AFFINITY WATER ACQUISITIONS (INVESTMENTS) LIMITED

ANNUAL REPORT AND FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 MARCH 2016

(Registered Number 08101550)

Affinity Water Acquisitions (Investments) Limited

Contents

Affinity Water Acquisitions (Investments) Limited

Directors and advisers

Directors

Philip Nolan (Chairman)
Mike Bryan
Georgina Dellacha (resigned 30 July 2015)
Alberto Donzelli
Stephen Nelson
Yacine Saidji
Bernd Schumacher
James Wilmott

Company Secretary

Tim Monod

Registered Office

Tamblin Way
Hatfield
Hertfordshire
AL10 9EZ

Independent Auditor

PricewaterhouseCoopers LLP
Abacus House
Castle Park
Cambridge
CB3 0AN

Registered Number

08101550

Affinity Water Acquisitions (Investments) Limited

Chairman's statement

"Affinity Water Acquisitions (Investments) Limited continues to meet the principles contained in Ofwat's publication: Board leadership, transparency and governance – holding company principles, and this annual report explains how the company is meeting these principles."

Chairman
Dr Philip Nolan

I am delighted to present Affinity Water Acquisitions (Investments) Limited's annual report and financial statements for the year ended 31 March 2016.

The vision of the group's principal trading subsidiary (Affinity Water Limited) is to be the UK's leading community focused water company and I am pleased that, in the first year of the 2015-2020 price control period (Asset Management Plan, 'AMP6'), it is making progress on that ambition.

For Affinity Water Limited, community focused means playing an active role in the communities it serves, keeping our customers informed of its activities and giving them a real opportunity to provide thoughts on how it is performing.

Affinity Water Limited's vision captures its response to three overriding imperatives.

Firstly, as a private provider of a public utility, it recognises how important it is that its customers trust the service provided. That is why Affinity Water Limited will continue to invest in building relationships with its customers and the communities it serves.

Secondly, its customers and stakeholders must have confidence that it is operating in a responsible and accountable way. To achieve this, Affinity Water Limited will be publishing its performance on its website so its customers can see exactly how it is performing against the commitments it made for AMP6.

Thirdly, it is vital to Affinity Water Limited that it creates value. It creates value by performing efficiently and by maintaining its local environment, sustaining its local communities and supporting its local economies. By doing this, Affinity Water Limited will achieve value for its investors while delivering the standards of service its customers expect along with the performance commitments included in its Business Plan for AMP6 (its 'Business Plan').

Affinity Water Limited's Customer Scrutiny Group ('CSG'), which consists of members representing household customers, commercial customers and working for special interest groups, holds it to account on how it is performing against its AMP6 commitments.

Affinity Water Limited's CSG is chaired independently and I would like to thank Robin Dahlberg, who served as chair until June 2016, for his valuable contribution over a number of years. I am delighted that Teresa Perchard has succeeded Robin as the new chair. Teresa has 30 years of experience in consumer advocacy, consumer protection and regulatory roles.

Chairman's statement (continued)

Affinity Water Limited recognises that water is essential for economic development. It has an important role to play in supporting its local economies and regional growth whilst working with its customers to reduce water use and to ensure a sustainable supply.

Affinity Water Limited's people play a critical role in creating long-term value. They are its ambassadors, living and working in the communities it serves. They have the local knowledge and understanding to make sure Affinity Water Limited is delivering what its communities expect of it and ensure its contribution to those communities really makes a difference.

Attracting and retaining highly motivated people is central to Affinity Water Limited's ability to deliver an outstanding service for its customers. It is making sure it invests time and resources to make Affinity Water a fantastic place to work and help its people develop.

Looking ahead, Affinity Water Limited is preparing for the biggest transformation of the water industry in England since privatisation.

In April 2017 the competitive retail market for all non-household customers in England is expected to open. New entrants are already signalling their intention to join this market.

For the first time, many of Affinity Water Limited's non-household customers will have the chance to choose their retail service provider. This is a significant change and over the course of 2016/17 Affinity Water Limited will be working to ensure that its non-household customers are aware and informed of the changes that will be taking place.

Further reform of the market in addition to this is expected. The government has asked the water industry economic regulator, Ofwat, to consider the extension of retail competition into the household market and, while this is in the early stages of assessment, it is something of which Affinity Water Limited has to be mindful.

You may have seen that Affinity Water Limited appointed Trevor Didcock and Susan Hooper to the Board as independent non-executive directors in the year following the retirement of Baroness Peta Buscombe and Dr Jeffrey Herbert, who we thank for their significant contributions. Trevor and Susan specifically bring customer, retail and technology transformation skills, which will be highly relevant to the future of Affinity Water Limited, with their appointments completing the building of its strong, experienced and balanced Board.

Affinity Water Limited has set itself ambitious performance commitments for AMP6. Its teams are passionate about delivering against these to ensure a sustainable supply for future generations along with meeting the standards of service it customers expect. Affinity Water Limited's partnership with its communities and customers will help it realise that vision.

Affinity Water Acquisitions (Investments) Limited continues to meet the principles contained in Ofwat's publication: Board leadership, transparency and governance – holding company principles, and this annual report explains how the company is meeting these principles.

Affinity Water Acquisitions (Investments) Limited

Strategic report
for the year ended 31 March 2016

Introduction

The directors present their strategic report on Affinity Water Acquisitions (Investments) Limited for the year ended 31 March 2016.

Affinity Water Acquisitions (Investments) Limited invests in and manages long term interests in the water industry in the United Kingdom.

Affinity Water Limited is the principal trading subsidiary of the group. Affinity Water Limited owns and manages the water assets and network in an area of approximately 4,515km^2 split over three regions, comprising eight water resource zones, in the southeast of England.

Affinity Water Limited supplies high quality drinking water to communities within the southeast of England. It:

- supplies on average 900 million litres of water a day to around 3.5 million people, serving 1.5 million homes and businesses;
- operates 98 water treatment works to ensure that water is of the highest quality;
- distributes water through a network of over 16,500km of mains; and
- carried out over 170,000 tests on water leaving water treatment works, at reservoirs and at customers' taps as part of its regulatory monitoring programme in 2015. In addition, it carried out over 400,000 tests on operational samples. Its overall compliance performance in 2015, as regulated by the Drinking Water Inspectorate ('DWI'), was 99.99 per cent ('%');

Information on Affinity Water Limited's vision and business model are detailed in the strategic report of its own annual report and financial statements for the year ended 31 March 2016.

Performance

The group generated a profit for the financial year of £50,591,000 (2015: £39,203,000). The balance sheets detailed on pages 31 and 32 show shareholders' funds amounting to £227,976,000 (2015: £191,195,000) for the group and £340,777,000 (2015: £340,777,000) for the company at the year-end.

As both the financial and operational results of the group are primarily determined by the results of its principal trading subsidiary, Affinity Water Limited, the operational and financial performance indicators and targets for the group are those of Affinity Water Limited. These performance indicators, and the performance of Affinity Water Limited for 2015/16 against targets set, are provided in detail in the strategic report of its own annual report and financial statements for the year ended 31 March 2016.

Affinity Water Acquisitions (Investments) Limited

Strategic report
for the year ended 31 March 2016 (continued)

Principal risks and uncertainties

The group has an established framework for identifying, evaluating and managing the key risks faced. The main risks of the group are centred on its principal trading subsidiary, Affinity Water Limited, and hence this section focuses on the risks and uncertainties of Affinity Water Limited (referred to as the 'subsidiary' throughout the remainder of this section).

Operational risks are recorded and assessed, including existing management and control processes, and an action plan is prepared, if necessary, for further mitigation. Activities against these plans are monitored on an on-going basis. Operational risks are also ranked by our teams during the year. Based on these rankings the most significant risks are discussed by our senior management and included in the strategic risk register, which is presented to the Board and Audit Committee of Affinity Water Limited. The latter reviews senior management's work on risk management and reports to the Board on the effectiveness of risk management processes.

The following have been identified from this risk management process as potentially having a material adverse effect on the subsidiary's business, financial condition, results of operations and reputation. They are managed as described but are not always wholly within its control and may still result in a material adverse impact. Factors beside those listed could also have a material adverse effect on its business activities.

Key:

↔ Unchanged during the year ↑ Increased during the year ↓ Decreased during the year

Risk	Commentary	Mitigation
Operational		
Injuries and accidents to its people and the public ↔	Failing to manage this risk may result in disruption to operations, reputational damage, criminal fines, civil damages and regulatory penalties.	The subsidiary seeks to operate its business to the OHSAS18001 safety standard and help its employees to take personal responsibility for their own safety and the safety of others. The subsidiary has been implementing a number of initiatives aimed at significantly reducing its accident frequency rate over AMP6. It has already seen a reduction in lost time injuries in 2015/16 compared to the previous year (refer to the strategic report of its own annual report and financial statements for the year ended 31 March 2016 for further information on its safety and health performance in 2015/16).

Affinity Water Acquisitions (Investments) Limited

Strategic report
for the year ended 31 March 2016 (continued)

Principal risks and uncertainties (continued)

<table>
<tr><th>Risk</th><th>Commentary</th><th>Mitigation</th></tr>
<tr><td colspan="3">Operational (continued)</td></tr>
<tr>
<td>Failure to supply wholesome water
↓</td>
<td>The subsidiary is required to maintain a continuous supply of high quality water for its customers.

Interruptions to supply caused by the contamination of water supplies, pollution and flooding events, and water resource restrictions could impact on the health, safety and security of its people or communities, or on its financial position and our reputation.

The risk has decreased in the year, as the subsidiary has reached an agreement with the Secretary of State for Transport, which requires the High Speed 2 promoter to protect its aquifer sources, provide treatment for any interim effects and compensate them for any long-term impacts.

The risk in respect of availability of water remains relatively high for the subsidiary, as it operates in an area of serious water stress. Plans for a third runway at Heathrow Airport and the Western Rail Link to Heathrow may further increase this risk in the future.</td>
<td>The subsidiary manages this risk through:
its Water Resource Management Plan which identifies, over a 25 year period, how it will balance available supplies and required demand with sufficient headroom for unplanned outage;
its water saving programme, including new customer meters, water efficiency and leakage reduction, which allows it to maintain headroom as demand grows through new building developments and its supply base is eroded by committed sustainable abstraction reductions;
its drinking water safety plans which provide a comprehensive risk assessment and risk management approach to its water supply chain, supported by its distribution and operations management strategy. The subsidiary uses these plans to inform its investment and maintenance programmes. To provide assurance of the quality of water it supplies, the subsidiary carries out over 150,000 tests on water leaving water treatment works, at reservoirs and at customers' taps. In addition, it carries out over 400,000 tests on operational samples;
its investment in its trunk main assets to keep the condition stable through targeted renewal. The subsidiary is also implementing trunk main burst mitigation schemes to reduce the number of customers potentially affected by any one incident;
its implementation of improvements to increase resilience through measures such as moving and protecting pipework, protecting electrical and control infrastructure, and increasing connectivity to provide greater flexibility of operation;
its Drought Management Plan which is approved by the Secretary of State; and
its emergency and business continuity plans. Should water supplies be compromised, the subsidiary has plans in place to ensure the provision of essential water supplies at all times. Its contingency plans are audited annually by an independent certifier whose reports are shared with the Secretary of State.</td>
</tr>
</table>

Affinity Water Acquisitions (Investments) Limited

Strategic report
for the year ended 31 March 2016 (continued)

Risk	Commentary	Mitigation
Operational (continued)		
Unavailability of resources (people and materials) ↑	The subsidiary relies on the availability of skilled employees and contractor resources to maintain service levels and implement its investment plans. In the event of these resources being unavailable, it may experience significant disruption to its service, damage to its reputation and consequent regulatory action. The risk has continued to increase during the year with ongoing significant construction activity around London, including construction of the Thames Tideway Tunnel now underway, reducing contractor availability.	The subsidiary seeks to ensure that its relationship with critical suppliers is secured under long-term agreements, where appropriate. For key activities, it may retain more than one supplier to mitigate the risk of supplier failure. The subsidiary also undertakes significant due diligence in the selection and on-going management of suppliers through audit, inspection and verification of performance. The subsidiary also seeks to mitigate this risk by maintaining a constructive relationship with employees regarding their remuneration through the Joint Negotiating and Consultative Committee, succession planning and investing in its employees through training and apprenticeship schemes. It has recently launched its "Leading The Affinity Way" leadership programme, specifically designed to help it develop a high performing leadership environment.
Information security or privacy failure ↑	The subsidiary must protect customer information and its data from unauthorised disclosure and improper use. Failure to do so may lead to increased costs of operation, reputational damage, criminal fines and civil damages. As the use of online communications, cloud-based technology and the sophistication of hackers continues to increase, so too does the risk of cyber attack.	During the year the subsidiary continued to strengthen its capabilities to ensure that its technical and organisational controls against the unauthorised disclosure, loss or improper use of data are kept under review and improved where appropriate. The subsidiary has made significant progress in implementing a robust information security management system with a view to protecting itself against current and future threats. It has also commenced adoption of the General Data Protection Regulation ('GDPR') which will come into force in 2018.

Risk	Commentary	Mitigation
Regulatory		
Adverse changes to the regulatory framework ↑	Changes to the regulatory framework by Ofwat or the government may have an adverse effect on the subsidiary's operational or financial performance. The risk has increased in the year, as a result of Ofwat's launch of "Towards Water 2020" in July 2015 and a consultation in December 2015 on its preferred approach to the design of the future regulatory framework for the water industry for the next price review ('PR19'). Ofwat published further thinking in May 2016 confirming its preferred approach following the December 2015 consultation and setting out specific areas for further consultation. The new framework aims to make greater use of markets in relation to the areas of sludge and water resources with separate binding price controls for both. For PR19 Ofwat has also set out its intention to use the Consumer Price Index ('CPI'), rather than Retail Price Index ('RPI'), for indexing revenues (and therefore prices) and regulatory capital value ('RCV') to be indexed using a combination of CPI and RPI.	The subsidiary continues to contribute fully to consultations with the regulators and seeks to ensure its voice is heard on emerging changes through strong relationships with all its stakeholders.
Adverse change in the social and/or political climate ↔	The subsidiary is exposed to risks arising from the general social and political climate, for example, political pressure to restrain price increases and other issues, such as some objections to universal metering. These pressures may lead to a reduction in revenue or have a reputational impact.	The subsidiary continues to engage with its customers and their representatives to understand and respond to their issues and concerns.
Failure to comply with laws, its instrument of appointment and other recognised standards ↔	The subsidiary needs to ensure that its activities and outputs comply with licence conditions or statutory requirements arising from its appointment, and applicable laws and standards. Failure to do so may result in an enforcement order, a fine up to 10% of appointed turnover or termination of its appointment and special administration.	The subsidiary has policies, processes and controls in place that seek to ensure that applicable regulation, laws and standards are fully understood and complied with. The subsidiary continues to operate its abstraction, treatment and supply activities to environmental standard ISO14001.

Risk	Commentary	Mitigation
Regulatory (continued)		
Failure to deliver its business plan obligations ↔	The subsidiary has made a number of performance commitments in its Business Plan which, if not met, may result in financial penalties. The subsidiary must implement the investment programme set out in its Business Plan. Failure to do so may lead to the imposition of sanctions, including financial penalties or other enforcement action. Whilst the subsidiary has not met all of its very challenging AMP6 year 1 performance commitments, it has robust plans to address those challenges going forward and is confident that it will deliver the required outcomes over the remainder of AMP6.	The subsidiary has an established programme management function with the responsibility for delivering the investment programme. The subsidiary's Board and senior management team monitor performance and ensure that corrective action is taken when required.
Being required to undertake unremunerated activity ↑	The subsidiary may experience unforeseen financial, regulatory or legal obligations or costs which were not taken into account by Ofwat in setting its price controls. For example, the subsidiary is incurring greater costs on delivery of the Market Reform programme than allowed for in the AMP6 price controls.	The subsidiary's Instrument of Appointment provides some protection against unforeseen financial risks materialising during a price control period. It can ask Ofwat to undertake an interim determination of price limits in certain circumstances. Ofwat will make an interim determination only where it is satisfied that a 10% cost threshold has been met. There is no assurance that Ofwat will make an interim determination or that any determination made would provide adequate revenue compensation. Refer to the financial risks section of the table for details of the subsidiary's mitigation in relation to liquidity risks.
Market reform		
Failure to prepare for market reform ↑	The requirements for implementing the retail market for non-household customers on 1 April 2017 are developed but not finalised. Delays to the Open Water Programme could affect the subsidiary's preparation, which may lead to additional costs, loss of revenue and regulatory enforcement action. This risk has heightened during the year, as the market entry assurance requirements have become known and there have been delays to the Open Water Programme.	The subsidiary continues to take an active role in the Open Water Programme and with Market Operator Services Limited ('MOSL') directly. The subsidiary has put in place a business transformation programme supported by a cross-functional team to manage the organisational, cultural and behavioural change needed to be ready for the new market arrangements.

Affinity Water Acquisitions (Investments) Limited

Strategic report
for the year ended 31 March 2016 (continued)

Risk	Commentary	Mitigation
Financial		
Liquidity risk ↔	The subsidiary has an on-going liquidity requirement, driven by the operational cash flows of the business and its substantial capital investment programme. This results in liquidity risk in the event that the subsidiary is unable to meet its cash flow requirements as and when they fall due.	The subsidiary has revolving loan facilities, cash balances and standby loan facilities to meet its forecast cash flow needs. Its Treasury Policy requires it to maintain a minimum level of liquidity capable of covering at least twelve months' forecast cash flow requirements. Longer term financing needs are sourced from the private and public bond markets. The subsidiary's policy is to maintain a diverse portfolio of counterparties through which it can access liquidity at all times. This ensures it is not reliant on any single treasury counterparty.
Macro economic risk (interest rate, inflation and tax risks) ↔	Movements in interest rates can result in an increase in the cost of the subsidiary's debt. The subsidiary has a financial covenant within its Whole Business Securitisation ('WBS') documentation stipulating that at least 85% of its outstanding debt is hedged against movements in interest rates. The subsidiary's wholesale revenues in a given financial year are explicitly linked to the RPI published the previous November. An inability to control its cost inflation on the same basis would lead to a reduction in the subsidiary's profitability. In addition, its RCV is also linked to RPI and nominal returns are therefore likely to be further reduced in a low inflation environment. The subsidiary operates a pension plan providing defined benefits based on final pensionable salary. The assets and liabilities within the plan depend on a number of external factors outside its control, including performance of equity markets, interest rates and future inflation, which may increase the cost of its defined benefit pension plan. During the year the government introduced proposals to take effect from 1 April 2017 that will limit the amount of interest that may be deductible for corporation tax purposes for the largest UK businesses. This may increase its corporation tax payments.	Interest rate risk is primarily managed by using a mixture of fixed rate and inflation linked borrowings, and approved hedging instruments. Further disclosure on the management of interest rate and liquidity risks is included in the statutory financial statements of the subsidiary. Each year the subsidiary undertakes a robust and challenging budgeting process to ensure costs are clearly understood and then subsequently controlled during the financial year. The subsidiary also uses inflation linked debt to ensure a proportion of its interest costs are linked to RPI and therefore offsets an element of the reduction in revenue and RCV that results from lower inflation. The defined benefits plan has been closed to new members since September 2004 and the assets of the plan are held separately from those of the subsidiary. The subsidiary contributes fully to consultations with HMRC and HM Treasury through Water UK to avoid any unintended tax burden on the water industry.

Affinity Water Acquisitions (Investments) Limited

Strategic report
for the year ended 31 March 2016 (continued)

Risk	Commentary	Mitigation
Financial (continued)		
Breach of and changes to its borrowing covenants ↔	The subsidiary is subject to a number of covenants in relation to its borrowings. If a covenant is breached, this could lead to an event of default with any outstanding borrowings becoming immediately repayable.	The subsidiary has a regular monitoring and certification process of the covenants within its WBS documentation. This covers information, financial and general covenants. The Treasury Policy requires that financial covenants, which include gearing and interest cover ratios, are monitored and reported on a regular basis to the subsidary's Board.
Revenue and debtor risk ↔	Customer debt and affordability remain key areas of focus for the subsidiary. The subsidiary is not permitted to disconnect water supplies to household and certain other types of premises in the event of non-payment, resulting in loss of revenue and increased cost of collection.	The subsidiary has processes and teams dedicated to the efficient collection of customer debt. For those customers who want to pay their bill but struggle to do so, the subsidiary has payment arrangements that are as flexible as possible and it encourages customers who find themselves in difficulty to contact them as early as possible. The subsidiary also has a social tariff 'LIFT' to help support customers who are least able to pay their bills.

Approval of the strategic report

Approved by the Board and signed by its order:

Tim Monod
Company Secretary
28 July 2016

Affinity Water Acquisitions (Investments) Limited

Directors' report
for the year ended 31 March 2016

Introduction

The directors present their annual report and the audited consolidated financial statements of Affinity Water Acquisitions (Investments) Limited ('the company') for the year ended 31 March 2016.

The company is a limited liability company registered in England and Wales and it is the ultimate holding and controlling company of the Affinity Water group in the United Kingdom. Details of the ownership of the company and the group structure are set out on pages 13 to 17 and note 23 of these financial statements. The address of the principal place of business is Tamblin Way, Hatfield, Hertfordshire, AL10 9EZ.

The strategic report from pages 4 to 11 provides information relating to the group, its strategy and its results and financial position for the year ended 31 March 2016. Details of the risks and principal uncertainties facing the company are set out on pages 5 to 11.

Dividends and dividend policy

The group's dividend policy is primarily based on maintaining a target level of gearing (net debt to RCV) of 80 per cent ('%') in Affinity Water Limited, the group's principal trading subsidiary. The amount of the dividend is dependent on the level of success of this subsidiary to generate cash flows and achieving its regulatory outputs in the reported period. The policy distributes earnings equal to the amount necessary to maintain net debt to RCV at the targeted gearing ratio. This is consistent with the requirements of Condition F of Affinity Water Limited's licence that dividends paid will not impair the ability of the appointee to finance the appointed business and under a system of incentive regulation, dividends would be expected to reward efficiency and the management of economic risk.

The directors have declared and paid the following ordinary dividends to the group's shareholders during the year ended 31 March 2016:

	£000
First interim paid of 2.601p per share	**8,865**
Second interim paid of 1.360p per share	**4,635**
Third interim paid of 2.016p per share	**6,870**
Fourth interim paid of 2.113p per share	**7,200**
	27,570

This compares to interim dividends of £21,464,000 declared and paid in the year ended 31 March 2015.

No final dividend is proposed (2015: £nil).

Significant events during the year

On 29 October 2015, Affinity Water Programme Finance Limited, a wholly owned financing subsidiary of the group, completed a £40.0m tap issue of its 1.548% RPI linked guaranteed bond due 2045 on the same terms as the existing 2045 bond. On 19 February 2016, Affinity Water Programme Finance Limited issued £10.0m Class B guaranteed RPI linked notes maturing in June 2033 with a coupon rate of 1.024%. The net proceeds of the tap issue and bond issue have been lent to Affinity Water Limited, the group's principal trading subsidiary, on the same terms.

Details of the significant events relating to Affinity Water Limited, that occurred during the year are set out in the highlights, Chairman's statement and Chief Executive Officer's introduction of its own annual report and financial statements for the year ended 31 March 2016.

Affinity Water Acquisitions (Investments) Limited

Directors' report
for the year ended 31 March 2016 (continued)

Ownership

The effective equity interests in the group at 31 March 2016 are shown below.

Infracapital Partners II (35%)

Infracapital Partners II (consisting of Infracapital Partners II LP and Infracapital Partners (NT) II LP) is a European infrastructure fund managed by M&G Alternatives Investment Management Limited, a subsidiary of Prudential plc. The fund was established to make investments in income-generative infrastructure assets and businesses, including electricity and gas networks, water companies, transport infrastructure and renewable energy. The fund holds its investment in the group indirectly through subsidiaries including Infracapital F2 Rift S.à.r.l., which is a wholly owned subsidiary of Infracapital F2 Rift Holdings S.à.r.l.. Both Infracapital F2 Rift S.à.r.l. and Infracapital F2 Rift Holdings S.à.r.l. are incorporated in Luxembourg.

Beryl Datura Investment Limited (10%)

Beryl Datura Investment Limited (BDIL) is a company established by the State Administration of Foreign Exchange of the People's Republic of China. It is managed by Gingko Tree Investments Limited which focuses on investments in real assets such as infrastructure and real estate and is attracted to relatively stable, predictable, long-term investments. It holds its investment in the group indirectly through Infracapital F2 Rift Holdings S.à.r.l., which is managed by Infracapital Partners II.

Partners Group (5%)

Partners Group is a global private markets investment management firm. It has investment programs under management in private equity, private real estate, private infrastructure and private debt. The firm is listed on the SIX Swiss Exchange. It holds its investment in the group indirectly through Partners Group Global Infrastructure 2012 LP Inc., incorporated in the United States, and Partners Group Direct Infrastructure 2011 LP, registered in Guernsey. It holds its investment in the group indirectly through Rift SLP 2 LP, which is managed by Infracapital Partners II.

North Haven Infrastructure Partners LP (40%)

North Haven Infrastructure Partners LP is a global infrastructure investment fund managed by Morgan Stanley Infrastructure Inc., part of the investment management division of Morgan Stanley. It was established in 2007 to make investments in core infrastructure assets that provide essential public goods and services to societies across the globe and seeks to improve asset performance using active management. It holds its investment in the group indirectly through MSIP Dalis B.V., which is incorporated in the Netherlands.

Veolia Water UK Limited (10%)

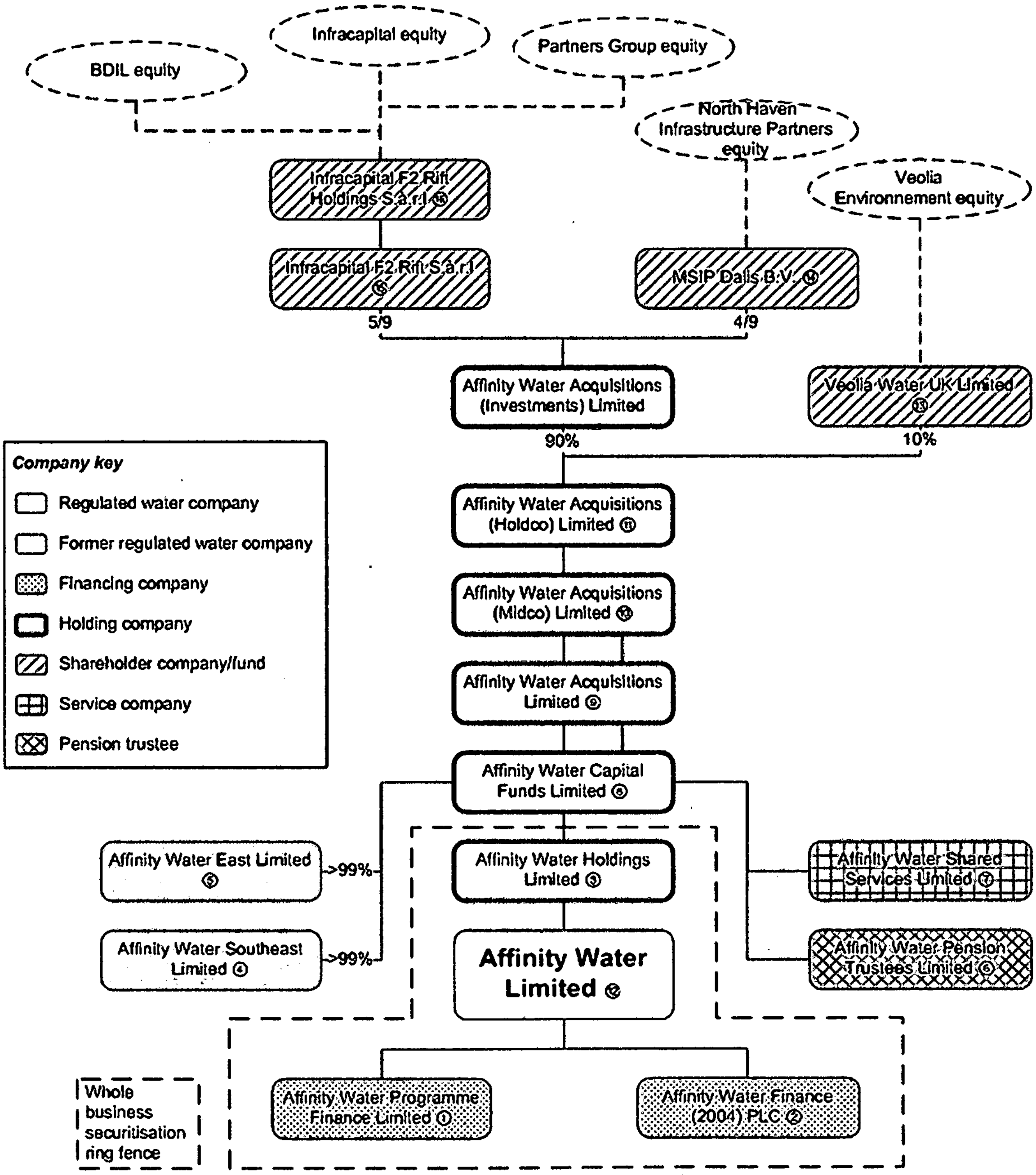
Veolia Water UK Limited is incorporated in England and Wales and is a subsidiary of Veolia Environnement S.A. which is listed on the Paris and New York Stock Exchanges. It holds its investment in the group through its shareholding in Affinity Water Acquisitions (Holdco) Limited and has established with the group a capability sharing arrangement. This arrangement gives it access to the group's knowhow, experience and expertise while the group has access to Veolia Water's advice on global water technologies and developments.

Affinity Water Acquisitions (Investments) Limited

Directors' report
for the year ended 31 March 2016 (continued)

Ownership (continued)

The following chart shows the ownership of the company and the group structure, excluding dormant subsidiaries except for Affinity Water Pension Trustees Limited. Unless otherwise indicated, all companies are wholly owned by the parent company shown. The numbers listed alongside the companies within the group structure may be cross referenced to the table on pages 15 to 17.



Directors' report
for the year ended 31 March 2016 (continued)

Ownership (continued)

Infracapital Partners II and North Haven Infrastructure Partners LP are considered to be the ultimate controllers of the group, as they are in a position to exercise material influence over the group's policy and affairs. These entities have provided Affinity Water Limited with legally enforceable undertakings that they will:

- give Affinity Water Limited such information as may be necessary to enable the group to comply with its obligations under the Water Industry Act 1991 and Instrument of Appointment;
- refrain from any action which would cause Affinity Water Limited to breach any of its obligations under the Water Industry Act 1991 or the conditions of the Appointment; and
- use their best endeavours to ensure that the Board of Affinity Water Limited maintains not less than three independent non-executive directors, who shall be persons of standing with relevant experience and who shall collectively have connections with and knowledge of the areas for which the group's principal trading subsidiary is a water undertaker and an understanding of the interests of the group's customers and how these can be respected and protected.

The Board is satisfied that these undertakings are being properly discharged and that Affinity Water Limited is able fully to meet its regulatory obligation to operate its appointed business as if it were substantially its sole business and were a separate listed company. Further, no issues have been identified at the group level which may materially impact on Affinity Water Limited during the year.

Group structure

The following table provides further explanation of the group structure in keeping with the first principle set out in Ofwat's publication: *Board leadership, transparency and governance – holding company principles*: transparency.

Companies within the whole business securitisation			
Name	**Description**	**Place of registration**	**Structure chart reference**
Affinity Water Limited	A water undertaker holding an appointment under the Water Industry Act 1991, supplying water to a population of around 3.5 million people in the southeast of England. It is the principal trading subsidiary of the group.	England and Wales	12
Affinity Water Programme Finance Limited	A financing subsidiary of Affinity Water Limited established in 2013 to issue bonds under a Euro Medium Term Note ('EMTN') programme. It lends monies raised from its bonds to Affinity Water Limited. The company is resident in the United Kingdom for tax purposes and its incorporation in the Cayman Islands (an internationally recognised and highly regulated financial centre used for financings by the UK and US governments) brings no tax benefit to the group. It does not hold funds off-shore, with all finance being raised and held within the United Kingdom.	Cayman Islands	1
Affinity Water Finance (2004) PLC	A financing subsidiary of Affinity Water Limited established in 2004 to issue a bond. It lends monies raised from its bond to Affinity Water Limited.	England and Wales	2
Affinity Water Holdings Limited	Affinity Water Limited's immediate holding company. Its equity is provided as security to bondholders in the event of default.	England and Wales	3

Directors' report
for the year ended 31 March 2016 (continued)

Group structure (continued)

Other companies			
Name	**Description**	**Place of registration**	**Structure chart reference**
Affinity Water Southeast Limited	A company which formerly held an Instrument of Appointment as water undertaker for the Southeast Region of Affinity Water Limited's water supply area. The appointment was transferred to Affinity Water Limited on 27 July 2012. The company is no longer trading but continues to honour income assurances made to minority shareholders on transfer of its water undertaking to Affinity Water Limited.	England and Wales	4
Affinity Water East Limited	A company which formerly held an Instrument of Appointment as water undertaker for the East Region of Affinity Water Limited's water supply area. The appointment was transferred to Affinity Water Limited on 27 July 2012. The company is no longer trading but continues to honour income assurances made to minority shareholders on transfer of its water undertaking to Affinity Water Limited.	England and Wales	5
Affinity Water Shared Services Limited	A company which provided administrative and technical services solely to Affinity Water Limited until 31 March 2015. Prior to the group's acquisition of Veolia Water UK Limited's 90% equity interest in June 2012 (and for a 12 month transitional period following), the company also provided services to the non-regulated businesses of Veolia Water UK Limited.	England and Wales	7

Holding companies			
Name	**Description**	**Place of registration**	**Structure chart reference**
Affinity Water Capital Funds Limited	The original holding company for Veolia's regulated water businesses, which was acquired by the group in June 2012 through Affinity Water Acquisitions Limited (the "target" company), which provides management services to the company.	England and Wales	8
Affinity Water Acquisitions Limited	The company which bid for and acquired Affinity Water Capital Funds Limited and its subsidiaries from Veolia Water UK Limited in 2012 (the "bid" company). It has issued subordinated debt notes to Affinity Water Acquisitions (Midco) Limited as part of the acquisition finance.	England and Wales	9
Affinity Water Acquisitions (Midco) Limited	The holding company of Affinity Water Acquisitions Limited which holds subordinated debt notes issued by Affinity Water Acquisitions Limited. It has issued subordinated debt notes to the shareholders and exists to enable the introduction or withdrawal of shareholder subordinated debt without impacting on agreements between the original acquisition consortia and Veolia Water UK Limited.	England and Wales	10
Affinity Water Acquisitions (Holdco) Limited	The holding company of Affinity Water Acquisitions (Midco) Limited. The inclusion of a holding company between Affinity Water Acquisitions (Midco) Limited and Affinity Water Acquisitions (Investments) Limited enables the introduction or withdrawal of additional shareholders without impacting on shareholder agreements between the original acquisition consortia.	England and Wales	11
Affinity Water Acquisitions (Investments) Limited	The ultimate holding company of the group in the United Kingdom, paying dividends to the acquisition consortia subsidiaries. The inclusion of this company in the group structure allows the original consortia to change their individual equity holdings without requiring structural changes in the organisation below.	England and Wales	
MSIP Dalis BV	A company established by North Haven Infrastructure Partners LP under its Netherlands-based operations to own its European and Asian investments.	Netherlands	14
Infracapital F2 Rift S.a.r.l	A company established at the time of acquisition in 2012 to hold indirectly Infracapital Partners II's investment in the group.	Luxembourg	15
Infracapital F2 Rift Holdings S.a.r.l	A company established at the time of acquisition in 2012 through which Infracapital Partners II and Beryl Datura Investment Limited (and Partners Group indirectly) hold their investment in the group.	Luxembourg	16

Group structure (continued)

Dormant companies			
Name	**Description**	**Place of registration**	**Structure chart reference**
Affinity Water Pension Trustees Limited	The trustee company of the Affinity Water Pension Plan.	England and Wales	6
Three Valleys Water Limited	A dormant subsidiary of Affinity Water Limited owned for name protection purposes.	England and Wales	Not shown
Tendring Hundred Water Services Limited	A dormant subsidiary of Affinity Water Limited owned for name protection purposes.	England and Wales	Not shown
Folkestone and Dover Water Services Limited	A dormant subsidiary of Affinity Water Limited owned for name protection purposes.	England and Wales	Not shown
White Cliffs Water Limited	A dormant subsidiary of Affinity Water Limited owned for name protection purposes.	England and Wales	Not shown
Affinity for Business (Retail) Limited	A subsidiary of Affinity Water Capital Funds Limited incorporated in the year to operate as a water and wastewater retailer in the non-household market.	England and Wales	Not shown

Debt financing

Affinity Water Limited is financially and operationally 'ring-fenced' from the rest of the Affinity Water group by way of a whole business securitisation. The securitisation has further enhanced the ring-fencing provisions already in its licence. The sole business of its immediate holding company, Affinity Water Holdings Limited, is holding the shares of Affinity Water Limited.

The group has two financing subsidiaries which have issued bonds which are listed by the UK Listing Authority ('UKLA') and the proceeds of which have been lent on to and are guaranteed by the group's principal trading company:

- Affinity Water Finance (2004) PLC has issued an external bond of £250 million; and
- Affinity Water Programme Finance Limited has issued external bonds totalling £625 million.

The group believes that the ring-fencing structure provides significant corporate benefits, providing better access to long-term debt markets and an opportunity to reduce the cost of capital employed in the regulated business for the benefit of customers.

Certain bonds issued by both Affinity Water Programme Finance Limited and Affinity Water Finance (2004) PLC are subject to the Listing Rules and Disclosure and Transparency Rules, being listed by the UKLA.

Affinity Water Programme Finance Limited is incorporated in the Cayman Islands but resident in the United Kingdom for tax purposes, as the bonds were, in part, used to discharge financing put in place by our investors in 2012 to finance their acquisition of the target company and subsidiaries. It was not possible for the group to establish a UK company to act as issuer. By being resident in the United Kingdom for tax purposes the group is clear that this arrangement does not avoid UK tax and brings no tax benefit. Further, there are no funds which are held off-shore with all finance being raised and held within the United Kingdom.

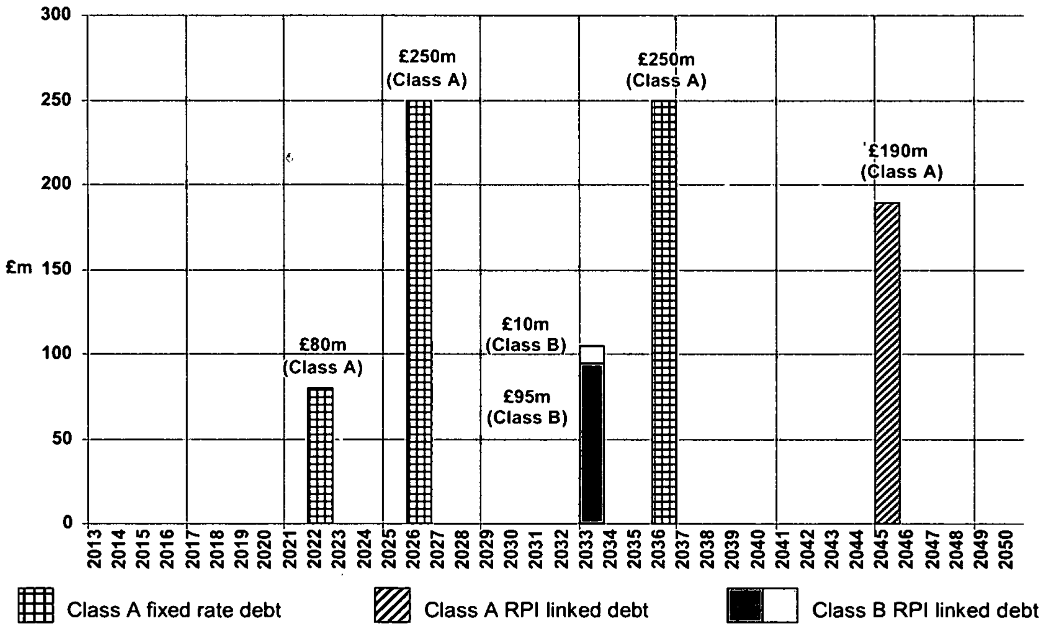
Directors' report
for the year ended 31 March 2016 (continued)

Debt financing (continued)

The bonds issued by the group can be summarised as follows:

Debt	Bond £000	Coupon	Maturity Date
Class A fixed rate bond 2026	250,000	5.875%	July 2026
Class A RPI linked bond 2045	190,000	1.548% (real)	June 2045
Class A fixed rate bond 2036	250,000	4.500%	March 2036
Class A fixed rate bond 2022	80,000	3.625%	September 2022
Total Class A	**770,000**		
Class B RPI linked bond 2033	95,000	3.249% (real)	June 2033
Class B RPI linked bond 2033	10,000	1.024% (real)	June 2033
Total Class B	**105,000**		
Total	**875,000**		

The following chart shows the maturity profile of the bonds:



The credit ratings for the group's bonds assigned by the rating agencies, Moody's and Standard & Poors, at 31 March 2016 were as follows:

Bonds	Moody's	Standard & Poors
Class A	A3	A -
Class B	Baa3	BBB
Corporate family rating for Affinity Water Limited	Baa1	Not applicable

Debt financing (continued)

The total value of the issued bonds can be reconciled to the group's net debt position at 31 March 2016 as follows:

	2016 **£000**
Nominal value of Class A fixed interest bonds issued	580,000
Nominal value of Class A index linked bonds issued	190,000
Nominal value of Class B index linked bonds issued	105,000
Total nominal value of bonds issued	875,000
Accretion on Class A index linked bonds	10,107
Accretion on Class B index linked bonds	4,996
Capitalised bond issue costs and net premium/discount related to Class A bonds	10,004
Capitalised bond issue costs relating to Class B bonds	(1,448)
Debentures	34
Loans from shareholders	130,020
Cash in hand	(93,795)
Net debt	**934,918**

In July 2015, Affinity Water Limited, the group's principal trading subsidiary refinanced its existing £100.0m syndicated facility provided by five banks. The facility has been replaced with two revolving credit facilities, £60.0m provided by Barclays Bank PLC and £40.0m provided by Lloyds Bank PLC. The facilities are intended for the purpose of financing capital expenditure and working capital requirements to the extent that additional funding is required by the subsidiary.

Affinity Water Limited also has available two standby facilities with different counterparties in the event of a liquidity shortfall: a 364 day revolving Debt Service Reserve Facility of £38.0m, which is intended for the purpose of funding any debt service payments, and a 364 day revolving Operations and Maintenance Reserve Facility of £20.0m, which is intended for the purpose of funding operating and capital maintenance expenditure.

Affinity Water Acquisitions (Investments) Limited

Directors' report for the year ended 31 March 2016 (continued)

Board of directors

The directors of Affinity Water Acquisitions (Investments) Limited who were in office during the year and up to the date of signing the financial statements are disclosed on page 1.

Certain Board members are also directors of other group companies. The numbers listed alongside their name in the table below may be cross referenced to the relevant company shown on the structure chart on page 14.

All directors declare their position when as individuals they have a possible conflict of interest and do not vote on any contract, arrangement or proposal with Affinity Water Limited in which they have an interest by virtue of other directorships. Directors have access to the advice and services of the Company Secretary and are able to obtain access to independent professional advice where they think it necessary.

The table below sets out attendance at Board meetings for the year ended 31 March 2016.

	Number of meetings in year
Philip Nolan (Chairman) ⑫	5/5
Mike Bryan	2/5
Alberto Donzelli ①②③⑧⑨⑩⑪	2/5
Stephen Nelson ①②③⑧⑨⑩⑪⑫	5/5
Yacine Saidji ①②③⑧⑨⑩⑪	5/5
Bernd Schumacher ⑧⑨⑩⑪	2/5
James Wilmott ⑧⑨⑩⑪⑫	5/5
Former directors	
Georgina Dellacha ①②③⑧⑨⑩⑪	1/1*

* denotes not a member of the Board for the whole year

Directors' report
for the year ended 31 March 2016 (continued)

Corporate governance

The group and company benefits from the corporate governance arrangements established by Affinity Water Limited, full details of which can be found in Affinity Water Limited's own annual report and financial statements for the year ended 31 March 2016, together with more detailed corporate reporting disclosures.

Affinity Water Limited remains committed to the highest standards of governance and supports the principles of good corporate governance set out in the 2014 UK Corporate Governance Code ('the Code') and the UK Stewardship Code. It is owned by private investors and therefore Affinity Water Limited applies the principles of the Code in this context, having regard to the Guidelines for Disclosure and Transparency in Private Equity (the Walker Guidelines) and the work of the Private Equity Reporting Group (formerly the Walker Guidelines Monitoring Group).

Affinity Water Limited complies with the principles of the Code, except in terms of board composition, membership of committees, appointment of a senior independent director, re-election of directors and externally facilitated board evaluation. This is explained in detail in its own annual report and financial statements.

The Board has overall responsibility for the group's and company's systems of internal control and for reviewing the effectiveness of these systems. It is responsible for ensuring the group and company meets its obligations to its shareholders and meets from time to time to facilitate this.

There are certain matters that the Board of Affinity Water Limited has reserved for shareholder approval. These matters are published on Affinity Water Limited's stakeholder website: **stakeholder.affinitywater.co.uk.**

Financial and business reporting

Having taken into account all matters considered by the Board and brought to its attention during the year, the directors are satisfied that the annual report and financial statements taken as a whole are fair, balanced and understandable.

The Board believes that the disclosures set out on pages 4 to 11 of the annual report provide the information necessary for shareholders to assess the group's performance, business model and strategy.

Market environment

The water industry is undertaking progressive reform of its market to facilitate greater competition. This will result in new entrants to the retail water market and allow non-household customers to exercise choice. These changes present opportunities as well as challenges for the group's principal trading subsidiary.

Directors' report
for the year ended 31 March 2016 (continued)

Market environment (continued)

In April 2017 the competitive retail market for all non-household water and sewerage customers in England is expected to open. The work needed to introduce changes to open the market is being delivered by the Open Water Programme, working with market participants, Ofwat and the Department for Environment, Food & Rural Affairs ('Defra'). The programme will define the overall market architecture and deliver operational and market codes, central systems and contracts required for the market to function effectively and efficiently. With less than twelve months to go before market opening, the industry, including Affinity Water Limited, is entering the final stages of implementation of new market arrangements.

The Water Act 2014 has paved the way for further reform of upstream activities. Whilst the reforms are not expected to be implemented before 2020, Ofwat and Defra are considering how principles of contestability might be introduced. Affinity Water Limited remains closely involved in debates on this issue, with Ofwat having published its proposals and thinking in May 2016 ahead of price setting methodology consultations in 2017.

Additionally in November 2015 the government announced that Ofwat would consider the case for the extension of retail competition into the household market. Ofwat published the terms of reference for its review in January 2016 and issued a call for evidence from the industry and interested stakeholders. Ofwat is expected to publish the outcome of its review during the late summer/early autumn of 2016.

Future developments

It is anticipated the company will continue to invest and manage its long term interests in the water industry in the United Kingdom for the foreseeable future.

Likely future developments in the business resulting from expected changes in the regulatory and competitive environments that Affinity Water Limited, the principal trading subsidiary of the group, operates in are discussed in the strategic report in its own annual report and financial statements for the year ended 31 March 2016.

Research and development activities

The development and application of new techniques and technology is an important part of the group's principal trading subsidiary's activities. Affinity Water Limited is a member of UK Water Industry Research ('UKWIR'), and participates and benefits from its research programme. The UKWIR research programme relating to Affinity Water Limited is currently divided into the following topics: drinking water quality and health; toxicology; water resources; climate change; water mains and services; leakage and metering and regulatory issues. Affinity Water Limited carried out more specific research in the fields of improving data, metaldehyde removal, pipeline materials and water resources during the year.

Political contributions

No political contributions were made during the year (2015: £nil), in accordance with the group's policy of not making political contributions.

Directors' report for the year ended 31 March 2016 (continued)

Information required under the Listing Rules

During the year no interest was capitalised by the group (2015: £nil).

The remuneration report in Affinity Water Limited's annual report and financial statements for the year ended 31 March 2016 provides disclosures in relation to relevant requirements of the Listing Rules.

Employee matters

The group's principal trading subsidiary consults and informs its employees on all aspects of business performance through formal and informal consultation bodies, regular team meetings, email and the intranet. Affinity Water Limited constantly discusses ways to enhance and improve its communications and consultation channels directly with employees as well as with the Trade Unions to which a number of employees belong. Several initiatives have been introduced with the aim of improving the health and well-being of Affinity Water Limited's employees and these were expanded on during 2015/16.

Employees are kept informed of changes in the business, general, financial and economic factors influencing the company together with performance targets. This is achieved through a systematic approach to employee communication, which includes regular briefings or presentations and electronic mailings. Affinity Water Limited also produces a regular employee magazine, which is sent to all company sites.

Affinity Water Limited aims to ensure that each employee or applicant for employment receives the same treatment irrespective of race, gender, disability, sexual orientation, religious belief, creed, marital or parental status. This extends through all company policies including recruitment where the candidate's particular aptitudes and abilities are consistent with the requirements of the job. Opportunities are available to disabled employees for training, career development and promotion. Employees who become disabled whilst employed by Affinity Water Limited are actively supported to find appropriate employment within the business.

Greenhouse gas emissions

The greenhouse gases emitted by the group are those of its principal trading subsidiary, Affinity Water Limited, which are reported in the strategic report of its annual report and financial statements for the year ended 31 March 2016.

Financial instruments disclosures

Details are included in note A4 of the financial statements.

Post balance sheet events

There were no significant post balance sheet events.

Directors' report for the year ended 31 March 2016 (continued)

Statement of directors' responsibilities

The directors are responsible for preparing the annual report and financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the group and parent company financial statements in accordance with International Financial Reporting Standards ('IFRS') as adopted by the European Union ('EU'). 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 the company and of the profit or loss of the group for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable IFRSs as adopted by the EU, have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company and group will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the group and company's transactions and disclose with reasonable accuracy at any time the financial position of the group and company and enable them to ensure that the financial statements comply with the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the group and company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Each of the directors, whose names are listed on page 1, confirm that, to the best of his/her knowledge:

- the financial statements, which have been prepared in accordance with IFRSs as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the group and company; and
- the strategic report contained in the annual report includes a fair review of the development and performance of the business and the position of the group and company, together with a description of the principal risks and uncertainties that they face.

Affinity Water Acquisitions (Investments) Limited

Directors' report
for the year ended 31 March 2016 (continued)

Disclosure of information to auditors

In accordance with Section 418 of the Companies Act 2006:

(a) so far as each director is aware, there is no relevant audit information of which the company's auditor is unaware; and

(b) he or she has taken all the steps that he or she ought to have taken as a director in order to make himself or herself aware of any relevant audit information and to establish that the company's auditor is aware of that information.

Independent auditor

In accordance with Section 485 of the Companies Act 2006, a resolution to re-appoint PwC will be proposed by the Board.

By order of the Board

Tim Monod
Company Secretary
28 July 2016

Independent auditor's report to the members of Affinity Water Acquisitions (Investments) Limited

Report on the financial statements

Our opinion

In our opinion:

- Affinity Water Acquisitions (Investments) Limited's group financial statements and company financial statements (the "financial statements") give a true and fair view of the state of the group's and of the company's affairs as at 31 March 2016 and of the group's profit and cash flows for the year then ended;
- the group and company financial statements have been properly prepared in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union;
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

What we have audited

The financial statements, included within the Annual report and financial statements (the "Annual Report"), comprise:

- the consolidated statement of financial position as at 31 March 2016;
- the company statement of financial position as at 31 March 2016;
- the consolidated statement of comprehensive income for the year then ended;
- the consolidated statement of changes in equity for the year then ended;
- the company statement of changes in equity for the year then ended;
- the consolidated statement of cash flows for the year then ended;
- the accounting policies; and
- the notes to the financial statements, which include other explanatory information.

The financial reporting framework that has been applied in the preparation of the group and company financial statements is IFRSs as adopted by the European Union, and applicable law.

In applying the financial reporting framework, the directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion, the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Independent auditor's report to the members of Affinity Water Acquisitions (Investments) Limited (continued)

Other matters on which we are required to report by exception

Adequacy of accounting records and information and explanations received

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

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the company, or returns adequate for our audit have not been received from branches not visited by us; or
- the company financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Directors' remuneration

Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

Responsibilities for the financial statements and the audit

Our responsibilities and those of the directors

As explained more fully in the Statement of directors' responsibilities set out on page 24, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)"). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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

Independent auditor's report to the members of Affinity Water Acquisitions (Investments) Limited (continued)

What an audit of financial statements involves

We conducted our audit in accordance with ISAs (UK & Ireland). An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the group's and the company's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the directors; and
- the overall presentation of the financial statements.

We primarily focus our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Charles Joseland (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Cambridge
28 July 2016

Affinity Water Acquisitions (Investments) Limited

Consolidated income statement for the year ended 31 March 2016

(Registered Number 08101550)

	Note	2016 £000	2015 £000
Revenue	1	**302,622**	296,136
Cost of sales		**(184,220)**	(159,834)
Gross profit		**118,402**	136,302
Administrative expenses		**(53,081)**	(52,477)
Other income		**17,195**	12,536
Operating profit	2	**82,516**	96,361
Finance income	4	**1,978**	983
Finance costs	4	**(50,274)**	(49,400)
Finance costs – net		**(48,296)**	(48,417)
Profit before income tax		**34,220**	47,944
Income tax credit/(expense)	5	**16,371**	(8,741)
Profit for the year		**50,591**	39,203
Profit is attributable to:			
Owners of the group		**45,614**	35,138
Non-controlling interests		**4,977**	4,065
		50,591	39,203

All profits of the group in the current period and prior period are from continuing operations.

The notes on pages 36 to 84 are an integral part of these financial statements.

Affinity Water Acquisitions (Investments) Limited

Consolidated statement of comprehensive income for the year ended 31 March 2016

(Registered Number 08101550)

	Note	2016 £000	2015 £000
Profit for the year		**50,591**	39,203
Other comprehensive income / (expense) for the year which will not be reclassified to profit or loss:			
Remeasurements of post-employment benefit assets	9	**20,667**	30,399
Deferred income tax on items that will not be reclassified	5	**(3,720)**	(6,080)
Other comprehensive income for the year, net of tax		**16,947**	24,319
Total comprehensive income for the year		**67,538**	63,522
Profit is attributable to:			
Owners of the group		**62,561**	59,457
Non-controlling interests		**4,977**	4,065
		67,538	63,522

The notes on pages 36 to 84 are an integral part of these financial statements.

Affinity Water Acquisitions (Investments) Limited

Consolidated statement of financial position as at 31 March 2016

(Registered Number 08101550)

	Note	2016 £000	2015 £000
Assets			
Non-current assets			
Property, plant and equipment	6	**1,259,527**	1,234,907
Intangible assets	7	**155,644**	149,564
Investments	8	**51**	51
Retirement benefit surplus	9	**72,588**	45,098
		1,487,810	1,429,620
Current assets			
Inventories	10	**1,222**	1,262
Trade and other receivables	11	**80,887**	80,970
Current income tax assets		**691**	-
Cash and cash equivalents	12	**93,795**	60,359
		176,595	142,591
Total assets		**1,664,405**	1,572,211
Equity and liabilities			
Equity			
Ordinary shares	13	**3,408**	3,408
Retained earnings		**204,764**	169,773
Non-controlling interests		**19,804**	18,014
Total equity		**227,976**	191,195
Liabilities			
Non-current liabilities			
Trade and other payables	14	**87,977**	84,958
Borrowings	15	**1,028,713**	961,546
Deferred income tax liabilities	16	**184,652**	196,617
Provisions for other liabilities and charges	17	**2,885**	2,748
		1,304,227	1,245,869
Current liabilities			
Trade and other payables	14	**132,202**	131,764
Current income tax liabilities		**-**	3,383
		132,202	135,147
Total liabilities		**1,436,429**	1,381,016
Total equity and liabilities		**1,664,405**	1,572,211

The notes on pages 36 to 84 are an integral part of these financial statements. The statutory financial statements on pages 29 to 84 were approved by the Board of Directors and were signed and authorised for issue on 28 July 2016 on its behalf by:

Dr Philip Nolan

Affinity Water Acquisitions (Investments) Limited

Company statement of financial position as at 31 March 2016
(Registered Number 08101550)

	Note	2016 £000	2015 £000
Investments	8	**340,777**	340,777
Net assets		**340,777**	340,777
Equity			
Ordinary shares		**3,408**	3,408
Retained earnings[1]		**337,369**	337,369
Total equity		**340,777**	340,777

The notes on pages 36 to 84 are an integral part of these financial statements. The statutory financial statements on pages 29 to 84 were approved by the Board of Directors and were signed and authorised for issue on 28 July 2016 on its behalf by:

Dr Philip Nolan

[1] Profit for the year of £27,570,000 (2015: £21,464,000) for the company, consisting of dividend income from its subsidiary undertaking, is included within retained earnings.

Affinity Water Acquisitions (Investments) Limited

Consolidated statement of changes in equity for the year ended 31 March 2016

(Registered Number 08101550)

	Note	Attributable to owners of the group Share capital	Retained earnings	Total	Non-controlling interests	Total
		£000	£000	£000	£000	£000
Balance as at 1 April 2014		3,408	131,780	135,188	16,464	151,652
Profit for the year		-	35,138	35,138	4,065	39,203
Other comprehensive income		-	24,319	24,319	-	24,319
Total comprehensive income		-	59,457	59,457	4,065	63,522
Dividends	18	-	(21,464)	(21,464)	(2,515)	(23,979)
Total transactions with owners recognised directly in equity		-	(21,464)	(21,464)	(2,515)	(23,979)
Balance as at 31 March 2015		3,408	169,773	173,181	18,014	191,195
Balance as at 1 April 2015		**3,408**	**169,773**	**173,181**	**18,014**	**191,195**
Profit for the year		**-**	**45,614**	**45,614**	**4,977**	**50,591**
Other comprehensive income		**-**	**16,947**	**16,947**	**-**	**16,947**
Total comprehensive income		**-**	**62,561**	**62,561**	**4,977**	**67,538**
Dividends	18	**-**	**(27,570)**	**(27,570)**	**(3,187)**	**(30,757)**
Total transactions with owners recognised directly in equity		**-**	**(27,570)**	**(27,570)**	**(3,187)**	**(30,757)**
Balance as at 31 March 2016		**3,408**	**204,764**	**208,172**	**19,804**	**227,976**

The notes on pages 36 to 84 are an integral part of these financial statements.

Affinity Water Acquisitions (Investments) Limited

Company statement of changes in equity for the year ended 31 March 2016
(Registered Number 08101550)

	Share capital £000	Retained earnings £000	Total £000
Balance as at 1 April 2014 (as previously reported under UK GAAP and under IFRS)	3,408	337,369	340,777
Profit for the year	-	21,464	21,464
Total comprehensive income for the year	-	21,464	21,464
Dividends	-	(21,464)	(21,464)
Total transactions with owners, recognised directly in equity	-	(21,464)	(21,464)
Balance as at 31 March 2015	3,408	337,369	340,777
Balance as at 1 April 2015	**3,408**	**337,369**	**340,777**
Profit for the year	**-**	**27,570**	**27,570**
Total comprehensive income for the year	**-**	**27,570**	**27,570**
Dividends	**-**	**(27,570)**	**(27,570)**
Total transactions with owners, recognised directly in equity	**-**	**(27,570)**	**(27,570)**
Balance as at 31 March 2016	**3,408**	**337,369**	**340,777**

The notes on pages 36 to 84 are an integral part of these financial statements.

Affinity Water Acquisitions (Investments) Limited

Consolidated statement of cash flows for the year ended 31 March 2016

(Registered Number 08101550)

	Note	2016 £000	2015 £000
Cash flows from operating activities			
Cash generated from operations	19	**128,780**	152,667
Interest paid		**(47,809)**	(44,423)
Income tax paid		**(3,384)**	(1,817)
Net cash generated from operating activities		**77,587**	106,427
Cash flows from investing activities			
Purchase of investment		**-**	(51)
Purchases of property, plant and equipment		**(70,924)**	(78,310)
Capital contributions		**4,959**	4,084
Proceeds from sale of property, plant and equipment		**91**	58
Purchase of intangibles		**(12,545)**	(6,575)
Interest received		**390**	167
Net cash used in investing activities		**(78,029)**	(80,627)
Cash flows from financing activities			
Repurchase of debentures		**-**	(2)
Repayments of borrowings		**-**	(17,200)
Proceeds from tap of existing bond		**64,635**	58,568
Dividends paid to group's shareholders		**(27,570)**	(21,464)
Dividends paid to non-controlling interests in subsidiary undertakings		**(3,187)**	(2,515)
Net cash generated from financing activities		**33,878**	17,387
Net increase in cash and cash equivalents		**33,436**	43,187
Cash and cash equivalents at beginning of year		**60,359**	17,172
Cash and cash equivalents at end of year	12	**93,795**	60,359

The notes on pages 36 to 84 are an integral part of these financial statements.

Accounting policies

Basis of preparation

These financial statements have been prepared under the historical cost convention, in accordance with International Financial Reporting Standards ('IFRS') and IFRS Interpretations Committee ('IFRS IC') interpretations issued, effective and ratified by the EU as at 31 March 2016, and in compliance with the Companies Act 2006.

These financial statements are the first statutory financial statements prepared by the group in accordance with IFRS.

For further information on the material adjustments on adoption of IFRS, see note A8. The adjustments on adoption of IFRS take account of the requirements and options in International Financial Reporting Standard 1: 'First-time adoption of International Financial Reporting Standards' ('IFRS 1').

Going concern

The directors consider it appropriate to adopt the going concern basis of accounting in preparing the financial statements. This is based on assessment of the principal risks of the group and consideration of the group's budgeted cash flows, long term forecasts and related assumptions, as well as available debt facilities.

Basis of consolidation

The group financial statements consolidate the financial statements of Affinity Water Acquisitions (Investments) Limited and its subsidiaries from the date of the acquisition of the Affinity Water Capital Funds Limited group. The subsidiary companies have been included in the group financial statements using the acquisition method of accounting.

As permitted by Section 408 of the Companies Act 2006, the parent company's profit and loss account has not been included in the financial statements. The company's profit for the year has been included within the company's statement of financial position on page 32 by reference to a footnote.

The company is the parent undertaking of the smallest and largest group to prepare consolidated financial statements.

Principles of consolidation

Subsidiaries are all entities over which the group has control. The group controls an entity when the group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power to direct the activities of the entity. Subsidiaries are fully consolidated from the date on which control is transferred. They are deconsolidated from the date that control ceases.

Intercompany transactions and balances between group companies are eliminated on consolidation.

Non-controlling interests in the results and equity of subsidiairies are shown separately in the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of financial position and consolidated statement of changes in equity respectively.

Principal accounting policies

The principal accounting policies applied in the preparation of these financial statements are set out in note A3.

Affinity Water Acquisitions (Investments) Limited

Accounting policies (continued)

Adoption of new and revised standards

The following standards have been adopted by the group for the first time for the financial year beginning on 1 April 2015 and did not have any impact on the current year or any prior year and are not likely to affect future years.

Topic	Key requirements	Effective date
Improvements to IFRS (2012) and IFRS (2013)	This is a collection of amendments to 11 standards as part of the International Accounting Standards Board's programme of annual improvements.	1 July 2014 (EU endorsed from 1 February 2015 and 1 January 2015 respectively)
Amendment to International Accounting Standard ('IAS') 19: 'Employee benefits'	The amendments to IAS 19: 'Employee benefits' permit contributions that are independent of the number of years of service to be recognised as a reduction in the service cost in the period in which the service is rendered, instead of allocating the contributions to periods of service. Other contributions by employees or third parties are required to be attributed to periods of service either using the plan's contribution formula or on a straight-line basis.	1 July 2014 (EU endorsed from 1 February 2015)

New standards and interpretations not yet adopted

Certain new accounting standards and interpretations have been published that are not mandatory for 31 March 2016 reporting periods and have not been early adopted by the group. The directors anticipate that the group will adopt these standards and interpretations on their effective dates. None of these are expected to have a significant effect on the group's financial statements, except as set out below:

IFRS 15: 'Revenue from contracts with customers' deals with revenue recognition and establishes principles for reporting useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. Revenue is recognised when a customer obtains control of a good or service and thus has the ability to direct the use and obtain the benefits from the good or service. The standard replaces IAS 18: 'Revenue' and IAS 11: 'Construction contracts' and related interpretations. The standard may affect the measurement and recognition of revenue, and grants and contributions with effect from 1 April 2018. At this stage, the group is considering the impact of the new rules on the group's financial statements. The group will make more detailed assessments of the impact over the next twelve months.

IFRS 16: 'Leases' provides a comprehensive model for the identification of lease arrangements and their treatment in the financial statements of both lessees and lessors. It supersedes IAS 17: 'Leases' and its associated interpretative guidance. Significant changes to lessee accounting are introduced, with the distinction between operating and finance leases removed and assets and liabilities recognised in respect of all leases (subject to limited exceptions for short term leases and leases of low value assets). The standard may affect the recognition, measurement, presentation and disclosure of the group's lease arrangements in its financial statements with effect from 1 April 2019. At this stage, the group is considering the impact of the new rules on the group's financial statements. The group intends to commence more detailed assessments of the impact over the next twelve months.

Accounting policies (continued)

Critical accounting estimates and judgements

The preparation of financial statements in conformity 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 involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial information are disclosed below.

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

Measured income accrual

The group records an accrual for measured consumption of water that has not yet been billed (refer to note 11). The accrual is estimated using a defined methodology based upon weighted average water consumption by tariff, which is calculated based upon historical information.

Provision for impairment of trade receivables

The group makes an estimate of the recoverable value of trade receivables and records a provision for impairment based on experience (refer to note 11). This provision is based on, amongst other things, a consideration of actual collection history. The actual level of receivables collected may differ from the estimated levels of recovery, which could impact operating results positively or negatively.

Defined benefit pension plan

The group has an obligation to pay pension benefits to certain employees. The cost of these benefits and the present value of the obligation depend on a number of factors, including: life expectancy, salary increases, asset valuations and the discount rate on corporate bonds. Management estimates these factors in determining the net pension obligation in the statement of financial position. The assumptions (refer to note A5) reflect historical experience and current trends, and may differ from actual results due to changing market and economic conditions and longer or shorter lives of participants. There are no restrictions to the realisability of the surplus relating to the defined benefit section of the pension plan.

Accounting policies (continued)

Critical accounting estimates and judgements (continued)

Impairment of investment in subsidiary

Determining whether the company's investment in its subsidiary has been impaired requires an estimation of the investment's value in use. The value in use calculation uses an estimate of the enterprise value of Affinity Water Limited, the principal trading indirect subsidiary of the company, which is based on its regulatory capital value at the year-end and market premiums paid for UK water supply companies. The carrying amount of investments in subsidiaries at the date of the statement of financial position was £340,777,000 with no impairment loss recognised in either the year ended 31 March 2015 or 2016.

Useful economic lives of property, plant and equipment

The annual depreciation charge for property, plant and equipment is sensitive to changes in the estimated useful economic lives and residual values of the assets. The useful economic lives and residual values are re-assessed annually. They are amended when necessary to reflect current estimates, based on management's judgement and experience, which include the knowledge and research of the company's dedicated asset management teams. Refer to note 6 for the carrying amount of property, plant and equipment and note A3 for the useful economic lives for each class of assets.

Critical judgments in applying the entity's accounting policies

Cost capitalisation

The group capitalises expenditure on its infrastructure assets to property, plant and equipment where such expenditure enhances or increases the capacity of the network, or relates to material replacements of network components. Any expenditure classed as maintenance is expensed in the period it is incurred. Distinguishing between enhancement and maintenance expenditure is a subjective area, particularly when projects have both elements within them. Refer to note 6 for the carrying amount of property, plant and equipment.

Affinity Water Acquisitions (Investments) Limited

Notes to the financial statements

1. Revenue

	2016 £000	2015 £000
Unmeasured supplies	**130,448**	129,975
Measured supplies	**165,825**	161,182
Connection charges	**5,564**	4,695
Chargeable services	**785**	284
	302,622	296,136

All revenue is derived in the United Kingdom.

2. Operating profit

2.1 Operating costs

The following items have been charged/(credited) to either cost of sales or administrative expense in the consolidated income statement:

	2016 £000	2015 £000
Staff costs (note 3.1)	**51,865**	46,201
(Gain)/loss on disposal of property, plant and equipment	**(91)**	24
Purchase of bulk water and water supplied under statutory entitlement	**6,466**	5,497
Water abstraction charges	**3,817**	4,069
Business rates	**16,342**	16,305
Chargeable services direct expenditure	**668**	617
Credit notes received from the Environment Agency in respect of Environmental Impact Unit Charges ('EIUC') levied in 2013/14	**-**	(1,700)
Reimbursement of EIUC levied from 2008 to 2013	**-**	(3,840)
Depreciation of infrastructure assets	**10,906**	11,202
Depreciation of other property, plant and equipment	**35,533**	33,320
Amortisation of intangible assets	**5,019**	4,769
Amortisation of deferred grants and contributions	**(1,447)**	(1,475)
Impairment of trade receivables	**9,286**	9,770
Research and development	**287**	162
Operating lease rentals – land and buildings	**1,547**	1,547
Operating lease rentals – other	**1,908**	2,196
Auditor's remuneration (note 2.3)	**549**	444

2. Operating profit (continued)

2.2 Other income

	2016 £000	2015 £000
Commission and rentals	**17,195**	12,536

The majority of other income relates to commission earned by Affinity Water Limited billing and collecting charges in respect of sewerage and infrastructure within its area on behalf of Thames Water Utilities Limited and Anglian Water Services Limited.

2.3 Auditor's remuneration

During the year the company obtained the following services from its auditor and its associates:

	2016 £000	2015 £000
Fees payable to the company's auditor and its associates for the audit of the parent company and consolidated financial statements	**15**	15
Fees payable to the company's auditor and its associates for other services:		
Audit of the company's subsidiaries	**184**	198
Audit-related assurance services		
– regulatory reporting	**57**	40
– Thames Water and Anglian Water annual returns	**8**	8
– audit related assurance service - other	**22**	22
Tax advisory services	**8**	13
Other assurance services including related to bond issue	**137**	28
All other non-audit services	**118**	120
Total auditor's remuneration	**549**	444

3. Employees

3.1 Employee benefit expense (including executive directors)

Group

	2016 £000	2015 £000
Wages and salaries	**47,409**	42,335
Social security costs	**4,337**	3,968
Defined benefit pension costs (note 9)	**4,543**	4,693
Defined contribution pension costs (note 9)	**1,355**	1,244
Other pension administration costs	**1,275**	703
Staff costs	**58,919**	52,943
Staff costs capitalised	**(7,054)**	(6,742)
Staff costs recognised in the income statement	**51,865**	46,201

3.2 Average number of people employed

The average monthly number of persons (including executive directors) employed by the group during the year was:

By activity	2016	2015
Operations	**645**	617
Customer service	**349**	315
Administration	**200**	191
	1,194	1,123

The company had no employees during the current or prior years.

3.3 Directors' remuneration

The disclosure is provided in respect of the directors of Affinity Water Acquisitions (Investments) Limited and their services in respect of the Affinity Water Acquisitions (Investments) Limited group.

All but one of the directors who sit on the Board of Affinity Water Acquisitions (Investments) Limited have been appointed by Infracapital Partners II, North Haven Infrastructure Partners LP and Veolia Water UK Limited and do not receive any remuneration from the company, or any company within the Affinity Water group. Therefore the disclosure below also reflects the highest paid director of the company.

	2016 £000	2015 £000
Aggregate remuneration in respect of qualifying services	**410**	376

None of the directors of the company participate in the group's pension plans. Charges of £100,000 (2015: £100,000) have been rendered under a Management Services Agreement against Affinity Water Acquisitions Limited, a subsidiary of the group, in respect of directors who sit on its Board as representatives of Infracapital Partners II, North Haven Infrastructure Partners LP and Veolia Water UK Limited. The company does not have any listed shares and so the directors have not been offered any share incentives.

Affinity Water Acquisitions (Investments) Limited

Notes to the financial statements (continued)

3. Employees (continued)

3.4 Key management personnel compensation

	2016 £000	2015 £000
Short-term employee benefits	**1,193**	1,122
Post-employment benefits	**67**	59
	1,260	1,181

Key management personnel are considered to be directors of group companies who do not sit on the Board of the company. Only executive directors and independent non-executive directors of Affinity Water Limited receive remuneration for their services as directors. Further information can be found within the remuneration report of Affinity Water Limited's annual report and financial statements for the year ended 31 March 2016.

4. Finance income and costs

	2016 £000	2015 £000
Net income from post-employment benefits	**1,588**	816
Bank interest income	**390**	167
Total finance income	**1,978**	983
Interest payable to shareholders	**(10,532)**	(10,532)
Interest payable to related party	**(1,170)**	(1,170)
Accretion payable on bonds	**(3,189)**	(2,791)
Interest payable on bonds	**(34,754)**	(33,795)
Interest payable on borrowings held at amortised cost	**(49,645)**	(48,288)
Preference dividends and debenture interest	**(51)**	(60)
Other interest expense	**(578)**	(1,052)
Total finance costs	**(50,274)**	(49,400)
Net finance cost	**(48,296)**	(48,417)

Affinity Water Acquisitions (Investments) Limited

Notes to the financial statements (continued)

5. Income tax expense

5.1 Tax expense included in the income statement

	2016	2015
	£000	£000
Current tax:		
– UK Corporation tax on profits for the year	**70**	6,471
– Adjustment in respect of prior years	**(756)**	(413)
Total current tax	**(686)**	6,058
Deferred tax:		
– Origination and reversal of temporary differences	**7,129**	2,674
– Impact of change in tax rate	**(19,949)**	
– Adjustment in respect of prior years	**(2,865)**	9
Total deferred tax	**(15,685)**	2,683
Income tax (credit)/expense	**(16,371)**	8,741

Tax expense assessed for the period is lower (2015: lower) than the standard rate of corporation tax in the UK for the year ended 31 March 2016 of 20% (2015: 21%). The differences are explained below:

	2016	2015
	£000	£000
Profit before income tax	**34,220**	47,944
Tax calculated at the standard rate of tax in the UK of 20% (2015: 21%)	**6,844**	10,068
Tax effects of:		
– Adjustments in respect of prior years	**(3,621)**	(404)
– Expenses not deductible for tax purposes	**355**	(923)
– Impact of change in tax rate on deferred tax	**(19,949)**	-
Income tax (credit)/expense	**(16,371)**	8,741

5.2 Tax expense included in the statement of comprehensive income

	2016	2015
	£000	£000
Deferred tax:		
- Origination and reversal of temporary differences on retirement benefit surplus	**3,720**	6,080

5. Income tax expense (continued)

5.3 Factors that may affect future tax charges

The tax rate for the current year is lower than the prior year due to changes in the UK Corporation tax rate which decreased from 21% to 20% from 1 April 2015.

In October 2015 changes were enacted to the main rate of corporation tax in the UK from 20% to 19% effective from 1 April 2017 and from 19% to 18% effective from 1 April 2020.

In March 2016 a further change was announced to the main rate of corporation tax in the UK from 18% to 17% effective from 1 April 2020. As the change to 17% had not been substantively.enacted at the balance sheet date its effects are not included in these financial statements. The overall effect of that change, if it had been applied to the deferred tax balance at the balance sheet date, would be to reduce the net deferred tax liability by an additional £10,140,000 and decrease the expense for the period by £10,140,000.

Affinity Water Acquisitions (Investments) Limited

Notes to the financial statements (continued)

6. Property, plant and equipment

Group

	Land, buildings and operational structures	Potable water distribution mains	Raw water pipes	Fixed plant	Vehicles and mobile plant	Assets in course of construction	Total
	£000	£000	£000	£000	£000	£000	**£000**
Cost or deemed cost							
At 1 April 2014	270,113	701,275	19,062	547,645	27,510	89,567	1,655,172
Additions	576	17,761	-	1,703	170	62,788	82,998
Transfers	3,901	780	-	34,215	2,338	(41,234)	-
Disposals	(82)	(2,491)	(211)	-	(8,544)	-	(11,328)
At 31 March 2015	274,508	717,325	18,851	583,563	21,474	111,121	1,726,842
Accumulated depreciation							
At 1 April 2014	(69,042)	-	-	(362,360)	(24,587)	-	(455,989)
Charge for the year	(4,733)	(11,073)	(129)	(26,903)	(1,684)	-	(44,522)
Disposals	-	30	2	-	8,544	-	8,576
At 31 March 2015	(73,775)	(11,043)	(127)	(389,263)	(17,727)	-	(491,935)
Net book amount							
At 1 April 2014	201,071	701,275	19,062	185,285	2,923	89,567	1,199,183
Movement in year	(338)	5,007	(338)	9,015	824	21,554	35,724
At 31 March 2015	200,733	706,282	18,724	194,300	3,747	111,121	1,234,907
Cost or deemed cost							
At 1 April 2015	**274,508**	**717,325**	**18,851**	**583,563**	**21,474**	**111,121**	**1,726,842**
Additions	**272**	**1,831**	**-**	**1,220**	**103**	**69,210**	**72,636**
Transfers	**7,915**	**2,610**	**-**	**45,624**	**5,467**	**(61,616)**	**-**
Disposals	**-**	**(1,614)**	**(4)**	**-**	**(565)**	**-**	**(2,183)**
At 31 March 2016	**282,695**	**720,152**	**18,847**	**630,407**	**26,479**	**118,715**	**1,797,295**
Accumulated depreciation							
At 1 April 2015	**(73,775)**	**(11,043)**	**(127)**	**(389,263)**	**(17,727)**	**-**	**(491,935)**
Charge for the year	**(4,641)**	**(10,590)**	**(316)**	**(28,571)**	**(2,321)**	**-**	**(46,439)**
Disposals	**-**	**41**	**-**	**-**	**565**	**-**	**606**
At 31 March 2016	**(78,416)**	**(21,592)**	**(443)**	**(417,834)**	**(19,483)**	**-**	**(537,768)**
Net book amount							
At 1 April 2015	**200,733**	**706,282**	**18,724**	**194,300**	**3,747**	**111,121**	**1,234,907**
Movement in year	**3,546**	**(7,722)**	**(320)**	**18,273**	**3,249**	**7,594**	**24,620**
At 31 March 2016	**204,279**	**698,560**	**18,404**	**212,573**	**6,996**	**118,715**	**1,259,527**

All land and buildings are held as freehold.

Company

The company does not have any property, plant or equipment.

7. Intangible assets

Group	Goodwill £000	Internally generated software development costs £000	**Total £000**
Cost			
At 1 April 2014	126,971	43,308	170,279
Additions	-	5,791	5,791
Disposals	-	(13,369)	(13,369)
At 31 March 2015	126,971	35,730	162,701
Accumulated amortisation			
At 1 April 2014	-	(21,737)	(21,737)
Charge for the year	-	(4,769)	(4,769)
Disposals	-	13,369	13,369
At 31 March 2015	-	(13,137)	(13,137)
Net book amount			
At 1 April 2014	126,971	21,571	148,542
Movement in year	-	1,022	1,022
At 31 March 2015	126,971	22,593	149,564
Cost			
At 1 April 2015	**126,971**	**35,730**	**162,701**
Additions	**-**	**11,099**	**11,099**
At 31 March 2016	**126,971**	**46,829**	**173,800**
Accumulated amortisation			
At 1 April 2015	**-**	**(13,137)**	**(13,137)**
Charge for the year	**-**	**(5,019)**	**(5,019)**
At 31 March 2016	**-**	**(18,156)**	**(18,156)**
Net book amount			
At 1 April 2015	**126,971**	**22,593**	**149,564**
Movement in year	**-**	**6,080**	**6,080**
At 31 March 2016	**126,971**	**28,673**	**155,644**

Affinity Water Limited, the group's principal trading company, is the only cash generating unit ('CGU'). It constitutes the smallest identifiable group of assets that generate cash flows for the entity, by means of supplying drinking water to customers. The recoverable amount has been determined using the regulatory capital value of Affinity Water Limited at 31 March 2016. Per management's assessment it has been determined that the headroom is such that no reasonable change in any key assumptions is expected to result in impairment of the goodwill recognised.

Company

The company does not have any intangible assets.

8. Investments

Group

	2016 £000	2015 £000
Investments (refer to note A6)	**51**	51

The directors believe that the carrying value of investments is supported by their underlying net assets.

Company

	2016 £000	2015 £000
Investment in subsidiary (refer to note A6)	**340,777**	340,777

The investment balance in the company relates to Affinity Water Acquisitions (Holdco) Limited. The directors believe that the carrying value of the investment is supported by its underlying net assets.

9. Retirement benefit surplus

Group

Defined benefit section

The net pension expense before taxation recognised in the income statement in respect of the defined benefit plan is:

	2016 £000	2015 £000
Current service cost	**(4,543)**	(4,918)
Pension expense charged to operating profit	**(4,543)**	(4,918)
Net pension interest income credited to finance income	**1,588**	816
Net pension expense charged before taxation	**(2,955)**	(4,102)

The opening and closing retirement benefit surpluses included in the statement of financial position are summarised as follows:

	2016 £000	2015 £000
At 1 April	**45,098**	10,006
Employer contributions	**9,778**	8,795
Current service cost	**(4,543)**	(4,918)
Net interest income	**1,588**	816
Net re-measurement gain	**20,667**	30,399
At 31 March	**72,588**	45,098

Re-measurement gains and losses are recognised directly in the statement of comprehensive income and are summarised as follows:

	2016 £000	2015 £000
Re-measurement (losses)/gains on plan assets	**(5,311)**	60,338
Re-measurement gains/(losses) on plan liabilities	**25,978**	(29,939)
	20,667	30,399

Further analysis and underlying assumptions of the defined benefit plan are provided in note A5.

Company

The company does not have any retirement benefit surplus.

10. Inventories

Group

	2016 £000	2015 £000
Raw materials and consumables	**1,222**	1,262

Inventories are stated after provisions for impairment of £603,000 (2015: £517,000).

Company

The company does not have any inventories.

11. Trade and other receivables

Group

	2016 £000	2015 £000
Trade receivables	**54,883**	55,364
Less: provision for impairment of trade receivables	**(26,313)**	(24,645)
Trade receivables - net	**28,570**	30,719
Amounts owed by related parties	**778**	565
Other receivables	**4,269**	4,318
Unbilled accrual for metered customers	**41,455**	39,876
Prepayments and accrued income	**5,815**	5,492
	80,887	80,970

The carrying amounts of trade and other receivables approximate to their fair value.

Company

The company does not have any trade and other receivables

11.1 Provision for impairment of trade receivables

Trade receivables do not carry interest and are stated net of a provision for impairment, as follows:

	2016 £000	2015 £000
At 1 April	**24,645**	24,324
Provision for receivables impairment charged to income statement	**9,286**	9,770
Receivables written off during the year as uncollectable	**(7,618)**	(9,449)
At 31 March	**26,313**	24,645

At 31 March 2016 and 2015, the group had no trade receivables that were overdue and not individually impaired.

Affinity Water Acquisitions (Investments) Limited

Notes to the financial statements (continued)

11. Trade and other receivables (continued)

11.2 Aging analysis of trade receivables

The aged analysis of trade receivables at the reporting date is as follows:

	2016 £000	2015 £000
Aged less than one year	**16,996**	19,990
Aged between one year and two years	**10,687**	9,813
Aged greater than two years	**887**	916
	28,570	30,719

12. Cash and cash equivalents

Group

	2016 £000	2015 £000
Cash at bank and in hand	**23,626**	30,359
Term deposits	**70,169**	30,000
	93,795	60,359

The carrying amounts of cash and cash equivalents approximate to their fair value.

Company

The company does not have any cash or cash equivalents.

13. Share capital

Group and company

Allotted, called up and fully paid share capital	2016 £000	2015 £000
340,776,655 (2015: 340,776,655) ordinary shares of £0.01 each	**3,408**	3,408

The company was incorporated on 12 June 2012 with a share capital of 316,382,004 ordinary shares of £1 each. There was a further capital injection on 18 July 2012 for an amount of £24,394,651 upon the issuance of 24,394,651 additional ordinary shares of £1 each. On 21 December 2012, the directors approved a capital reduction by reducing the share capital from £340,776,655 divided into 340,776,655 ordinary shares of £1 each to £3,407,767 divided into 340,776,655 ordinary shares of £0.01.

Infracapital Partners II owns 189,320,364 of the above shares and North Haven Infrastructure Partners LP owns the remaining 151,456,291.

Affinity Water Acquisitions (Investments) Limited

Notes to the financial statements (continued)

14. Trade and other payables

Group

	2016 £000	2015 £000
Non-current		
Amounts falling due after more than one year		
Deferred grants and contributions	**5,807**	6,133
Amounts falling due after more than five years		
Deferred grants and contributions	**82,170**	78,825
	87,977	84,958
Current		
Amounts falling due within one year		
Trade payables	**8,120**	14,118
Amounts due to related parties	**494**	791
Interest payable	**12,642**	12,347
Interest payable to external parties	**63**	159
Social security and other taxes	**1,237**	1,276
Other payables	**9,089**	13,209
Capital accruals	**17,022**	19,570
Deferred grants and contributions	**1,187**	1,166
Payments received in advance	**47,522**	41,951
Other accruals and deferred income	**34,826**	27,177
	132,202	131,764
	220,179	216,722

The carrying amounts of trade and other payables approximate to their fair value.

Company

The company does not have any trade and other payables.

15. Borrowings

Group

	2016 £000	2015 £000
Borrowings measured at amortised cost:		
Bonds	**898,659**	831,492
Loans from shareholders	**117,018**	117,018
Loan from related party	**13,002**	13,002
4% irredeemable consolidated debenture stock	**8**	8
4% irredeemable debenture stock	**1**	1
5% irredeemable debenture stock	**24**	24
5.25% irredeemable debenture stock	**1**	1
	1,028,713	961,546

On 13 July 2004, Affinity Water Finance (2004) PLC, a subsidiary of the group, issued a £200.0m bond at an interest rate of 5.875% and repayable in July 2026. On 16 July 2014 Affinity Water Finance (2004) PLC completed a tap issue of £50.0m on the same terms as the existing £200.0m bond.

On 4 February 2013, Affinity Water Programme Finance Limited, a subsidiary of the group, issued £80.0m Class A guaranteed notes maturing in September 2022 with a coupon of 3.625%, £250.0m Class A guaranteed notes maturing in March 2036 with a coupon of 4.500%, £150.0m Class A guaranteed RPI linked notes maturing in June 2045 with a coupon of 1.548% and £95.0m Class B guaranteed RPI linked notes maturing in June 2033 with a coupon of 3.249%. On 29 October 2015 Affinity Water Programme Finance Limited completed a tap issue of its 1.548% RPI linked notes maturing in June 2045 of £40.0m on the same terms as the existing 2045 notes. On 19 February 2016, Affinity Water Programme Finance Limited issued £10.0m Class B guaranteed RPI linked notes maturing in June 2033 with a coupon rate of 1.024%. The net proceeds from both the above issues were then lent by these companies to their immediate parent undertaking, Affinity Water Limited, on the same terms.

Affinity Water Limited, a subsidiary of the group, has unconditionally and irrevocably guaranteed the due and punctual payment of all sums from time to time payable by Affinity Water Finance (2004) PLC and Affinity Water Programme Finance Limited in respect of the issued bonds. This guarantee constitutes direct, general and unconditional obligations of the company which will at all times rank at least pari passu with all other present and future unsecured obligations. These issues are also guaranteed by Affinity Water Holdings Limited, the immediate parent undertaking of Affinity Water Limited.

The fair value of the bonds at 31 March 2016 is £1,056,079,000 (2015: £1,006,791,000), which has been derived from 'level 1' fair value measurements: quoted prices (unadjusted) in active markets for identical liabilities.

Affinity Water Limited is subject to a number of covenants in relation to the group's borrowings, which, if breached, would result in its loans becoming immediately repayable. These covenants specify certain limits in terms of key ratios such as net cash flow to debt interest and net debt to regulatory capital value. At 31 March 2016 Affinity Water Limited was not in breach of any financial covenants.

The loans from shareholders relate to a £65,010,000 loan from Infracapital F2 Rift S.à.r.l. and £52,008,000 from MSIP Dalis B.V. The loan from related party relates to a loan from Veolia Water UK Limited.

Notes to the financial statements (continued)

15. Borrowings (continued)

Company

The company does not have any borrowings.

16. Deferred income tax liabilities

16.1 Analysis of deferred tax assets and deferred tax liabilities

Group

	2016 £000	2015 £000
Deferred tax assets:		
– Deferred tax asset to be recovered after more than 12 months	**(881)**	(857)
– Deferred tax asset to be recovered within 12 months	**-**	(6,289)
	(881)	(7,146)
Deferred tax liabilities:		
– Deferred tax liability to be recovered after more than 12 months	**185,533**	203,763
	185,533	203,763
Deferred tax liabilities - net	**184,652**	196,617

The gross movement on the deferred income tax account is as follows:

	2016 £000	2015 £000
At 1 April	**196,617**	187,855
(Credited)/charged to the income statement	**(15,685)**	2,682
Charged to other comprehensive income	**3,720**	6,080
At 31 March	**184,652**	196,617

Company

The company does not have any deferred income tax assets or liabilities.

Affinity Water Acquisitions (Investments) Limited

Notes to the financial statements (continued)

16. Deferred income tax liabilities (continued)

The movement in deferred income tax assets and liabilities during the year is as follows:

16.2 Deferred tax liabilities

	Accelerated capital allowances £000	Retirement benefit obligations £000	Total £000
At 1 April 2014	193,345	2,002	195,347
Charged to the income statement	1,398	938	2,336
Charged to other comprehensive income	-	6,080	6,080
At 31 March 2015	**194,743**	**9,020**	**203,763**
(Credited)/charged to the income statement	(22,276)	326	(21,950)
Charged to other comprehensive income	-	3,720	3,720
At 31 March 2016	**172,467**	**13,066**	**185,533**

16.3 Deferred tax assets

	Provisions £000	Other £000	Total £000
At 1 April 2014	(2,032)	(5,460)	(7,492)
Charged/(credited) to the income statement	559	(213)	346
At 31 March 2015	**(1,473)**	**(5,673)**	**(7,146)**
Charged to the income statement	592	5,673	6,265
At 31 March 2016	**(881)**	**-**	**(881)**

Affinity Water Acquisitions (Investments) Limited

Notes to the financial statements (continued)

17. Provisions for other liabilities and charges

Group

	Insurance £000	Other £000	Total £000
At 1 April 2014	1,609	2,217	3,826
Charged to the income statement	15	-	15
Utilised in the year	-	(1,093)	(1,093)
At 31 March 2015	**1,624**	**1,124**	**2,748**
Charged to the income statement	126	251	377
Utilised in the year	(240)	-	(240)
At 31 March 2016	**1,510**	**1,375**	**2,885**

Insurance

Insurance represents the amount of the group's liability in respect of individual claims. This is based upon data provided by loss adjusters to insurers and is calculated on settlement experience.

Other provisions

Other provisions include £670,000 (2015: £670,000) in relation to unfunded pension liabilities for a former non-executive director, which will be utilised over the 20 years from January 2019. The remaining balance relates to outstanding legal claims at 31 March 2016.

Company

The company does not have any provision for liabilities and other charges.

18. Dividends

	2016 £000	2015 £000
First interim paid of 2.601p per share (2015: 3.829p)	**8,865**	13,050
Second interim paid of 1.360p per share (2015: 0.462p)	**4,635**	1,574
Third interim paid of 2.016p per share (2015: 2.007p)	**6,870**	6,840
Fourth interim paid of 2.113p per share	**7,200**	-
	27,570	21,464

19. Cash generated from operations

	2016 £000	2015 £000
Profit before income tax	**34,220**	47,944
Adjustments for:		
Depreciation of property, plant and equipment (note 6)	**46,439**	44,522
Amortisation of grants and contributions	**(1,447)**	(1,475)
Amortisation of intangible fixed assets (note 7)	**5,019**	4,769
Profit/(loss) on disposal of property, plant and equipment	**(91)**	24
Loss on disposal of infrastructure assets	**1,577**	2,670
Post-employment benefits	**(5,235)**	(3,877)
Finance costs – net (note 4)	**48,296**	48,417
Changes in working capital		
– Inventories	**40**	150
– Trade and other receivables	**(83)**	(186)
– Trade and other payables		
– provision element	**137**	(1,078)
– other	**(92)**	10,787
Cash generated from operations	**128,780**	152,667

20. Commitments

20.1 Capital commitments

Capital expenditure contracted for at the end of the reporting period but not yet incurred is as follows:

Group

	2016 £000	2015 £000
Property, plant and equipment	**22,333**	9,454
Intangible assets	**900**	946
	23,233	10,400

Company

The company does not have any capital commitments.

20.2 Commitments under operating leases

The future aggregate minimum lease payments under non-cancellable operating leases are as follows:

Group

	2016		2015	
	Land and buildings £000	**Other £000**	Land and buildings £000	Other £000
No later than one year	**1,547**	**1,751**	1,547	1,497
Later than 1 year and no later than 5 years	**6,187**	**2,721**	6,187	2,550
Later than 5 years	**6,832**	**2**	8,379	-
	14,566	**4,474**	16,113	4,047

Company

The company does not have any commitments under operating leases.

21. Billing on behalf of Thames Water and Anglian Water

The group's principal trading subsidiary, Affinity Water Limited, bills and collects charges in respect of sewerage and infrastructure within its area on behalf of Thames Water Utilities Limited and Anglian Water Services Limited. No amounts are included in these financial statements in respect of uncollected sewerage and sewerage infrastructure charges at 31 March 2016 (2015: £nil).

Affinity Water Acquisitions (Investments) Limited

Notes to the financial statements (continued)

22. Events after the reporting period

There were no significant events after the end of the reporting period.

23. Ultimate parent company and controlling party

Affinity Water Acquisitions (Investments) Limited, a company registered in England and Wales, is the parent undertaking of the smallest and largest group to consolidate the statutory financial statements of this group.

The directors consider that Affinity Water Acquisitions (Investments) Limited is the ultimate holding and controlling company in the United Kingdom.

Affinity Water Acquisitions (Investments) Limited is owned by a consortium of investors led by Infracapital Partners II (consisting of Infracapital Partners II LP and Infracapital Partners (NT) II LP) and North Haven Infrastructure Partners LP. Veolia Environnement S.A. holds a 10% shareholding in Affinity Water Acquisitions (Holdco) Limited, the direct subsidiary of Affinity Water Acquisitions (Investments) Limited, through its subsidiary Veolia Water UK Limited. The directors consider Infracapital Partners II and North Haven Infrastructure Partners LP to be the company's ultimate controllers, as they are in a position to exercise material influence over the company's policy and affairs.

Infracapital Partners II is a European infrastructure fund managed by M&G Alternatives Investment Management Limited, a subsidiary of Prudential plc. Infracapital Partners II LP was established in 2010 and Infracapital Partners (NT) II LP was established in 2012, to make investments in income-generative infrastructure assets and businesses, including electricity and gas networks, water companies, transport infrastructure and renewable energy.

North Haven Infrastructure Partners LP is a leading global infrastructure investment fund. It is managed by Morgan Stanley Infrastructure Inc., part of the investment management division of Morgan Stanley. North Haven Infrastructure Partners LP targets core infrastructure assets that provide essential public goods and services to societies across the globe and seeks to improve asset performance using active management.

Affinity Water Acquisitions (Investments) Limited

Notes to the financial statements – appendices

A1. General information

The group owns and manages the water assets and network in an area of approximately 4,515km^2 split over three regions, comprising eight separate water resource zones, in the southeast of England. Affinity Water Limited, the group's principal trading indirect subsidiary, is the sole supplier of drinking water in these areas.

The company manages an investment in Affinity Water Acquisitions (Holdco) Limited.

The company is a private company and is incorporated and domiciled in the United Kingdom. The address of its registered office is Tamblin Way, Hatfield, Hertfordshire, AL10 9EZ.

Refer to note 23 for details of the company's controlling company.

A2. Segmental reporting

As financial information was reported to the Board, the group's chief operating decision maker, during the current and previous financial year on a combined basis, the group and company present their results under a single segment for financial reporting purposes.

A3. Accounting policies

Property, plant and equipment

Property, plant and equipment are held at historical cost (or deemed cost for infrastructure assets held on transition to IFRS, refer to note A8) less accumulated depreciation and impairment charges.

Infrastructure assets comprise a network of mains and associated underground pipe-work. Infrastructure assets are held at deemed cost established through an event-driven valuation on transition to IFRS and subsequent additions are recorded at historical cost less accumulated depreciation and impairment charges.

For accounting purposes the network is segmented into components based on the material used to construct the pipe concerned. The estimated useful economic lives of infrastructure pipes are based on management's judgement and experience, which includes the knowledge and research of the group's dedicated asset management teams. Where management identifies that the actual useful economic life of an asset significantly differs from the estimate used to calculate its depreciation, the depreciation charge is adjusted prospectively.

Expenditure on infrastructure assets relating to increases in capacity, enhancements or material replacements of network components is capitalised where it can be reliably measured and it is probable that incremental future economic benefits will flow to the group. The carrying amount of the replaced part is derecognised. Costs of day-to-day servicing of network components are recognised in the income statement as they arise.

Cost for other property, plant and equipment includes own work capitalised comprising the direct costs of materials, labour and applicable overheads.

A3. Accounting policies (continued)

Property, plant and equipment (continued)

Property, plant and equipment are depreciated to their estimated residual values over their estimated useful lives using the straight-line method, with the exception of freehold land which is not depreciated. Assets in the course of construction are not depreciated until commissioned.

The estimated useful lives are:

Infrastructure assets

Potable water distribution mains	50-150 years
Raw water pipes	50-150 years

Other property, plant and equipment

Buildings	40-60 years
Operational structures	5-85 years
Fixed plant – short life	3-10 years
– other	10-30 years
Vehicles and mobile plant	3-10 years

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in operating profit.

The group is required to evaluate the carrying value of its property, plant and equipment for impairment whenever circumstances indicate, in management's judgement, that the carrying value of such assets may not be recoverable. An impairment review in such circumstances requires management to make subjective judgements concerning the future cash flows, growth rates and discount rates of the CGU under review.

Intangible assets

Goodwill

Goodwill represents the excess of the fair value of purchase consideration transferred over the fair value of the net assets of the subsidiary acquired. Fair value adjustments based on provisional estimates are amended within one year of the acquisition, if required, with a corresponding adjustment to goodwill.

Goodwill is not amortised but is reviewed for impairment at least annually. Impairment reviews are also carried out if there is an indication that impairment may have occurred, or, where otherwise required, to ensure that fixed assets are not carried above their estimated recoverable amounts. Goodwill is allocated to the CGU that derives benefit from the goodwill for impairment testing purposes. Impairments are recognised immediately in the income statement.

Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the enity sold.

A3. Accounting policies (continued)

Intangible assets (continued)

Computer software

Costs associated with maintaining computer software programmes are recognised as an expense as incurred. Development costs that are directly attributable to the design and testing of identifiable and unique software products controlled by the group are recognised as intangible assets only if they meet the criteria of IAS 38: 'Intangible Assets'.

Other development expenditures that do not meet these criteria are recognised as an expense as incurred.

Computer software development costs recognised as assets are amortised on a straight-line basis over their estimated useful lives, which does not exceed five years. Amortisation charged on assets with finite lives is recognised in the income statement in operating costs.

Intangible assets are reviewed for impairment where indicators of impairment exist. Impairments are recognised immediately in the income statement.

Grants and contributions

Grants and contributions received in respect of property, plant and equipment are treated as deferred income and released to cost of sales over the useful economic life of the property, plant and equipment to which they relate. Grants and contributions which are given in compensation for expenses incurred with no future related costs are recognised in revenue in the income statement in the period that they become receivable.

These grants and contributions are not government grants within the scope of IAS 20: 'Accounting for government grants and disclosure of government assistance'.

Investment in subsidiaries

The company's investments in subsidiaries are held at cost less accumulated impairment losses.

Trade receivables

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment.

The provision for impairment is based on experience and calculated by applying a range of different percentages to trade receivables of different ages. These percentages also vary between categories of trade receivables. Higher percentages are applied to those categories of trade receivables which are considered to be of greater risk and also to trade receivables of greater age.

Inventories

Inventories are valued at the lower of cost or net realisable value after allowance for obsolete and slow moving items. In accordance with established practice in the water industry, no value has been placed upon the water in reservoirs, mains or in the course of treatment.

A3. Accounting policies (continued)

Cash and cash equivalents

Cash and cash equivalents include cash at bank and in hand, deposits held at call with banks and other short-term highly liquid investments with original maturities of three months or less. Term deposits with original maturities longer than three months that can be redeemed, subject to the interest income being forfeited, are classed as cash and cash equivalents if the deposit is held to meet short term cash needs and there is no risk of a significant change in value as a result of an early withdrawal.

Current and deferred income tax

The tax expense 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 shareholder's funds. In this case, the tax is also recognised in other comprehensive income or directly in shareholder's funds, respectively.

The current income tax charge is based on taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the date of the statement of financial position.

Deferred taxation is provided in full, using the liability method, on taxable temporary differences between the tax bases of assets and liabilities and their carrying amounts in the financial statements. A deferred tax asset is only recognised to the extent that it is probable that sufficient taxable profits will be available in the future to utilise it. Deferred taxation is measured on a non-discounted basis using the tax rates and laws that have been enacted or substantively enacted by the date of the statement of financial position and are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

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

Payables

Payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

Borrowings

All loans are recognised initially at fair value plus directly attributable transaction costs. The carrying amount of the debt is increased by the amortisation of the finance and transaction costs determined using the effective interest rate in respect of the accounting period and reduced by any payments made in the year. The finance cost recognised in the income statement is allocated to accounting periods over the term of the debt using the effective interest method.

Provisions

A provision is recognised when the group has a legal or constructive obligation as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation, and the amount can be reliably estimated.

A3. Accounting policies (continued)

Revenue recognition

Revenue represents the fair value of the income receivable in the ordinary course of business for goods and services provided. The group recognises revenue when the amount of revenue can be reliably measured, when it is probable that future economic benefit will flow to the entity and when specific criteria have been met.

Charges billed to customers for water provided are recognised in the year in which they are earned. An accrual is estimated for unmeasured consumption relating to metered customers that has not yet been billed. The accrual is estimated using a defined methodology based upon weighted average water consumption by tariff, which is calculated based upon historical information. The group does not recognise revenue where historical evidence indicates that the group will probably never be able to collect the revenue billed.

Where an invoice has been raised and payment received but the service has not been provided in the year this will be treated as a payment in advance. The value of such invoices raised will not be recognised within the current year's revenue but will instead be recognised within payables as deferred income.

Other income

Other income includes all income derived from sources associated with the ordinary activities of the business, other than revenue derived from the regulatory activities of the business. It is stated net of value added taxes.

Interest income

Interest income is recognised using the effective interest method. When a loan receivable is impaired, the group reduces the carrying amount to its recoverable amount, being the estimated future cash flow discounted at the original effective interest rate of the instrument, and continues unwinding the discount as interest income.

Leases

Leases in which substantially all the risks and rewards of ownership are retained by the lessor are classified as operating leases. Operating lease rentals are charged to the income statement on a straight-line basis over the period of the lease.

A3. Accounting policies (continued)

Grafham reservoir

Under the Great Ouse Water Act of 1961, the group has an entitlement to water from the Grafham reservoir owned and operated by Anglian Water Services Limited ('Anglian Water'). The group pays Anglian Water a charge for the supply of water, which covers its share of the overall costs of running Grafham Reservoir. These costs are recognised as an expense in the income statement as incurred.

Retirement benefits

The group operates a pension plan (the AWPP) providing defined benefits based on final pensionable salary. The assets of the plan are held separately from those of the group. The plan's corporate trustee is a subsidiary of the group.

The cost of providing benefits under the defined benefit plan is determined using the projected unit method, which attributes entitlement to benefits to the current period (to determine current service cost) and to the current and prior periods (to determine the present value of defined benefit obligations) and is based on actuarial advice. Past service costs are recognised immediately in the income statement. When a settlement or a curtailment occurs, the changes in the present value of the plan liabilities and the fair value of the plan assets reflect the gain or loss which is recognised in the income statement. Losses are measured at the date that the employer becomes demonstrably committed to the transaction and gains when all parties whose consent is required are irrevocably committed to the transaction.

The retirement benefit surplus or deficit in the statement of financial position comprises the present value of the defined benefit obligation (using a discount rate based on high quality corporate bonds), less any past service cost not yet recognised and less the fair value of plan assets out of which the obligations are to be settled directly. Fair value is based on market price information and in the case of quoted securities is the published bid price.

Re-measurement gains and losses arising from changes in actuarial assumptions are charged or credited to shareholder's funds in other comprehensive income in the period in which they arise.

The amount charged or credited to finance costs is a net interest amount calculated by applying the liability discount rate to the net defined benefit asset or liability.

Contributions to the defined contribution section of the plan are recognised in the income statement in the period in which they become payable.

The group also has an obligation to pay pensions to former non-executive directors of predecessor companies. A provision in respect of the obligation is included within the net pension asset or liability.

Dividend distributions

Dividend distributions to the group's shareholders are recognised as a liability in the group's financial statements in the period in which the dividends are approved by the group's shareholders.

A4. Financial instruments and risk management

Risk management

The group's financial instruments comprise borrowings, debentures, cash and liquid resources, and various items, such as trade receivables and trade payables that arise directly from operations. The main purpose of these financial instruments is to provide finance for the group's operations. The group finances its operations through a mixture of retained profits, borrowings from its subsidiary companies and debentures.

It is the group's policy, and has been throughout the year under review, that no trading in financial instruments shall be undertaken.

The main risks arising from the group's financial instruments are liquidity risk, credit risk, and interest rate and inflation risk.

The Board reviews and agrees policies for managing each of these risks (refer to page 5 of the strategic report for further information on management of these risks). These policies have remained unchanged during the year.

Day-to-day responsibility for operational compliance with the treasury policies rests with the treasurer. A treasury report is provided monthly to the Board, which summarises treasury activities and includes details on the group's position in regards to debt and cash at the end of the month.

The group's treasury function does not act as a profit centre and does not undertake speculative transactions.

Liquidity risk

The objective of the group's liquidity risk management policy is to ensure that the group has banking arrangements and adequate, though not excessive, cash resources, borrowing arrangements and standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business and service objectives.

Liquidity risk is primarily managed by maintaining a level of liquidity such that there are sufficient cash balances and committed loan facilities capable of immediate draw down to cover as a minimum the next twelve months' forecast cash requirement ensuring that over-reliance is not placed on any one counterparty, whether through cash holdings or available facilities.

Liquidity is actively monitored by the group's treasury function and reported to the Board on a monthly basis through the treasury report.

At 31 March 2016, the group had £251,795,000 (2015: £218,359,000) of available liquidity, which comprised £93,795,000 (2015: £60,359,000) of cash and term deposits and £158,000,000 (2015: £158,000,000) of undrawn committed borrowing facilities.

Notes to the financial statements – appendices (continued)

A4. Financial instruments and risk management (continued)

Liquidity risk (continued)

The group had available the following undrawn borrowing facilities:

	2016	2015
	£000	£000
Floating rate:		
– Expiring within one year	**58,000**	58,000
– Expiring in more than one year but not more than two years	**-**	-
– Expiring in more than five years	**100,000**	100,000
	158,000	158,000

In July 2015 the group refinanced its existing £100,000,000 syndicated facility provided by five banks. The facility has been replaced with two revolving credit facilities, £60,000,000 provided by Barclays Bank PLC and £40,000,000 provided by Lloyds Bank PLC. The facilities are intended for the purpose of financing capital expenditure and working capital requirements to the extent that additional funding is required.

The group also has available two liquidity facilities with different counterparties in the event of a liquidity shortfall: a 364 day revolving Debt Service Reserve Facility of £38,000,000, which is intended for the purpose of funding any debt service payments, and a 364 day revolving Operations and Maintenance Reserve Facility of £20,000,000, which is intended for the purpose of funding operating and capital maintenance expenditure.

Maturity analysis

Additional risk may arise if large cash flows are concentrated within particular time periods. The maturity profile in the following table represents the forecast future contractual principal and interest cash flows in relation to the group's financial liabilities with agreed repayment periods on an undiscounted basis.

At 31 March 2016	**Total**	**1 year or less**	**1-2 years**	**2-3 years**	**3-4 years**	**4-5 years**	**More than 5 years**
	£000	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
Bonds	**1,509,856**	**35,361**	**35,533**	**35,717**	**35,907**	**36,101**	**1,331,237**
Loan from shareholders	**235,499**	**10,532**	**10,532**	**10,532**	**10,532**	**10,532**	**182,839**
Loan from related party	**26,187**	**1,170**	**1,170**	**1,170**	**1,170**	**1,170**	**20,337**
	1,771,542	**47,063**	**47,235**	**47,419**	**47,609**	**47,803**	**1,534,413**

At 31 March 2015	Total	1 year or less	1-2 years	2-3 years	3-4 years	4-5 years	More than 5 years
	£000	£000	£000	£000	£000	£000	£000
Bonds	1,458,586	34,530	34,643	34,780	34,943	35,111	1,284,579
Loan from shareholders	246,030	10,532	10,532	10,532	10,532	10,532	193,370
Loan from related party	27,359	1,170	1,170	1,170	1,170	1,170	21,509
	1,731,975	46,232	46,345	46,482	46,645	46,813	1,499,458

Notes to the financial statements – appendices (continued)

A4. Financial instruments and risk management (continued)

Credit risk

Credit risk arises principally from trading (the supply of services to customers) and treasury activities (the depositing of cash). The group does not believe it is exposed to any material concentrations of credit risk.

The group manages its risk from trading through effective management of customer relationships. Concentrations of credit risk with respect to trade receivables are limited due to the group's customer base consisting of a large number of unrelated households and businesses. The Water Industry Act 1991 (as amended by the Water Industry Act 1999) prohibits the disconnection of a water supply and the limiting of supply with the intention of enforcing payment for certain premises, including domestic dwellings. However allowance is made by the water industry economic regulator in revenue limits at each price review for a proportion of receivables deemed to be irrecoverable. Therefore the directors of the group do not believe there is any further credit risk provision required in excess of the provision for impairment of trade receivables (see note 11).

The group manages its risk from treasury activities by ensuring counterparties meet the minimum credit requirements approved by the Board, which include a maximum peak exposure limit and minimum credit rating. Credit exposure is monitored regularly by the group's treasury function and is reported monthly to the Board through the treasury report.

At 31 March 2016 and 31 March 2015, the maximum exposure to credit risk was represented by the carrying amount of each financial asset in the statement of financial position:

	2016	2015
	£000	£000
Cash and term deposits (note 12)	**93,795**	60,359
Trade and other receivables (note 11)	**80,887**	80,970
	174,682	141,329

Interest rate and inflation risk

The group seeks to manage its interest rate risk by maintaining its exposure within a board approved range, primarily through using a mixture of fixed, inflation linked and floating rate borrowings.

The group earns an economic return on its RCV, comprising a real return through revenues and an inflation return as an uplift to its RCV. To the extent that nominal debt liabilities finance a proportion of the RCV, there is an asset liability mismatch which potentially exposes the group to the risk of economic loss where actual inflation is lower than that implicitly locked in through nominal debt. The group's index-linked borrowings, which are linked to RPI inflation, form a partial economic hedge of the group's regulatory assets, which are also linked to RPI inflation.

Interest rate and inflation risk is reported monthly to the Board through the treasury report.

Affinity Water Acquisitions (Investments) Limited

Notes to the financial statements – appendices (continued)

A4. Financial instruments and risk management (continued)

Interest rate and inflation risk (continued)

The interest rate profile of the group's debt is as follows:

As at	Fixed rate debt £000	RPI-linked debt £000	Total £000
31 March 2016	**710,358**	**318,355**	**1,028,713**
31 March 2015	710,473	251,073	961,546

Sensitivity analysis

The following table details the sensitivity of profit before taxation to changes in RPI on the group's index-linked borrowings. The analysis relates to the position at the reporting date and is not indicative of the years then ended, as these factors would have varied throughout the year.

	2016 £000	2015 £000
1 per cent increase in RPI	**(3,156)**	(2,621)
1 per cent decrease in RPI	**3,154**	2,621

The analysis assumes a one per cent change in RPI having a corresponding one per cent impact on this position over a 12-month period.

Currency risk

The group has no material net exposure to movements in currency rates.

Capital risk management

The policy approved by the Board is a target gearing, measured as net debt (as defined in Affinity Water Limited's WBS documentation) to RCV, of 80%. This allows sufficient headroom within the group's financial covenants, which are triggered at a level of more than 90%. Affinity Water Limited's gearing on this basis was 75% at 31 March 2016 (80% at 31 March 2015).

Assuming no significant changes to existing credit rating agencies' methodologies or sector risk assessments, the group aims to maintain the existing credit ratings of A3 with Moody's and A- with Standard & Poors for the Class A bonds issued by its financing subsidiaries. These ratings are used by the industry's economic regulator, Ofwat, to assess the group's ability to comply with its licence requirement to maintain an investment grade credit rating.

The group looks to manage its risk by monitoring and maintaining the relevant key financial ratios used by the credit rating agencies to determine the credit ratings given. Further detail on the precise measures and methodologies used to assess water companies' credit ratings can be found in the methodology papers published by the rating agencies. Gearing and credit ratings are reported monthly to the Board through the treasury report.

A5. Retirement benefits

Defined benefit section

The group's pension plan providing benefits based on final pensionable salary is closed to new members (the two precursor plans closing in April 1996 and September 2004). The assets of the AWPP are held separately from those of the group. The plan's corporate trustee (the 'Trustee') is a subsidiary of the group.

The risks of the plan are as follows:

Asset volatility

The plan liabilities are calculated using a discount rate set with reference to high quality corporate bond yields. If plan assets underperform this yield, this will create a deficit.

The plan holds a significant proportion of equities, which are expected to outperform corporate bonds in the long-term while providing volatility and risk in the short-term. As the plan further matures, the Trustee intends to reduce the level of investment risk by investing more in assets that better match the liabilities and expected cash outflows based on the plan's maturity profile.

The group believes that due to the strength of its business and the long-term nature of the plan liabilities, a level of continuing equity investment is an appropriate element of the Trustee's long term strategy to manage the plan efficiently.

Changes in bond yield

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

Life expectancy

The majority of the plan's obligations are to provide benefits for the life of the members, so increases in life expectancy will result in an increase in the plan's liabilities.

Inflation risk

The pension obligations are linked to inflation, and higher inflation will lead to higher liabilities (although, in most cases, caps on the level of inflationary increases are in place to protect the plan against extreme inflation). However, the Trustee has increased the level of interest rate and inflation hedging provided by the plan's assets through Liability Driven Investment.

Affinity Water Acquisitions (Investments) Limited

Notes to the financial statements – appendices (continued)

A5. Retirement benefits (continued)

The latest formal valuation of the AWPP, determined by an independent qualified actuary, was at 31 March 2013. This actuarial valuation was made on the "attained age" funding method, based on the following assumptions:

RPI inflation:	measured by reference to the Bank of England gilt inflation curve less an allowance for an inflation risk premium of 0.15% per annum;
CPI inflation:	measured by reference to the RPI inflation curve described above less 0.7% per annum;
Pre-retirement discount rate:	measured by reference to the Bank of England gilt yield curves plus 2.5% per annum;
Post retirement discount rate:	measured by reference to the Bank of England gilt yield curves plus 0.5% per annum;
Salary increases:	measured by reference to the RPI inflation curve described above plus 1% per annum;
Deferred pension increases:	measured by reference to the CPI or RPI inflation curves described above with an appropriate adjustment for any caps and collars; and
Pension increases:	measured by reference to the CPI or RPI inflation curves described above with an appropriate adjustment for any caps and collars.

Defined benefit section – funding requirements

Based on the actuarial valuation at 31 March 2013, the contributions expected to be paid in the year ending 31 March 2017 are £9,656,000 (£9,174,000 in the year ended 31 March 2016). A formal actuarial valuation of the defined benefit section of the AWPP at 31 December 2015 was in the process of being carried out at the date of approval of these financial statements. This will form the basis of future funding arrangements and the funding policy affecting future contributions.

The weighted average duration of the defined benefit obligation is 17.1 years (2015: 17.9 years).

Defined benefit section - financial and demographic assumptions

Adjustments to the valuation at 31 March 2013 have been made based on the following assumptions:

	2016	2015
Discount rate	**3.55% pa**	3.15% pa
Salary growth	**2.85% pa**	2.90% pa
RPI	**2.85% pa**	2.90% pa
CPI	**1.85% pa**	1.90% pa
Life expectancy for a male pensioner from age 65 (years)	**22**	22
Life expectancy for a female pensioner from age 65 (years)	**24**	25
Life expectancy from age 65 (years) for a male participant currently aged 45 (years)	**24**	24
Life expectancy from age 65 (years) for a female participant currently aged 45 (years)	**26**	27

Deferred pensions are revalued to retirement age in line with the CPI assumption of 1.85% per annum (2015: 1.90% per annum) unless otherwise prescribed by statutory requirements or the plan rules.

Affinity Water Acquisitions (Investments) Limited

Notes to the financial statements – appendices (continued)

A5. Retirement benefits (continued)

Defined benefit section - sensitivity analysis

	Change in assumption	Impact on defined benefit obligation	Change in assumption	Impact on defined benefit obligation
2016				
Discount rate	**0.5% decrease**	**8.1% increase**	**0.5% increase**	**8.1% decrease**
Salary growth	**0.5% increase**	**0.9% increase**	**0.5% decrease**	**0.9% decrease**
Pension growth rate	**0.5% increase**	**6.7% increase**	**0.5% decrease**	**6.7% decrease**
Life expectancy	**1 year increase**	**3.0% increase**	**1 year decrease**	**3.0% decrease**
2015				
Discount rate	0.5% decrease	8.9% increase	0.5% increase	8.2% decrease
Salary growth	0.5% increase	1.6% increase	0.5% decrease	1.5% decrease
Pension growth rate	0.5% increase	8.9% increase	0.5% decrease	8.2% decrease
Life expectancy	1 year increase	3.0% increase	1 year decrease	3.1% decrease

The above sensitivity analyses are based on a change in an assumption while holding all other assumptions constant. In practice this is unlikely to occur, and changes in some of the assumptions may be correlated. When calculating the sensitivity of the defined benefit asset to significant actuarial assumptions, the same method (present value of the defined benefit asset calculated using the projected unit credit method at the end of the reporting period) has been applied as when calculating the pension asset recognised within the statement of financial position.

Defined benefit section - net retirement benefit surplus

At 31 March, the fair values of the plan's assets recognised in the statement of financial position were as follows:

	Plan assets %	**2016 £000**	Plan assets %	2015 £000
Equity securities	**15%**	**64,980**	17%	71,432
Debt securities	**27%**	**113,920**	24%	100,990
Diversified growth funds	**24%**	**99,000**	19%	77,810
Property	**1%**	**4,370**	1%	4,037
Infrastructure	**2%**	**10,240**	2%	10,193
Liability driven investments	**31%**	**129,110**	36%	151,920
Cash and cash equivalents	**0%**	**880**	1%	2,840
Total fair value of the plan's assets	**100%**	**422,500**	100%	419,222
Present value of defined benefit obligations		**(349,912)**		(374,124)
Net retirement benefit surplus		**72,588**		45,098

Notes to the financial statements – appendices (continued)

A5. Retirement benefits (continued)

Defined benefit section - fair value of plan assets

Movements in the fair value of the plan's assets were as follows:

	2016 £000	2015 £000
At 1 April	**419,222**	348,479
Benefits paid	**(15,167)**	(14,335)
Employer contributions	**9,778**	8,795
Contributions by plan participants	**844**	860
Interest income	**13,134**	15,085
Re-measurement (losses)/gains	**(5,311)**	60,338
At 31 March	**422,500**	419,222

Defined benefit section - present value of plan liabilities

Movements in the present value of the defined benefit liabilities are as follows:

	2016 £000	2015 £000
At 1 April	**(374,124)**	(338,473)
Benefits paid	**15,167**	14,335
Contributions by plan participants	**(844)**	(860)
Current service cost	**(4,543)**	(4,918)
Interest expense	**(11,546)**	(14,269)
Re-measurement gains/(losses)	**25,978**	(29,939)
At 31 March	**(349,912)**	(374,124)

Defined contribution section

At the same time that the defined benefit section became closed to new entrants, the group established a defined contribution section to provide pension benefits to new employees.

The total pension charge for the defined contribution section of the AWPP for the year ended 31 March 2016 was £1,355,000 (2015: £1,244,000). There are no amounts prepaid or outstanding in respect of the defined contribution section at 31 March 2016 (2015: nil).

Affinity Water Acquisitions (Investments) Limited

Notes to the financial statements – appendices (continued)

A6. Subsidiaries

Name of company	Country of registration/ incorporation	Nature of business	Type of holding	Proportion of voting rights and shares held
Affinity Water Acquisitions (Holdco) Limited*	United Kingdom	Holding company	Ordinary shares	90%
Affinity Water Acquisitions (Midco) Limited	United Kingdom	Holding company	Ordinary shares	100%
Affinity Water Acquisitions Limited	United Kingdom	Holding company	Ordinary shares	100%
Affinity Water Capital Funds Limited	United Kingdom	Holding company	Ordinary shares	100%
Affinity Water Holdings Limited	United Kingdom	Holding company	Ordinary shares	100%
Affinity Water Limited	United Kingdom	Water supply	Ordinary shares	100%
Affinity Water Finance (2004) PLC	United Kingdom	Finance company	Ordinary shares	100%
Affinity Water Programme Finance Limited	Cayman Islands	Finance company	Ordinary shares	100%
Affinity Water East Limited	United Kingdom	Investment company	Ordinary shares	99%
			Ordinary non-voting shares	88%
			10% preference shares	98%
Affinity Water Southeast Limited	United Kingdom	Investment company	Ordinary shares	99%
			Ordinary non-voting shares	92%
			14% preference shares	98%
Affinity Water Shared Services Limited	United Kingdom	Service company	Ordinary shares	100%
Affinity Water Pension Trustees Limited	United Kingdom	Pension trustee	Ordinary shares	100%
Three Valleys Water Limited	United Kingdom	Dormant company	Ordinary shares	100%
Tendring Hundred Water Services Limited	United Kingdom	Dormant company	Ordinary shares	100%
Folkestone and Dover Water Services Limited	United Kingdom	Dormant company	Ordinary shares	100%
White Cliffs Water Limited	United Kingdom	Dormant company	Ordinary shares	100%
Affinity for Business (Retail) Limited (formerly Affinity Utilities Limited)	United Kingdom	Dormant company	Ordinary shares	100%

* held directly by Affinity Water Acquisitions (Investments) Limited.

Affinity Water Acquisitions (Investments) Limited

Notes to the financial statements – appendices (continued)

A7. Related party transactions

Group

a) Sales of goods and services

Related party	Nature of Relationship	In respect of	2016 Value £000	2016 Balance £000	2015 Value £000	2015 Balance £000
Veolia Water UK Limited	Shareholder	Transitional services, capability sharing agreement and other support	**302**	**334**	178	17
Veolia Environmental Services (UK) Limited	Partial common ownership	Waste water disposal	**22**	**2**	-	-
Other Veolia entities	Partial common ownership	Transitional services, capability sharing agreement and laboratory services	**84**	**442**	112	548

b) Purchases of goods and services

Related party	Nature of Relationship	In respect of	Value £000	Balance £000	Value £000	Balance £000
Infracapital F2 Rift S.à.r.l and MSIP Dalis B.V.	Shareholders	Interest paid on loan	**10,532**	**-**	10,532	-
Infracapital F2 Rift S.à.r.l and MSIP Dalis B.V.	Shareholders	Dividend	**27,570**	**-**	21,464	-
Veolia Water UK Limited	Shareholder	Interest paid on loan	**1,170**	**-**	1,170	-
Veolia Water UK Limited	Shareholder	Dividend	**3,063**	**-**	2,385	-
Veolia Water UK Limited	Shareholder	Management and technical support	**256**	**344**	50	422
Veolia Environmental Services (UK) Limited	Partial common ownership	Waste water disposal	**350**	**-**	254	-
Other Veolia entities	Partial common ownership	Transport and other services	**715**	**-**	409	159
North Haven Infrastructure Partners LP/ Infracapital Partners II/ Veolia Water UK Limited	Shareholders	Support services	**100**	**150**	100	210

Affinity Water Acquisitions (Investments) Limited

Notes to the financial statements – appendices (continued)

A7. Related party transactions (continued)

Group (continued)

c) Loans

Related party	Nature of Relationship	In respect of	2016 Value £000	2016 Balance £000	2015 Value £000	2015 Balance £000
Infracapital F2 Rift S.à.r.l	Shareholder	Loans payable	-	**65,010**	-	65,010
MSIP Dalis B.V.	Shareholder	Loans payable	-	**52,008**	-	52,008
Veolia Water UK Limited	Shareholder	Loans payable	-	**13,002**	-	13,002

d) Term deposit

Related party	Nature of Relationship	In respect of	Value £000	Balance £000	Value £000	Balance £000
Morgan Stanley Liquidity Funds	Common ownership	Term deposit and interest thereon	**9**	**10,000**	-	-

See note 3 for directors' remuneration and key management personnel compensation disclosures.

Company

a) Sales of goods and services

Related party	Nature of Relationship	In respect of	Value £000	Balance £000	Value £000	Balance £000
Affinity Water Acquisitions (Holdco) Limited	Subsidiary undertaking	Dividend	**27,570**	-	21,464	-

b) Purchases of goods and services

Related party	Nature of Relationship	In respect of	Value £000	Balance £000	Value £000	Balance £000
Infracapital F2 Rift S.à.r.l and MSIP Dalis B.V.	Shareholders	Dividend	**27,570**	-	21,464	-

Affinity Water Acquisitions (Investments) Limited

Notes to the financial statements – appendices (continued)

A8. Explanation of transition to IFRS

This is the first year that the group has presented its financial statements in accordance with IFRS. Comparative information for the year ended 31 March 2016, the year ended 31 March 2015, has been represented under IFRS; the date of transition being 1 April 2014.

Opening consolidated statement of financial position at 1 April 2014

	As previously reported under UK GAAP £000	Effects of transition £000	Under IFRS £000
Assets			
Non-current assets			
Property, plant and equipment	1,211,963	(12,780)	1,199,183
Intangible assets	126,971	21,571	148,542
Investments	1	-	1
Retirement benefit surplus	5,205	4,801	10,006
	1,344,140	13,592	1,357,732
Current assets			
Inventories	1,412	-	1,412
Trade and other receivables	81,516	-	81,516
Cash and cash equivalents	17,172	-	17,172
	100,100	-	100,100
Total assets	1,444,240	13,592	1,457,832
Equity and liabilities			
Equity			
Ordinary shares	3,408	-	3,408
Retained earnings	303,272	(171,492)	131,780
Non-controlling interests	35,518	(19,054)	16,464
Total equity	342,198	(190,546)	151,652
Liabilities			
Non-current liabilities			
Trade and other payables	21,670	61,127	82,797
Borrowings	900,030	-	900,030
Deferred income tax liabilities	44,958	142,897	187,855
Provisions for other liabilities and charges	3,826	-	3,826
	970,484	204,024	1,174,508
Current liabilities			
Trade and other payables	131,558	114	131,672
Current income tax liabilities	-	-	-
	131,558	114	131,672
Total liabilities	1,102,042	204,138	1,306,180
Total equity and liabilities	1,444,240	13,592	1,457,832

A8. Explanation of transition to IFRS (continued)

Reconciliation of equity

	1 April 2014 £000	31 March 2015 £000
Equity reported under UK GAAP (as previously reported)	342,198	354,287
Opening adjustments to equity on transition to IFRS (see Opening adjustments to equity at 1 April 2014 section)	(190,546)	(190,546)
Reversal of goodwill amortisation (see note a)	-	6,956
Treatment of infrastructure assets (see note b)	-	3,247
Treatment of grants and contributions (see note c)	-	1,686
Treatment of Grafham reservoir (see note d)	-	(87)
Removal of pension asset limit (see note e)	-	2,746
Reversal of discounting deferred tax liability under UK GAAP (see note f)	-	10,435
Other adjustments to deferred tax liability under IAS 12 (see note f)	-	2,471
Equity reported under IFRS	**151,652**	**191,195**

Opening adjustments to equity at 1 April 2014

Initial exemptions on first time adoption

In preparing its opening statement of financial position and adjusting amounts reported previously in accordance with UK GAAP, the group applied IFRS 1, which contains a number of voluntary exemptions and mandatory exceptions from the requirement to apply IFRS retrospectively.

The group applied the following exemptions and exceptions:

- Estimates – Hindsight has not been used to create or revise estimates. The estimates previously made by the group under UK GAAP have not been revised for the application of IFRS except where necessary to reflect any difference in accounting policies.
- Business combinations - Under IFRS 1, a first-time adopter may elect not to apply IFRS 3: 'Business combination' retrospectively to past business combinations that occurred before the date of transition to IFRS. The group has elected to apply IFRS 3 prospectively from the date of transition. Accordingly, business combinations completed prior to the transition date have not been restated, thus any goodwill arising from business combinations which took place before the date of transition is recognised at the carrying amount based on UK GAAP.
- Deemed cost of property, plant and equipment – As described below, the group has measured the opening position of its infrastructure assets at their deemed cost, derived from an event driven fair value.

Intangible assets

Under IAS 38: 'Intangible assets', software and development costs, which were capitalised as tangible fixed assets under the previous reporting framework, are classified as intangible assets. This led to a reclassification of £21,571,000 at 1 April 2014.

Notes to the financial statements – appendices (continued)

A8. Explanation of transition to IFRS (continued)

Opening adjustments to equity at 1 April 2014 (continued)

Infrastructure assets

Under UK GAAP, the group's infrastructure assets were accounted for in accordance with the renewals accounting provisions of Financial Reporting Standard ('FRS') 15: 'Tangible fixed assets'. Such provisions are not present within IAS 16: 'Property, plant and equipment'.

Under renewals accounting, the infrastructure network was assumed to be a single asset. Expenditure on infrastructure assets relating to increases in capacity or enhancements to the network and on maintaining the operating capability of the network in accordance with defined standards of service was capitalised. The depreciation charged was effectively the estimated anticipated level of annual expenditure required to maintain the operating capability of the network. Grants and contributions relating to the infrastructure network were deducted from the cost of infrastructure assets.

Under IAS 16: 'Property, plant and equipment' this treatment may not be applied. Significant parts within the infrastructure network, principally water pipes, were identified and useful lives and residual values determined so that each significant part could be depreciated individually.

The opening position of infrastructure assets on transition is their deemed cost, derived from an event-driven fair value established in June 2012 and adjusted for subsequent depreciation, capital expenditure, transfers at cost from assets in the course of construction and disposals.

The significant parts recognised were based on the material used to construct the water pipe concerned. These were assigned zero residual values at the end of their useful lives, which range from 50 to 150 years.

Historical grants and contributions at 1 April 2014 of £94,438,000 relating to the enhancement of the infrastructure network were removed from the cost of infrastructure assets and recognised as deferred income at their amortised amount of £80,643,000 (£1,120,000 due within one year and £79,523,000 due after more than one year), with the amortisation of £13,795,000 recognised in the income statement. £87,734,000 of historical grants and contributions at 1 April 2014 given in compensation for expenses incurred with no future related costs were removed from the cost of infrastructure assets and recognised in the income statement. Infrastructure assets were subsequently revalued downwards to the opening position at 1 April 2014 determined through the process described above.

£4,691,000 of costs in work in progress at 1 April 2014 relating to the aforementioned historical grants and contributions recognised in the income statement were written off from the cost of tangible fixed assets and recognised in the income statement.

Grafham reservoir

The accounting treatment for the entitlement to water from the Grafham reservoir owned and operated by Anglian Water was revisited on adoption of IFRS, as International Financial Reporting Interpretations Committee ('IFRIC') 4: 'Determining whether an arrangement contains a lease' provides specific guidance, not provided in UK GAAP accounting standards, on determining whether an arrangement contains a lease.

A8. Explanation of transition to IFRS (continued)

Opening adjustments to equity at 1 April 2014 (continued)

Grafham reservoir (continued)

On assessment, the Grafham arrangement was found not to contain a lease under IFRIC 4: 'Determining whether an arrangement contains a lease'. Furthermore the arrangement did not meet the definition of a joint arrangement in order to be accounted for as such in accordance with IFRIC 11: 'Joint arrangements'. The arrangement was considered to be a purchase contract for the supply of goods under IFRS and the treatment of the arrangement as a quasi-finance lease under UK GAAP was reversed on adoption of IFRS. This led to a reduction in current liabilities of £1,005,000 and in non-current liabilities of £18,396,000 at 1 April 2014.

Retirement benefit obligations

Under UK GAAP, the group applied an asset limit to its net pension asset at 1 April 2014 of £3,500,000. This asset limit was removed on assessment of the pension assets and liabilities under IFRIC 14: 'The limit on a defined benefit asset, minimum funding requirements and their interaction', as the group has an unconditional right to a refund of surplus in the event of a plan wind-up.

In addition, IAS 19: 'Employee benefits' requires that pension assets or liabilities are presented gross of the related deferred tax.

Deferred tax

Under UK GAAP, the group had elected to apply discounting to its deferred tax liability. Under IAS 12: 'Income taxes', discounting is not permitted. The impact of eliminating discounting from the accounting for deferred tax was to increase the deferred tax liability at 1 April 2014 by £44,169,000.

IAS 12: 'Income taxes' takes a different approach to deferred tax from that applied by FRS 19: 'Deferred tax'. Under IAS 12: 'Income taxes' deferred tax must be provided for on all temporary differences between the carrying amount of an asset or liability in the statement of financial position and its tax base, whereas under FRS 19: 'Deferred tax' deferred tax must be provided for on timing differences between the treatment of items in the tax computation and the income statement. This change in approach results in deferred tax provisions under IAS 12 for items which under FRS 19: 'Deferred tax' would be permanent differences and hence would not be provided for.

The difference in approach results in deferred tax being provided on previous revaluations to the tangible fixed assets owned by the group, including those revalued prior to the business combination with Affinity Water East Limited and Affinity Water Southeast Limited. For the purposes of IAS 12, revaluation of the assets results in an increase in their carrying amount on the statement of financial position with no corresponding increase in their tax base, as tax relief is not given for the revalued amount, therefore giving rise to a temporary difference on which a deferred tax liability is recognised. The impact on the group's statement of financial position under IFRS was to increase the deferred tax liability at 1 April 2014 by £101,573,000.

Other IAS 12 adjustments resulted in a decrease in the deferred tax liability at 1 April 2014 of £4,146,000.

The net impact of the above adjustments, and the reclassification of deferred tax on the pension asset of £622,000 from the retirement benefit obligation to deferred tax provisions, was to increase the deferred tax liability as at 1 April 2014 by £142,897,000.

A8. Explanation of transition to IFRS (continued)

Reconciliation of total comprehensive income

	Year ended 31 March 2015 £000
Total comprehensive income attributable to owners of the group for the financial year under UK GAAP	34,390
Adjustments to profit for the year	
Reversal of goodwill amortisation (see note a)	6,956
Treatment of infrastructure assets (see note b)	3,247
Treatment of grants and contributions (see note c)	1,686
Treatment of Grafham reservoir (see note d)	(87)
Application of IAS 19 (revised) (see note e)	(2,131)
Reversal of discounting deferred tax liability under UK GAAP (see note f)	10,435
Other adjustments to deferred tax liability under IAS 12 (see note f)	2,471
Total adjustments to profit for the year	22,577
Total adjustments attributable to non-controlling interests	(2,387)
Adjustments to other comprehensive income	
Application of IAS 19 (revised) (see note e)	2,131
Removal of pension asset limit (see note e)	2,746
Total adjustments to other comprehensive income	4,877
Total comprehensive income attributable to owners of the group for the financial year under IFRS	59,457

a) Intangible assets

Software and development costs with a net book value of £22,593,000 at 31 March 2015, which were capitalised as tangible fixed assets under UK GAAP, were reclassified as intangible assets under IAS 38: 'Intangible assets'. The change in treatment did not have an impact on net profit for the year ended 31 March 2015.

£6,089,000 of software and development expenditure was reclassified in the statement of cash flows for the year ended 31 March 2015 from purchases of property, plant and equipment to purchases of intangible assets.

Goodwill is considered to have an indefinite useful economic life under IAS 38: 'Intangible assets'. Therefore amortisation of £6,956,000 was not recognised in the income statement under IFRS.

b) Infrastructure assets

As described previously, the renewals accounting provisions of FRS 15: 'Tangible fixed assets' are not present in IAS 16: 'Property, plant and equipment'. The infrastructure renewals charge of £36,092,000 recognised in cost of sales and infrastructure renewals expenditure included within tangible fixed assets under UK GAAP for the year ended 31 March 2015 was not recognised under IFRS.

Notes to the financial statements – appendices (continued)

A8. Explanation of transition to IFRS (continued)

Reconciliation of total comprehensive income (continued)

b) Infrastructure assets (continued)

£17,120,000 of expenditure on infrastructure assets during the year ended 31 March 2015 relating to increases in capacity, enhancements or material replacements of network components was capitalised to tangible fixed assets in accordance with IAS 16: 'Property, plant and equipment' with the remaining amount of £18,972,000 being recognised within cost of sales under IFRS. Furthermore, £21,132,000 of expenditure was reclassified in the statement of cash flows for the year ended 31 March 2015 from purchases of property, plant and equipment to reduce cash generated from operations.

Infrastructure assets are depreciated on a straight-line basis over their useful economic lives under IFRS, and are:

Potable water distribution mains	50-150 years
Raw water pipes	50-150 years

Depreciation of £11,203,000 was recognised in cost of sales under IFRS, together with £2,670,000 of costs associated with abandoning infrastructure assets before the end of their useful economic lives.

The net impact of the change in treatment of infrastructure assets was to increase net profit for the year ended 31 March 2015 under IFRS by £3,247,000.

c) Grants and contributions

£98,120,000 of grants and contributions netted against infrastructure assets at 31 March 2015 under UK GAAP relating to the enhancement of the infrastructure network were removed from the cost of infrastructure assets and recognised as deferred income at their amortised amount of £83,099,000 under IFRS, with amortisation of £1,227,000 recognised in net profit for the year ended 31 March 2015.

£92,430,000 of grants and contributions at 31 March 2015 netted against infrastructure assets at 31 March 2015 under UK GAAP given in compensation for expenses incurred with no future related costs were removed from the cost of infrastructure assets and recognised in the income statement under IFRS. £4,695,000 relating to the year ended 31 March 2015 was recognised in revenue in the income statement prepared under IFRS with associated expenditure of £4,236,000 recognised in cost of sales.

Infrastructure assets were subsequently revalued downwards to their position at 31 March 2015 determined through applying the treatment described in the paragraphs preceding those relating to the treatment of grants and contributions to the opening position at 1 April 2014.

The net impact of the change in treatment of grants and contributions was to increase net profit for the year ended 31 March 2015 under IFRS by £1,686,000.

£7,605,000 of cash received relating to grants and contributions given in compensation for expenses incurred with no future related costs was reclassified in the statement of cash flows for the year ended 31 March 2015 from capital contributions to increase cash generated from operations. £4,236,000 of associated expenditure was also reclassified in the statement of cash flows for the year ended 31 March 2015 from purchases of property, plant and equipment to reduce cash generated from operations.

A8. Explanation of transition to IFRS (continued)

Reconciliation of total comprehensive income (continued)

d) Grafham reservoir

The treatment of the arrangement as a quasi-finance lease under UK GAAP was reversed under IFRS. This led to a reduction in current liabilities of £1,201,000 and in non-current liabilities of £19,600,000 at 31 March 2015.

As a result of treating the arrangement as a purchase contract for the supply of goods, an additional £1,029,000 of costs relating to the arrangement were recognised in cost of sales in the income statement for the year ended 31 March 2015 prepared under IFRS. This included a reclassification of £942,000 of costs recognised as interest payable in the income statement for the year ended 31 March 2015 prepared under UK GAAP. £1,019,000 of depreciation charged on expenditure capitalised in tangible fixed assets under UK GAAP was reclassified to bulk water purchases within cost of sales under IFRS. The change in treatment of this arrangement reduced net profit for the year ended 31 March 2015 by £87,000 under IFRS.

The impact of this adjustment on the statement of cash flows for the year ended 31 March 2015 was not material.

e) Retirement benefit obligations

Under UK GAAP, the group applied an asset limit to its net pension asset at 31 March 2015 of £6,932,000. This asset limit and the associated deferred tax liability of £1,386,000 were removed on assessment of the pension assets and liabilities under IFRIC 14: 'The limit on a defined benefit asset, minimum funding requirements and their interaction'. The reversal of the £2,746,000 movement in the asset limit net of deferred tax in the year ended 31 March 2015 increased other comprehensive income under IFRS.

Under IAS 19 (revised): 'Employee Benefits' the expected return on scheme assets was made equal to the discount rate used to calculate present value of scheme liabilities. The impact was a £2,131,000 reclassification between profit and other comprehensive income.

In addition, IAS 19: 'Employee benefits' requires that pension assets or liabilities were presented gross of the related deferred tax amounting to a deferred tax liability of £9,019,000.

f) Deferred tax

Under IAS 12: 'Income taxes', discounting is not permitted. The impact of reversing the decrease in discounting of the deferred tax liability under UK GAAP at 31 March 2015 was to reduce the deferred tax charge under International Accounting Standard 12: 'Income taxes' by £10,435,000 for the year ended 31 March 2015.

Other IFRS adjustments resulted in a further £2,471,000 reduction of the deferred tax charge for the year ended 31 March 2016 under IAS 12: 'Income taxes'.

A8. Explanation of transition to IFRS (continued)

Reconciliation of total comprehensive income (continued)

g) Cash and cash equivalents

Under UK GAAP, the group presented £15,000,000 of cash deposits with a maturity of greater than one day but less than twelve months within liquid resources at 31 March 2015 for the purposes of the statement of cash flows. These cash deposits were included as cash and cash equivalents within the statement of cash flows prepared under IAS 7: 'Statement of cash flows'. Refer to note A3 for details of the group's cash and cash equivalents accounting policy under IFRS.