## Our opinion is unmodified

We have audited the financial statements of Sutton and East Surrey Water plc ("the Company") for the year ended 31 March 2019 which comprise the Profit and loss account and other comprehensive income, Balance Sheet, Cash Flow Statements, and the related notes, including the accounting policies in note 1.

In our opinion the financial statements:

- the financial statements give a true and fair view of the state of Company's affairs as at 31 March 2019 and of its profit for the year then ended;
- have been properly prepared in accordance with UK accounting standards, including FRS 101 Reduced Disclosure framework; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

### Overview

| | | |
|---|---|---|
| **Materiality:** Financial statements as a whole | £400,000 (2018: £480,000) 4% of profit before tax (2018:5% profit before tax) | |
| **Coverage** | 100% (2018: 100%) of profit before tax | |
| **Risks of material misstatement vs 2018** | | **vs 2018** |
| **Recurring risks** | Bad debt provision | ◀▶ |
| | **Gross defined benefit obligation** | ◀▶ |

## Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion. Our audit opinion is consistent with our report to the audit committee.

We were first appointed as auditor by the directors on date of appointment. The period of total uninterrupted engagement is for over 20 financial years ended 31 March 2019. We have fulfilled our ethical responsibilities under, and we remain independent of the Company in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to public interest entities. No non-audit services prohibited by that standard were provided.

## Key audit matters: our assessment of risks of material misstatement

Key audit matters are those matters that, in our professional judgment, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. We summarise below the key audit matters, in decreasing order of audit significance, in arriving at our audit opinion above, together with our key audit procedures to address those matters and, as required for public interest entities, our results from those procedures. These matters were addressed, and our results are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the financial statements as a whole, and in forming our opinion thereon, and consequently are incidental to that opinion, and we do not provide a separate opinion on these matters.

| | The risk | Our response |
|---|---|---|
| **Bad debt provision**<br>£2.3m, 2018 £2.1m.<br><br>Refer to page 62 (Audit Committee Report), pages 73 to 78 accounting policy and pages 78 to 89 financial disclosures). | The water industry has a unique debtor profile mainly due to its customer base and the service provided. In order to assess the recoverability of these debts a detailed analysis of the debtor aging is required, including componentisation, as well as a complex calculation. This is considered a key audit risk because an error in just one stage of this calculation, either through an inappropriate judgement taken or human error, could result in a material misstatement to the level of provision required. | Our procedures included:<br>• Control reperformance: with the assistance of KPMG IT specialists, we will audit the completeness and accuracy of the billing system that underpins the provision calculation;<br>• Use our sector expertise to assess componentisation of debtor balances: Assess the breakdown of debt used in the provision calculation into components;<br>• Our testing identified weaknesses in the design and operation of automated control in relation to the aged debt report for unmeasured debtors. As a result we expanded the extent of our detailed substantive testing over and above that originally planned.<br>• Expected credit loss rate: Compare the movement in debtors between the aged buckets between 2017 to 2019 to determine whether a higher proportion of debt is becoming older, thus resulting in the need for a higher provision;<br>• Historical comparison of provision rates year on year: Critically assess the provision rates set in the accounting policy by challenging the Directors regarding variances during the year as compared to past trends as well as critically assessing the rates against changes in the economy and the industry.<br>• **Our results:** We found the provision for bad debts to be acceptable (2018 results: acceptable). |
| **Gross defined benefit obligation**<br>£15.5m, 2018: £20.1m<br><br>Refer to page 63 (Audit Committee Report), pages 73 to 78 accounting policy and pages 78 to 89 financial disclosures). | The company's retirement benefit surplus is the difference between the fair value of the pension assets £124.6m and the retirement benefit obligation £109.1m.<br><br>Significant estimates are made in valuing the company's retirement benefit obligation. Small changes in assumptions and estimates used to value the company's pension obligation would have a significant effect on the company's financial position.<br><br>In addition for 2019, following the judgement reached in the High Court on 26 October 2019, schemes that have not previously made an allowance for the impact of GMP equalisation will be subject to a plan amendment, requiring recognition of an adjustment for the past service cost through the income statement as at the date of the court judgement. | Our procedures included:<br>• challenging the key assumptions supporting the company's retirement benefit obligations valuation with input from our own actuarial specialists, including comparing the discount rate, inflation rate, salary, pension increase rates and life expectancy assumptions used against externally derived data;<br>• assessing the company's disclosure in respect of the sensitivity of the surplus to changes in the key assumptions;<br>• assessing the valuer's credentials by evaluating the external expert's competence and independence; and<br>• Reviewing the actuary's methodology and estimated impact of GMP equalisation and assessing reasonableness using KPMG's independent model.<br>• **Our results:** We found the valuation of the net pension asset to be acceptable (2018 results: acceptable). |

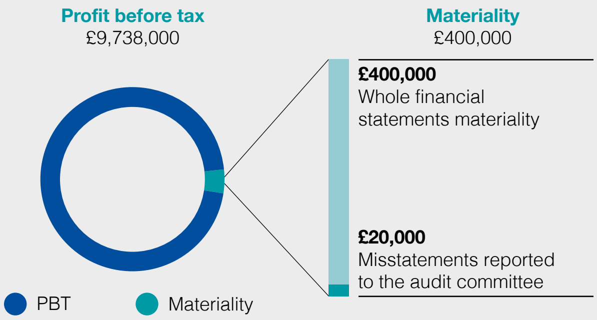
We continue to perform procedures over the classification of expenditure between operating and capital. However, following a number of years with no issues noted we have not assessed this as one of the most significant risks in our current year audit and, therefore, it is not separately identified in our report this year.

## Our application of materiality and an overview of the scope of our audit

Materiality for the financial statements as a whole was set at £0.4 million (2018: £0.48 million).

This has been determined with reference to a benchmark of the Company's profit before tax which represents 5% (2018: 5%).

We agreed to report to the Audit Committee any corrected or uncorrected misstatements exceeding £20,000 (2018: £25,000), in addition to other identified misstatements that warranted reporting on qualitative grounds.




## We have nothing to report on going concern

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

Our responsibility is to conclude on the appropriateness of the Directors' conclusions and, had there been a material uncertainty related to going concern, to make reference to that in this audit report. However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the absence of reference to a material uncertainty in this auditor's report is not a guarantee that the Company will continue in operation.

In our evaluation of the Directors' conclusions, we considered the inherent risks to the Company's business model and analysed how those risks might affect the Company's financial resources or ability to continue operations over the going concern period. The risks that we considered most likely to adversely affect the Company's available financial resources over this period were:

- The ability to refinance the revolving credit facility.

As this risk could potentially cast significant doubt on the Company's ability to continue as a going concern, we considered sensitivities over the level of available financial resources indicated by the Company's financial forecasts taking account of reasonably possible (but not unrealistic) adverse effects that could arise from this risk and evaluated the achievability of the actions the Directors consider they would take to improve the position should the risk materialise. We also considered less predictable but realistic second order impacts, such as the impact of Brexit on the chemical supply chain and the erosion of customer or supplier confidence, which could result in a rapid reduction of available financial resources.

Based on this work, we are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least a year from the date of approval of the financial statements.

We have nothing to report in these respects, and we did not identify going concern as a key audit matter.

## We have nothing to report on the strategic report and the directors' report

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

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

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

### Directors' remuneration report

In addition to our audit of the financial statements, the directors have engaged us to audit the information in the Directors' Remuneration Report that is described as having been audited, which the directors have decided to prepare as if the company were required to comply with the requirements of Schedule 8 to The Large and medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2018 No.40) made under the Companies Act 2006.

In our option the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006, as if those requirements applied to the company.

### Corporate governance disclosures

We are required to report to you if:

- we have identified material inconsistencies between the knowledge we acquired during our financial statements audit and the directors' statement that they consider that the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy; or
- the section of the annual report describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.

In addition to our audit of the financial statement the directors have engaged us to review their Corporate Governance Statement as if the company were required to comply with the Listing Rules and Disclosure Guidance and Transparency Rules of the Financial Conduct Authority in relation to those matters. Under the terms of our engagement we are required to review the part of the Corporate Governance Statements relating to the Company's compliance with the eleven provisions of the UK Corporate Governance Code specified for our review.

We have nothing to report in these respects.

### Disclosures of Principal Risks and Long-term viability

Based on the knowledge we acquired during our financial statements audit, we have nothing material to add or draw to in relation to:

- the directors' confirmation within the long term viability statement (page 48) that they have carried out a robust assessment of the principal risks facing the company, including those that would threaten its business model, future performance, solvency and liquidity.
- the Principal risks and uncertainties disclosures describing these risks and explaining how they are being managed and mitigated; and
- the directors' explanation in the Long-term viability statement of how they have assessed the prospects of the Company, over what period they have done so and why they considered that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

Our work is limited to assessing these matter in the context of only the knowledge acquired during our financial statements audit. As we cannot predict all future events or conditions and as subsequent events may result in outcomes that inconsistent with judgements that are reasonable at the time they were made the absence of anything to report on these statements is not a guarantee as to the Company's long term viability.

### We have nothing to report on the other matters on which we are required to report by exception

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

- adequate accounting records have not been kept by the Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in these respects.

### Respective responsibilities

As explained more fully in their statement set out on page 64, the Directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

## Auditor's responsibilities

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

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

## Irregularities – ability to detect

We identified areas of laws and regulations that could reasonably be expected to have a material effect on the financial statements from our general commercial and sector experience and through discussion with the directors and other management (as required by auditing standards), and from inspection of the Company's regulatory and legal correspondence and discussed with the directors and other management the policies and procedures regarding compliance with laws and regulations. We communicated identified laws and regulations throughout our team and remained alert to any indications of noncompliance throughout the audit. The potential effect of these laws and regulations on the financial statements varies considerably. Firstly, the Company is subject to laws and regulations that directly affect the financial statements; including financial reporting legislation (including related companies legislation); distributable profits legislation and taxation legislation; and we assessed the extent of compliance with these laws and regulations as part of our procedures on the related financial statement items.

Secondly, the Company is subject to many other laws and regulations where the consequences of non-compliance could have a material effect on amounts or disclosures in the financial statements, for instance through the imposition of fines or litigation. We identified the following areas as those most likely to have such an effect: Ofwat, Environmental Agency, Drinking Water Inspectorate, health and safety, anti-bribery, employment law, regulatory capital and liquidity and certain aspects of company legislation recognising the financial and regulated nature of the Company's activities. Auditing standards limit the required audit procedures to identify non-compliance with these laws and regulations to enquiry of the directors and inspection of regulatory and legal correspondence, if any. Through these procedures, we became aware of actual or suspected non-compliance and considered the effect as part of our procedures on the related financial statement items. The actual or suspected non-compliance was not sufficiently significant to our audit to result in our response being identified as a key audit matter.

Owing to the inherent limitations of an audit, there is an unavoidable risk that we may not have detected some material misstatements in the financial statements, even though we have properly planned and performed our audit in accordance with auditing standards. For example, the further removed non-compliance with laws and regulations (irregularities) is from the events and transactions reflected in the financial statements, the less likely the inherently limited procedures required by auditing standards would identify it. In addition, as with any audit, there remained a higher risk of non-detection of irregularities, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls. We are not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations.

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

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

**John Luke (Senior Statutory Auditor)**
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
15 Canada Square
London
E14 5GL
United Kingdom
15 July 2019