

We respect human dignity and the rights of individuals. Our Group policy articulates how colleagues should behave towards each other. We offer unconscious bias training to all colleagues through eLearning as part of our induction programme for new colleagues.

#### Supplier Code of Conduct

We are in the process of implementing our Supplier Code of Conduct. Our suppliers play an essential part in enabling us to deliver services to our customers and we expect all of our suppliers to operate to the highest standards of openness, honesty, integrity and business ethics as set out in the Code.

#### Safeguarding

We are committed to ensuring that colleagues who work with children and vulnerable adults are properly supported, and this year we have held a series of training events for designated safeguarding leads and their deputies who work with children and vulnerable adults. During the year we also became corporate subscribers to the "Safe spaces" initiative – which provides a link to support for individuals suffering domestic abuse. The link - which includes an "Escape" feature in case the person viewing the information is disturbed – is now visible on our customer website pages.

## Directors' report (continued)

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### Whistleblowing

A healthy culture where individuals feel able to speak out about anything that causes them concern is an important part of our three lines of defence compliance model. Colleagues, suppliers, business partners and other stakeholders are encouraged to 'Speak Up' to raise concerns about conduct which is contrary to our values. Where appropriate, concerns will be investigated by the Business Assurance Team, reporting directly to the Audit Committee. The Committee receives reports on the outcome of investigations in private sessions with the Head of Business Assurance. We are fully committed to protecting any employee who reports a breach or suspected breach of the Code of Conduct or raises any other public interest disclosure. We publicise an external helpline, which provides an additional confidential and secure means to raise concerns.

### Modern slavery act 2015

Our Anti-Slavery Policy sets out Welsh Water's commitment to acting ethically and with integrity in our supply chain arrangements and to ensuring fair work practices across our business. In 2020 the Procurement Department commenced the supply chain mapping of commodity supplies and services that may be at greater risk of modern-day slavery. Our People and Change Team maintains recruitment policies to protect against slavery and human trafficking in our own operations and we are working towards meeting the Welsh Government's 12 commitments in its Code of Practice on Ethical Employment in supply chains. Our Anti-Slavery statement can be found at [dwrcymru.com/AR2021-antislavery](http://dwrcymru.com/AR2021-antislavery).

### Anti-bribery & corruption and anti-fraud

Our Group policy makes it clear that we will not tolerate any acts of fraud, dishonesty, bribery, corruption, theft or improper disclosure of confidential information. The Group treats these issues very seriously and expects any issues to be reported immediately. This is reinforced by our strict policy on hospitality and gifts from suppliers, which is regularly monitored and actively enforced. The Audit Committee carries out an annual review of our systems of internal control as part of our ongoing efforts to prevent bribery and corruption in our business and our supply chain.

### Conflicts of interest

We require our employees to perform their duties honestly and to avoid conflict between any personal, financial or commercial interests and their responsibilities to Welsh Water.

### Data protection and information security

Welsh Water is committed to ensuring that we handle the personal information of our customers and employees in a responsible and honest way, including respecting their data protection rights in compliance with legislation. Our Privacy Statement is available on our website: <https://corporate.dwrcymru.com/en/legal-privacy/privacy-policy>. Our policies also reinforce the role of individuals in keeping information secure and accurate. The Technology Committee of the Board regularly reviews our approach to cyber security risk (see the report of the Chair of the Technology Committee on page 128 of the 2020-21 Annual Report and Accounts of GCHC).

### Political donations

It is Board policy not to make donations to political parties or to incur political expenditure. During the year we agreed to make payments of £22,500 to Citizens Advice to fund a debt adviser providing advice to our customers in Rhondda Cynon Taff, and £25,579 to Step Change to support the work the charity does in providing debt advice to our customers. We are disclosing these payments as both organisations also campaign for government policy change, including on debt issues, however, none of the funding provided would have been used directly to support campaign work. Other than this, no donations or payments were made which would require to be disclosed under section 366 of the Companies Act 2006

### Financial risk management

The Group's operations expose it to a variety of financial risks that include the effect of changes in debt market prices, credit risk, liquidity risk and interest rate risk. The Group has in place a risk management programme that seeks to limit the adverse effects on the financial performance of the Group by monitoring levels of debt finance and the related finance costs.

### Dividend

No dividend was declared or paid in the year (2020: none).

## Directors' report (continued)

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### Welsh Language Scheme

The Welsh Government has set a target of doubling the number of Welsh speakers by 2050. As a flagship company in Wales, we are committed to supporting this goal, and set ourselves the challenge of increasing the proportion of Welsh speakers who are registered to receive our services in Welsh from 6,472 in 2019 to 25,000 by 2025. Our ambitious target is recognised by the Welsh Language Commissioner as the first of its kind in the private sector in Wales. To help improve the take-up of Welsh language services, we have invested in ensuring that all our new digital platforms (e.g. live-chat functionality, online account management and virtual exhibitions) are now available in Welsh to allow customers to interact with us and in the language of their choice. There are still some areas being developed (such as emergency texts issued to customers to warn them of any disruption to water supplies that are currently only sent in English). In 2020-21, there are 6,472 customers registered on our Welsh language register. A further 2,575 customers contacted us in Welsh via another contact channel (e.g. webchat) and, on average, we received 6,500 visitors to our Welsh website every month. We encourage the use of Welsh among our colleagues and have invested in online training to help those who wish to improve their proficiency of this language. This also helps ensure that we have the necessary skillsets to provide an excellent bilingual service.

### Disclosure of information to auditor

The Directors who held office at the date of approval of this Directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Group's auditor is unaware; and each Director has taken all the steps that he ought to have taken as a Director to make himself aware of any relevant audit information and to establish that the Group's auditor is aware of that information.

### Auditor

In accordance with Section 489 of the Companies Act 2006, a resolution for the re-appointment of KPMG LLP as auditor of the Group is to be proposed at the forthcoming Annual General Meeting.

By order of the Board



N Williams  
**Company Secretary**

Registered office:  
Linea  
Fortran Road  
St Mellons  
Cardiff  
CF3 0LT  
4 June 2021



## Statement of Directors' responsibilities in respect of the Strategic report, Director's report and the financial statements

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The Directors are responsible for preparing the Strategic Report, the Directors' Report and the group and parent company financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare group and parent company financial statements for each financial year. Under that law they have elected to prepare both the group and the parent company financial statements in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006 and applicable law.

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

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable, relevant and reliable;
- state whether they have been prepared in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006;
- assess the group and parent company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the group or the parent company or to cease operations, or have no realistic alternative but to do so.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the parent company's transactions and disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 2006. They are responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

# Independent auditor's report to the members of Glas Cymru Anghyfyngedig

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## Opinion

We have audited the financial statements of Glas Cymru Anghyfyngedig ("the company") for the year ended 31 March 2021 which comprise the consolidated statement of comprehensive income, consolidated statement of changes in equity, consolidated balance sheet, parent company balance sheet, parent company statement of changes in equity, consolidated cash flow, parent company cash flow statement and related notes, including the accounting policies in note 1.

In our opinion:

- the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 March 2021 and of the group's loss for the year then ended;
- the group financial statements have been properly prepared in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006;
- the parent company financial statements have been properly prepared in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements 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 are described below. We have fulfilled our ethical responsibilities under, and are independent of the group in accordance with, UK ethical requirements including the FRC Ethical Standard. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion.

## Going concern

The directors have prepared the financial statements on the going concern basis as they do not intend to liquidate the Group or the Company or to cease their operations, and as they have concluded that the Group's and 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 their ability to continue as a going concern for at least a year from the date of approval of the financial statements ("the going concern period").

We used our knowledge of the Group, its industry, and the general economic environment to identify the inherent risks to its business model and analysed how those risks might affect the Group's and 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 Group's and 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 Group's current and projected cash and facilities (a reverse stress test). We also assessed the completeness of the going concern disclosure.

Our conclusions based on this work:

- we consider that the Directors' use of the going concern basis of accounting in the preparation of the financial 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 Group's ability to continue as a going concern for the going concern period; and
- we found the going concern disclosure in note 1 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 group or the company will continue in operation.

## Independent auditor's report to the members of Glas Cymru Anghyfyngedig (continued)

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### **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 Group's high-level policies and procedures to prevent and detect fraud, including the internal audit function, and the Group's channel for "whistleblowing", as well as whether they have knowledge of any actual, suspected or alleged fraud.
- Reading Board/ audit committee minutes.
- 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 Group management may be in a position to make inappropriate accounting. 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 financial 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 Group'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 financial statements varies considerably.

Firstly, the Group is subject to laws and regulations that directly affect the financial statements including financial reporting legislation (including related companies' legislation), 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 financial statement items.

Secondly, the Group 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 financial statements, for instance through the imposition of fines or litigation or the loss of the Group'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 Group'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.

## Independent auditor's report to the members of Glas Cymru Anghyfngedig (continued)

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### *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 financial 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 financial 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.

### **Strategic report and Directors' report**

The Directors are responsible for the strategic report and the directors' report. Our opinion on the financial statements does not cover those reports and we do not express an audit opinion thereon.

Our responsibility is to read the strategic report and the directors' report and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work:

- we have not identified material misstatements in the strategic report and the directors' report;
- in our opinion the information given in those reports for the financial year is consistent with the financial statements; and
- in our opinion those reports have been prepared in accordance with the Companies Act 2006.

### **Matters on which we are required to report by exception**

Under the Companies Act 2006, we are required 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 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.

We have nothing to report in these respects.

### **Directors' responsibilities**

As explained more fully in their statement set out on page 15, the directors are responsible for: the preparation of the financial statements and for being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; 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 they 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**

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 our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not 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 aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A fuller description of our responsibilities is provided on the FRC's website at [www.frc.org.uk/auditorsresponsibilities](http://www.frc.org.uk/auditorsresponsibilities).

## **Independent auditor's report to the members of Glas Cymru Anghyfyngedig (continued)**

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### **The purpose of our audit work and to whom we owe our responsibilities**

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.



**James Ledward (Senior Statutory Auditor)  
for and on behalf of KPMG LLP, Statutory Auditor**

*Chartered Accountants*

3 Assembly Square

Britannia Quay

Cardiff

CF10 4AX

**4 June 2021**

## Consolidated income statement for the year ended 31 March 2021

		2021	2020
Continuing activities	Note	£m	£m
Revenue	2	776.2	777.3
<b>Operating costs:</b>			
- Operational expenditure	3	(327.6)	(324.1)
- Exceptional item	3	(33.5)	(10.5)
- Infrastructure renewals expenditure	3	(74.4)	(96.5)
- Depreciation and amortisation	3	(333.1)	(315.1)
		<u>(768.6)</u>	<u>(746.2)</u>
<b>Operating profit</b>		<u>7.6</u>	<u>31.1</u>
Profit on disposal of property, plant and equipment		0.1	0.4
Profit before interest		<u>7.7</u>	<u>31.5</u>
<b>Financial expenses:</b>			
Financial income	4a	4.8	6.1
Financial expenses	4a	(126.1)	(164.4)
Fair value losses on derivative financial instruments	4b	(6.8)	(48.3)
		<u>(128.1)</u>	<u>(206.6)</u>
<b>Loss before taxation</b>		<u>(120.4)</u>	<u>(175.1)</u>
Taxation	5	21.9	6.9
<b>Loss for the year</b>		<u>(98.5)</u>	<u>(168.2)</u>

The Company has taken the exemption under section 408 of the Companies Act 2006 not to present the parent company's income statement. The profit of the parent company for the year to 31 March 2021 was £nil (2020: nil).

## Consolidated statement of comprehensive income for the year ended 31 March 2021

	Note	2021 £m	2020 £m
<b>Loss for the year</b>		<b>(98.5)</b>	<b>(168.2)</b>
<b>Items that will not be reclassified to profit or loss</b>			
Actuarial loss recognised in the pension scheme	21	<b>(1.3)</b>	(0.9)
Related deferred tax	6	<b>0.3</b>	0.2
Revaluation of property, plant and equipment	7	<b>28.6</b>	132.0
Related deferred tax	6	<b>(5.4)</b>	(52.1)
		<b>22.2</b>	79.2
<b>Total comprehensive loss for the year</b>		<b>(76.3)</b>	<b>(89.0)</b>

## Consolidated balance sheet as at 31 March 2021

	Note	2021 £m	2020 £m
<b>Assets</b>			
<b>Non-current assets</b>			
Property, plant and equipment	8	5,808.8	5,748.7
Intangible assets	9	203.6	191.8
Other financial assets:			
- derivative financial instruments	15	3.3	0.2
		<u>6,015.7</u>	<u>5,940.7</u>
<b>Current assets</b>			
Inventories		4.3	4.0
Trade and other receivables	11	569.7	575.2
Cash and cash equivalents	12	209.1	658.7
Other financial assets:			
- derivative financial instruments	15	32.6	36.2
		<u>815.7</u>	<u>1,274.1</u>
<b>Total assets</b>		<u>6,831.4</u>	<u>7,214.8</u>
<b>Liabilities</b>			
<b>Current liabilities</b>			
Trade and other payables	13	(540.0)	(561.8)
Provisions	17	(8.5)	(6.4)
Other financial liabilities:			
- borrowings	14	(78.3)	(415.0)
- derivative financial instruments	15	(39.2)	(28.3)
		<u>(666.0)</u>	<u>(1,011.5)</u>
<b>Net current assets</b>		<b>149.7</b>	<b>262.6</b>
<b>Non-current liabilities</b>			
Trade and other payables	13	(401.9)	(314.4)
Employee benefits	21	(89.9)	(87.4)
Provisions	17	(7.1)	(7.9)
Other financial liabilities:			
- borrowings	14	(3,676.6)	(3,706.1)
- derivative financial instruments	15	(478.0)	(482.7)
Deferred tax - net	6	(471.3)	(487.9)
		<u>(5,124.8)</u>	<u>(5,086.4)</u>
<b>Total liabilities</b>		<u>(5,790.8)</u>	<u>(6,097.9)</u>
<b>Net assets</b>		<u>1,040.6</u>	<u>1,116.9</u>
<b>Equity</b>			
Share capital	25	-	-
Revaluation reserve		1,157.1	1,203.7
Retained earnings		(116.5)	(86.8)
<b>Reserves</b>		<u>1,040.6</u>	<u>1,116.9</u>

The notes on pages 26 to 63 form part of the financial statements.

The financial statements on pages 20 to 63 were approved by the Board of Directors on 4 June 2021 and were signed on its behalf by:



P M Davis  
Director



## Consolidated statement of changes in equity for the year ended 31 March 2021

	Share capital £m	Revaluation reserve £m	Retained earnings £m	Total £m
At 1 April 2019	-	1,189.5	16.4	1,205.9
Loss for the year	-	-	(168.2)	(168.2)
Actuarial loss net of tax	-	-	(0.7)	(0.7)
Revaluation net of tax	-	79.9	-	79.9
Transfer to retained earnings	-	(65.7)	65.7	-
At 31 March 2020	<u>-</u>	<u>1,203.7</u>	<u>(86.8)</u>	<u>1,116.9</u>
Loss for the year	-	-	(98.5)	(98.5)
Actuarial loss net of tax	-	-	(1.0)	(1.0)
Revaluation net of tax	-	23.2	-	23.2
Transfer to retained earnings	-	(69.8)	69.8	-
<b>At 31 March 2021</b>	<u>-</u>	<u>1,157.1</u>	<u>(116.5)</u>	<u>1,040.6</u>

## Parent company balance sheet as at 31 March 2021

	Note	2021 £m	2020 £m
<b>Assets</b>			
<b>Non-current assets</b>			
Investments	10	-	-
Loans to group undertakings	11	<u>3.3</u>	<u>3.3</u>
		<b>3.3</b>	<b>3.3</b>
<b>Current assets</b>			
Trade and other receivables		<b>0.2</b>	0.2
<b>Liabilities</b>			
<b>Current liabilities</b>			
Trade and other payables		<u>(3.5)</u>	<u>(3.5)</u>
		<b>(3.5)</b>	<b>(3.5)</b>
<b>Net assets</b>			
		<u>-</u>	<u>-</u>
<b>Reserves</b>			
Share capital	25	-	-
Retained earnings		<u>-</u>	<u>-</u>
<b>Total reserves</b>		<u>-</u>	<u>-</u>

## Parent company statement of changes in equity for the year ended 31 March 2021

	Share capital £m	Retained earnings £m	Total £m
Balance at 1 April 2019	-	-	-
Profit for the year	-	-	-
Balance at 1 April 2020	<u>-</u>	<u>-</u>	<u>-</u>
Profit for the year	-	-	-
<b>Balance at 31 March 2021</b>	<u>-</u>	<u>-</u>	<u>-</u>

The financial statements on pages 20 to 63 were approved by the Board of Directors on 4 June 2021 and were signed on its behalf by:



P M Davis  
Director

## Consolidated cash flow statement for the year ended 31 March 2021

		2021	2020
	Note	£m	£m
<b>Cash flows from operating activities</b>			
Cash generated from operations *	18a	347.5	341.0
Interest paid	18b	(110.7)	(136.8)
Income tax received		2.5	2.1
<b>Net cash generated from operating activities</b>		<b>239.3</b>	<b>206.3</b>
<b>Cash flows from investing activities</b>			
Interest received		5.1	6.0
Purchase of property, plant and equipment		(277.8)	(337.0)
Purchase of intangible assets		(44.6)	(46.1)
Proceeds from sale of property, plant and equipment		0.2	0.6
Grants and contributions received		18.2	24.6
<b>Net cash outflow from investing activities</b>		<b>(298.9)</b>	<b>(351.9)</b>
<b>Net cash flow before financing activities</b>		<b>(59.6)</b>	<b>(145.6)</b>
<b>Cash flows from financing activities</b>			
Repayment of borrowings		(2.2)	(140.1)
Bond issue		-	500.0
Bond Issue costs		-	(7.2)
Bond repayment		(325.0)	-
Term loan repayments		(49.9)	(29.2)
Payment of lease liabilities		(12.9)	(12.3)
<b>Net cash flow from financing activities</b>		<b>(390.0)</b>	<b>311.2</b>
<b>Increase in cash and cash equivalents</b>	19b	<b>(449.6)</b>	<b>165.6</b>
Cash and cash equivalents at 1 April		658.7	493.1
<b>Cash and cash equivalents at 31 March</b>	12	<b>209.1</b>	<b>658.7</b>

There were no cash flow activities to report for the parent company during the year to 2021 (2020: none).

\* Exceptional costs are included in cash flows generated from operations.

# Notes to the financial statements

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## 1. Accounting policies, financing risk management and accounting estimates

### Accounting policies for the year ended 31 March 2021

Glas Cymru Anghyfyngedig ('the Company') is a private company incorporated, domiciled and registered in Wales in the UK. The registered number is 3975719 and the registered address is Linea, Fortran Road, St Mellons, Cardiff, CF3 0LT.

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

#### **Basis of preparation**

The consolidated financial statements of Glas Cymru Anghyfyngedig and the parent company financial statements have been prepared and approved by the Directors in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006. The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of fixed assets, other financial assets and liabilities (including derivative financial instruments) at fair value through profit or loss. The presentational currency of these accounts is GBP and all balances are shown rounded in £m.

The preparation of financial statements to conform with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas including a higher degree of judgement or complexity, or areas where assumptions and estimates are material to the financial statements, are disclosed on page 35.

#### **Basis of consolidation**

The consolidated financial statements include the financial statements of the Company and its subsidiaries. Intra-group transactions and profits are eliminated on consolidation. The parent company financial statements present information about the Company as a separate entity and not about its group.

#### **Going concern**

The financial statements have been prepared on the going concern basis as the Directors have a reasonable expectation that the Group and parent company have 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 Group in the form of cash and committed bank facilities as well as consideration of the Group's capital adequacy, along with a baseline plan which reflects a view of the estimated impact of the COVID-19 pandemic on the Group.

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 below -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 our financial metrics, they remain within rating agencies' guidance for our current ratings.

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

## Notes to the financial statements (continued)

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### 2. Accounting policies, financing risk management and accounting estimates (continued)

#### Changes in accounting policies and disclosures

The following new standards, amendments and interpretations have been adopted by the Group for the first time for the financial year beginning on 1 April 2020:

- **IFRS 9** 'Financial Instruments', **IAS 39** 'Financial Instruments: Recognition and Measurement' and **IFRS 7** 'Financial Instruments: Disclosures' amendments relating to Interest Rate Benchmark Reform ('IBOR') reform Phase 1 exceptions.
- **IFRS 3** 'Business Combinations' amendments to the definitions of a business
- **IFRS 16** amendments relating to COVID-19 related rent concessions
- **IAS 1** 'Presentation of Financial Statements' and **IAS 8** 'Accounting Policies, Changing in Accounting Estimates and Errors' amendments to the definition of materiality
- **Conceptual framework** revision

The adoption of these standards, amendments and interpretations has not had a material impact on the financial statements of the Group or parent company.

#### IFRS, IAS 39 and IFRS 7 amendments relating to IBOR:

The Phase 1 exceptions modify specific hedge accounting requirements which allow for the assumption that the interest rate benchmark on which the hedged cash flows and cash flows from hedged instruments are based will not be altered as a result of the interest rate benchmark reform. This exception is not intended to provide relief from any other consequences arising from the interest rate benchmark reform, such as the discontinuation of hedge accounting due to a termination of the hedge relationship. It also identifies the specific disclosures about the extent to which the Group's hedging relationships are affected.

The Phase 1 exceptions did not impact the Group at the balance sheet date as the Group's hedged instruments do not qualify for hedge accounting. For transparency and understanding of the potential impact the IBOR reforms have on the Group's Treasury dealings, we have included an impact assessment below:

Following the financial crisis, the reform and replacement of benchmark interest rates such as GBP LIBOR and other interbank offered rates (IBORs) has become a priority for global regulators. The Financial Conduct Authority (FCA) has set UK financial institutions a deadline of 30th September 2021 to agree and implement LIBOR reform language changes, which will impact several of the Group's bilateral Treasury contracts. The Group's risk exposure that is directly affected by the interest rate benchmark reform is £100m floating-rate debt (see note 15). This is made up of £1,405m of floating rate nominal debt consisting of a mixture of loans, leases, and Revolving Credit Facility ('RCF'), offset by £741m notional swaps value. The Group has hedged this debt with interest rate swaps and index-linked swaps, although the Group does not hedge account for any of its derivatives. At 31 March 2021, the Group had fixed the interest rate through interest rate swaps on £192m of floating rate liabilities, and index-linked the interest rate on £391m notional value of lease liabilities by reference to the Retail Price Index.

It is currently expected that Sterling Overnight Index Average (SONIA) will replace GBP LIBOR. There are key differences between GBP LIBOR and SONIA. GBP LIBOR is a 'term rate', which means that it is published for a borrowing period, and it is 'forward-looking', because it is published at the beginning of the borrowing period. SONIA is currently a 'backward-looking' rate; it is based on overnight rates from actual transactions, and it is published at the end of the overnight borrowing period. Furthermore, GBP LIBOR includes a credit spread over the risk-free rate, which SONIA does not. To transition existing contracts and agreements that reference GBP LIBOR to SONIA, adjustments for term differences and credit differences might need to be applied to SONIA, to enable the two benchmark rates to be economically equivalent on transition.

The Board has established a project plan to oversee the Group's GBP LIBOR transition. This transition project will include changes to policies, processes, risk and valuation models, as well as managing related tax and accounting implications. The Group currently anticipates that the areas of greatest change will be amendments to the contractual terms of GBP LIBOR-referenced floating-rate debt and swaps.

## Notes to the financial statements (continued)

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### 2. Accounting policies, financing risk management and accounting estimates (continued)

#### Future changes to accounting standards

At the date of approval of these financial statements, the following Standard and Amendments, which have not been applied in these financial statements, were in issue but not yet effective:

#### Standards

- **IFRS 17** – Insurance Contracts

#### Amendments

- **IAS 1** amendments – Classification of liabilities
- **IAS 16** amendments – Proceeds before intended use
- **IFRS 9** ‘Financial Instruments’, **IAS 39** ‘Financial Instruments: Recognition and Measurement’ and **IFRS 7** ‘Financial Instruments: Disclosures’ amendments relating to Interest Rate Benchmark Reform (‘IBOR’) reform Phase 2 exceptions.
- **IFRS 3** amendments – Reference to the conceptual framework
- **IAS 37** amendments – Cost of fulfilling a contract
- **IFRS 10 and IAS 28** amendments – Sale or contribution of assets between an investor and its associate or joint venture
- **IAS 8** amendments - Distinction between accounting policies and accounting estimates
- **IFRS 9** amendments – derecognition of financial liabilities
- **Annual Improvements 2018-20**

The Directors anticipate that the adoption of this Standard and Amendments in future periods will have no material impact on the financial statements of the Group or parent company.

#### Revenue recognition

Revenue represents the income receivable in the ordinary course of business for services provided, excluding value added tax. Where services have been provided, but for which no invoice has been raised at the year-end, an estimate of the value is included in revenue. Revenue recognised reflects the value of services provided to customers in the year. Where customers have made payments in advance as at the year end, this is recognised as deferred income.

Revenue is recognised when a customer obtains control of a good or service and thus has the ability to direct the use of and obtain the benefits from the good or service. The Group recognises that contracts with customers are, in a majority of cases, governed by legislative requirements rather than discrete commercial arrangements. As a result, the application of judgement is important in determining the most appropriate treatment of certain income streams.

The key consideration in respect of the Group’s activities is where revenues from bundled goods and services require separation, which may result in deferring or recognising revenue immediately. Our core water and sewerage supply services (including retail) constitute more than 95% of total income and there is a clear performance obligation satisfied over a measured period of time; however, there are some peripheral income streams which do require more in-depth consideration. All water companies have a legal obligation to allow third parties to establish an authorised connection to their networks and a number of activities may be necessary in order to achieve this, giving rise to the following transactions and accounting treatments under IFRS 15:

Connection charges: these are amounts received from developers for connection to the network which we recognise as income on delivery of that performance obligation.

Infrastructure charges and requisitions: third party contributions towards the Group’s obligation to ensure future service provision to the connection or mains over its life; we estimate that an average connection lasts for 80 years and defer the release of charges over that period.

Asset adoptions: usually sewers adopted at no cost, whereby the receipt of the asset is out of scope of IFRS 15 and should therefore be recognised at fair value (with deferral of related non-cash income).

Diversions: payment in return for moving a water or sewer main to accommodate other infrastructure changes. The performance obligation is to move the main, with no additional asset creation, therefore revenue is recognised immediately.

## Notes to the financial statements (continued)

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### 2. Accounting policies, financing risk management and accounting estimates (continued)

#### Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segment, has been identified as the Board.

#### Exceptional items

Exceptional items are those significant items which are disclosed separately by virtue of their size and/or nature to enable a true understanding of the Group's performance.

#### Investments

The parent company's investments comprise equity holdings in wholly-owned subsidiaries, as set out in note 10. These are stated at historic cost.

#### Property, plant and equipment

The economic value of the Group's water and sewerage business is derived from the Regulatory Capital Value (RCV) set by Ofwat during its five yearly price reviews. The Group considers that a fair value approach to valuing its assets better reflects the underlying value of the assets than historical cost accounting which understates the assets' current value in use.

As at 31 March 2021 the total value of tangible and intangible fixed assets has been revalued to the Group's 'shadow RCV' (Regulatory Capital/Asset Value), being the 31 March 2021 RCV published by Ofwat in its PR19 Final Determination as adjusted for the impact of any totex over/underspend and the Outcome Delivery Incentive rewards/penalties. The classes of asset impacted are infrastructure assets and operational structures.

The carrying value of assets is reviewed for impairment if circumstances dictate that the carrying value may not be recoverable; asset lives and residual values are reviewed annually.

Property, plant and equipment comprise:

- a) Infrastructure assets (being mains and sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls); and
- b) Other assets (including properties, overground operational structures and equipment, and fixtures and fittings).

#### Infrastructure assets

Infrastructure assets comprise principally impounding reservoirs and a network of underground water and wastewater systems. For accounting purposes, the water system is segmented into components representing categories of asset classes with similar characteristics and asset lives. The wastewater system is segmented into components representing geographical operating areas, reflecting the way the Group operates its wastewater activities.

Expenditure on infrastructure assets relating to increases in capacity, enhancements or material replacements of network components is treated as additions, which are included at cost. Expenditure incurred in repairing and maintaining the operating capability of individual infrastructure components, "infrastructure renewals expenditure", is expensed in the year in which the expenditure is incurred.

The depreciation charge for infrastructure assets is determined for each component of the network and is based on each component's cost, estimated residual value and the expected remaining average useful life. The useful average economic lives of the infrastructure components range principally from 35 to 150 years.

#### Other assets

Other assets are depreciated on a straight-line basis over their estimated useful economic lives, which are as follows:

Freehold buildings	60 years
Operational structures	5 – 80 years
Plant, equipment and computer hardware	3 – 40 years

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

## Notes to the financial statements (continued)

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### 2. Accounting policies, financing risk management and accounting estimates (continued)

#### Borrowing costs

Borrowing costs are general and specific borrowing costs directly attributable to the acquisition, construction and production of qualifying assets. Qualifying assets are assets that necessarily take a substantial period of time to get ready for their intended use or sale.

#### Intangible assets

Intangible assets, which comprise principally computer software, system developments and research and development, are included at cost less accumulated amortisation. Cost reflects purchase price together with any expenditure directly attributable to bringing the asset into use, including directly attributable internal costs. Research expenditure is recognised as an expense as incurred. Costs incurred on development projects are recognised as intangible assets when the relevant recognition criteria are met (as per IAS 38).

The carrying values of intangible assets are reviewed for impairment if circumstances dictate the carrying value may not be recovered. Intangible assets are amortised on a straight line basis over their estimated useful economic lives, which range between 3 and 20 years. These asset lives are reviewed annually.

#### IFRS 16 'Leases' Accounting policy

The Group recognises a right-of-use asset and a lease liability at the lease commencement date. The right-of-use asset is initially measured at cost, and subsequently at cost less any accumulated depreciation and impairment losses and adjusted for certain re-measurements of the lease liability.

The Group presents right-of-use assets that do not meet the definition of investment property in property, plant and equipment and lease liabilities in borrowings in the balance sheet.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Group's incremental borrowing rate. Generally, the Group uses its incremental borrowing rate as the discount rate.

The lease liability is subsequently increased by the interest cost on the lease liability and decreased by lease payments made. It is re-measured when there is a change in future lease payment arising from a change in an index or rate or, as appropriate, changes in the assessment of whether a purchase or extension option is reasonably certain to be exercised or a termination option is reasonably certain not to be exercised.

The Group has also elected to apply a single discount rate to the portfolio of leases that are deemed to have reasonably similar characteristics as well as to exclude any initial direct costs in the measurement of the right-of-use asset. The discount rate of 4% is based on the Group's estimated incremental borrowing rate.

All other leases that do not involve right-of-use assets are charged to the income statement over the period of the lease.

When the Group acts as a lessor, it determines at lease inception whether each lease is a finance lease or an operating lease.

To classify each lease, the Group makes an overall assessment of whether the lease transfers substantially all the risks and rewards incidental to ownership of the underlying asset. If this is the case, then the lease is a finance lease; if not, then it is an operating lease. As part of this assessment, the Group considers certain indicators such as whether the lease is for the major part of the economic life of the asset.

The Group has used a number of practical expedients when applying IFRS 16 to leases previously classified as operating leases under IAS 17. In particular the Group:

- did not recognise right of use assets and liabilities for leases for which the lease term ends within 12 months of the date of initial application;
- did not recognise right of use assets and liabilities for leases of low value assets (e.g. IT equipment);
- excluded initial direct costs from the measurement of the right of use asset at the date of initial application; and
- used hindsight when determining the lease term.



## Notes to the financial statements (continued)

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### 2. Accounting policies, financing risk management and accounting estimates (continued)

#### Grants and customer contributions

Grants and customer contributions in respect of expenditure on property, plant and equipment have been offset against these assets. Grants in respect of revenue expenditure are credited to the income statement over the same period as the related expenditure is incurred.

#### Capital expenditure programme incentive payments

The Group's agreements with its construction partners involved in delivering capital expenditure programmes incorporate incentive bonuses payable after completion of the programmes. The cost of property, plant and equipment additions includes an accrual for incentive bonuses earned to date, relating to projects substantially completed at the year-end, where the likelihood of making the incentive payment is considered probable. Amounts recoverable from contract partners relating to targets not being achieved are recognised only on completed projects.

#### Trade receivables

Trade receivables are recognised initially at fair value and measured subsequently at amortised cost less provision for impairment. They are first assessed individually for impairment, or collectively where the receivables are not significant individually. Where there is no objective evidence of impairment for an individual receivable, it is included in a group of receivables with similar credit risk characteristics and these are assessed collectively for impairment based on the expected credit loss. Movements in the provision for impairment are recorded in the income statement.

#### Cash and cash equivalents

Cash and cash equivalents include highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of change in value. Such investments are normally those with less than three months' maturity from the date of acquisition and typically include cash in hand and deposits with banks or other financial institutions.

#### Pension costs

##### i) Defined benefit scheme

The Group operates a defined benefit scheme, the DCWW Pension Scheme, which was closed to future accrual from 1 April 2017 for all members except for 18 ESPS section members. The scheme is funded by employer contributions as well as employee contributions from the remaining active members. The most recent actuarial valuation of the scheme was carried out as at 31 March 2019.

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 reporting period less the fair value of plan assets. The fair value of these assets has been estimated based on the latest available observable prices, updated with reference to movements in comparable observable indices to the reporting date, and adjusted for judgements to reflect differences in the liquidity and credit components of the asset pricing. The defined benefit obligation is calculated annually by an independent actuary using the projected unit 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 that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension obligation. In countries where there is no deep market in such bonds, the market rates on government bonds are used.

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

Past-service costs are recognised immediately in the income statement.

##### ii) Defined contribution scheme

The Group operates a defined contribution scheme, the DCWW Company Personal Pension Plan, which all employees are eligible to join. Obligations for contributions to the scheme are recognised as an expense in the income statement in the period in which they arise.

## Notes to the financial statements (continued)

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### 2. Accounting policies, financing risk management and accounting estimates (continued)

#### Other financial liabilities

Debt is measured initially at fair value, being net proceeds after deduction of directly attributable issue costs, with subsequent measurement at amortised cost. Debt issue costs are recognised in the income statement over the expected term of such instruments at a constant rate on the carrying amount.

Trade payables are obligations to pay for goods and services acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year, or in the normal operating cycle of the business.

Derivative instruments utilised by the Group are interest rate swaps, inflation swaps and power hedges. Derivative instruments are used for hedging purposes to alter the risk profile of existing underlying exposures within the Group. Derivatives are recognised initially and subsequently re-measured at fair value. During the year to 31 March 2021, none of the Group's derivatives qualified for hedge accounting (2020: none). These instruments are carried at fair value with changes in fair value being recognised immediately in the income statement.

#### Financing income and expenses

Financing expenses include interest payable, indexation on index-linked borrowings, index-linked swaps and finance charges on lease liabilities recognised in profit or loss using the effective interest method. Borrowing costs that are directly attributable to the acquisition, construction or production of an asset that takes a substantial time to be prepared for use, are capitalised as part of the cost of that asset. Financing income comprise interest receivable on funds invested.

Interest income and interest payable is recognised in profit or loss as it accrues, using the effective interest method.

#### Taxation

The Group continues to invest heavily in capital expenditure for the benefit of our customers. The tax relief for this capital expenditure and the interest we pay to fund it have the effect of delaying corporation tax payments to future periods. Income tax 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 other comprehensive income or directly in equity, respectively. Current tax is the expected tax payable on the taxable income for the year using rates substantially enacted at the balance sheet date, and any adjustments to tax payable in respect of prior years.

Amounts receivable from tax authorities in relation to research and development tax relief under the RDEC scheme are recognised within operating profit in the period in which the research and development costs are treated as an expense. Where amounts are outstanding at the year end and have not been formally agreed, an appropriate estimate of the amount is included within other receivables.

#### Deferred taxation

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, the deferred income tax is not accounted for if it arises 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 income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax has been recognised in relation to rolled-over gains except for where reinvestment has been made in certain operational assets which the Group plans to use until the end of their useful economic life. The Group anticipates that these assets will then be scrapped for negligible proceeds, or proceeds less than their tax base, and therefore no chargeable gain is expected to arise in the future.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profits will be available against which the temporary differences can be utilised.

## Notes to the financial statements (continued)

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### 2. Accounting policies, financing risk management and accounting estimates (continued)

#### Provisions

Provisions for restructuring costs, dilapidations, uninsured losses and losses on swap closure are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and the amount has been estimated reliably. Restructuring provisions comprise employee severance and pension fund top-up costs. Where the Group receives claims that are either not covered by insurance or where there is an element of the claim for which insurance cover is not available, a provision is made for the expected future liabilities. Provisions are not recognised for future operating losses.

Where there is a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligation may be small.

#### Financing risk management objectives and policies

Treasury activities are managed centrally by the Group within a formal set of treasury policies and objectives, which are reviewed regularly and approved by the Board. The policies specifically prohibit any transactions of a speculative nature and the use of complex financial instruments. Certain detailed policies for managing interest rate, currency, inflation risk and liquidity risk are approved by the Board and may be changed only with the consent of Dŵr Cymru Cyfyngedig's Security Trustee. The risk is mitigated further by limiting exposure to any one counterparty.

The Group uses financial instruments to raise finance and manage operational risk; these instruments principally include listed bonds, leases, bank loan facilities and derivatives.

#### Credit risk

The Group has a prudent policy for investing cash and short-term bank deposits set by the bond documentation within the Common Terms Agreement. Deposits can be placed with our Account Bank for overnight risk only or for up to one year with counterparties that have a minimum short-term rating of A1/P1/F1 from Standard & Poor's, Moody's and Fitch Ratings respectively. Deposits of over one year are placed with counterparties having a minimum long-term rating of AA-/Aa3/AA-.

In practice, the Group has adopted a more prudent approach to cash management and timed deposits are placed for a maximum of 35 days with banks subject to minimum long-term rating criteria of A-/A3/A-. Bonds can be purchased from certain AA-rated counterparties with maturities of up to one year and commercial paper purchases of up to one year can be placed with certain AAA-rated supranationals only. The maximum cash investment with a single counterparty was £100m (2020: £100m).

#### Interest rate risk

The Group is covenanted to hedge at least 85% of its total outstanding financial liabilities into either index-linked or fixed rate obligations. As at 31 March 2021, the Group had hedges covering 99% of its total outstanding financial liabilities into either index-linked or fixed rate obligations, including free cash balances (2020: 100%). For this purpose, floating rate interest liabilities are hedged through a combination of derivative instruments and cash balances. The regulatory framework under which revenues and the regulatory asset value are indexed also exposes the Group to inflation risk. Therefore, subject to market constraints and Board approval, the Group may seek to raise new debt through index-linked instruments or to enter into appropriate hedging transactions.

The Group analyses its interest rate exposure on a dynamic basis. Various scenarios are simulated taking into consideration refinancing, renewal of existing positions, alternative financing and hedging. Of total borrowings of £3,707m as at 31 March 2021 (2020: £4,055m), £45m related to floating rate debt (2020: none). The Group therefore considers overall interest rate exposure at the balance sheet date to be minimal.

As at 31 March 2021, 99% (2020: 100%) of the Group's gross debt was at fixed or index-linked to RPI rates of interest after taking into account interest rate and RPI swaps. The hedges established to manage interest rate risks are economic in nature, but do not satisfy the requirements in order to be treated as hedges for accounting purposes. Accordingly, all movements in the fair value of derivative financial instruments are reflected in the income statement. This has resulted in a net liability of £481m in the balance sheet at 31 March 2021 (2020: £475m) but, assuming that the swaps are held to maturity, this will ultimately reduce to £nil.

## Notes to the financial statements (continued)

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### 2. Accounting policies, financing risk management and accounting estimates (continued)

#### Power price hedges

The Group enters into contracts which fix the price of a proportion of future power purchases in order to reduce the impact of power price variances. These contracts qualify as financial instruments and are included within the financial statements.

#### Refinancing risk

Refinancing risk is managed by maintaining a balance between the continuity of funding and flexibility through the use of borrowings across a range of instruments, types and maturities. The Group's policy is to ensure that the maturity profile does not impose an excessive strain on its ability to repay loans. Under this policy, no more than 20% of the principal of Group borrowings of £3,707m (2020: £4,055m) can fall due in any 24 month period.

#### Liquidity risk

The Group maintains committed banking facilities in order to provide flexibility in the management of its liquidity. Under the Common Terms Agreement which governs obligations to bondholders and other financial creditors, the Group is required to have cash available to fund operations for 12 months.

During the year the Group renewed all four of its revolving credit facilities and increased three of them by £10m each. As at 31 March 2021, the Group had committed undrawn borrowing facilities of £200m (2020: £170m) and cash and cash equivalents (excluding debt service payments account) of £187m (2020: £657m). The undrawn facilities are available for two years with a one year extension option. There is also a £10m overdraft facility renewable on an annual basis.

As at 31 March 2021 there was also a special liquidity facility of £135m (2020: £135m); this is required in order to meet certain interest and other obligations that may not be funded through operating cash flow in the event of a standstill being declared by the Security Trustee, following an event of default under the Group's debt financing covenants. The facility has been provided by an insurance provider and is renewable on a rolling five-year evergreen basis.

#### Capital risk

The Group's objective when managing capital is to safeguard its ability to continue as a going concern. Given the regulatory environment in which the Group operates, the Group monitors capital on the basis of the gearing ratio. This is calculated as net debt (as defined in the Group's borrowing covenants) as a proportion of its Regulatory Capital Value and linked to the movements in the Retail Prices Index as determined by Ofwat. As at 31 March 2021 this regulatory gearing was 60% (2020: 60%).

In respect of the risks detailed above, further quantitative disclosures are provided in note 16.

## Notes to the financial statements (continued)

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### 2. Accounting policies, financing risk management and accounting estimates (continued)

#### Critical accounting estimates and judgements

The preparation of financial statements conforming to IFRS requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results ultimately may differ from those estimates.

#### **Provision for impairment of trade receivables**

Individual impairment losses on customer debts are calculated based on an individual assessment of expected cash flows. Collective impairment losses on receivables with similar credit risk are calculated using a statistical model. Management uses standardised collection rates to determine the level of bad debts. These are as follows:

Measured debt based on historical evidence:

- 95% collection of debt less than one year old; and
- no collection of debt over one year old.

Unmeasured debt based on historical evidence:

- 80% collection of debt less than one year old;
- 5% collection of debt between one and four years' old; and
- no collection of debt over four years' old.

Accounting estimate: the probability of failing to recover a debt is based on expected credit loss, determined by past experience and expected future movements in collection rates, adjusted for changes in external factors (including the estimated impact of the COVID-19 pandemic). The accuracy of the impairment calculation would therefore be affected by unexpected changes to the economic situation, and to changes in customer behaviour. To the extent that the failure to recover debts in arrears alters by 5%, the provision for impairment would increase or decrease by £3.9m (2020: £4.1m). Charging orders are secured against property owned by customers, providing security over debt owed. We make an assumption that 90% of these charging orders will be received. To the extent that this assumption was to alter by 10%, the provision for impairment would increase or decrease by £1m (2020: £1m).

#### **Pension benefits**

The present value of the pension obligations is dependent on the actuarial calculation, which includes a number of assumptions. These assumptions include the discount rate, price inflation and mortality rates, which are used to calculate the present value of the estimated future cash outflows that will be required to meet the pension obligations. In determining the discount rate to use, the Group considers market yields of high-quality corporate bonds, denominated in sterling, that have times to maturity approximating the terms of the pension liability. Were this discount rate to reduce or increase by 0.1%, the carrying value of the pension obligations as at 31 March 2021 would increase or reduce by £9.8m (2020: £8.7m). The key assumptions include: discount rates, RPI, pay growth, mortality and increases to pensions in payment and deferred pensions. It should be noted that actual rates may differ from the assumptions used due to changing market and economic conditions and longer or shorter lives of participants and, as such, this represents a key source of estimation uncertainty. A further source of estimation uncertainty pertains to the inflation risk premium (IRP) which has been set at 0.6% this year, compared with 0.4% in the prior year, which has increased as a result of our view on the market's uncertainty and volatility. The impact of the change in the IRP applied represents a significant area of judgment, with the change expected to have an impact of reducing the obligation by circa £19m. Sensitivities in respect of the assumptions used during the year are disclosed in note 21.

If the scheme's assets underperform relative to the discount rate used to calculate the liabilities, this will increase the value of the projected deficit. With the exception of cash, assets consist of pooled investment funds, alternative strategy funds and property funds which are not quoted on an active market. Of total assets amounting to £443m (2020: £388m), assets with a fair value of £100m (2021: £147m) are Level 3 financial assets; these are considered to be the least liquid and hardest to value and are therefore subject to a higher degree of estimation. The fair value of these assets has been estimated based on the latest available observable prices, updated with reference to movements in comparable observable indices to the reporting date, and adjusted for judgements to reflect differences in the liquidity and credit components of the asset pricing. A 5% movement in the fair value of these Level 3 financial assets would increase or decrease the overall carrying value of the pension liability by £5.0m (2020: £7.4m). (See also note 21.)

## Notes to the financial statements (continued)

### 2. Accounting policies, financing risk management and accounting estimates (continued)

#### COVID-19 accounting judgement impact on pension benefits

The mortality assumption used to calculate the present value of the pension obligations is broken down into two distinct parts. Firstly, current mortality rates (base table), and secondly, how these rates should allow for future improvements. For the present value calculation, the S3PxA base tables have been used with improvements in line with the Continuous Mortality Investigation (CMI) 2018 projection model, with a long-term trend rate of 1.0% p.a. These assumptions remain unchanged from those adopted last year and are consistent with the mortality assumptions currently used for funding purposes. Future period assumptions will be updated following the completion of the formal triennial valuation of the Scheme as at 31 March 2022. No allowance has been made in these disclosures for the impact of COVID-19.

No accounting estimate has been made in these accounts to predict the long-term impact of COVID-19 on life expectancies due to the current number of uncertainties surrounding this estimate. Furthermore, the CMI has not made any allowance for COVID-19 within their latest projection model but will monitor the position as more data becomes available. The CMI model is used by UK pension schemes and insurance companies which need to make assumptions about future mortality rates. The CMI have stated that mortality experience during 2020 is likely to be an outlier and not indicative of the future path that mortality rates will follow. For this reason, the CMI places no weight on the data for 2020 when projecting mortality rates into the future and therefore the assumptions used to calculate the present value of pension obligations, with no explicit allowance for COVID-19, remain appropriate at the current time.

#### Fair value estimation

In accordance with IFRS 13 Fair Value Measurement trading and treasury derivatives of the Group are categorised into different levels:

- **Level 1:** quoted prices (unadjusted) in active markets for identical assets or liabilities.
- **Level 2:** 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 3:** inputs for the asset or liability not based on observable market data.

All of the Group's treasury derivatives are categorised as Level 2. In accordance with IFRS 13 an adjustment factor has been applied to the swaps based on industry standard practice to take into account credit risk by estimating future cash flows based on applicable interest rate curves. Projected cash flows are then discounted back using discount factors which are derived from the applicable interest rate curves adjusted for management's estimate of counterparty and own credit risk, where appropriate.

Trading derivatives, relating to power price hedges, are categorised as Level 2 where marked-to-market valuations are received for these trades. Where marked-to-market valuations are not received the fair values are estimated rather than observable, and are therefore categorised as Level 3.

At 31 March 2021 the fair values of derivatives were as follows:

#### Level 2:

**Assets:** trading derivatives £3.9m, treasury derivatives £28.1m (2019: trading derivatives £0.1m, treasury derivatives £36.1m).  
**Liabilities:** trading derivatives £nil treasury derivatives £517.2m (2020: trading derivatives £1.2m, treasury derivatives £508.9m).

#### Level 3:

**Assets:** trading derivatives £3.9m, treasury derivatives £nil (2020: trading derivatives £0.2m, treasury derivatives £nil).  
**Liabilities:** trading derivatives £nil treasury derivatives £nil (2020: trading derivatives £0.9m, treasury derivatives £nil).

Trading derivatives relate to power hedges. Treasury derivatives relate to interest rate swap contracts. All derivatives are recorded on the balance sheet at fair value.

Level 2 debt investments are valued using a discounted cash flow approach, which discounts the contractual cash flows using discount rates derived from observable market prices of other quoted debt instruments of the counterparties.

Level 3 debt instruments are valued using a discounted cash flow approach, which discounts the contractual cash flows using discount rates derived from observable market prices of other quoted debt instruments of the counterparties. Level 3 debt instruments are valued by comparing valuations from Level 2 trades for the same periods, with the valuations from observable trades being inflated or deflated to allow for any fixed price variations.

## Notes to the financial statements (continued)

### 2. Accounting policies, financing risk management and accounting estimates (continued)

#### Capitalisation

There is a high degree of judgement involved in determining whether costs, both initial and subsequent expenditure, including employee and other internal expenditure on both infrastructure and non-infrastructure assets meet the relevant criteria for capitalisation (directly attributable to the asset, provide probable economic benefit and can be measured reliably) and therefore are included in the valuation of property, plant and equipment, or alternatively should be expensed immediately. This is monitored continually through a process of capital programme cost challenge and operating cost scrutiny, complemented by a third-party analysis of the capital programme breakdown between maintenance costs charged to the income statement and property, plant and equipment additions to the balance sheet.

### 2. Segmental information

The Directors consider that there is only one operating segment, being the operation of water and sewerage business (and peripheral commercial activities) in the UK. As the Group has only domestic activities there is also only one geographical segment; therefore, the disclosures for this segment have also already been given in these financial statements.

While the Group operates in a single segment, its activities can be disaggregated into the following principal income streams:

<b>Group</b>	<b>2021</b>	<b>2020</b>
	<b>£m</b>	<b>£m</b>
<b>Regulated revenue</b>		
Water	<b>323.1</b>	322.8
Sewerage	<b>399.8</b>	394.0
Retail	<b>49.1</b>	55.3
<b>Total regulated revenue</b>	<b>772.0</b>	772.1
Other (non-regulated)	<b>4.2</b>	5.2
<b>Total revenue</b>	<b>776.2</b>	777.3

Regulated revenue relates to the provision of water, sewerage and related retail services operating under Dŵr Cymru Cyfyngedig's licence as part of the water industry and England and Wales, regulated by The Office of Water Trading (Ofwat).

Other (non-regulated) revenue relates to income streams which are not subject to Ofwat's price control; these principally comprise activities which are peripheral and/or complementary to the Group's core water and sewerage business.

## Notes to the financial statements (continued)

### 3. Operating profit

The following items have been included in arriving at the operating profit:

Group	2021 £m	2020 £m
<b>Operating expenditure</b>		
Power	45.8	46.9
Chemicals	9.5	11.3
Materials and equipment	7.1	5.6
Vehicles and plant	6.7	8.2
Office expenses	5.6	6.7
Property costs	4.7	4.2
Insurance	6.6	4.9
Sewerage contractors	20.1	19.8
Laboratories and analytical services	1.1	0.8
Collection commissions	2.8	2.7
IT Contracts	14.6	14.0
Bought-in services and other costs	40.1	38.6
	<u>164.7</u>	<u>163.7</u>
Employee costs (note 20)	168.1	165.8
Staff costs capitalised	(67.9)	(69.6)
	<u>100.2</u>	<u>96.2</u>
Research and development credit	(0.9)	(1.3)
Trade receivables impairment	20.9	25.2
Rates	26.5	24.2
Natural Resources Wales/Environment Agency charges	15.8	15.6
Fees payable to auditors	0.4	0.5
<b>Total operational expenditure</b>	<u>327.6</u>	<u>324.1</u>
<b>Exceptional items</b>	<b>33.5</b>	<b>10.5</b>
<b>Infrastructure renewals expenditure</b>	<b>74.4</b>	<b>96.5</b>
<b>Depreciation and amortisation</b>		
- Depreciation of property, plant and equipment	309.4	293.2
- Release of deferred income	(9.1)	(7.2)
- Amortisation of intangible assets	32.8	29.1
<b>Total depreciation and amortisation</b>	<u>333.1</u>	<u>315.1</u>
<b>Total operating costs</b>	<u>768.6</u>	<u>746.2</u>

The Group incurred insignificant expenses relating to short-term leases, leases of low-value assets or variable lease payments in 2021 and 2020.



## Notes to the financial statements (continued)

### Services provided by the Group's auditors

During the year the group headed by the parent company, Glas Cymru Anghyfyngedig, obtained the following services from its auditors, all of which were paid by the Group's wholly-owned subsidiary, Dŵr Cymru Cyfyngedig:

	Group	
	2021	2020
	£000	£000
<b>Audit fees</b>		
Audit of parent company and consolidated financial statements	34	28
Audit of subsidiary companies	268	222
Total audit fees	<u>302</u>	<u>250</u>
<b>Audit-related assurance services</b>		
Review of interim financial statements	24	21
Regulatory audit services pursuant to legislation	82	53
Investor report reviews	8	8
Environment Agency levy assurance work	6	6
Bond issuance assurance work	-	38
<b>Total audit and audit-related assurance services</b>	<u>422</u>	<u>376</u>
<b>Other services</b>		
Tax iXBRL document tagging	-	5
Pensions advice	-	62
Direct Procurement for Customers project assessment	-	37
<b>Total other services</b>	<u>-</u>	<u>104</u>
<b>Total cost of services provided by the Group's auditors</b>	<u><u>422</u></u>	<u><u>480</u></u>

Regulatory audit services include audit work in respect of regulatory requirements: the Annual Performance Report.

The Board has adopted a formal policy with respect to services received from external auditors. The external auditors will not be used for internal audit services and all non-audit work will be subject to prior competitive tendering or approval by the Audit Committee.

### Exceptional item

During the year the Group has incurred significant additional costs as a direct result of the COVID-19 pandemic; due to their size and nature these costs, amounting to £29.4m, have been disclosed in aggregate as an exceptional item on the face of the income statement. In addition, a further £4.1m of restructuring costs have been disclosed as exceptional following a reassessment of the level of restructuring provision, taking into account delays to the restructuring plans as a result of the COVID-19 pandemic (included in manpower in the list below).

The additional costs can be split into the following categories:

	2021
	£m
Bad debt charges	12.5
National Grid (additional levy following national demand drop)	3.4
Personal protective equipment (hand sanitisers, wipes, masks, goggles etc.)	7.6
Cleaning, tankering, security	1.6
Maintenance work on infrastructure assets	2.4
IT hardware	0.5
Vehicle hire	0.2
Manpower	5.2
Other	0.1
<b>Total</b>	<u><u>33.5</u></u>

Glas Cymru's final business plan for the regulatory period 2020 to 2025 included restructuring plans to meet a challenging cost efficiency target, reflected in Ofwat's PR19 Final Determination published on 10 December 2019. As a consequence, in the year to 31 March 2020 the Group recognised £10.5m of restructuring costs associated with a projected headcount reduction of around 200; these were considered exceptional by their nature and disclosed separately in the financial statements.

## Notes to the financial statements (continued)

### 4. Financing costs

#### a) Finance cost before fair value losses on derivative financial instruments

	Group	
	2021	2020
	£m	£m
<b>Finance income</b>	<b>4.8</b>	6.1
Interest payable on bonds	(75.6)	(93.5)
Indexation on index-linked bonds	(21.2)	(36.3)
Indexation on index-linked loan	(3.2)	(6.1)
Interest payable on leases (including swaps to RPI)	(11.6)	(17.4)
Other loan interest	(16.8)	(17.7)
Other interest payable and finance costs	(7.0)	(5.6)
Net interest charge on pension scheme liabilities	(2.0)	(2.2)
Capitalisation of borrowing costs under IAS 23 (2021: 3.7%; 2020: 4.7%)	11.3	14.4
<b>Financial expenses</b>	<b>(126.1)</b>	(164.4)
<b>Net finance cost before fair value adjustments</b>	<b>(121.3)</b>	(158.3)

#### b) Fair value losses on derivative financial instruments

Derivative financial instruments are held for economic hedging purposes although they do not qualify as accounting hedges. Consequently, the Group's interest rate and currency swaps are fair valued at each balance sheet date with the movement (net loss or gain) disclosed in the income statement. Over the life of these swaps, if held to maturity, these fair value adjustments will reverse and reduce to zero. (See note 15 in respect of derivative financial instruments recognised in the balance sheet.)

	Group	
	2021	2020
	£m	£m
Fair value losses on interest rate swaps	(18.8)	(21.6)
Fair value gains/(losses) on index-linked swaps	2.5	(20.9)
Fair value gains/(losses) on trading derivatives	9.5	(5.8)
Total fair value losses on derivative financial instruments	(6.8)	(48.3)

Interest rate swap movements are caused by fluctuations in long-term interest rates, while the index-linked swap movements result from fluctuations in the value of index-linked gilts.

## Notes to the financial statements (continued)

### 5. Taxation

Analysis of credit in the year:

	Group	
	2021	2020
	£m	£m
<b>Current tax</b>		
- Current tax on profits for the year	-	0.8
- Current tax on research and development credit	(0.2)	(0.2)
- Adjustment in respect of prior years	0.4	1.3
Total current tax	<u>0.2</u>	<u>1.9</u>
<b>Deferred tax</b>		
- Origination and reversal of timing differences	22.2	29.7
- Adjustment in respect of prior year	(0.5)	(1.4)
- Effect of tax rate change	-	(23.3)
Total deferred tax credit (note 6)	<u>21.7</u>	<u>5.0</u>
<b>Taxation</b>	<u>21.9</u>	<u>6.9</u>

Current tax is corporation tax which is payable on a company's profit or loss adjusted for tax purposes, and is only charged where a taxable profit arises after these tax adjustments - see current tax reconciliation.

Operating expenditure includes a Research & Development tax credit of £0.9m (2020: £1.3m). The tax credit is taxable and the corresponding charge of £0.2m (2020: £0.2m) is shown above. The Research & Development Expenditure Credit claimed is a government incentive that provides tax credits for qualifying research and development expenditure. Claims are made based on an assessment of qualifying expenditure in accordance with the criteria specified under the incentive.

Current taxes in respect of prior years of £0.4m (2020: £1.3m) relate to tax credits for energy efficient capital expenditure and the remediation of contaminated land. Both are claimed under government incentives which provide tax credits for this particular expenditure. Claims are made based on an assessment of qualifying expenditure in accordance with the criteria for these incentives. As a consequence, a deferred tax charge in respect of prior years of £0.5m (2020: £1.4m) has arisen from claiming these tax credits and from adjustments to deferred tax balances in respect of capital expenditure. The net adjustment relating to prior years is £0.2m (2020: £0.1m) as shown in the total tax reconciliation below.

In the 3 March 2021 Budget it was announced that the UK tax rate will increase from 19% to 25% from 1 April 2023. This will have a consequential effect on the Group's future tax charge. Management estimates that if this rate change had been substantively enacted at the current balance sheet date the net deferred tax liability, which is currently calculated at 19%, would have increased by £149m. Approximately £91.5m of the increase relates to fixed assets which have been revalued and would be recognised in equity, the remaining £57.5m would be recognised in the income statement.

The effective rate of tax for the year is lower (2020: lower) than the standard rate of corporation tax in the UK of 19% (2020: 19%). The differences are explained below:

	Group	
	2021	2020
	£m	£m
<b>Loss before tax</b>	<u>(120.4)</u>	<u>(175.1)</u>
Loss before tax multiplied by the corporation tax rate in the UK of 19% (2020: 19%)	23.0	33.3
Effect of:		
- Adjustments in respect of prior years	(0.2)	(0.1)
- Depreciation charged on non-qualifying assets	(0.8)	(0.9)
- Expenses non-deductible for tax purposes	(0.1)	(0.1)
- Effect of pension payments in excess of service charge	-	1.6
- Effect of changing rate for deferred taxes from 17% to 19%	-	(23.3)
- Difference in standard rate of corporation tax (19%) and rate used for deferred tax (17%)	-	(3.6)
<b>Taxation</b>	<u>21.9</u>	<u>6.9</u>

## Notes to the financial statements (continued)

### 5. Taxation (continued)

	Group	
	2021	2020
	£m	£m
<b>Loss before tax</b>	<b>(120.4)</b>	<b>(175.1)</b>
Expected tax charge (19%)	22.9	33.4
Depreciation in excess of capital allowances	(27.7)	(29.5)
Pension costs in excess of payments	(0.4)	1.8
Expenses not deductible for tax purposes	(0.1)	(0.1)
Fair value movements in derivatives - non taxable	1.1	(7.9)
IFRIC 18 - release of income not taxable	1.7	1.4
Movement in provisions deductible when paid	0.1	(1.1)
Capitalised interest - tax deductible when capitalised	2.1	2.7
R&D Expenditure Credits taxed in prior years	-	0.2
Adjustments in respect of prior years	0.5	1.4
Effect of lower tax credit (12.7%) for tax loss surrender re energy efficient expenditure	-	(0.4)
<b>Taxation</b>	<b>0.2</b>	<b>1.9</b>

The most significant factor impacting the Group's current tax charge is the difference between depreciation charged on property, plant and equipment in the financial statements and the tax relief claimed for this expenditure (capital allowances). Deferred taxes are recognised on the temporary difference between the carrying amount of the fixed assets in the accounts and the amount that will be deductible for tax purposes in future years. Depreciation exceeds the claim for capital allowances as the Group is able to determine the amount of capital allowances it claims during each period in accordance with the tax legislation. Capital allowances have not been fully claimed this year, or in the prior period.

Treasury derivative financial instruments are carried at their fair value. Fair value gains and losses arising between balance sheet dates are recognised in the income statement but are not subject to corporation tax. Deferred taxes are recognised on the temporary difference which is equal to the net fair value of the derivatives in the financial statements less the amounts which have been deducted for tax purposes.

Tax relief is claimed for interest costs which include the effect of the current year cash flows relating to treasury derivative financial instruments. Tax relief is also claimed for interest which is capitalised as part of fixed assets (see note 4). The group is entirely UK resident for tax purposes and is funded wholly by external debt which is fully deductible in accordance with UK tax legislation.

New debt is raised through bond issues and the Group's bonds are listed on the Luxembourg stock exchange. As 'quoted Eurobonds', there is no requirement to deduct UK withholding tax from interest payments. As such, there are no tax advantages to listing bonds in Luxembourg compared to London, as bonds listed on either exchange benefit from a withholding tax exemption in relation to interest. Whilst bonds are issued as bearer bonds, they are transferred electronically via Euroclear and Clearstream and have not been issued in 'definitive' (paper) form.

## Notes to the financial statements (continued)

### 6. Deferred tax

Deferred tax is calculated in full on temporary differences under the liability method using a tax rate of 19% (2020: 19%).

The movement in the deferred tax provision is as shown below:

	Group	
	2021	2020
	£m	£m
At 1 April	487.9	441.0
Credit to income statement	(21.7)	(5.0)
Credit to statement of comprehensive income	(0.3)	(0.2)
Charge to revaluation reserve	5.4	52.1
At 31 March	<u>471.3</u>	<u>487.9</u>

Analysis of amounts of deferred tax credited to the statement of comprehensive income and revaluation reserve:

	Group	
	2021	2020
	£m	£m
Defined benefit pension schemes	(0.3)	(0.1)
Reallocation of tax from income statement - pension payment in excess of service charge	-	1.6
Increase in corporation tax – pension scheme	-	(1.7)
<b>Credited to the statement of comprehensive income</b>	<u>(0.3)</u>	<u>(0.2)</u>
Revaluation of fixed assets	5.4	22.4
Increase in corporation tax rate – revaluation of fixed assets	-	29.7
<b>Charged to the revaluation reserve</b>	<u>5.4</u>	<u>52.1</u>

	Group	
	2021	2020
	£m	£m
Effect of:		
- Tax allowances in excess of depreciation	295.7	302.1
- Deferred tax on revaluation of fixed assets	271.1	282.0
- Capital gains rolled over	3.0	3.0
- Deferred tax on tax losses carried forward	(0.3)	(0.3)
- Deferred tax on losses on derivative financial instruments	(79.3)	(80.4)
- Pensions	(16.4)	(15.7)
- Other tax differences	(2.5)	(2.8)
<b>Deferred tax</b>	<u>471.3</u>	<u>487.9</u>

Deferred taxes have been recognised on the temporary difference between the carrying amount of the fixed assets in the accounts and the amounts that will be deductible for tax purposes (capital allowances) in future years. As capital allowances have exceeded the depreciation charged on the fixed assets to date, there is a deferred tax liability of £295.7m at the balance sheet date (2020: £302.1m).

A deferred tax liability of £271.1m (2020: £282.0m) has also been recognised in relation to revaluation surpluses arising from revaluing fixed assets to reflect Ofwat's 'shadow regulatory capital value'. The associated deferred tax charge is charged to the revaluation reserve.

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. These deferred tax assets will be recovered against the deferred tax liabilities in relation to fixed assets which will reverse in the same periods.

## Notes to the financial statements (continued)

### 7. Revaluation reserve

The economic value of the Group's water and sewerage business is derived from the Regulatory Capital Value (RCV) set by Ofwat during its five yearly price reviews. The Group considers that a fair value approach to valuing its assets better reflects the underlying value of the assets than historical cost accounting which understates the assets' current value in use.

As at 31 March 2021 the total value of tangible and intangible fixed assets has been revalued to the Group's 'shadow RCV', being the 31 March 2021 RCV published by Ofwat in its PR19 Final determination as adjusted for the impact of any totex over/underspend and the Outcome Delivery Incentive rewards/penalties. The classes of asset impacted are infrastructure assets and operational structures.

The carrying value of assets is reviewed for impairment if circumstances dictate that the carrying value may not be recoverable, asset lines and residual values are reviewed annually.

Revaluation reserve movement	Group	
	2021 £m	2020 £m
Revaluation reserve as at 1 April	1,203.7	1,189.5
Revaluation of assets to RCV	28.6	132.0
Depreciation charge on revalued assets	(86.2)	(81.1)
	<u>(57.6)</u>	<u>50.9</u>
Deferred tax on revaluation	(5.4)	(52.1)
Deferred tax on depreciation charge	16.4	15.4
	<u>11.0</u>	<u>(36.7)</u>
Revaluation reserve as at 31 March	<u>1,157.1</u>	<u>1,203.7</u>

## Notes to the financial statements (continued)

### 8. Property, plant and equipment

#### Group

	Freehold land and buildings £m	Infrastructure assets £m	Operational structures £m	Plant, equipment, computer hardware £m	Total £m
<b>Current year</b>					
<b>Cost or valuation</b>					
At 1 April 2020	43.1	2,632.5	4,562.0	276.9	7,514.5
Additions net of grants and contributions	-	165.7	172.0	3.3	341.0
Disposal	(0.1)	-	-	(1.6)	(1.7)
<b>At 31 March 2021</b>	<b>43.0</b>	<b>2,798.2</b>	<b>4,734.0</b>	<b>278.6</b>	<b>7,853.8</b>
<b>Accumulated depreciation</b>					
At 1 April 2020	23.0	1.9	1,469.7	271.2	1,765.8
Revaluation	-	(12.9)	(15.7)	-	(28.6)
Charge for the year	1.1	68.4	237.5	2.4	309.4
Released on disposal	-	-	-	(1.6)	(1.6)
<b>At 31 March 2021</b>	<b>24.1</b>	<b>57.4</b>	<b>1,691.5</b>	<b>272.0</b>	<b>2,045.0</b>
<b>Net book value</b>					
<b>At 31 March 2021</b>	<b>18.9</b>	<b>2,740.8</b>	<b>3,042.5</b>	<b>6.6</b>	<b>5,808.8</b>
<b>At 31 March 2021 (historic cost)</b>	<b>18.9</b>	<b>2,023.8</b>	<b>2,332.9</b>	<b>6.6</b>	<b>4,382.2</b>

The net book value of property, plant and equipment includes £272.9m in respect of assets in the course of construction (2020: £263.6m) and £85.0m of borrowing costs capitalised in accordance with IAS 23 (2020: £77.9m), of which £9.5m were additions in the year (2020: £12.6m).

#### Right-of-use assets

Included within the above are right-of-use assets as analysed below:

<b>Group - 2021</b>	Infrastructure assets £m	Operational structures £m	Total £m
Net book value at 1 April 2020	654.4	33.6	688.0
Revaluation	4.2	0.2	4.4
Depreciation charge for the year	(25.3)	(4.8)	(30.1)
<b>Net book value at 31 March 2021</b>	<b>633.3</b>	<b>29.0</b>	<b>662.3</b>
<b>Net book value at 31 March 2021 (historical cost basis)</b>	<b>467.6</b>	<b>22.3</b>	<b>489.9</b>

## Notes to the financial statements (continued)

### 8. Property, plant and equipment (continued)

2020	Freehold land and buildings £m	Infrastructure assets £m	Operational structures £m	Plant, equipment, computer hardware £m	Total £m
Cost or valuation					
At 1 April 2019	41.7	2,491.1	4,324.0	272.2	7,129.0
Additions net of grants and contributions	1.4	141.4	238.0	7.3	388.1
Disposal	-	-	-	(2.6)	(2.6)
At 31 March 2020	43.1	2,632.5	4,562.0	276.9	7,514.5
Accumulated depreciation					
At 1 April 2019	22.1	-	1,315.8	269.1	1,607.0
Revaluation	-	(59.0)	(73.0)	-	(132.0)
Charge for the year	0.9	60.9	226.9	4.5	293.2
Released on disposal	-	-	-	(2.4)	(2.4)
At 31 March 2020	23.0	1.9	1,469.7	271.2	1,765.8
Net book value					
At 31 March 2020	20.1	2,630.6	3,092.3	5.7	5,748.7
At 31 March 2020 (historic cost)	20.1	1,910.7	2,328.0	5.6	4,264.4

#### Right-of-use assets

Included within the above are right-of-use assets as analysed below:

Group - 2020	Infrastructure assets £m	Operational structures £m	Total £m
Net book value at 1 April 2019	662.9	36.0	698.9
Additions	-	1.4	1.4
Revaluation	19.9	1.1	21.0
Depreciation charge for the year	(28.4)	(4.9)	(33.3)
<b>Net book value at 31 March 2020</b>	<b>654.4</b>	<b>33.6</b>	<b>688.0</b>
<b>Net book value at 31 March 2020 (historical cost basis)</b>	<b>475.3</b>	<b>25.3</b>	<b>500.6</b>

The Group's leases are principally made up of water and sewerage treatment infrastructure assets and equipment in order to carry out its operations.

The parent company owns no property, plant or equipment.

### 9. Intangible assets

Group:

Current year	Cost £m	Amortisation £m	Net book value £m
At 1 April 2020	417.6	(225.8)	191.8
Additions/(charge) for year	44.6	(32.8)	11.8
<b>At 31 March 2021</b>	<b>462.2</b>	<b>(258.6)</b>	<b>203.6</b>
Prior year	Cost £m	Amortisation £m	Net book value £m
At 1 April 2019	371.5	(196.7)	174.8
Additions/(charge) for year	46.1	(29.1)	17.0
At 31 March 2020	417.6	(225.8)	191.8



## Notes to the financial statements (continued)

### 9. Intangible assets (continued)

Intangible assets principally comprise computer software and related system developments.

The net book value of intangible assets includes £39.0m in respect of assets in the course of construction (2020: £34.7m). The net book value of intangible assets includes £9.3m of borrowing costs capitalised in accordance with IAS 23 (2020: 8.2m) of which £1.8m were additions in the year (2020: £1.8m).

The parent company owns no intangible assets.

### 10. Investments

#### Group

Equity of less than 10% is held in the following unlisted company:

	Principal activities	Country of incorporation	Holding
Water Research Centre (1989) plc	Water research	England and Wales	B Ordinary Shares of £1

#### Parent company

The parent company has a £1 investment in Glas Cymru (Securities) Cyfyngedig (100% holding) and has indirect investments in the following subsidiary undertakings:

	Principal activities	Tax Residency	Country of incorporation	Holding
Dŵr Cymru (Holdings) Limited	Holding company	UK resident	England and Wales	100%
Dŵr Cymru Cyfyngedig	Water and sewerage	UK resident	England and Wales	100%
Dŵr Cymru (Financing) UK plc	Raising finance	UK resident	England and Wales	100%

Dŵr Cymru (Financing) UK Plc was incorporated on 16 April 2019. On 1 August 2019 the trade and assets of Dŵr Cymru (Financing) Limited were transferred into Dŵr Cymru (Financing) UK Plc. Dŵr Cymru (Financing) Limited entered voluntary liquidation on 9 September 2019 and was dissolved on 22 March 2021.

The registered office of all the above companies is Linea, Fortran Road, St Mellons, Cardiff, CF3 0LT.

### 11. Trade and other receivables

	Group	
	2021	2020
	£m	£m
<b>Current</b>		
Trade receivables	551.2	558.0
Provision for impairment of receivables	(77.8)	(81.8)
Trade receivables - net	473.4	476.2
Prepayments and accrued income	86.9	85.6
Other receivables	9.4	13.4
<b>Total trade and other receivables</b>	<b>569.7</b>	<b>575.2</b>

All non-current receivables are due within five years from the balance sheet date.

As at 31 March 2021, based on a review of historical collection rates it was considered that £77.8m (2020: £81.8m) of trade receivables were impaired and these have therefore been provided for. The impaired receivables relate mainly to the measured and unmeasured supply of water and sewerage services. Trade receivables aged greater than one month are past due; the net column shows amounts deemed not to be impaired.

## Notes to the financial statements (continued)

### 11. Trade and other receivables (continued)

The ageing of receivables was as follows:

<b>Current year</b>	<b>Total</b>	<b>Provided</b>	<b>Net</b>
<b>Trade receivables</b>	<b>£m</b>	<b>for</b>	<b>£m</b>
		<b>£m</b>	
Billings in advance	369.1	-	369.1
Under one month	25.0	(2.5)	22.5
Between one and six months	37.8	(3.6)	34.2
Between six months and one year	26.7	(2.9)	23.8
Between one and two years	40.2	(28.4)	11.8
Between two and three years	29.8	(21.4)	8.4
Over three years	22.6	(19.0)	3.6
	<b>551.2</b>	<b>(77.8)</b>	<b>473.4</b>

<b>Prior year</b>	<b>Total</b>	<b>Provided</b>	<b>Net</b>
<b>Trade receivables</b>	<b>£m</b>	<b>for</b>	<b>£m</b>
		<b>£m</b>	
Billings in advance	364.6	-	364.6
Under one month	29.0	(2.9)	26.1
Between one and six months	38.5	(3.7)	34.8
Between six months and one year	31.0	(3.4)	27.6
Between one and two years	41.4	(28.9)	12.5
Between two and three years	27.0	(21.3)	5.7
Over three years	26.5	(21.6)	4.9
	<b>558.0</b>	<b>(81.8)</b>	<b>476.2</b>

Movements in the provision for impairment of trade receivables are as follows:

	<b>Group</b>	
	<b>2021</b>	<b>2020</b>
	<b>£m</b>	<b>£m</b>
At 1 April	81.8	78.7
Charge to income statement	32.4	24.4
Receivables written off during the year as uncollectable	(36.4)	(21.3)
At 31 March	<b>77.8</b>	<b>81.8</b>

During the year the Group has written off £36.4m of debt which had been provided for in full (2020: £21.3m).

The total charge to the income statement of £33.4m (2020: £25.2m) includes the estimated impact on collections of the COVID-19 pandemic and the bad debt element of collection charges under arrangements with third parties who collect debt on the Group's behalf. For the year ended 31 March 2021, the impact of the pandemic on the bad debt charge has been disclosed separately as part of the exceptional item (see note 3).

	<b>Group</b>	
	<b>2021</b>	<b>2020</b>
	<b>£m</b>	<b>£m</b>
Core bad debt charge	19.9	20.4
COVID-19 impact	12.5	4.0
Third party	1.0	0.8
<b>Total</b>	<b>33.4</b>	<b>25.2</b>

The maximum exposure to credit risk at the reporting date is the carrying value of each class of receivable mentioned above.

The creation and release of provision for impaired receivables have been included in operational expenditure, with the exception of the COVID-19-related element which in the current year has been disclosed as an exceptional item owing to its size and nature.

The risk of impairment of other classes of trade and other receivables is very low. All trade and other receivables are denominated in sterling.

## Notes to the financial statements (continued)

### 11. Trade and other receivables (continued)

The tables below illustrate the impact of applying the “expected loss” model in accordance with IFRS 9. Debt provisioning is based on historical experience as adjusted for certain forward-looking factors, including the impact of charging orders which improve the underlying collectability of debt. The Group holds around 7,000 charging orders as collateral against £12m of debt (2020: 7,000 orders against £12m of debt).

Current year	Historical	Forward-	Adjustment	Historical	Forward-	Total
	default rates	looking	total	impairment	looking	impairment
	%	adjustment	%	£m	£m	£m
Billed in advance	-	-	-	-	-	-
< 1 month	9.0%	1.0%	10.0%	2.3	0.2	2.5
1 > 6 months	8.4%	0.8%	9.2%	3.2	0.3	3.5
6 months > 1 year	10.1%	0.8%	10.9%	2.7	0.2	2.9
1 > 2 years	76.0%	(5.3%)	70.7%	30.5	(2.1)	28.4
2 > 3 years	78.0%	(6.2%)	71.8%	23.3	(1.8)	21.5
> 3 years	78.1%	6.0%	84.1%	17.7	1.3	19.0
				<b>79.7</b>	<b>(1.9)</b>	<b>77.8</b>

  

Prior year	Historical	Forward-	Adjustment	Historical	Forward-	Total
	default rates	looking	total	impairment	looking	impairment
	%	adjustment	%	£m	£m	£m
Billed in advance	-	-	-	-	-	-
< 1 month	9.2%	0.8%	10.0%	2.6	0.2	2.8
1 > 6 months	8.6%	0.9%	9.5%	3.3	0.4	3.7
6 months > 1 year	10.1%	0.7%	10.8%	3.2	0.2	3.4
1 > 2 years	76.4%	(6.6%)	69.8%	31.6	(2.7)	28.9
2 > 3 years	86.9%	(7.9%)	79.0%	23.5	(2.1)	21.4
> 3 years	77.7%	3.9%	81.6%	20.6	1.0	21.6
				<b>84.8</b>	<b>(3.0)</b>	<b>81.8</b>

The Group’s trade receivables provisioning methodology incorporates an “expected loss” model which also determines an appropriate level of losses against which to provide in the measured income accrual. The impact on the accrual as at 31 March 2021 is £5.4m, being a revenue provision of 7% against a gross balance of £77.1m (2020: £5.4m and 7%).

The parent company’s loan to group undertakings of £3.3m (2020: £3.3m) represents loans to wholly-owned subsidiaries Glas Cymru (Securities) Limited of £1.3m (2020: £1.3m) and Dŵr Cymru Cyfyngedig of £2.0m (2020: £2.0m). Interest on these loans has been waived.

### 12. Cash and cash equivalents

	Group	
	2021	2020
	£m	£m
Cash at bank and in hand	86.1	0.1
Short-term deposits	123.0	658.6
	<b>209.1</b>	<b>658.7</b>

The effective interest rate on short-term deposits as at 31 March 2021 was 0.1% (2020: 0.7%) and these deposits had an average maturity of 12 days (2020: 23 days). All cash and cash equivalents were held in sterling.

## Notes to the financial statements (continued)

### 13. Trade and other payables

	Group	
	2021 £m	2020 £m
<b>Current</b>		
Trade payables	46.0	51.8
Capital payables	18.0	46.3
Other taxation and social security	3.5	5.7
Accruals and deferred income	472.5	458.0
	<b>540.0</b>	<b>561.8</b>
	2021 £m	2020 £m
<b>Non-current</b>		
Deferred income	401.9	314.4

### 14. Other financial liabilities – borrowings

	Group	
	2021 £m	2020 £m
<b>Current</b>		
Overdrawn funds	-	2.2
Interest accruals	8.3	11.1
Bonds	(0.6)	325.4
Term loans	53.4	48.7
Lease liabilities	17.2	27.6
	<b>78.3</b>	<b>415.0</b>
	2021 £m	2020 £m
<b>Non-current</b>		
Interest accruals	39.9	37.4
Bonds	2,620.9	2,599.0
Term loans	621.8	673.2
Lease liabilities	394.0	396.5
	<b>3,676.6</b>	<b>3,706.1</b>

The parent company has no borrowings.

A security package was granted by DCC, as part of the Group's bond programme for the benefit of holders of senior bonds, finance lessors and other senior financial creditors.

The obligations of DCC are guaranteed by the Group, Glas Cymru (Securities) Cyfyngedig and Dŵr Cymru (Holdings) Limited. The main elements of the security package are:

- i) a first fixed and floating security over all of DCC's assets and undertaking, to the extent permitted by the Water Industry Act, other applicable law and its licence; and
- ii) a fixed and floating security given by the guarantors referred to above which are accrued on each of these companies' assets including, in the case of Dŵr Cymru (Holdings) Limited, a first fixed charge over its shares in DCC.

The Group's Class A Bonds of £1,052m (2020: £1,042m) benefit from a guarantee from Assured Guaranty (Europe) Plc. Assured Guaranty's credit rating is graded as A2/AA by Moody's and Standard & Poor's respectively and is not rated by Fitch. The credit rating of the Class A bonds has therefore defaulted to the higher of the financial guarantor's rating or the underlying rating of these bonds, of A3/A-/A from Moody's, Standard & Poor's and Fitch respectively. The underlying rating (A3/A-/A) reflects the standalone credit quality of these bonds without the benefit of the guarantee from Assured Guaranty and is the same as the credit ratings of the Group's Class B bonds of £1,378m (2020: £1,691m).

As at 31 March 2020, the Group issued £200m of Junior (Class C) bonds. Since 31 March 2020, the Group has issued a further £300m of Junior (Class C) debt. Formal issuance and drawdown took place on 9 April 2021. The Class C bonds are rated Baa2/BBB/BBB+ by Moody's, Standard & Poor's and Fitch respectively (note 28).

## Notes to the financial statements (continued)

### 15. Derivative financial instruments

Derivative financial instruments are held for economic hedging purposes. However, they do not qualify as accounting hedges and movements in their fair value are taken to the Income Statement (see note 4b).

#### Group - 2021

	Fair values	
	Assets £m	Liabilities £m
<b>Current</b>		
Index-linked swaps	28.1	(28.6)
Interest rate swaps	-	(10.6)
Power hedging swaps	4.5	-
	<b>32.6</b>	<b>(39.2)</b>
<b>Non-current</b>		
Index-linked swaps	-	(403.9)
Interest rate swaps	-	(74.1)
Power hedging swaps	3.3	-
	<b>3.3</b>	<b>(478.0)</b>
<b>Total</b>	<b>35.9</b>	<b>(517.2)</b>

#### Group - 2020

	Fair values	
	Assets £m	Liabilities £m
<b>Current</b>		
Index-linked swaps	36.1	(16.9)
Interest rate swaps	-	(10.0)
Power hedging swaps	0.1	(1.4)
	<b>36.2</b>	<b>(28.3)</b>
<b>Non-current</b>		
Index-linked swaps	-	(392.3)
Interest rate swaps	-	(89.7)
Power hedging swaps	0.2	(0.7)
	<b>0.2</b>	<b>(482.7)</b>
<b>Total</b>	<b>36.4</b>	<b>(511.0)</b>

The Group has reviewed all contracts for embedded derivatives that are required to be accounted for separately if they do not meet certain requirements set out in IFRS 9; the Group has no such embedded derivatives.

The parent company has no derivative financial instruments or embedded derivatives.

#### Interest rate swaps

At 31 March 2021 an interest rate swap fixes the interest rate on £192m (2020: £192m) of floating liabilities held by the Group. The maturity date of the swap is 31 March 2031 and the fixed interest rate is 5.67% per annum, payable quarterly.

#### Index-linked swaps

##### Lease swaps

The index-linked swaps have the effect of index-linking the interest rate on £379m (2020: £380m) of lease liabilities by reference to the Retail Prices Index (RPI).

The notional amount of index-linked swaps allocated to leases as at 31 March 2021 was £391m (2020: £394m), representing the average balance on the leases subject to floating interest rates for the year to 31 March 2021. The notional amount amortises over the life of the swaps to match the average floating rate balances of the leases.

## Notes to the financial statements (continued)

### 15. Derivative financial instruments (continued)

The principal terms of the index linked swaps are as follows:

Notional amount	£391m amortising (2020: £394m amortising)
Average swap maturity	15 years (2020: 16 years)
Average interest rate	1.42% fixed plus RPI (2020: 1.43% fixed plus RPI)

#### **Bond swap**

The index-linked swap have the effect of index-linking the interest rate on £950m of fixed rate bonds by reference to the RPI (2020: £950m)

The principal terms are as follows:

Indexed notional amount	£1,014m (2020: £1,001m)
Swap maturity	18 years (2020: 19 years)
Interest rate	0.15% indexed by RPI (2020 0.14% indexed)

### 16. Financial risk management

The policies of the Group in respect of financial risk management are included in the accounting policies note on page 33. The numerical financial instrument disclosures as required by IFRS 7 are set out below.

#### **a) Interest rate risk**

The effective interest rates at the balance sheet dates were as follows:

	2021	2020
<b>Assets:</b>		
Cash and cash equivalents	0.1%	0.7%
<b>Liabilities:</b>		
Bonds	3.2%	3.6%
Term loans	0.5%	1.0%
Other unsecured loans	2.9%	3.2%
Lease obligations	1.2%	0.7%

Trade and other receivables and payables are non interest-bearing.

The effective interest rates ignore the effect of the interest rate and index-linked swaps set out in note 15. They also exclude the indexation charge applicable to the index-linked bonds.

#### **b) Liquidity risk**

Group - 2021	Within 1	1 - 2 years	2 - 5 years	> 5 years	Total
	year				
	£m	£m	£m	£m	£m
<b>Assets:</b>					
Cash and cash equivalents	209.1	-	-	-	209.1
Trade and other receivables	569.7	-	-	-	569.7
	<b>778.8</b>	-	-	-	<b>778.8</b>
<b>Liabilities:</b>					
Bonds	0.7	0.8	422.8	2,209.0	2,633.3
Term loans	53.4	52.6	223.1	346.0	675.1
Other unsecured loans	-	-	0.1	0.1	0.2
Lease liabilities	17.2	1.0	233.6	159.4	411.2
Trade and other payables	540.0	9.1	27.3	365.5	941.9
Future interest payable	107.5	108.3	323.4	652.5	1,191.7
	<b>718.8</b>	<b>171.8</b>	<b>1,230.3</b>	<b>3,732.5</b>	<b>5,853.4</b>

## Notes to the financial statements (continued)

### 16. Financial risk management (continued)

#### Liquidity risk

Group – 2020	Within 1 year £m	1 - 2 years £m	2 - 5 years £m	> 5 years £m	Total £m
<b>Assets:</b>					
Cash and cash equivalents	658.7	-	-	-	658.7
Trade and other receivables	575.2	-	-	-	575.2
	<u>1,233.9</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,233.9</u>
<b>Liabilities:</b>					
Cash and cash equivalents	2.2	-	-	-	2.2
Bonds	325.7	0.7	2.3	2,609.1	2,937.8
Term loans	48.6	53.3	191.5	428.2	721.6
Other unsecured loans	0.1	-	-	0.2	0.3
Finance lease liabilities	27.6	16.9	203.6	176.0	424.1
Trade and other payables	561.8	7.2	21.6	285.6	876.2
Future interest payable	136.5	114.7	343.4	782.2	1,376.8
	<u>1,102.5</u>	<u>192.8</u>	<u>762.4</u>	<u>4,281.3</u>	<u>6,339.0</u>

The minimum lease payments fall due as follows:

	2021 £m	2020 £m
<b>Gross lease liabilities</b>		
Within one year	34.6	37.0
Between two and five years	252.3	54.0
After five years	169.4	421.6
	<u>456.3</u>	<u>512.6</u>
Future interest	(45.1)	(88.5)
<b>Net lease liabilities</b>	<u>411.2</u>	<u>424.1</u>
Net lease liabilities are repayable as follows:		
<b>Within one year (note 14)</b>	<u>17.2</u>	<u>27.6</u>
Between two and five years	234.6	220.5
After five years	159.4	176.0
<b>Total over one year (note 14)</b>	<u>394.0</u>	<u>396.5</u>

#### c) Fair values

The fair values of the Group's derivative financial instruments are set out in note 15. The following table summarises the fair value and book value of the Group's bonds.

	2021		2020	
	Book value £m	Fair value £m	Book value £m	Fair value £m
Bonds (note 14)	<u>2,633.3</u>	<u>3,426.4</u>	2,937.8	3,742.0

The fair values of all other financial instruments are equal to the book values.

## Notes to the financial statements (continued)

### 16. Financial risk management (continued)

#### d) Borrowing facilities

As at 31 March 2021, the Group had available undrawn committed borrowing facilities of £200m expiring as set out below, in respect of which all conditions precedent had been met (2020: £170m).

	2021 £m	2020 £m
Expiring in less than one year:		
- revolving credit facilities	-	170
Expiring in more than one year:		
- revolving credit facilities	200	-
	<b>200</b>	<b>170</b>

During the year the Group renewed all four of its revolving credit facilities and increased three of these by £10m each, such that available commitment is now £200m (2020: £170m). The facilities are all available for two years with a one year extension option. There is also a £10m overdraft facility renewable on an annual basis.

As at 31 March 2021 there was also a special liquidity facility of £135m (2020: £135m); this is required in order to meet certain interest and other obligations that may not be funded through operating cash flow in the event of a standstill being declared by the security trustee, following an event of default under the Group's debt financing covenants. A standstill would arise in the event that Dŵr Cymru Cyfyngedig defaults on its debt financing covenants. The facility is a five-year evergreen facility provided by an insurer.

All of the above facilities are at floating rates of interest.

#### e) Capital risk management

##### Gearing ratios (Glas Cymru Holdings Cyfyngedig group)

	2021 £m	2020 £m
Total borrowings	(3,755)	(4,119)
Less: cash and cash equivalents	209	667
Net debt	<b>(3,546)</b>	<b>(3,452)</b>
Regulatory capital value (RCV)	<b>6,010</b>	<b>5,906</b>
Total capital	<b>2,464</b>	<b>2,454</b>
Less: unamortised bond costs and swap indexation	(77)	(64)
Total capital per bond covenants	<b>2,387</b>	<b>2,390</b>
Gearing ratio	<b>60%</b>	<b>60%</b>

As set out on page 34, the Group monitors its capital structure based on a regulatory gearing ratio which compares its net debt with the Ofwat-determined RCV.

Under the Common Terms Agreement regulatory gearing is calculated as the level of net debt in the whole business securitisation relative to the regulatory capital value.



## Notes to the financial statements (continued)

### 17. Provisions

Group - 2021	Restructuring provision	Uninsured loss provision	Other provisions	Total
	£m	£m	£m	£m
At 1 April 2020	10.0	3.8	0.5	14.3
Charged to Income Statement	4.1	2.5	-	6.6
Utilised in year	(3.6)	(1.7)	-	(5.3)
<b>At 31 March 2021</b>	<b>10.5</b>	<b>4.6</b>	<b>0.5</b>	<b>15.6</b>

Split as:

Amounts to be utilised within one year	6.8	1.4	0.3	8.5
Amounts to be utilised after more than one year	3.7	3.2	0.2	7.1
<b>At 31 March 2021</b>	<b>10.5</b>	<b>4.6</b>	<b>0.5</b>	<b>15.6</b>

Group - 2020	Restructuring provision	Uninsured loss provision	Other provisions	Total
	£m	£m	£m	£m
At 1 April 2019	1.6	3.5	1.5	6.6
Charged to Income Statement	10.0	1.8	-	11.8
Utilised in year	(1.6)	(1.5)	(1.0)	(4.1)
<b>At 31 March 2020</b>	<b>10.0</b>	<b>3.8</b>	<b>0.5</b>	<b>14.3</b>

Split as:

Amounts to be utilised within one year	5.0	1.3	0.1	6.4
Amounts to be utilised after more than one year	5.0	2.5	0.4	7.9
<b>At 31 March 2020</b>	<b>10.0</b>	<b>3.8</b>	<b>0.5</b>	<b>14.3</b>

The parent company had no provisions at 31 March 2021 (2020: none).

#### Restructuring provision

This provides for the cost of a reduction in the headcount by around 200 over the period 2020 to 2025 (see details of exceptional item in note 3). For the year to 31 March 2021, an additional restructuring charge of £4.1m was incurred as a result of reassessing the level of provision necessary.

#### Uninsured loss provision

This provision is in respect of uninsured losses and instances where insurance does not cover a deductible amount. The utilisation period of these liabilities is uncertain due to the nature of claims, but is estimated to be within five years.

#### Other provisions

Other provisions are made for certain other obligations which arise during the ordinary course of the Group's business.

## Notes to the financial statements (continued)

### 18. Net cash inflow from operating activities

#### a) Cash generated from operations

Reconciliation of operating profit to cash generated from operations:

	Group	
	2021	2020
	£m	£m
Operating profit	7.6	31.1
Adjustments for:		
- Depreciation and amortisation	333.1	315.1
- Changes in working capital:		
Decrease/(increase) in trade and other receivables	4.3	(1.6)
(Increase)/decrease in inventories	(0.3)	0.1
Increase in trade and other payables	3.3	0.5
Pension contributions above service cost	-	(11.9)
(Decrease)/increase in provisions	(0.5)	7.7
	<u>6.8</u>	<u>(5.2)</u>
<b>Cash generated from operations</b>	<b><u>347.5</u></b>	<b><u>341.0</u></b>

#### b) Interest paid

	Group	
	2021	2020
	£m	£m
Interest payable per income statement	126.1	164.4
Less non-cash items:		
- Indexation on index-linked bonds	(21.2)	(36.3)
- Indexation on index-linked debt	(3.2)	(6.1)
- Amortisation of bond issue costs	(1.3)	(0.6)
- Interest charge on pension scheme liabilities	(2.0)	(2.2)
- Amortisation of bond issue premium	0.8	0.7
- Effect of capitalisation under IAS 23	11.3	14.4
- Increase in accruals	0.2	2.5
	<u>(15.4)</u>	<u>(27.6)</u>
<b>Interest paid</b>	<b><u>110.7</u></b>	<b><u>136.8</u></b>

## Notes to the financial statements (continued)

### 19. Analysis and reconciliation of net debt

Net debt is defined as the value of cash and cash equivalents less net accrued interest and total borrowings.

a) Net debt at the balance sheet date may be analysed as:

	Group	
	2021	2020
	£m	£m
Cash and cash equivalents	209.1	658.7
Debt due after one year	(3,242.7)	(3,272.2)
Debt due within one year	(52.8)	(376.3)
Lease liabilities	(411.2)	(424.1)
Accrued interest	(48.2)	(48.5)
	<b>(3,754.9)</b>	<b>(4,121.1)</b>
<b>Net debt</b>	<b>(3,545.8)</b>	<b>(3,462.4)</b>

b) The movement in net debt during the year may be summarised as:

	Group	
	2021	2020
	£m	£m
Net debt at start of year	(3,462.4)	(3,275.6)
Movement in net cash	(449.6)	165.6
Movement in debt arising from cash flows	390.3	(311.4)
<b>Movement in net debt arising from cash flows</b>	<b>(59.3)</b>	<b>(145.8)</b>
Movement in accrued interest	0.3	2.5
Indexation of index-linked debt	(24.4)	(42.4)
Other non-cash movements	-	(1.1)
Movement in net debt during the year	(83.4)	(186.8)
<b>Net debt at end of year</b>	<b>(3,545.8)</b>	<b>(3,462.4)</b>

## Notes to the financial statements (continued)

### 20. Employees and Directors

#### Staff costs for the Group during the year

##### a) Directors' emoluments

The aggregate emoluments of the Directors of Dŵr Cymru Cyfyngedig for their services as Directors of the Company are set out below:

	2021 £000	2020 £000
Salary (including benefits in kind)	1,292	1,587
Fees	<u>566</u>	<u>619</u>
	<u>1,858</u>	<u>2,206</u>
Long-term incentive plan	<u>111</u>	<u>114</u>
<b>Highest paid Director: P Perry (2020: C Jones)</b>		
Aggregate emoluments <sup>1</sup>	<u>495</u>	<u>619</u>
Accrued pension under defined benefit scheme	305	7
Long-term incentive plan	75	60

<sup>1</sup> excluding pension accrual and long-term incentive plan

Retirement benefits are accruing for one Director (2020: two) under defined benefit schemes. None of the Directors are a member of the defined contribution scheme (2020: none).

Remuneration payable to the Executive Directors in respect of the financial year ended 31 March 2021 was as follows:

- During the period for May, June and July 2020, the Board requested their salaries be reduced by 20%, with the value of this being added to the Group's Community Fund. This reduction did not impact their other elements of remuneration. This fee reduction was taken in the year for all directors except one, with the fee reduction of £3,100 taking place retrospectively from June 2021.
- Base salaries were increased by 2% for the Executive Directors in April 2020. This was the same as the pay award for the rest of the workforce, which had been agreed with our recognised Trade Unions.
- Under the AVPS, up to 100% of salary can be earned in any year (maximum 20% of salary for each element). For 2020-21, awards have been made equivalent to: 11.1% of base salary for performance against the Customer element, 24.3% against Operational Performance, 10.3% against the Strategic Annual Focus element. This gives a total award for AVPS of 45.7% of base salary. This compares with total awards of between 54.9% and 59.9% in 2019-20.
- Under the LTVPS, the overall maximum that can be awarded in the AMP7 five year regulatory period is 300% of salary (i.e. 60% per annum), except in the case of the Chief Executive Officer, where the maximum award is 100% per annum from 2019-20. LTVPS awards for AMP7 were based on Totex performance and Performance Development measures (made up of continuous service measures and investment programme measures).
- For the Totex element of LTVPS targets, an award of 46.2% of salary has been awarded for this objective. Totex performance has been adjusted by the Committee to exclude £33.5m of exceptional costs related to the COVID-19 pandemic which were not anticipated when the original targets were set.
- For the Performance Development element of the scheme measured for the year to 31 March 2021, a payment of 0% of salary has been awarded.
- This gives a total award for LTVPS of 23.1% of base salary.
- The Committee also concluded that the Chair of the Board's fee should also be subject to the 15% discount against the benchmark, and this was implemented in both 2020-21 and 2019-20. The Chair of the Board and the Executive Directors reviewed the fees paid to Non-Executive Directors and concluded it was appropriate to freeze the Non-Executive Director fee.

(Further details are provided in the 2021 Remuneration Report which forms part of GCHC's 2021 annual report and consolidated financial statements.)

## Notes to the financial statements (continued)

### 20. Employees and Directors (continued)

#### b) Staff costs during the year

	2021	2020
	£m	£m
Wages and salaries	140.1	138.5
Social security costs	15.1	14.1
Other pension costs	13.7	13.2
	<u>168.9</u>	<u>165.8</u>

Of the above, £74.6m (2020: £69.6m) has been capitalised, being the investment cost of employees' work on the capital programme. Exceptional items amounting to £0.8m have been disclosed separately on the face of the income statement (note 3).

Average monthly number of people (including executive directors) employed by the Group	2021	2020
	Number	Number
Regulated water and sewerage activities	<u>3,602</u>	<u>3,525</u>

The Board delegates certain of the Group's Strategic and operational activities to the Dŵr Cymru Executive, a senior management group comprising both executive Directors and employees. Total remuneration of these key personnel was as follows:

	2021	2020
	£m	£m
Executive directors	1.3	1.7
Other key personnel	3.2	2.1
	<u>4.5</u>	<u>3.8</u>

### 21. Pension commitments

The Group operates a funded defined benefit pension scheme for current employees (based on final pensionable salary and pensionable service), the DCWW Pension Scheme. The assets of the scheme are held in a separate trustee-administered fund. The Welsh Water Pension Scheme was closed to new members from 31 December 2005 and closed to the majority of sections of the scheme to future accrual from 1 April 2017. A new defined contribution scheme, the Dŵr Cymru Defined Contribution Scheme, was introduced from 1 January 2006.

#### EFRBS

During 2011, the Group put arrangements in place via an Employer-Financed Retirement Benefit Scheme (EFRBS) for four 'capped' Executive Members of the scheme. The accrual of benefits under this agreement is conditional on remaining a member of the DCWW Pension Scheme. At 31 March 2021, there were two Executive Members with entitlements under this arrangement, one of whom has commenced the receipt of his benefits.

#### Risks

Through the Scheme, the Group is exposed to numerous risks, the most significant of which are detailed below:

- Asset volatility:

Scheme liabilities are calculated using discount rates set with reference to bond yields (although discount rate methodology differs for accounting and funding purposes). If Scheme assets deliver a return which is lower than the discount rate, this will create or increase the Scheme deficit (all other things being equal). The Scheme holds various return seeking assets which are expected to outperform bonds in the long-term, albeit at the risk of short-term volatility.

- Movement in bond yields:

A decrease in corporate bond yields will increase the Scheme liabilities, although this will be partially offset by an increase in the value of the Scheme's bond holdings.

- Inflation risk:

As a large majority of the members' benefits are linked to inflation (subject to maximum annual caps), a high level of inflation will result in an increase of benefits attributable to the members, which will in turn increase the Scheme's liabilities.

## Notes to the financial statements (continued)

### 21. Pension commitments (continued)

- Life expectancy

The Scheme's obligations are to provide members with benefits for the remainder of their lives, so an increase in life expectancy will result in the Scheme paying members' benefits over a longer period, which will in turn increase the Scheme's liabilities.

#### Defined benefit scheme

A full actuarial valuation of the scheme was undertaken as at 31 March 2019 by Joanne Eynon of Quantum Advisory, an independent, professionally qualified actuary, using the projected unit method. This valuation has been updated as at 31 March 2021 and the principal assumptions made by the actuaries were:

	2021	2020
Discount rate	2.0%	2.4%
RPI Inflation assumption	3.0%	2.6%
Rate of increase in pensionable salaries	3.0%	2.6%
Rate of increase in pensions in payment	2.9%	2.6%
Post retirement mortality (life expectancy):		
- Current pensioners aged 65 - males	86.7 years	86.7 years
- Current pensioners aged 65 - females	89.0 years	88.9 years
- Future pensioners aged 65 (currently aged 45) - males	87.8 years	87.7 years
- Future pensioners aged 65 (currently aged 45) - females	90.2 years	90.1 years

The mortality assumptions are the S3PxA base tables with future improvements in line with the CM1 2018 projection model with a long-term trend rate of 1% p.a.

A change in accounting estimate this year pertains to the inflation risk premium (IRP) which has been set at 0.6%, compared with 0.4% in the prior year. The impact of the change in the IRP applied represents multiple significant areas of judgment, with the change expected to have an impact of reducing the obligation by circa £19m.

Changes in the defined benefit obligation are as follows:

	2021 £m	2020 £m
At 1 April	470.3	488.4
Current service cost	0.4	0.3
Interest expense	11.1	12.5
Remeasurement: loss from change in financial assumptions	61.4	(12.7)
Benefits paid	(14.3)	(18.2)
At 31 March	528.9	470.3

Changes in the fair value plan assets are as follows:

	2021 £m	2020 £m
At 1 April	387.6	396.9
Interest income	9.1	10.2
Actuarial (losses)/gains	60.1	(13.5)
Contributions	0.2	12.2
Benefits paid	(14.3)	(18.2)
At 31 March	442.7	387.6

Scheme assets	2021 £m	2020 £m
Cash	16.7	24.9
Equity	326.2	201.5
Absolute return	-	80.3
Property	-	14.5
Private equity	99.8	66.4
	442.7	387.6

## Notes to the financial statements (continued)

### 21. Pension commitments (continued)

With the exception of cash, assets consist of pooled investment funds, which are not quoted on an active market, shown by the category in the table above. Of the total, assets with a fair value of £99.8m are Level 3 financial assets (2020: £147m); these are considered to be the least liquid and hardest to value and are therefore subject to a higher degree of estimation. See also the critical accounting estimates in note 1. Experience gains and losses are differences between the actual events as they have turned out and the assumptions that were made as at the date of the earlier actuarial valuation.

Charges to the income statement and other comprehensive income are as follows:

	2021 £m	2020 £m
<b>Income statement:</b>		
Service costs	0.3	0.3
Interest costs	2.0	2.2
<b>Total charged to the income statement</b>	<b>2.3</b>	<b>2.5</b>
<b>Other comprehensive income:</b>		
Actuarial gain/(loss) on plan assets	60.1	(13.5)
Actuarial (loss)/ gain on defined benefit obligation	(61.4)	12.7
<b>Total charged to the statement of comprehensive income</b>	<b>(1.3)</b>	<b>(0.9)</b>
	2021 £m	2020 £m
Present value of funded obligations	(528.9)	(470.3)
Fair value of plan assets	442.7	387.6
	(86.2)	(82.7)
EFRBS unfunded liability	(3.7)	(4.7)
Net defined benefit liability recognised in the balance sheet	(89.9)	(87.4)

There were no special contributions paid in the year to 31 March 2021 (2020: £11.9m).

	Change in assumption	Movement in Liabilities
Discount rate	0.10%	£9.8m
Price inflation	0.10%	£9.4m
Life expectancy	1 year	£16.8m

The above sensitivity analysis is based on isolated changes in each assumption whilst holding all other assumptions constant. In practice, this is unlikely to occur, and there is likely to be some level of correlation between the movements in different assumptions.

#### Effect on future cash flows

The level of contributions is reviewed at each triennial valuation. The next valuation is due as at 31 March 2022. The Group must reach agreement with the Trustee (based on actuarial advice) within 15 months of the valuation date.

Under the current Schedule of Contributions, no deficit recovery contributions are expected to be paid for the year-ending 31 March 2022. Future service contributions (consisting of amounts payable by members and the Group) will be in the region of £175,000.

The duration of the Scheme's liabilities is approximately 19 years.

#### Regulatory Framework

The Scheme is funded and governed in line with the requirements of the Pensions Regulator. We have not made any allowance for any minimum funding requirements under IFRIC14.

The Scheme operates under Trust law and the corporate trustee (Welsh Water Pension Trustee Limited) is responsible for its day-to-day governance. The Trustee Directors are assisted in the management of the Scheme by experienced professionals such as actuaries, administrators, and investment consultants.

## Notes to the financial statements (continued)

### 21. Pension commitments (continued)

The Trustees have put in place a diversified investment strategy which aims to meet the liabilities of the Scheme. Details are set out in the Statement of Investment Principles. Day-to-day decisions around asset selection have been delegated to BlackRock as their fiduciary investment manager.

### 22. Lessor

	2021	2020
	£m	£m
Operating lease		
Lease income	<u>0.6</u>	<u>-</u>

The Group leases land to Cardiff City County Council, currently the site of a composting facility which is operated by a fellow Group company, Welsh Water Organic Energy Limited ('WWOE'), supplying food and green waste services. The Group has classified this lease as an operating lease because it does not transfer substantially all the risks and rewards incidental to the ownership of the land.

The remaining term of the lease is 11 years, with the total undiscounted current minimum lease receipts amounting to £1.1m, recognised evenly over the remaining term.

In addition the Group leases two waste facility sites at Nash and Eign to an associated company, Welsh Water Organic Waste Limited. The Group has classified this lease as an operating lease because it does not transfer substantially all the risks and rewards incidental to the ownership of the land. The lease for Nash ends on November 2022 with the total undiscounted lease receipt of £94,250. The lease for Eign ends on February 2022 with the total undiscounted lease receipt of £28,250.

### 23. Capital and other financial commitments

The Group's business plan at 31 March 2021 shows net capital expenditure and infrastructure renewals expenditure of £367m (2020: £366m) during the next financial year. While only a portion of this amount has been formally contracted for, the Group is effectively committed to a majority of the total as part of the capital investment programme approved by its regulator, Ofwat.

### 24. Related party transactions

In accordance with the exemption afforded by IAS 24 there is no disclosure in the consolidated financial statements of transactions with entities that are part of the Glas Cymru Anghyfyngedig group.

A wholly-owned subsidiary of the Group, Dŵr Cymru Cyfyngedig, paid costs during the year on behalf of two other members of the larger group headed by the ultimate parent undertaking, Glas Cymru Holdings Cyfyngedig. The outstanding balances are reported as intercompany balances: £10,879 (2020: £281,392) in respect of Cambrian Utilities Limited, £18,901 (2020: £18,901) in respect of Welsh Water Infrastructure Limited, £320,559 (2020: £149,259) in respect of Welsh Water Organic Energy (Cardiff) Limited, £nil in respect of Welsh Water Organic Energy Limited (2020: £9,675) and £147,563 (2020: £nil) in respect of Welsh Water Organic Waste Limited.

### 25. Share capital

	2021	2020
	£	£
Authorised		
10 (2020: 10) ordinary shares of £1 each	<u>10</u>	<u>10</u>
Allotted and fully paid		
10 (2020: 10) ordinary shares of £1 each	<u>10</u>	<u>10</u>

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Group.



## Notes to the financial statements (continued)

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### 26. Elan Valley Trust Fund

In 1984 Dŵr Cymru Authority entered into a conditional sale and purchase agreement with Severn Trent Water Authority for the sale of the aqueduct and associated works by which the bulk supply to Severn Trent reservoirs is conveyed.

The sum of £31.7 million, representing the consideration for the conditional sale, was invested in a trust fund. The principal function of the fund was to provide an income to Dŵr Cymru Authority, whilst preserving the capital value of the fund in real terms. Dŵr Cymru Authority's interest in this fund was vested in Dŵr Cymru Cyfyngedig under the provisions of the Water Act 1989.

The assets of the fund are not included in these financial statements. As at 31 March 2021 the market value of the trust fund was £116m (2020: £119m). Interest receivable includes £3.0m (2020: £3.1m) in respect of distributions from the Elan Valley Trust Fund.

### 27. Immediate and ultimate holding company and controlling party

The immediate and ultimate holding company and controlling party is Glas Cymru Holdings Cyfyngedig, a company registered in England and Wales on 15 December 2015. The largest and smallest groups within which the results of the Company are consolidated are those headed by Glas Cymru Holdings Cyfyngedig and Glas Cymru Anghyfyngedig respectively. Both consolidated financial statements can be obtained from the Company Secretary at Linea, Fortran Road, St Mellons, Cardiff, CF3 0LT.

### 28. Post balance sheet events

Shortly after the financial year end, we successfully issued £300 million in new bonds, which received a positive response from investors.

In addition, on 6 April 2021 the Group entered into swap contracts, which commenced from 9th April, effectively hedging the new debt issuance to the Retail Prices Index (RPI), with RPI indexation accreting on the balance sheet over the term.

The combined effect of these instruments generates a cash interest rate of -1.149% per annum until maturity in 2034 when the RPI-indexed principal (notional £300m x RPI) is repayable in full.