Annual Performance Report 2021/22

Part 1 – Regulatory financial reporting

dwrcymru.com

Index

Foreword

References to “the Company”, “Dŵr Cymru” and “Welsh Water” in the Annual Performance Report Parts 1 to 11 inclusive relate to Dŵr Cymru Cyfyngedig, the sole operating company in the whole business securitisation formed by the Glas Cymru Anghyfyngedig group. References to “Glas Cymru” and “the Group” refer, respectively, to Glas Cymru Holdings Cyfyngedig and the group of which it is the parent.

Statement of Directors’ responsibilities for regulatory information

The following confirmations from our Directors are provided to comply with the requirements of Condition F of our Licence, which requires that accounting statements are prepared in accordance with the Regulatory Accounting Guidelines issued by Ofwat. In particular, Regulatory Accounting Guideline 3.13 issued in March 2022 requires the following statements to be made by our Directors:

- statement on executive pay and performance;
- statement on disclosure of information to auditors;
- statement on dividend policy for the appointed business;
- accounting policy note for price control units;
- a note on revenue recognition;
- a note on capitalisation policy;
- a note on bad debt policy;
- ring fencing certificate;
- tax strategy for the appointed business;
- statement on differences between statutory and RAG definitions;
- statement on long term viability;
- statement explaining out/under performance of the return on regulatory equity (Financial Flows and RORE);
- statement on variance on infrastructure network reinforcement charges; and
- statement on innovation competition.

Statement of Directors' responsibilities for regulatory information (continued)

Statement on Directors' pay and standards of performance

The Company is required under s35A of the Water Industry Act 1991 to provide a statement that the remuneration paid to Executive Directors is linked to standards of performance. This Statement is provided within the Directors' Remuneration Report which can be found within part 4 to 11 of this Annual Performance Report and also in the Group's 2022 Annual Report and Accounts which are available at www.dwrcymru.com.

Statement on disclosure of information to auditors

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

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

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

Statement on dividend policy

Glas Cymru Holdings Cyfyngedig is a company limited by guarantee and does not have share capital, therefore no dividends are paid outside the Group. Our not-for shareholder constitution means that value created in the business is used for the benefit of customers to support social tariffs and to increase investment in assets to provide our essential services.

DŴR CYMRU CYFYNGEDIG – APPOINTED BUSINESS

In March 2016 the Glas Board approved a dividend policy to permit up to £100 million of funds to be distributed within the Group, but outside the regulatory ringfence, to facilitate the funding of commercial projects.

In line with this Policy, intra-Group dividends totalling £30.2 million were paid in 2016-2017. No further intra-Group dividends have been paid since then and none are expected to be paid in the foreseeable future.

In the event that the Board considers such dividends in the future, it has confirmed that it will take into account the extent to which the appointed company is achieving its performance commitments for service delivery to customers and other regulatory obligations, and its other commitments at PR19 in respect of issues to be taken into account in making any decision to pay a dividend. A revised Dividend Policy was approved by the Board in February 2022 and by Ofwat in April 2022. See dwrcymru.com/ dividend policy.

Statement of Directors' responsibilities for regulatory information (continued)

Accounting policy note for price control segments

The financial statements have been drawn up in accordance with RAG2 – Guidance for classification of costs across the price control. An accounting policy note for price control units is disclosed in part 2 of this Annual Performance Report. The tables presented in parts 2 and 4 to 11 inclusive have been prepared in accordance with our Accounting Methodology Statement which can be found at www.dwrcymru.com.

Revenue recognition note

The revenue recognition note is included in the accounting policies note in appendix 5 of parts 4 to 11.

Capitalisation policy note

The capitalisation policy note is included in the accounting policies note in appendix 5 of parts 4 to 11.

Bad debt policy note

The bad debt policy note is included in the accounting policies note in appendix 5 of parts 4 to 11.

Statement on sufficiency of non-financial resources

Under paragraph P14 of Condition P of the Licence, the Company is at all times required to ensure, so far as is reasonably practicable, that if a special administration order were made, the Company would have available to it sufficient rights and assets (other than financial resources) to enable the special administrator to manage the affairs, business and property of the Company.

Going concern

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

In assessing the appropriateness of the going concern basis of accounting the Directors have reviewed the resources available to the Company in the form of cash and committed bank facilities as well as consideration of the Company's capital adequacy.

Statement of Directors' responsibilities for regulatory information (continued)

Going concern (continued)

The Directors have considered the magnitude of potential impacts resulting from uncertain future events or changes in conditions, and the likely effectiveness of mitigating actions that the directors would consider undertaking. The financial plan has been subjected to a number of severe but plausible downside scenarios in order to assess the Company's ability to operate within existing covenants and facilities. These scenarios consider: the potential impacts of increased totex costs, including a significant one-off totex impact arising in the assessment period; low and high inflation environments; elevated levels of bad debt; outcome delivery incentive penalties; and the impact of these factors materialising on a combined basis. Mitigating actions were considered to include: deferral of capital expenditure; a reduction in other discretionary totex spend; early termination of expensive debt; and an extension of revolving credit facilities. The directors have also assessed the potential impacts resulting from the conflict in Ukraine with primary impacts linked to cost volatility associated with energy prices and high inflation, and secondary supply chain and chemical price impacts, none of which pose a significant concern to disclose in relation to the Company's ability to continue as a going concern.

Reduced cash flows would impact on key financial metrics, in particular interest cover ratios. In the extreme downside scenario, gearing and interest covers retain 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.

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

Further details are provided in the long-term viability statement in part 4 to 11 of this Annual Performance Report

Statement of Directors' responsibilities for regulatory information (continued)

Statement on ring fencing certificate

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

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

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

c) the Company has available to it sufficient rights and resources other than financial resources

d) all contracts entered into between the Company and any Associated Company include the necessary provisions and requirements in respect of the standard of service to be supplied to the Company, to ensure that it is able to carry out the Regulated Activities

Statement on sufficiency of financial resources and facilities

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

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

b) the certainty on customer tariffs to March 2023 provided by the 2019 Final Determination of prices by Ofwat, following its acceptance by the Board;

c) the financial strength of the Company and the management and other resources available to the Company as recorded in the financial statements for the year ended 31 March 2022;

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

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

Statement of Directors' responsibilities for regulatory information (continued)

Statement on sufficiency of financial resources and facilities (continued)

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

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

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

i) the Company's employment policies and strategy;

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

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

- provide the Company with all such information as may be necessary to enable the Company to comply with the requirements of the conditions of Appointments, or such additional information as the Director may reasonably require about their activities and the financing of them;
- refrain from any action which would or may cause the Company to breach any of its obligations under the Act or conditions of Appointments;
- ensure that at all times the Board of the Company contains a majority of Non-Executive Directors;
- comply with the Principles of Good Governance outlined in the current UK Corporate Governance Code published by the Financial Reporting Council (or any successor document having a similar purpose or intent) as may from time to time be appended to or approved for the purposes of the Listing Rules of the UK Listing Authority; and
- not make any changes to their respective Memorandum and Articles of Association without the consent of Ofwat.

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

Statement of Directors' responsibilities for regulatory information (continued)

Statement on sufficiency of financial resources and facilities (continued)

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

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

The independent auditors' report can be found on page 12.

Licence Condition P26 – maintaining an investment grade rating

The Directors confirm that throughout 2021/22 the Company, or an associated company as issuer of debt on its behalf, has ensured that it has maintained at all times an issuer credit rating which is an investment grade rating. Dŵr Cymru has amongst the strongest credit ratings in the water sector, reflecting the Company's high level of creditworthiness. The ratings of the Company's Class A debt at 31 March 2022 were AA, A1 and A and those of Class B debt were A-, A3 and A (all with stable outlook) from Standard and Poor, Moody's and Fitch Ratings. (The Class A bonds are guaranteed by Assured Guaranty UK Ltd (AA/A1/not rated) and revert to the higher of the guarantor's ratings or underlying bond rating.

Tax strategy note

As required by RAG 3.13 the tax strategy note is included within this Annual Performance Report, in the accounting policies note in appendix 6 of part 4 to 9, and covers the following key areas:

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

Statement on differences between statutory and RAG definitions

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

Statement of Directors' responsibilities for regulatory information (continued)

Long term viability statement

- Our customers need to know they can rely on the services we provide over the long term. Ensuring the long-term resilience of our business, including financial resilience, is therefore a key area of focus for us. Ofwat expects companies to confirm that they are financially viable over the longer term. Our approach to doing this complies with Provision 31 of the UK Corporate Governance Code.
- As a result of our assessment, the Directors have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period to March 2030. The Long Term Viability Statement is provided at the end of appendix 5 – Additional Regulatory information of parts 4 to 11 of this Annual Performance Report and also in the 2022 Glas Cymru Annual Report and Accounts which are available at www.dwrcymru.com.
- **Statement explaining out/under performance of the return on regulated equity (RORE)**
- The movement in RORE compared to the base RORE set at the last price review is reported in appendix 5 of parts 4 to 11. This identifies and quantifies the key components of the out/under performance as required by RAG 3.13.
- **Statement on variance in infrastructure network reinforcement charges**
- This statement applies to English Companies where revenue from infrastructure charges is aligned to costs over a period of time. These rules do not apply in Wales as the infrastructure charges which are set in accordance with the terms of our licence are not directly aligned to costs; as a result we have not shown any variance in table 2K.
- **Statement on innovation competition**
- Innovation competition spend of £0.123m is not reported as totex and is shown as other operating income The revenue received from customers in 2021/22 for the purposes of innovation competition will not be used for business as usual activities funded through totex. The breakdown of the cash balance between the innovation competition and other appointed activities is shown alongside table 1C.
- **Licence Condition P19 – trading with associate companies at arm's length**
- We have an obligation to ensure that every transaction between the appointed business and any associated company is at arm's length so neither gives to nor receives from the other any cross-subsidy. There were no material transactions with associated companies except for:

Statement of Directors' responsibilities for regulatory information (continued)

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

- the Directors of Dŵr Cymru Cyfyngedig (DCC) are also directors of other companies within the Glas Cymru Group. However, the emoluments of the Directors are paid in full by DCC as their activities are predominantly related to the regulated water and sewerage business. During the year the Directors' emoluments amounted to £1,821,000 (2021: £1,968,528);
- no dividends were paid or received by the Company during the year;
- Welsh Water Infrastructure Limited (WWIL) intercompany balance at 31.03.2022 was £13,350 (2021: £nil) ; this increase relates to recharge of audit fees .This value has been included in the Company's balance sheet as an intercompany balance;
- Welsh Water Organic Energy (Cardiff) Limited (WOEC) intercompany balance at 31.03.2022 was £1,153,352 (2021: £320,559); the net increase of £832,793 relates to costs recharged to WOEC that have not yet been reimbursed. This value has been included in the Company's balance sheet as an intercompany balance;
- Welsh Water Organic Waste Limited (WWOW) intercompany balance at 31.03.2022 was £55,131 (2021: £147,563); the net decrease of £92,432 relates to reimbursement of costs recharged to WWOW. This value has been included in the Company's balance sheet as an intercompany balance;
- £18,901 (2021: £18,901) of Glas Cymru Holdings Cyfyngedig (CGHC) costs remain outstanding. This value has been included in the Company's balance sheet as an intercompany balance;
- £8,481 (2021: £8,481) of Glas Cymru Anghyfyngedig costs remain outstanding. This value has been included in the Company's balance sheet as an intercompany balance;
- Cambrian Utilities Limited intercompany balance at 31.03.2022 was £20,239 (2021: £10,879); this increase relates to recharge of audit fees. This value has been included in the Company's balance sheet as an intercompany balance;
- £1,971,000 (2021: £1,971,000) from Glas Cymru Anghyfyngedig remains outstanding and is included in the Company's balance sheet as an intercompany balance;
- an intercompany loan of £2,812,458 (2021: £2,812,458) from Dŵr Cymru Holdings Limited remains outstanding and is included in the Company's balance sheet as an intercompany loan;
- intercompany interest payable to the Group's financing company Dŵr Cymru (Financing) UK Plc (DCF), totalled £128,361,000 (2021: £107,550,000). As at 31 March 2022 the balance outstanding on the intercompany loan from DCF stood at £3,085,276,653 (2021: £2,744,327,596). All borrowings raised by DCF are immediately on-lent to DCC on an arm's length basis. The intercompany loan agreement is subject to the terms and conditions of the whole business securitisation structure of Glas Cymru Anghyfyngedig and its subsidiaries. DCC, in its capacity as debtor, repays such principal and interest as is due on each borrowing on the due date plus a margin of 0.01%;

Statement of Directors' responsibilities for regulatory information (continued)

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

- recharge of costs paid on behalf of Welsh Water Organic Energy (Cardiff) Limited and Welsh Water Organic Waste Limited of £640,000 and £297,000 respectively;
- services provided by the associated companies to the Company was £724,000 for supply of power from Welsh Water Organic Energy (Cardiff) Limited of which £23,280 remained outstanding at 31.03.2022 ; the contract was at arms length; and
- the Company received rent of £54,250 for two sites at Nash and Eign from Welsh Water Organic Waste Limited; the contract was at arms length.

For a complete list please see the accounting policies note in appendix 5 of parts 4 to 11.

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

Opinion

We have audited the tables within Dŵr Cymru Cyfyngedig's Annual Performance Report for the year ended 31 March 2022 ("the Regulatory Accounting Statements") which comprise:

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

We have not audited the outcome performance tables (3A to 3I) and the additional regulatory information in tables 4A to 4U, 5A to 5B, 6A to 6F, 7A to 7F, 8A to 8D, 9A, 10A to 10E and 11A.

In our opinion, Dwr Cymru Cyfyngedig's Regulatory Accounting Statements have been prepared, in all material respects, in accordance with Condition F of the Regulatory Accounting Guidelines issued by the WSRA (RAG 1.09, RAG 2.08, RAG 2.09, RAG 3.13, RAG 4.10 and RAG 5.07) and the accounting policies (including the Company's published accounting methodology statement(s), as defined in RAG 3.13, appendix 2), set out on page 114.

Basis for opinion

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

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

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

Emphasis of matter – special purpose basis of preparation

We draw attention to the fact that the Regulatory Accounting Statements have been prepared in accordance with a special purpose framework, Condition F of the Regulatory Accounting Guidelines, the accounting policies (including the Company's published accounting methodology statement(s), as defined in RAG 3.13, appendix 2) set out in the statement of accounting policies and under the historical cost convention.

The nature, form and content of the Regulatory Accounting Statements are determined by the WSRA. As a result, Regulatory Accounting Statements may not be suitable for another purpose. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the WSRA's purposes. Accordingly, we make no such assessment. In addition, we are not required to assess whether the methods of cost allocation set out in the accounting methodology statement are appropriate to the circumstances of the Company or whether they meet the requirements of the WSRA.

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

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

Our opinion is not modified in respect of this matter.

Conclusions relating to going concern

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

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

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

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 Company's current and projected cash and facilities (a reverse stress test). Our conclusions based on this work:

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

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

Other information

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

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

We have nothing to report based on these responsibilities.

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

Responsibilities of the Directors for the Annual Performance Report

As explained more fully in the Statement of Directors' Responsibilities set out on page 2, the directors are responsible for the preparation of the Annual Performance Report in accordance with the Regulatory Accounting Guidelines issued by the WSRA and the Company's accounting policies (including the Company's published accounting methodology statement(s), as defined in RAG 3.13, appendix 2).

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

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

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

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

Fraud and breaches of laws and regulations – ability to detect

Identifying and responding to risks of material misstatement due to fraud

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

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

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

- 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 management may be in a position to make inappropriate accounting entries. On this audit we do not believe there is a fraud risk related to revenue recognition because of the regulated nature of the revenues recognized and limited opportunity or incentive for management to manipulate these revenues.

We did not identify any additional fraud risks.

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, borrowings and cash entries made to unrelated accounts.
- Assessing significant accounting estimates for bias.

Identifying and responding to risks of material misstatement related to compliance with laws and regulations

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

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

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

Firstly, the Company is subject to laws and regulations that directly affect the Regulatory Accounting Statements including 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 Regulatory Accounting Statements items.

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

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

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

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

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

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

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

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

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

Use of this report

This report is made, on terms that have been agreed, solely to the Company and the WSRA in order to meet the requirements of Condition F of the Instrument of Appointment granted by the Secretary of State for the Environment to the Company as a water and sewage undertaker under the Water Industry Act 1991 ("Condition F"). Our audit work has been undertaken so that we might state to the Company and the WSRA those matters that we have agreed to state to them in our report, in order (a) to assist the Company to meet its obligation under Condition F to procure such a report and (b) to facilitate the carrying out by the WSRA of its regulatory functions, and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the WSRA, for our audit work, for this report or for the opinions we have formed.

Our opinion on the Regulatory Accounting Statements is separate from our opinion on the statutory financial statements of the Company for the year ended 31 March 2022 on which we reported on 1 June 2022, which are prepared for a different purpose. Our audit report in relation to the statutory financial statements of the Company (our "Statutory audit") was made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our Statutory audit work was undertaken so that we might state to the Company's members those matters we are required to state to them in a statutory audit report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume responsibility for any other purpose or to any other person to whom our Statutory audit report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

James Ledward
For and on behalf of KPMG LLP
Chartered Accountants
3 Assembly Square
Britannia Quay
Cardiff
CF10 4AX
7 July 2022

1A – Income statement for the year ended 31 March 2022

	Ref	Statutory £m	Adjustments: RAG differences[1] £m	Adjustments: Non-appointed[2] £m	Adjustments: Total adjustment £m	Total appointed £m
Revenue	2A	**806.966**	(7.602)	6.203	**(13.805)**	**793.161**
Operating costs	2A	**(726.547)**	(9.967)	(7.055)	**(2.912)**	**(729.459)**
Other operating income	2A	**0.559**	(0.133)	-	**(0.133)**	**0.426**
Operating profit	1D, 2A	**80.978**	(17.702)	(0.852)	**(16.850)**	**64.128**
Other income		-	22.073	-	**22.073**	**22.073**
Interest income		**4.105**	-	0.060	**(0.060)**	**4.045**
Interest expense[3]		**(281.025)**	(14.679)	-	**(14.679)**	**(295.704)**
Other interest expense[4]		-	(1.721)	-	**(1.721)**	**(1.721)**
Loss before tax and fair value movements		**(195.942)**	(12.029)	(0.792)	**(11.237)**	**(207.179)**
Fair value gains on financial instruments		**80.374**	-	-	-	**80.374**
Loss before tax		**(115.568)**	(12.029)	(0.792)	**(11.237)**	**(126.805)**
UK corporation tax		**0.088**	-	-	-	**0.088**
Deferred tax		**(34.460)**	8.150	0.146	**8.004**	**(26.456)**
Loss for the year	1B	**(149.940)**	(3.879)	(0.646)	**(3.233)**	**(153.173)**
Dividends		-	-	-	-	-

[1] Differences arising from statutory IFRS and RAG definitions are shown in the table on page 21.

[2] See accounting policies note in appendix 5 of parts 4 to 11 (appointed and non-appointed business) for a description of the Company's non-appointed activities.

[3] Interest expense consists of interest payable on:

	£m
External borrowings	(28.914)
Intra group borrowings	(227.360)
Amortisation of:	
Debt issuance cost	(1.458)
Debt premiums	0.745
Lease liabilities	(37.872)
Other loans	(0.845)
	(295.704)

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

1A – Income statement for the year ended 31 March 2022 (continued)

Tax analysis

		Adjustments			
	Statutory £m	RAG differences[1] £m	Non-appointed[2] £m	**Total adjustments £m**	**Total appointed £m**
Current year	**0.124**	-	-	**-**	**0.124**
Adjustments in respect of prior years	**(0.212)**	-	-	**-**	**(0.212)**
UK Corporation tax	**(0.088)**	-	-	-	**(0.088)**

[1] Differences arising from statutory IFRS and RAG definitions are shown in the table on page 21.

[2] See accounting policies note in parts 4 to 11 (appointed and non-appointed business) for a description of the Company's non-appointed activities.

Analysis of non-appointed revenue

	Non-appointed[2] £m
Imported sludge	-
Tankered waste	1.935
Other non-appointed revenue	4.268
Revenue	**6.203**

1A – Income statement for the year ended 31 March 2022 (continued)

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

	Revenue recognition - measured income accrual adjustment £m	Removal of interest capitalisation and related depreciation £m	Deferred income release moved from depreciation to other income £m	Infrastructure renewal income moved from operating costs to other income £m	New connection income moved from revenue to other income £m	Searches income moved from revenue to other income £m	Pension interest moved from interest expense to other interest £m	Innovation fund accrual removed from operating expenditure £m	Tax charge relating to measured income accrual and capitalisation of interest £m	Total £m
Revenue	(1.5)	-	-	-	(5.2)	(0.9)	-	-	-	(7.6)
Operating costs	-	3.6	(10.2)	(5.8)	-	-	-	2.3	-	(10.1)
Other operating income	-	-	-	-	-	-	-	(0.1)	-	(0.1)
Other income	-	-	10.2	5.8	5.2	0.9	-	-	-	22.1
Interest expense	-	(16.4)	-	-	-	-	1.7	-	-	(14.7)
Other interest expense	-	-	-	-	-	-	(1.7)	-	-	(1.7)
Deferred tax	-	-	-	-	-	-	-	-	8.2	8.2
Loss for the year	(1.5)	(12.8)	-	-	-	-	-	2.2	8.2	(3.9)

1B – Statement of comprehensive income for the year ended 31 March 2022

			Adjustments			
	Ref	**Statutory** **£m**	RAG differences[1] £m	Non-appointed[2] £m	**Total adjustments** **£m**	**Total appointed** **£m**
Loss for the year	1A	**(149.940)**	(3.879)	(0.646)	**(3.233)**	**(153.173)**
Actuarial losses on post-employment plans		**13.218**	**-**	**-**	-	**13.218**
Other comprehensive income[3]		**256.142**	-	-	**-**	**256.142**
Total comprehensive income for the year		**119.420**	**(3.879)**	**(0.646)**	**(3.233)**	**116.187**

[1] Differences in the income for the year arising from statutory IFRS and RAG definitions are shown in the table on page 21.

[2] See accounting policies note in appendix 5 in parts 4 to 11 (appointed and non-appointed business) for a description of the Company's non-appointed activities.

[3] Further details are provided in the statement of changes in equity; in the accounting policies note in appendix 5 in parts 4 to 11.

1C – Statement of financial position as at 31 March 2022

	Ref	Statutory £m	Adjustments: RAG differences[1] £m	Adjustments: Non-appointed[2] £m	Adjustments: Total adjustments £m	Total appointed activities £m
Non-current assets						
Fixed assets	2D	**6,264.057**	(96.538)	-	**(96.538)**	**6,167.519**
Intangible assets		**203.200**	(10.560)	-	**(10.560)**	**192.640**
Investments - loans to group companies		**-**	-	-	**-**	**-**
Investments - other		**-**	-	-	**-**	**-**
Financial instruments		**10.468**	-	-	**-**	**10.468**
Retirement benefit assets		**-**	-	-	**-**	**-**
Total non-current assets		**6,477.725**	(107.098)	-	**(107.098)**	**6,370.627**
Current assets						
Inventories		**4.271**	-	-	**-**	**4.271**
Trade and other receivables		**590.836**	4.043	-	**4.043**	**594.879**
Financial instruments		**31.476**	-	-	**-**	**31.476**
Cash and cash equivalents[4]	1E	**503.717**	-	42.658	**(42.658)**	**461.059**
Total current assets		**1,130.300**	4.043	42.658	**(38.615)**	**1,091.685**
Current liabilities						
Trade and other payables		**(576.096)**	4.903	-	**4.903**	**(571.193)**
Capex creditor		**(38.376)**	-	-	**-**	**(38.376)**
Borrowings[3]		**(83.417)**	10.016	-	**10.016**	**(73.401)**
Financial instruments		**(46.840)**	-	-	**-**	**(46.840)**
Provisions		**(2.800)**	(10.186)	-	**(10.186)**	**(12.986)**
Total current liabilities		**(747.529)**	4.733	-	**4.733**	**(742.796)**
Net current assets		**382.771**	8.776	42.658	**(33.882)**	**348.889**

[1] Differences arising from statutory IFRS and RAG definitions are shown in the table on page 25.

[2] See accounting policies note in appendix 5 of parts 4 to 11 (appointed and non-appointed business) for a description of the Company's non-appointed activities.

[3] A reconciliation between borrowings in statutory accounts and regulatory accounts is shown on page 25.

[4]Cash and cash equivalent value for total appointed activities of £461.059m consists of £5.271m cash balances for innovation competition and £455.788m cash balances for other appointed activities.

1C – Statement of financial position as at 31 March 2022 (continued)

		Adjustments			
	Statutory	RAG differences[1]	Non-appointed[2]	**Total adjustments**	**Total appointed activities**
	£m	£m	£m	**£m**	**£m**
Non-current liabilities					
Trade and other payables	**(447.146)**	407.130	-	**407.130**	**(40.016)**
Borrowings[3]	**(4,145.746)**	40.116	-	**40.116**	**(4,105.630)**
Financial instruments	**(177.187)**	-	-	**-**	**(177.187)**
Retirement benefit obligations	**(80.700)**	-	-	**-**	**(80.700)**
Provisions	**(6.299)**	-	-	**-**	**(6.299)**
Deferred income – grants and contributions	**-**	0.003	-	**0.003**	**0.003**
Deferred income – adopted assets	**-**	(447.249)	-	**(447.249)**	**(447.249)**
Deferred tax	**(697.032)**	26.774	2.343	**24.431**	**(672.601)**
Total non-current liabilities	**(5,554.110)**	26.774	2.343	**24.431**	**(5,529.679)**
Net assets	**1,306.386**	(71.548)	45.001	**(116.549)**	**1,189.837**
Equity					
Called-up share capital	**309.900**	-	-	**-**	**309.900**
Retained earnings and other reserves	**996.486**	(71.548)	45.001	**(116.549)**	**879.937**
Total equity[4]	**1,306.386**	(71.548)	45.001	**(116.549)**	**1,189.837**

[1] Differences arising from statutory IFRS and RAG definitions are shown in the table on page 25.

[2] See accounting policies note in appendix 5 of parts 4 to 11 (appointed and non-appointed business) for a description of the Company's non-appointed activities.

[3] A reconciliation between borrowings in statutory accounts and regulatory accounts is shown on page 25.

[4] A statement of changes in equity has been provided in the accounting policy note in appendix 5 of parts 4 to 11 to enable reconciliation between tables 1B and 1C.

1C – Statement of financial position as at 31 March 2022 (continued)

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

	Revenue recognition - measured income accrual adjustment £m	Accrued interest moved from borrowings to trade payables £m	Deferred income £m	Capitalisation of interest removed £m	Tax charge relating to changes £m	Removal of innovation fund provision £m	Overdraft moved from borrowings to trade payables £m	Total £m
Fixed assets	-	-	-	(96.5)	-	-	-	**(96.5)**
Intangible assets	-	-	-	(10.6)	-	-	-	**(10.6)**
Current assets								
Trade and other receivables	4.0	-	-	-	-	-	-	**4.0**
Current liabilities								
Trade and other payables	-	(7.5)	10.2	-	-	4.7	(2.5)	**4.9**
Borrowings	-	7.5	-	-	-	-	2.5	**10.0**
Provisions	-	-	(10.2)	-	-	-	-	**(10.2)**
Non-current liabilities								
Trade and other payables	-	(40.1)	447.2	-	-	-	-	**407.1**
Borrowings	-	40.1	-	-	-	-	-	**40.1**
Deferred income - adopted assets	-	-	(447.2)	-	-	-	-	**(447.2)**
Deferred tax	-	-	-	-	26.8	-	-	**26.8**
Net assets	**4.0**	**-**	**-**	**(107.1)**	**26.8**	**4.7**	**-**	**71.6**
Equity								
Retained earnings	4.0	-	-	(107.1)	26.8	4.7	-	**(71.6)**
Total equity	**4.0**	**-**	**-**	**(107.1)**	**26.8**	**4.7**	**-**	**(71.6)**

Reconciliation between total borrowings in Statutory Accounts and Regulatory Accounting Statements

	£m
Borrowings per Statutory Financial Statements	**4,229.2**
Bank overdraft reclassified as trade and other payables	(2.5)
Accrued interest reclassified as trade and other payables	(47.6)
Borrowings per Regulatory Accounting Statements	**4,179.0**

1D – Statement of cash flows for the year ended 31 March 2022

Statement of cash flows	Ref	Statutory £m	Adjustments: RAG differences[1] £m	Adjustments: Non-appointed £m	Adjustments: Total adjustments £m	Total appointed £m
Operating profit	**1A**	**80.978**	(17.702)	(0.852)	**(16.850)**	**64.128**
Other income		**-**	11.856	-	**11.856**	**11.856**
Depreciation[2]		**338.043**	(3.639)	-	**(3.639)**	**334.404**
Amortisation – grants and		**(10.217)**	10.217	-	**10.217**	**-**
Pension contributions		**-**	-	-	**-**	**-**
Movement in provisions		**(7.200)**	-	-	**-**	**(7.200)**
Profit on sale of fixed assets		**(0.559)**	-	-	**-**	**(0.559)**
Changes in working capital	**1D**	**27.100**	(0.733)	-	**(0.733)**	**26.367**
Cash generated from operations		**428.145**	(0.001)	(0.852)	**0.851**	**428.996**
Net interest paid		**(113.371)**	-	0.060	**(0.060)**	**(113.431)**
Tax rebate		**2.267**	-	-	**-**	**2.267**
Net cash generated from operating		**317.041**	(0.001)	(0.792)	**0.791**	**317.832**
Investing activities						
Capital expenditure		**(274.377)**	-	-	**-**	**(274.377)**
Grants and contributions		**23.100**	-	-	**-**	**23.100**
Disposal of fixed assets		**0.800**	-	-	**-**	**0.800**
Net cash used in investing		**(250.477)**	-	-	**-**	**(250.477)**
Net cash flow before financing		**66.564**	(0.001)	(0.792)	**0.791**	**67.355**
Cash flows from financing						
Net loans repaid		**228.344**	-	-	**-**	**228.344**
Net cash flow from financing		**228.344**	**-**	**-**	**-**	**228.344**
Decrease in net cash		**294.908**	(0.001)	(0.792)	**0.791**	**295.699**

[1] Differences arising from statutory IFRS and RAG definitions; for further details see table on page 27.

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

Depreciation of:	**£m**
Tangible fixed assets (2D)	297.591
Intangible fixed assets (2O)	36.813
	334.404

1D – Statement of cash flows for the year ended 31 March 2022 (continued)

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

	Revenue recognition: measured income accrual adjustment	Reversal of interest capitalisation	Deferred income	IRE income moved from operating costs to other income	New connections income moved from revenue to other income	Searches income moved from revenue to other income	Removal of innovation fund provision	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Operating profit	(1.5)	3.6	(10.2)	(5.8)	(5.2)	(0.9)	2.2	(17.8)
Other income	-	-	-	5.8	5.2	0.9	-	11.9
Depreciation	-	(3.6)	-	-	-	-	-	(3.6)
Amortisation – grants and contributions	-	-	10.2	-	-	-	-	10.2
Changes in working capital	1.5	-	-	-	-	-	(2.2)	(0.7)
Movement in net cash	-	-	-	-	-	-	-	-

1E – Net debt analysis (appointed activities) as at 31 March 2022

	Interest rate risk profile			
	Fixed rate £m	**Floating rate £m**	**Index-linked £m**	**Total appointed £m**
Borrowings (excluding preference shares)	495.225	215.964	3,478.254	4,189.443
Preference share capital				-
Total borrowings[2]				**4,189.443**
Cash				(53.752)
Short term deposits				(407.307)
Cash and cash equivalents[1]				**(461.059)**
Net debt				**3,728.384**
Gearing				57.712%
Adjusted gearing[1]				57.833%
Full year equivalent nominal interest cost	20.263	5.012	263.548	288.823
Full year equivalent cash interest payment	20.263	5.011	60.729	86.003
Indicative interest rates				
Indicative weighted average nominal interest rate	4.092%	2.321%	7.577%	6.895%
Indicative weighted average cash interest rate	4.092%	2.320%	2.148%	2.053%
Weighted average years to maturity	10.420	0.080	10.620	10.560

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

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

	Net debt £m	**RCV £m**	**Gearing %**
Gearing	3,728	6,460	57.71%
Accrued interest	51		
Overdrawn funds	3		
Loan from parent	(3)		
Non-appointed cash	(43)		
	8		
Adjusted gearing	3,736	6,460	57.83%

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

	Net debt £m
Borrowings per Statement of Financial Position– 1C	4,179.0
Bond issue premium	10.4
Total borrowings per net debt analysis – 1E	4,189.4

1F – Financial Flows

	Year ended 31 March 2022					
	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity
	%	%	%	£m	£m	£m
Regulatory equity	2308.766	2308.766	2255.511			
Return on regulatory equity	3.81%	3.72%	3.81%	87.890	85.862	85.862
Financing						
Impact of movement from notional		0.09%	(0.04%)		2.027	(0.928)
Gearing benefits sharing		0.00%	0.00%		0.000	0.000
Variance in corporation tax		0.18%	0.18%		4.126	4.126
Group relief		0.00%	0.00%		0.000	0.000
Cost of debt		2.90%	2.95%		66.982	66.626
Hedging instruments		(2.02%)	(2.07%)		(46.674)	(46.674)
Return on regulatory equity including financing adjustments	3.81%	4.87%	4.83%	87.890	112.324	109.012
Operational performance						
Totex out/(under) performance		(0.06%)	(0.06%)		(1.390)	(1.390)
ODI out/(under)performance		(0.46%)	(0.47%)		(10.594)	(10.594)
C-Mex out/(under)performance		0.09%	0.09%		2.014	2.014
D-Mex out/(under)performance		(0.02%)	(0.02%)		(0.354)	(0.354)
Retail out/(under)performance		(0.75%)	(0.77%)		(17.355)	(17.355)
Other exceptional items		0.00%	0.00%		0.000	0.000
Operational performance total		(1.20%)	(1.23%)		(27.679)	(27.679)
RoRE	**3.81%**	**3.67%**	**3.61%**	**87.890**	**84.645**	**81.333**
RCV growth	4.86%	4.86%	4.86%	112.206	112.206	109.618
Voluntary sharing arrangements		(0.49%)	(0.50%)		(11.267)	(11.267)
Total shareholder return	8.67%	8.04%	7.97%	200.096	185.584	179.684
Gross dividend	3.00%	0.00%	0.00%	69.263	0.000	0.000
Interest received on intercompany		0.00%	0.00%	0.000	0.000	0.000
Retained value	5.67%	8.04%	7.97%	130.833	185.584	179.684
Totex out/(under) performance		0.22%	0.22%		5.065	5.065
ODI out/(under) performance		0.00%	0.00%		0.019	0.019
Total out/(under) performance		0.22%	0.23%		5.084	5.084

1F – Financial Flows Financial flows for the price review to date

	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity
	%	%	%	£m	£m	£m
Regulatory equity	2292.213	2292.213	2270.973			
Return on regulatory equity	3.79%	3.75%	3.79%	86.875	86.070	86.070
Financing						
Gearing		0.04%	(0.02%)		0.805	(0.498)
Gearing benefits sharing		0.00%	0.00%		0.000	0.000
Variance in corporation tax		0.11%	0.11%		2.508	2.508
Group relief		0.00%	0.00%		0.000	0.000
Cost of debt		1.42%	1.44%		32.711	32.547
Hedging instruments		(1.40%)	(1.43%)		(32.285)	(32.285)
Return on regulatory equity including financing adjustments	3.79%	3.92%	3.89%	86.875	89.809	88.342
Operational performance						
Totex out/(under) performance		(0.37%)	(0.38%)		(8.487)	(8.487)
ODI out/(under)performance		(0.39%)	(0.40%)		(8.940)	(8.940)
C-Mex out/(under)performance		0.04%	0.04%		1.007	1.007
D-Mex out/(under)performance		(0.01%)	(0.01%)		(0.177)	(0.177)
Retail out/(under)performance		(1.02%)	(1.04%)		(23.498)	(23.498)
Other exceptional items		0.00%	0.00%		0.000	0.000
Operational performance total		(1.74%)	(1.78%)		(40.095)	(40.095)
RoRE	**3.79%**	**2.18%**	**2.11%**	**86.875**	**49.714**	**48.247**
RCV growth	2.94%	2.94%	2.94%	67.391	67.391	66.767
Voluntary sharing arrangements		(0.49%)	(0.49%)		(11.233)	(11.233)
Total shareholder return	6.73%	4.63%	4.56%	154.266	105.872	103.780
Gross dividend	3.00%	0.00%	0.00%	68.766	0.000	0.000
Interest received on intercompany		0.00%	0.00%	0.000	0.000	0.000
Retained value	3.73%	4.63%	4.56%	85.500	105.872	103.780
Totex out/(under) performance		0.22%	0.22%		5.065	5.065
ODI out/(under) performance		0.00%	0.00%		0.019	0.019
Total out/(under) performance		0.22%	0.22%		5.084	5.084

1F – Financial flows for the year ended 31 March 2022: commentary

EXECUTIVE SUMMARY: WHAT DOES THE TABLE TELL US?

During the year to 31 March 2022 the returns to equity for Welsh Water totalled 7.97%, after inflation; higher than the 5.67% assumed by Ofwat. The principal factors contributing to this higher return are the impact of inflation increasing RCV growth, our cautious financing structure offset by a slight overall ODI and Retail underperformance against our PR19 Final Determination (FD19) targets.

Gearing and cost of debt

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

Cost and operational performance

Our AMP7 investment programme has been delivered broadly in line with plan during 2021-22, however the costs associated with ensuring that we were able to continue to safely deliver our capital schemes and provide our operational services have resulted in a slight totex underperformance. In addition, we have reported a higher bad debt charge within retail costs than was allowed in FD19, hence retail has also underperformed. Our ODI profile reflects an underperformance during the year contributed by our water quality compliance (CRI) and water supply interruptions.

Dividends

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

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

DETAILED TABLE PREPARATION COMMENTARY

Introduction

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

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

Line 1 – Regulatory equity

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

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

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

Actual regulatory equity			**2020/21**	**2021/22**
Average of the opening and closing RCV (in 2017/18 year average CPIH prices)				
Opening RCV				
Opening RCV per Ofwat's Regulatory Capital Values (Outturn year-end prices)			5,967.031	6,151.973
Outturn CPIH			109.700	116.500
2017/18 year-average CPIH			104.217	104.217
Opening RCV deflated			5,668.770	5,503.332
Closing RCV				
Closing RCV per Ofwat's Regulatory Capital Values (Outturn year-end prices)			6,009.929	6,460.303
Outturn CPIH			109.700	116.500
2017/18 year-average CPIH			104.217	104.217
Closing RCV deflated			5,709.524	5,779.152
Average RCV			**5,689.147**	**5,641.242**
Less: average net debt (using opening and closing values in table 1E, in 2017/18 year average CPIH prices)				
Opening net debt				
Table 1E outturn			3,510.947	3,616.980
Outturn CPIH			108.600	109.700
2017/18 year-average CPIH			104.217	104.217
Table 1E deflated			3,369.238	3,436,.186
Closing net debt				
Table 1E outturn			3,616.980	3,728.384
Outturn CPIH			109.700	116.500
2017/18 year-average CPIH			104.217	104.217
Table 1E deflated			3,436.186	3,335.277
Average net debt			**3,402.712**	**3,385.731**
Actual regulatory equity	**£m**	**3DP**	**2,286.435**	**2,255.511**

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

Line 2 – Return on regulatory equity

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

Line 3 – Gearing

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

Gearing			**2020/21**	**2021/22**
a)				
Notional gearing			60.00%	60.00%
Actual average gearing				
Table 1E Outturn (opening)			59.64%	60.18%
Table 1E Outturn (closing)			60.18%	57.71%
Actual average gearing			59.91%	58.95%
Difference			(0.09%)	(1.05%)
b)				
Allowed return on regulatory equity - base (Line 1 calculation)			3.78%	3.81%
Allowed cost of debt per Ofwat's Financial Flows Data Source model			2.42%	2.24%
			1.36%	1.56%
c)				
a) multiplied by b)			(0.00%)	(0.02%)
d)				
Average RCV (Line 2 calculation)			5,689.147	5,641.242
Gearing	**£m**	**3DP**	**(0.068)**	**(0.928)**

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

Line 4 – Gearing benefits sharing

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

Line 5 – Variance in corporation tax

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

Compared to the PR19 corporation tax allowance, the table reports a positive variance in 2021/22 (i.e. our tax charge was lower than the allowance).

Variance in corporation tax			**2020/21**	**2021/22**
Corporation tax allowance per Ofwat's Financial Flows Data Source model			1.384	1.494
Less: tax payable at the standard rate of corporation tax on the profit/(loss) on appointed activities only, before any fair value adjustments:				
Loss on appointed activities before tax and fair value movements (table 1A)			(130.012)	(207.179)
Standard rate of corporation tax			19.00%	19.00%
Corporation tax credit			(24.702)	(39.364)
Plus or minus: any adjustment for accelerated or deferred capital allowances			25.672	36.719
Plus or minus any amounts for prior year adjustments			(0.453)	(0.212)
Plus or minus other final determination adjustments to accounting profit			-	-
Total corporation tax - outturn prices			0.517	(2.857)
Outturn year-average CPIH			109.108	113.100
2017/18 year-average CPIH			104.217	104.217
Total corporation tax - 2017/18 prices			0.494	(2.632)
Variance in corporation tax	**£m**	**3DP**	**0.890**	**4.126**

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

Line 6 – Group relief

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

Line 7 – Cost of debt

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

Cost of debt	**2020/21**	**2021/22**
a) Net actual interest paid per income statement (table 1A)		
Interest income	(4.650)	(4.045)
Interest expense	148.267	295.704
Net interest	143.617	291.659
b) Divided by average net debt		
Opening net debt		
Table 1E opening outturn	3,510.947	3,616.980
Closing net debt		
Table 1E closing outturn	3,616.980	3,728.384
Average net debt	3,563.964	3,672.682
Divided by b)	4.03%	7.94%
c) Less:		
Movement in CPIH for the reporting period		
CPIH at outturn year-end	109.700	116.500
CPIH at outturn year-end	108.600	109.700
Movement in CPIH for the reporting period	1.01%	6.20%
Use Fisher equation to remove CPIH movement	2.99%	1.63%
Less: allowed cost of debt per Ofwat's Financial Flows Source Data model	2.42%	2.24%
Cost of debt underperformance	**(0.57%)**	**0.60%**

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

Line 7 – Cost of debt (continued)

			Actual/ notional	Actual/ actual
d) Multiplying c) by the average RCV for the period				
Average RCV (Line 2 calculation)			5,641.242	5,641.242
c) multiplied by average RCV			33.847	33.847
e) Multiplying d) by the notional gearing ratio				
Notional/actual gearing ratio			60.00%	58.95%
Cost of debt including impact of hedging instruments			20.308	19.952
Exclude hedging instruments (Line 8 calculation)			46.674	46.674
Cost of debt - unadjusted for hedging instruments			66.982	66.626
Cost of debt	**£m**	**3DP**	**66.982**	**66.626**

Line 8 – Hedging instruments

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

Hedging instruments			**2020/21**	**2021/22**
Floating to RPI swaps			(8.245)	(40.010)
Floating to fixed swap			(10.492)	(10.643)
Total - outturn prices			(18.736)	(50.653)
2020/21 year-average CPIH			109.108	113.100
2017/18 year-average CPIH			104.217	104.217
Total - 2017/18 prices	**£m**	**3DP**	**(17.896)**	**(46.674)**

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

Line 10 – Totex out/(under)performance

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

The values reported on this line are taken from table 4C, Lines 13, 14, 21 and 24 and converted from outturn prices into 2017/18 CPIH prices. Please refer to that table for a full breakdown of the elements of the overall totex overspend.

Totex out/(under)performance			**2020/21**	**2021/22**
Company share of totex out/(under)performance (table 4c Lines 13, 14, 21 and 24)				
Water resources			6.507	11.097
Water network plus			(6.615)	(10.017)
Wastewater network plus			0.034	(4.039)
Bioresources			(16.242)	1.451
Additional Control			-	-
Total - outturn prices			(16.314)	(1.508)
Outturn year-average CPIH			109.108	113.100
2017/18 year-average CPIH			104.217	104.217
Total - 2017/18 prices	**£m**	**3DP**	**(15.583)**	**(1.390)**

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

Line 11 – ODI out/(under) performance

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

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

ODI out/(under)performance			2020/21	2021/22
Table 3A				
Water quality compliance (CRI)			(1.059)	(3.660)
Water supply interruptions			(2.796)	(6.139)
Leakage			0.114	-
Per capita consumption			(1.310)	-
Mains repairs			(0.133)	-
Unplanned outage			-	-
Acceptability of drinking water			(1.107)	(0.891)
Lead pipes replaced			-	-
Business customer satisfaction			(0.125)	(0.125)
Unbilled properties			(0.340)	0.052
Visitors to recreational facilities			(0.530)	0.168
Delivery of our reservoirs enhancement programme			-	-
Delivery of our water network improvement programme			-	-
Delivery of our South Wales Grid water supply resilience scheme			-	-
Delivery of our new visitor centre			-	-
Cwm Taf Water Supply Strategy Scheme (Underperformance)			-	-
Cwm Taf Water Supply Strategy Scheme (Outperformance)			-	-
Total - 2017/18 prices			(7.285)	(10.594)
Total - 2017/18 prices	£m	3DP	(7.285)	(10.594)

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

Line 12 – C-Mex out/(under) performance

This line reports the C-Mex out/(under) performance disclosed in Ofwat’s Final determination of Dŵr Cymru's in-period outcome delivery incentives for 2020-21 document, accounted for on an accrual basis.

Line 13 – D-Mex out/(under) performance

This line reports the D-Mex out/(under) performance disclosed in Ofwat’s Final determination of Dŵr Cymru's in-period outcome delivery incentives for 2020-21 document, accounted for on an accrual basis.

Line 14 – Retail out/(under) performance

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

Retail out/(under)performance			**2020/21**	**2021/22**
Allowed retail operating costs per Ofwat's Financial Flows Data Source model			38.218	37.281
Actual retail operating costs (table 2C, line 21) - outturn prices			71.043	59.293
Outturn year-average CPIH			109.108	113.100
2017/18 year-average CPIH			104.217	104.217
Actual retail operating costs - 2017/18 prices			67.858	54.636
Retail out/(under)performance	**£m**	**3DP**	**(29.640)**	**(17.355)**

Line 15 – Other exceptional items

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

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

Line 18 – RCV growth from inflation

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

RCV growth from inflation			2020/21	2021/22
Data from Ofwat's Regulatory Capital Values				
Total: RCV at 31 March 2020 expressed in March 2020 prices			5,905.241	6,009.951
Total: Indexation roll forward in 2021 update			59.814	292.152
Actual performance adjustment 2015-20	**%**	**2DP**	**1.01%**	**4.86%**

Line 19 – Voluntary sharing arrangements

This line reports the value of any payment associated with voluntary sharing arrangements or similar schemes as set out in Ofwat's published document, PR19 final determination: aligning risk and return technical appendix. In the case of Welsh Water, our voluntary sharing relates to the company's contribution to the cost of providing more affordable social tariffs during 2021/22 (we incur this 'cost' by billing less than Ofwat allows us to and so our total revenues are lower).

Voluntary sharing arrangements			2020/21	2021/22
Company contribution to social tariffs			(11.724)	(12.228)
Outturn year-average CPIH			109.108	113.100
2017/18 year-average CPIH			104.217	104.217
Voluntary sharing arrangements	**£m**	**3DP**	**(11.198)**	**(11.267)**

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

Line 21 – Gross dividend

This line reports the total amount of dividends paid during the period for the appointee business only. The value has been obtained from Ofwat's financial flows, line 37, per the query log instructions.

			2020/21	2021/22
Notional				
Gross dividend	%	2DP	3.00%	3.00%
Actual				
Gross dividend	%	2DP	-%	-%

Line 24 – Totex out/(under) performance

This line reports the end of period performance adjustments from the previous AMP. The value has been obtained from Ofwat's financial flows model.

Line 25 – ODI out/(under) performance

This line reports the end of period performance adjustments from the previous AMP. The value has been obtained from Ofwat's financial flows model.