

Registered N<sup>o</sup>: 2366777

Dŵr Cymru Cyfyngedig

Directors' report and financial statements

for the year ended 31 March 2007



Registered Office -  
Pentwyn Road  
Nelson  
Treharris  
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## Foreword

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These financial statements for Dŵr Cymru Cyfyngedig cover the year to 31 March 2007. The Company's immediate parent company is Dŵr Cymru (Holdings) Limited. The entire share capital of Dŵr Cymru (Holdings) Limited is owned by Glas Cymru (Securities) Cyfyngedig. The ultimate holding company and controlling party is Glas Cymru Cyfyngedig, a company registered in England and Wales.

Full details and analysis of the operational performance of Dŵr Cymru during the year to 31 March 2007 is included in the published report and accounts for Glas Cymru Cyfyngedig.

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## **Directors and advisors**

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### **Directors**

Lord Burns	Chairman
Nigel Annett	Managing Director
Chris Jones	Finance Director
Peter Perry	Operations Director (appointed 1 August 2006)
Jim O'Sullivan	Operations Director (resigned 31 July 2006)
John Bryant	Non-Executive Director
Alison Carnwath	Non-Executive Director
Geraint Talfan Davies	Non-Executive Director
Dame Deirdre Hine	Non-Executive Director
Tony Hobson	Non-Executive Director
James Strachan	Non-Executive Director (appointed 1 June 2007)

### **Company secretary**

R G Curtis

### **Auditors**

PricewaterhouseCoopers LLP

### **Solicitors**

Linklaters & Alliance  
Edwards Geldard

### **Principal bankers**

National Westminster Bank Plc

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## Directors' report

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The Directors have pleasure in presenting their annual report to the shareholders, together with the audited financial statements for the year ended 31 March 2007 on pages 11 to 40

### Principal activity

The principal activity of the Company is the supply of water and the treatment and disposal of waste water under the Instrument of Appointment made by the Secretary of State for Wales under the Water Act 1989

### Financial results

Welsh Water's turnover in the year to 31 March 2007 was £578 million (2006 £554 million) – an increase of 4%. The increase primarily reflects the price increase of 6.4% in the year offset by a loss of revenue due to customers switching to metered charging and a reduction in consumption from metered and trade effluent customers. The effect of 'customer dividends' in the year was that turnover was some £25 million (2006 £23 million) below the level that would have resulted from the full price control allowed by Ofwat. The rate of voluntary customer switching to metered charging in the year slowed somewhat to nearly 22,000 customers (2006 27,000 customers), whilst some 9,000 new customers (2006 10,000 customers) were added during the year, who are all metered.

Net interest charges for the year were £151 million (2006 £150 million). Despite interest rate increases, the average cost of net debt during the period was 6.2% (2006 6.4%), reflecting the benefit of refinancing undertaken during the year. In addition, a credit of £10 million is made to the income statement for the movement in the fair value of financial instruments (2006 £4 million charge), which is a non-cash item.

Profit after tax was £6 million (2006 £35 million). This profit was made after funding the 'customer dividend' of £19 for customers receiving both water and wastewater services. The Board of Welsh Water has decided to increase the 'customer dividend' for 2007-08 to £20.

The tax charge for the period was £7 million (2006 £7 million credit), comprising of an £8 million deferred tax charge and a £1 million current tax credit.

### Directors' interests

The Directors who held office during the year are listed on page 1. With the exception of Jim O'Sullivan who resigned on 31 July 2006 and Peter Perry who was appointed a director on 1 August 2006, all directors served throughout the financial year. James Strachan was appointed a director on 1 June 2007. No Director has, or has had, a material interest, directly or indirectly, in any contract significant to the Company's business.

### Employees

At 31 March 2007 Welsh Water employed 165 people.

A key part in delivering continuous improvement in the performance of the business and the level of service received by Welsh Water's customers is our ongoing investment in our people at all levels. We are committed to equality of opportunity and aim to treat all employees fairly in every aspect of employment, including recruitment, training, career development and promotion. Those who seek employment with Welsh Water are considered solely on their skills and abilities.

We believe all employees should have the opportunity to maximise their potential and individual training and development needs are assessed as part of an annual development review that applies to all our employees.

Welsh Water's outsourced procurement strategy has fundamentally changed the manner in which services have been delivered to customers since 2001 and has made a major contribution to improved levels of customer service in the last five years. This has been achieved, in large part, by the development of operational 'alliances' through which contract partners are encouraged to work with Welsh Water in a 'one-team' approach in the delivery of Welsh Water's business plan.

## **Directors' report cont'd**

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The success of the business is delivered through our employees, and it is important that they share in this success. We do this through a staff incentive scheme, which pays an annual bonus directly linked to the financial performance and customer service performance of the business (as measured by Ofwat's 'Overall Performance Assessment'). As a result, in 2006-07 every employee received the maximum entitlement under these schemes totalling £2,188 each.

### **Health and safety**

There is nothing more important to us than the health and safety of the people who work for us, and those we affect through our work. Our commitment to health and safety and the performance of Welsh Water and its contract partners in 2006-07 is set out in our 2007 Health and Safety Report. A copy of this document is available on request or may be obtained from the Welsh Water website [www.dwrcymru.com](http://www.dwrcymru.com)

### **Research and development**

The Company continues to monitor and selectively participate in water industry initiatives, most notably through membership of UK Water Industry Research Limited. Through this, and by continuing to benefit from a sharing of best practice from the R&D investment and initiatives by our outsourced contract partners, we aim to maintain our achievements in improving operational efficiency, and to ensure continued compliance with appropriate national and international standards for potable water, sewage effluent and sludge treatment.

### **Payment policy**

Our policy is to agree payment terms at the start of a relationship with a supplier, which will only be changed by agreement. Payment will be made in accordance with agreed terms, save where we advise suppliers when an invoice is contested, which we will do without unreasonable delay. We will seek to remedy disputes as promptly as possible. Standard payment terms to suppliers of goods and services will be 30 days from date of receipt of a correct invoice for satisfactory goods or services which have been ordered or received, unless other terms are agreed in a contract.

In 2006-07, the average payment period was 43 days (2005 61 days). Regulations require that in calculating this we include within trade creditors monies retained under contract in respect of capital investment projects. This level of retentions varies from year to year and adversely affects the average payment period for the year.

### **Dividend**

During the year, the Company has not paid an ordinary dividend (2006 £nil)

### **Donations**

During the year, charitable donations amounted to £32,874 (2006 £33,395). Individual donations of above £200 were made to WaterAid (£17,900), Keep Wales Tidy (£10,000), Mike Paines Bursary Memorial (2,278), Ty Hafan (£1,500) and Business in the Community (£1,000). Of these, Water Aid, Keep Wales Tidy, Ty Hafan and Business in the Community are national charities. It is Company policy not to make donations to political parties. No payments or donations in kind have been made that are required to be disclosed under the Political Parties, Elections and Referendums Act 2000.

### **Welsh Language Scheme**

We welcome dealing with customers and other stakeholders in Welsh or English and aim to provide an equally effective standard of service in both languages. We operate an approved Welsh Language Scheme under the provisions of the Wales Language Act 1993.

### **Regulatory accounts**

Condition F of the Instrument of Appointment, under which Dŵr Cymru Cyfyngedig operates, requires that Dŵr Cymru Cyfyngedig publish additional financial information as an 'appointed business'. A copy

## **Directors' report cont'd**

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of this information will be published on Dŵr Cymru Cyfyngedig's website or will otherwise be available on request from the Company secretary after 14 July 2007

### **Auditors**

PricewaterhouseCoopers LLP acted as auditors to Dŵr Cymru Cyfyngedig for the accounts for the year ended 31 March 2007. As part of the audit process each Director has confirmed, as at the date of the financial statements, that as far as the director is aware (a) there is no relevant audit information of which the Company's auditors are unaware, and (b) they have taken steps to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

PricewaterhouseCoopers LLP have expressed their willingness to continue as auditors and a resolution for their reappointment will be considered at the 2007 annual general meeting.

By order of the Board



**R Curtis LLB ACIS**  
Company Secretary

**8 June 2007**

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## **Directors' responsibilities for the financial statements**

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The Directors are responsible for preparing the Annual Report and the Company financial statements in accordance with applicable law and regulations

Company law requires the Directors to prepare company financial statements for each financial year. They have elected to prepare the Company's financial statements in accordance with International Financial Reporting Standards ('IFRSs') as adopted by the EU.

The Company financial statements are required by law and IFRSs as adopted by the EU to present fairly the financial position of the Company and of the performance for that period. The Companies Act 1985 provides in relation to such financial statements that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation.

In preparing the Company financial statements, the Directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgments and estimates that are reasonable and prudent,
- state whether they have been prepared in accordance with IFRSs as adopted by the EU, and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the Directors are also responsible for preparing a Directors' Report that complies with that law and those regulations.

By order of the Board



**R Curtis LLB ACIS**  
Company Secretary

8 June 2007

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# Independent auditors' report to the members of Dŵr Cymru Cyfyngedig

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We have audited the financial statements of Dŵr Cymru Cyfyngedig for the year ended 31 March 2007 which comprise the Income Statement, the Statement of changes in shareholders' equity, the Balance Sheet, the Cash Flow Statement and the related notes. These financial statements have been prepared under the accounting policies set out therein.

## Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, 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.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements have been properly prepared in accordance with the Companies Act 1985. We report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements. We also report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements within it.

## Basis of audit opinion

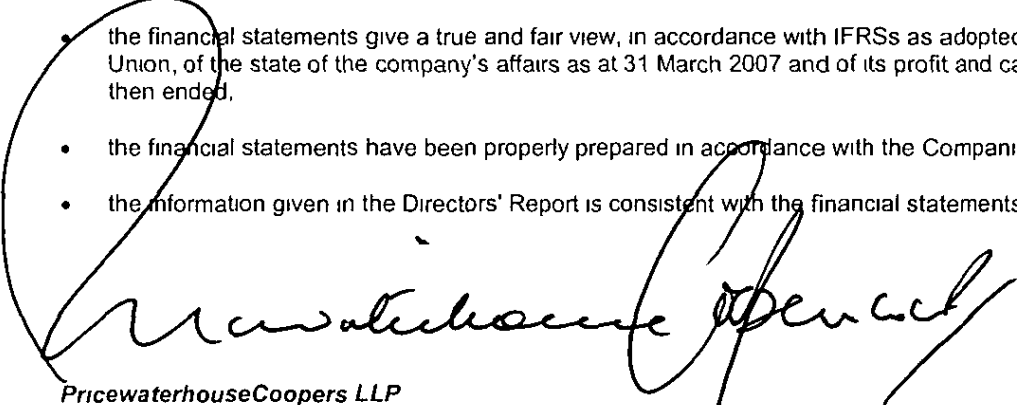
We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

## Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the company's affairs as at 31 March 2007 and of its profit and cash flows for the year then ended,
- the financial statements have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the Directors' Report is consistent with the financial statements.



**PricewaterhouseCoopers LLP**  
Chartered Accountants and Registered Auditors  
Cardiff

13 July 2007

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## Income statement for the year ended 31 March 2007

	Note	2007 £m	2006 £m
Revenue		578 0	553 5
<b>Operating costs</b>			
- Operational expenditure		(228 6)	(213 2)
- Infrastructure renewals expenditure		(84 1)	(48 8)
- Depreciation		(111 8)	(97 5)
- Profit on disposal of fixed assets		-	0 8
<b>Operating profit</b>		<u>153 5</u>	<u>194 8</u>
<b>Financing costs</b>			
- Interest payable and similar charges	3a	(158 5)	(159 5)
- Interest receivable	3a	7 4	9 7
- Fair value gains/(losses) on financial instruments	3b	<u>10 8</u>	<u>(3 5)</u>
		(140 3)	(153 3)
<b>Profit before taxation</b>	4	<u>13 2</u>	<u>41 5</u>
Taxation	5	(7 3)	(7 0)
<b>Profit for the year</b>		<u><u>5 9</u></u>	<u><u>34 5</u></u>

## Statement of changes in Shareholders equity for the year ended 31 March 2007

	Share capital £m	Capital redemption reserve £m	Retained earnings £m	Total Reserves £m
At 1 April 2005	309 9	166 2	(72 4)	403 7
Net Profit for year	-	-	34 5	34 5
At 31 March 2006	<u>309 9</u>	<u>166 2</u>	<u>(37 9)</u>	<u>438 2</u>
Net Profit for year	-	-	5 9	5 9
At 31 March 2007	<u><u>309 9</u></u>	<u><u>166 2</u></u>	<u><u>(32 0)</u></u>	<u><u>444 1</u></u>


The Company has no other recognised gains or losses in the period (2006 nil) and accordingly a statement of recognised income and expenses has not been presented

## Balance sheet as at 31 March 2007

	Note	2007 £m	2006 £m
<b>Assets</b>			
<b>Non-current assets</b>			
Intangible assets	6	7 0	4 4
Property, plant & equipment	7	2,846 9	2,795 6
Investments	8	0 1	0 1
Trade and other receivables	9b	370 5	370 5
Financial assets			
- derivative financial instruments	13	<u>14 7</u>	<u>6 3</u>
		<u>3,239 2</u>	<u>3 176 9</u>
<b>Current assets</b>			
Trade and other receivables	9a	90 5	86 8
Financial assets			
- derivative financial instruments	13	-	4 2
Cash and cash equivalents	10	<u>157 5</u>	<u>13 9</u>
		<u>248 0</u>	<u>104 9</u>
<b>Liabilities</b>			
<b>Current liabilities</b>			
Financial liabilities			
- borrowings	12	(65 8)	(124 7)
- derivative financial instruments	13	(2 3)	-
Trade and other payables	11	<u>(105 3)</u>	<u>(122 2)</u>
		<u>(173 4)</u>	<u>(246 9)</u>
<b>Net current assets/(liabilities)</b>		<b>74 6</b>	<b>(142 0)</b>
<b>Non-current liabilities</b>			
Financial liabilities			
- borrowings	12	(2,521 3)	(2,247 2)
- derivative financial instruments	13	(5 1)	(14 0)
Trade and other payables	11	(2 5)	-
Retirement benefit obligations	21	(5 5)	(6 6)
Provisions	15	<u>(15 5)</u>	<u>(17 3)</u>
		<u>(2,549 9)</u>	<u>(2,285 1)</u>
<b>Net assets before deferred tax</b>		<b>763 9</b>	<b>749 8</b>
Deferred tax	16	<u>(319 8)</u>	<u>(311 6)</u>
<b>Net assets</b>		<u><u>444 1</u></u>	<u><u>438 2</u></u>
<b>Shareholders' equity</b>			
Called up share capital	17	309 9	309 9
Capital redemption reserve		166 2	166 2
Retained earnings		<u>(32 0)</u>	<u>(37 9)</u>
<b>Total equity</b>		<u><u>444 1</u></u>	<u><u>438 2</u></u>

The financial statements on pages 9 to 36 were approved by the Board of Directors on 8 June 2007 and were signed on its behalf by

  
N C Annett  
Managing Director

  
CA Jones  
Finance Director

## Cashflow statement for the year ended 31 March 2007

	Note	2007 £m	2006 £m
Cash generated from operations	18	245 6	259 3
Interest received		7 1	10 1
Interest paid		(73 7)	(142 7)
Tax paid		-	(1 1)
<b>Net cash inflow from operating activities</b>		<u>179 0</u>	<u>125 6</u>
<b>Cash flows from investing activities</b>			
Purchase of property, plant and equipment		(188 7)	(182 5)
Grants and contributions received		22 5	16 8
Proceeds from sale of property, plant and equipment		-	0 8
<b>Net cash used in investing activities</b>		<u>(166 2)</u>	<u>(164 9)</u>
<b>Net cash inflow/(outflow) before financing activities</b>		12 8	(39 3)
<b>Cash flows from financing activities</b>			
Long term loans and finance leases received		255 3	259 0
Loan repaid to group undertaking		(120 3)	(525 0)
Loan repaid from group undertaking		-	0 8
Capital element of finance lease payments		(3 7)	(5 2)
Reduction in held to maturity investments		-	89 1
Other loan repayments		(0 5)	(0 4)
<b>Net cash used in financing activities</b>		<u>130 8</u>	<u>(181 7)</u>
<b>Increase/(decrease) in net cash</b>	19(b)	143 6	(221 0)
Net cash at 1 April		13 9	234 9
<b>Net cash at 31 March</b>	11	<u>157 5</u>	<u>13 9</u>

# Principal accounting policies

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

### Basis of preparation

The financial statements are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and those parts of the Companies Act 1985 applicable to reporting under IFRS. The financial statements have been prepared under the historical cost convention as modified by the revaluation of certain financial instruments to fair value in accordance with IFRS and as permitted by the Fair Value Directive as implemented in the amended Companies Act 1985.

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

IFRS 7	Financial Instruments Disclosures, and the related amendment to IAS 1 on capital disclosures
IFRS 8	Operating Segments
IFRIC 8	Scope of IFRS 2 – Share Based Payment
IFRIC 9	Reassessment of Embedded Derivatives
IFRIC 10	Interim Financial Reporting and Impairment
IFRIC 11	Group and Treasury Share Transactions
IFRIC 12	Service Concession Arrangements

The directors anticipate that the adoption of these Standards and Interpretations in future periods will have no material impact on the financial statements of the group except for additional disclosures that may be required on financial instruments when the relevant standards come into effect for periods commencing on or after 1 January 2007.

### Consolidated financial statements

The Company has taken advantage of Section 228(1) of Companies Act 1985 not to produce consolidated financial statements, as it is a wholly owned subsidiary of Glas Cymru Cyfyngedig.

### Accounting policies for the year ended 31 March 2007

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

### Revenue recognition

Revenue represents the income receivable in the ordinary course of business for services provided, excluding value added tax. Where services have been provided, but for which no invoice has been raised at the year-end, an estimate of the amounts are included in revenue. See further details in the critical accounting estimates section.

Revenue recognised reflects the actual charges levied on customers in the year. The difference between the actual revenue and the level of revenue that could have resulted had the full Ofwat allowed level of charges been levied is referred to as a 'customer dividend'.

## Principal accounting policies cont'd

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### Property, plant & equipment

Property, plant and equipment are included at cost less accumulated depreciation. Cost reflects purchase price together with any expenditure directly attributable to bringing the asset into use, including directly attributable internal costs but excluding interest.

Property, plant and equipment comprise

- (i) infrastructure assets (being mains and sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls), and
- (ii) other assets (including properties, overground operational structures and equipment, and fixtures and fittings)

The carrying value of assets is reviewed for impairment if circumstances dictate that the carrying value may not be recoverable. Asset lives and residual values are reviewed annually, which has this year resulted in a change to the useful economic life of water distribution network assets.

### Infrastructure assets

Infrastructure assets, which comprise principally of impounding reservoirs and a network of underground water and wastewater systems, are stated at fair value on the date of transition to IFRS as a deemed cost under the exemption available under IFRS1. For accounting purposes, the water system is segmented into components representing categories of asset classes with similar characteristics and asset lives. The wastewater system is segmented into components representing geographical operating areas reflecting the way the Company operates its wastewater activities.

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

The depreciation charge for infrastructure assets is determined for each component of the network and is based on each component's cost, estimated residual value and the expected remaining average useful life. The useful average economic lives of the infrastructure components range from 60 to 150 years.

### Other assets

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

Freehold buildings	60 years
Leasehold properties	over the lease period
Operational structures	40 – 80 years
Fixed plant	20-40 years
Vehicles, mobile plant, equipment and computer hardware & software	3-16 years

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

### Intangible assets

Intangible assets, which comprise principally computer software and system developments, are included at cost less accumulated depreciation. Cost reflects purchase price together with any expenditure directly attributable to bringing the asset into use, including directly attributable internal costs but excluding interest.

The carrying values of intangible assets are reviewed for impairment if circumstances dictate the carrying value may not be recovered.

Intangible assets are depreciated on a straight-line basis over their estimated useful economic lives, which range between 3 and 15 years. These asset lives are reviewed annually.

## **Principal accounting policies cont'd**

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### **Leased assets**

Where assets are financed by leasing arrangements, which transfer substantially all the risks and rewards of ownership of an asset to the lessee (finance leases), the assets are capitalised and included in "property, plant & equipment" with the corresponding liability to the lessor included within "finance liabilities – borrowings". Leasing payments are treated as consisting of a capital element and a finance charge, the capital element reducing the obligation to the lessor with the finance charge being recognised over the period of the lease based on its implicit rate so as to give a constant rate of interest on the remaining balance of the liability.

All other leases are regarded as operating leases. Rental costs arising under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

### **Asset revaluations**

The economic value of the Company's water and sewerage business is derived from the regulatory capital value (RCV) set by Ofwat during its five yearly price reviews. Accordingly, the carrying values of the regulatory assets will be periodically revalued to their economic values at five-yearly intervals, starting on 31 March 2010. The previous revaluation of regulatory assets was undertaken at 31 March 2004, as part of the transition to IFRS.

### **Grants and customer contributions**

Grants and customer contributions in respect of expenditure on property, plant and equipment have been offset against fixed assets.

Grants in respect of revenue expenditure are credited to the Income Statement over the same period as the related expenditure is incurred.

### **Capital expenditure programme incentive payments**

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

### **Target cost contracts**

The Company maintains target cost contracts with its main operating partners. The Company's policy in respect of pain/gain share payments/receivables arising from these contracts is to recognise when final agreement with the relevant service partner has been achieved.

### **Allowance for doubtful debts**

Trade receivables are first assessed individually for impairment, or collectively where the receivables are not individually significant. Where there is no objective evidence of impairment for an individual receivable, it is included in a group of receivables with similar credit risk characteristics and these are collectively assessed for impairment. Movements in the provision for doubtful debts are recorded in the income statement.

### **Cash and cash equivalents**

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

## Principal accounting policies cont'd

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### Pension costs

The majority of the Company's employees belong to the Company pension scheme, which is funded by both employers' and employees' contributions and which is of the defined benefit type. Actuarial valuations of the scheme are carried out at intervals of not more than three years. Contribution rates are based on the advice of a professionally qualified actuary.

For the Company's defined benefit scheme, the net asset or liability recognised in the balance sheet represents the present value of the defined benefit obligations less the fair value of the plan's assets. In accordance with the amendment to IAS19, all cumulative actuarial gains and losses have been recognised in reserves at the date of transition to IFRS.

The full cost of providing pension benefits to employees (including the expected return on scheme assets and interest on scheme liabilities) is reported in the income statement within operating costs. All actuarial gains and losses are also recognised in the year in which they arise in determining the profit or loss for the year.

### Financial liabilities – borrowings

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

Foreign currency borrowings are translated into sterling at the rates ruling at the balance sheet date.

### Financial assets

Financial assets represent held to maturity investments that are non-derivative, with fixed or determinable payments and fixed maturities of over three months at the date of acquisition, which the Company intends to hold until maturity.

### Derivative financial instruments

Derivative instruments utilised by the Company are currency swaps, currency forward exchange contracts and interest rate swaps. Derivative instruments are used for hedging purposes to alter the risk profile of existing underlying exposures within the group.

Derivatives are recognised initially, and are subsequently remeasured at fair value.

The movement in the fair value between balance sheet dates is recognised in the income statement to the extent that such instruments do not qualify for hedge accounting under IAS 39. At present, no such derivatives qualify for hedge accounting.

### Deferred taxation

Deferred corporation tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognised in respect of all temporary differences. Deferred tax assets are recognised for all deductible temporary differences, carry-forward of unused tax assets and tax losses, to the extent that they are regarded as recoverable. They are regarded as recoverable where, on the basis of available evidence, there will be suitable taxable profits against which the future reversal of the underlying temporary differences can be deducted. The carrying value of the amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all, or part, of the asset to be utilised.

Deferred corporation tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on the tax rates that have been enacted at the balance sheet date.



## **Principal accounting policies cont'd**

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### **Provisions**

Provision is made for all known and estimated liabilities of the Company where there is a present obligation and it is probable that a transfer of economic benefits will be required to settle the obligation

In the case of leases, where the Company no longer occupies properties, provision is made for the liabilities that are expected to arise in respect of rental payments and dilapidations, prior to disposal or termination of the lease

Where the Company receives claims that are either not covered by insurance or where there is an element of the claim for which insurance cover is not available, a provision is made for the expected future liabilities

## **Financing risk management objectives and policies**

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Treasury activities are managed within a formal set of treasury policies and objectives, which are reviewed regularly and approved by the Board. The policy specifically prohibits any transactions of a speculative nature and the use of complex financial instruments. Certain detailed policies for managing interest rate, currency and inflation risk and that for managing liquidity risk are approved by the Board and may only be changed with the consent of Dŵr Cymru Cyfyngedig's security trustee (the "Security Trustee"). The risk is further mitigated by limiting exposure to any one counterparty. We use financial instruments, which principally include listed bonds, finance leases, bank loan facilities and derivatives, to raise finance and manage risk from our operations.

### **Credit risk**

Surplus cash is invested in short and medium term sterling financial investments. The Board annually establishes the investment criteria, which is restricted to banks and other financial institutions meeting required standards assessed by the major credit rating agencies.

### **Interest rate / Currency risk**

The Company minimises exposure to currency risk in respect of any foreign currency denominated borrowings by using appropriate derivative instruments to hedge these liabilities into sterling obligations.

The Company hedges at least 85% of its total outstanding financial liabilities, including finance leases, into either index-linked or fixed rate obligations. For this purpose interest rate liabilities on floating rate liabilities are hedged through a combination of derivative instruments and cash balances. The regulatory framework, under which revenues and the regulatory asset value are indexed also expose the Company to inflation risk. Subject to market constraints and Board approval the Company therefore may seek to raise new debt through index-linked instruments or to enter into appropriate hedging transactions.

The "hedges" established to manage currency risks are economic in nature, but do not satisfy the specific requirements of IAS 39 in order to be treated as hedges for accounting purposes.

### **Liquidity risk**

Liquidity risk is managed by maintaining a balance between the continuity of funding and flexibility through the use of borrowings across a range of currencies, instruments, type and maturities. Our policy is to ensure that the maturity profile does not impose an excessive strain on our ability to repay loans. Under this policy, no more than 20% of the principal of group borrowings can fall due in any twenty-four month period.

### **Banking facilities**

We maintain committed banking facilities in order to provide flexibility in the management of the Company's liquidity.

There is also a special liquidity facility, which we are required to maintain in order to meet certain interest and other obligations that cannot be funded through operating cashflow in the event of a standstill being declared by the Security Trustee, following an event of default under the group's debt financing covenants.

## Critical accounting estimates

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

### **Allowance for doubtful debts**

Individual impairment losses on customer debts are calculated based on an individual assessment of the cash flows that are expected. Collective impairment losses on receivables with similar credit risk are calculated using a statistical model. The key assumption in the model is the probability of a failure to recover amounts when they fall into arrears. The probability of failing to recover is determined by past experience, adjusted for changes in external factors. The accuracy of the impairment calculation would therefore be affected by unexpected changes to the economic situation, and to changes in customer behaviour. To the extent that the failure to recover debts in arrears alters by +/-5%, the bad debt allowance would increase or decrease by £4.2 million (2006: £3.6 million).

### **Pension benefits**

The present value of the pension obligations is dependent on the actuarial calculation, which includes a number of assumptions. These assumptions include the discount rate, which is used to calculate the present value of the estimated future cash outflows that will be required to meet the pension obligations. In determining the discount rate to use, the Group considers market yields of high quality corporate bonds, denominated in sterling, that have times to maturity approximating the terms of the pension liability. Were this discount rate to reduce or increase by 0.1%, the carrying value of the pension obligations would increase or reduce by £0.8 million (2006: £0.9 million).

### **Measured income accrual**

Revenue includes an estimation of charges unbilled at the period end. The accrual is estimated using a defined methodology based upon the weighted average water consumption by tariff, which is calculated based upon historical billing information, adjusted for changes in external factors, such as weather. A 5% change in actual consumption from that estimated would have the effect of increasing/decreasing the accrual by £2.3 million (2006: £2.2 million).

## Notes to the financial statements

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### 2. Segmental information

The Directors consider that there is only one reporting segment being the operation of water and sewerage business in the UK. Therefore the disclosures for the primary segment have already been given in these financial statements.

The secondary reporting format is by geographical analysis by origin and destination. As the Company has virtually only domestic activities there is only one geographical segment. Therefore the disclosures for the secondary segment have also already been given in these financial statements.

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### 3. Financing costs

#### 3a) Net interest before fair value losses on financial instruments

	2007	2006
	£m	
Interest payable on loans	(123.8)	(124.7)
Interest payable on finance leases	(33.8)	(31.9)
Amortisation of bond issue costs	<u>(0.9)</u>	<u>(2.9)</u>
Total interest payable	<u>(158.5)</u>	<u>(159.5)</u>
Interest receivable	<u>7.4</u>	<u>9.7</u>
Net interest payable before fair value adjustments	<u>(151.1)</u>	<u>(149.8)</u>

Included within interest payable on loans are amounts payable to group undertakings of £114.7m (2006 £117.3m)

#### 3b) Fair value gains/(losses) on financial instruments

Whilst the group employs an economically effective policy using interest rate and currency swaps, this policy does not satisfy the stringent hedge accounting criteria of IAS39. Consequently, the Company's interest rate and currency swaps are fair valued at each balance sheet date with the movement (gains or losses) disclosed in the income statement. Over the life of these swaps, providing that there is an effective match, these fair value adjustments will reverse and reduce to zero. (See note 13 for balance sheet note in respect of derivative financial instruments)

	2007	2006
	£m	
Fair value gains/(losses) on index linked swaps	<u>10.8</u>	<u>(3.5)</u>
Tax effect of fair value gains/(losses) on financial instruments	<u>(3.2)</u>	<u>1.1</u>
Net of tax impact of fair value gains/(losses) on financial instruments	<u>7.6</u>	<u>(2.4)</u>

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## Notes to the financial statements cont'd

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### 4. Profit before taxation

The following items have been included in arriving at profit before taxation

	2007	2006
	£m	£m
Operating charges from outsourced activities		
- Operating services agreement	115.9	107.7
- Customer services agreement	18.6	19.4
- Laboratories and analytical services	7.6	7.3
- Other contracts	14.2	11.7
	<u>156.3</u>	<u>146.1</u>
Employee costs (note 20)		
- Wages and salaries	8.0	7.2
- Social security	0.9	0.7
- Severance programme and other termination costs	0.2	0.4
- Net actuarial loss/(gain) (note 21)	0.9	(1.5)
- Pension costs (excluding actuarial gain / loss)	1.7	2.6
Research and development expenditure	0.4	0.4
Trade receivables impairment	11.0	7.6
Rates	21.0	18.8
Environment agency charges	13.5	13.0
Fees paid to auditors (see below)	0.2	0.2
Own work capitalised	(8.5)	(7.3)
Net rents payable	-	0.5
Other operating charges	23.0	24.5
	<u>228.6</u>	<u>213.2</u>
Depreciation of property, plant and equipment		
- Owned assets	75.1	60.1
- Under finance leases	35.0	33.6
Amortisation of intangible assets	1.7	3.8
Infrastructure renewals expenditure	84.1	48.8
Profit on disposal of fixed assets	-	(0.8)
	<u>424.5</u>	<u>358.7</u>

## Notes to the financial statements cont'd

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### 4. Profit before taxation cont'd

#### Services provided by the company's auditor

During the year the Company obtained the following services from the Company's auditor as detailed below

	2007 £'000	2006 £'000
Audit services	61	78
Other services		
- Regulatory audit services pursuant to legislation	49	32
- Tax advisory services	1	10
- Interim review	20	25
- Bond issue	24	-
- Grant applications	2	6
- Financial modelling	1	12
- IFRS transition	-	48
	<u>158</u>	<u>211</u>

Regulatory audit services includes work on the Regulatory Accounts, June Return and Principal Statement. In addition to the above services, PricewaterhouseCoopers LLP acted as auditor to the Welsh Water Pension Scheme. The appointment of auditors to the pension scheme and the fees paid in respect of the audit are agreed by the trustees of the scheme, who act independently from the management of the group. The fees paid in respect of audit services to the pension scheme during the year were £7,000 (2006 £7,000).

The Board has adopted a formal policy with respect to services received from external auditors. The external auditor will not be used for internal audit services and all non-audit work above a threshold of £25,000 will be subject to prior competitive tendering and approval by the Audit Committee.

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### 5. Taxation

#### Analysis of charge in the year

	2007 £m	2006 £m
Current tax – continuing operations		
- Current year movements	-	(2.3)
- Adjustment in respect of prior years	0.9	(1.4)
Deferred tax		
- current year movements	(8.9)	(8.6)
- Adjustment in respect of prior years	0.7	5.3
<b>Taxation charge</b>	<u>(7.3)</u>	<u>(7.0)</u>

## Notes to the financial statements cont'd

### 5. Taxation cont'd

The tax for the year is lower (2006 lower) than the standard rate of corporation tax in the UK (30%). The differences are explained below

	2007 £m	2006 £m
Profit before tax	13.2	41.5
Profit before tax multiplied by the corporation tax rate in the UK of 30% (2006 30%)	3.9	12.5
Effects of		
Adjustments to tax in respect of prior years	(1.7)	(3.9)
Expenses not deductible for tax purposes	0.3	0.2
Other permanent differences	4.8	(1.8)
Total taxation charge	7.3	7.0

### 6. Intangible fixed assets

Intangible fixed assets comprise computer software and related system developments

	Cost £m	Depreciation £m	Net book value £m
<b>Current Year</b>			
At 1 April 2006	53.4	(49.0)	4.4
Additions	4.3	-	4.3
Charge for the year	-	(1.7)	(1.7)
At 31 March 2007	57.7	(50.7)	7.0
	Cost £m	Depreciation £m	Net book value £m
<b>Prior Year</b>			
At 1 April 2005	49.6	(45.2)	4.4
Additions	3.8	-	3.8
Charge for the year	-	(3.8)	(3.8)
At 31 March 2006	53.4	(49.0)	4.4

## Notes to the financial statements cont'd

### 7. Property, plant and equipment

	Freehold land & buildings £m	Infrastructure assets £m	Operational structures £m	Plant equipment, computer hardware £m	Total £m
<b>Current year</b>					
<b>Cost</b>					
At 1 April 2006	32.7	1,375.2	2,055.0	193.2	3,656.1
Additions net of grants and contributions	0.2	37.5	128.0	25.0	190.7
Disposals	-	-	(64.9)	-	(64.9)
<b>At 31 March 2007</b>	<b>32.9</b>	<b>1,412.7</b>	<b>2,118.1</b>	<b>218.2</b>	<b>3,781.9</b>
<b>Accumulated depreciation</b>					
At 1 April 2006	15.5	39.8	654.6	150.6	860.5
Charge for the year	0.4	31.4	72.1	6.2	110.1
Disposals	-	-	(35.6)	-	(35.6)
<b>At 31 March 2007</b>	<b>15.9</b>	<b>71.2</b>	<b>691.1</b>	<b>156.8</b>	<b>935.0</b>
<b>Net book value</b>					
<b>At 31 March 2007</b>	<b>17.0</b>	<b>1,341.5</b>	<b>1,427.0</b>	<b>61.4</b>	<b>2,846.9</b>
<b>Prior year</b>					
<b>Cost</b>					
At 1 April 2005	32.8	1,310.6	1,959.6	184.8	3,487.8
Additions net of grants and contributions	-	64.6	95.4	8.4	168.4
Disposals	(0.1)	-	-	-	(0.1)
<b>At 31 March 2006</b>	<b>32.7</b>	<b>1,375.2</b>	<b>2,055.0</b>	<b>193.2</b>	<b>3,656.1</b>
<b>Accumulated depreciation</b>					
At 1 April 2005	14.8	18.8	589.1	144.2	766.9
Charge for the year	0.8	21.0	65.5	6.4	93.7
Disposals	(0.1)	-	-	-	(0.1)
<b>At 31 March 2006</b>	<b>15.5</b>	<b>39.8</b>	<b>654.6</b>	<b>150.6</b>	<b>860.5</b>
<b>Net book value</b>					
<b>At 31 March 2006</b>	<b>17.2</b>	<b>1,335.4</b>	<b>1,400.4</b>	<b>42.6</b>	<b>2,795.6</b>

Included within fixed assets is an amount £157.6m in respect of assets in the course of construction (2006 £99.9m)



## Notes to the financial statements cont'd

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### 7. Property, plant and equipment cont'd

#### Assets held under finance leases

Included within the above are assets held under finance leases, analysed as below

	Infrastructure assets £m	Operational structures £m	Total £m
<b>Cost</b>			
At 1 April 2006	526 8	565 9	1,092 7
Additions	-	32 2	32 2
<b>At 31 March 2007</b>	<b>526 8</b>	<b>598 1</b>	<b>1,124 9</b>

#### Accumulated depreciation

At 1 April 2006	30 1	126 1	156 2
Charge for the year	6 6	28 4	35 0
<b>At 31 March 2007</b>	<b>36 7</b>	<b>154 5</b>	<b>191 2</b>

#### Net book value

<b>At 31 March 2007</b>	<b>490 1</b>	<b>443 6</b>	<b>933 7</b>
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	Infrastructure assets £m	Operational structures £m	Total £m
<b>Cost</b>			
At 1 April 2005	424 7	535 5	960 2
Additions	102 1	30 4	132 5
<b>At 31 March 2006</b>	<b>526 8</b>	<b>565 9</b>	<b>1,092 7</b>

#### Accumulated depreciation

At 1 April 2005	22 5	100 1	122 6
Charge for the year	7 6	26	33 6
<b>At 31 March 2006</b>	<b>30 1</b>	<b>126 1</b>	<b>156 2</b>

#### Net book value

<b>At 31 March 2006</b>	<b>496 7</b>	<b>439 8</b>	<b>936 5</b>
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## Notes to the financial statements cont'd

### 8. Fixed asset investments

Cost and net book value	2007 £m	2006 £m
At 1 April and 31 March	0.1	0.1

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

	Nature of Business	Country of Incorporation	Description of Holding
Water Research Centre (1989) plc	Water Research	Great Britain	"B" Ordinary Shares of £1

In addition, the Company holds 5% Convertible Unsecured Loan Stock 2014 at a cost of £23,326 in Water Research Centre (1989) plc

In addition, the Company holds Ordinary shares of £1 each in the following subsidiary

	Principal Activity	Country of Incorporation	Holding
Welsh Water Utilities Finance Plc	Raising finance	England and Wales	100%

### 9 Trade and other receivables

	2007 £m	2006 £m
<b>(a) Amounts falling due within one year</b>		
Trade receivables	84.7	77.0
Less provision for impairment of receivables	(53.0)	(49.6)
Trade receivables - net	31.7	27.4
Amounts owed by group undertakings	0.1	0.1
Other receivables	5.2	9.8
Prepayments and accrued income	53.5	49.5
	90.5	86.8
<b>(b) Amounts falling due after more than one year</b>		
Amounts owed by group undertakings	370.5	370.5
	461.0	457.3

### 10. Cash and cash equivalents

	2007 £m	2006 £m
Cash at bank and in hand	3.8	3.8
Short-term bank deposits	153.7	10.1
	157.5	13.9

The effective interest rate on short-term deposits as at 31 March 2007 was 5.4% (2006 4.7%) and these deposits have an average maturity of 30 days (2006 82 days)

## Notes to the financial statements cont'd

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### 11. Trade and other payables

Current	2007	2006
	£m	£m
Trade payables	12 2	26 8
Capital payables	42 0	45 3
Amounts due to group undertakings	3 8	3 8
Other taxation and social security costs	0 3	0 3
Deferred income	0 4	-
Other payables	46 6	46 0
	<u>105 3</u>	<u>122 2</u>
Non-current	2007	2006
	£m	£m
Deferred income	2 5	-

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### 12. Financial liabilities – borrowings

Current	2007	2006
	£m	£m
Interest accruals	56 4	0 3
Loans due to group undertakings	4 4	120 3
Other unsecured loans	0 3	0 4
Finance lease obligations	4 7	3 7
	<u>65 8</u>	<u>124 7</u>
Non-current	2007	2006
	£m	£m
Interest accruals	24 6	18 7
Loans due to group undertakings	1,731 7	1,488 8
Other unsecured loans	2 9	3 3
Finance lease obligations	762 1	736 4
	<u>2,521 3</u>	<u>2,247 2</u>

A security package was granted by Dŵr Cymru Cyfyngedig (DCC), as part of the group's bond programme for the benefit of holders of senior bonds, finance lessors and other senior financial creditors

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

i) a first fixed and floating security over all of DCC's assets and undertaking, to the extent permitted by the Water Industry Act, other applicable law and its licence and

ii) a fixed and floating security given by the guarantors referred to above which are accrued on each of these company's assets including, in the case of Dŵr Cymru (Holdings) Limited, a first fixed charge over its shares in DCC

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## Notes to the financial statements cont'd

### 13. Derivative financial instruments

All derivative financial instruments are held for economic hedging purposes although they do not qualify as accounting hedges under IAS 39. As such, movements in their fair values are taken to the Income Statement (see note 3b). Fair values are obtained by reference to actual market transactions.

2007	Fair Values	
	Assets £m	Liabilities £m
<b>Current</b>		
Index linked swaps	-	(2.3)
<b>Non-Current</b>		
Index linked swaps	14.7	(5.1)
	<b>14.7</b>	<b>(7.4)</b>
2006	Fair Values	
	Assets £m	Liabilities £m
<b>Current</b>		
Index linked swaps	4.2	-
<b>Non-Current</b>		
Index linked swaps	6.3	(14.0)
	<b>10.5</b>	<b>(14.0)</b>

In accordance with IAS 39, 'Financial instruments: Recognition and measurement', Dŵr Cymru Cyfyngedig has reviewed all contracts for embedded derivatives that are required to be separately accounted for if they do not meet certain requirements set out in the standard. Dŵr Cymru Cyfyngedig has no embedded derivatives as per IAS 39.

#### Indexed-linked swaps

The indexed-linked swaps have the effect of fixing the interest rate on £626 million (2006: £630 million) of finance lease liabilities by reference to the retail price index ("RPI").

The notional amount of the swaps as at 31 March 2007 is £579 million (2006: £587 million), representing the average balance on the finance leases subject to floating interest rates for the year to 31 March 2008. The notional amount amortises over the life of the swaps to match the average floating rate balances of the leases.

The principal terms of the indexed-linked swaps are as follows:

Notional Amount	£579 million (amortising)
Average swap maturity	25 years
Average interest rate	1.60% (fixed) plus RPI

### 14. Financial risk management

The policies of the Company in respect of financial risk management are included in the accounting policies note on page 19. The numerical financial instrument disclosures as required by IAS 32 are set out below:

#### a) Interest rate risk

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

## Notes to the financial statements cont'd

### 14. Financial risk management cont'd

	2007	2006
<b>Assets</b>		
Cash and cash equivalents	5.4%	4.7%
Amounts owed by group undertakings	12.0%	12.0%
<b>Liabilities</b>		
Inter-company loans	5.5%	5.6%
Finance leases	4.5%	4.5%
Other Unsecured loans	6.5%	6.2%

Trade and other receivables and payables are not interest bearing

The effective interest rates ignore the effect of the index-linked swaps set out in note 13

#### b) Liquidity risk

	Within 1yr £m	1-2 years £m	2-5 years £m	> 5 years £m	Total £m
<b>2007</b>					
<b>Assets</b>					
Cash and cash equivalents	157.5	-	-	-	157.5
Trade and other receivables	90.5	-	-	370.5	461.0
	248.0	-	-	370.5	618.5
<b>Liabilities</b>					
Trade and other payables	105.3	0.4	1.1	1.0	107.8
Inter-company loan	4.4	4.4	152.9	1,574.4	1,736.1
Local Authority loans	0.3	0.4	1.1	1.4	3.2
Finance leases	4.7	5.8	24.9	731.4	766.8
	114.7	11.0	180.0	2,308.2	2,613.9
<b>2006</b>					
<b>Assets</b>					
Cash and cash equivalents	13.9	-	-	-	13.9
Trade and other receivables	86.8	-	-	370.5	457.3
	100.7	-	-	370.5	471.2
<b>Liabilities</b>					
Trade and other payables	122.2	-	-	-	122.2
Inter-company loan	120.3	4.4	15.4	1,469.0	1,609.1
Local Authority loans	0.4	0.3	1.1	1.9	3.7
Finance leases	3.7	4.6	21.0	710.8	740.1
	246.6	9.3	37.5	2,181.7	2,475.1

## Notes to the financial statements cont'd

### 14. Financial risk management cont'd

The minimum lease payments under finance leases fall due as follows

	2007 £m	2006 £m
Not later than one year	39 4	31 1
Later than one year but not more than five	180 2	147 0
More than five years	1,336 1	1,289 4
	<u>1,555 7</u>	<u>1,467 5</u>
Future finance charges on finance leases	(763 5)	(708 4)
Present value of finance lease liabilities	<u>792 2</u>	<u>759 1</u>

#### c) Fair values

The fair values of the Company's derivative financial instruments are set out in note 13

The fair value of the intercompany loan is £2,010 1m (2006 £1,950 4m) The fair value of the Company's other non-derivative financial instruments are the same as the book values

#### d) Borrowing facilities

The company has the following undrawn committed borrowing facilities available at 31 March in respect of which all conditions precedent had been met at that date

	2007 £m	2006 £m
Expiring in more than 1 year		
Inter-company revolving credit facilities	345 0	259 8
Inter-company loan facility	-	75 0
	<u>345 0</u>	<u>334 8</u>

A fellow subsidiary, Dŵr Cymru Financing Limited also has a special liquidity facility of £150 million, which it is required to maintain in order to meet certain group interest and other obligations that cannot be funded through operating cashflow of the group, in the event of a standstill being declared by the Security Trustee. A standstill would arise in the event that Dŵr Cymru Cyfyngedig defaults on its debt financing covenants. Dŵr Cymru Cyfyngedig also has a £20 million overdraft facility. Both of these facilities are renewable on an annual basis.

The above facilities are at floating rates of interest

### 15. Provisions

	Restructuring provision £m	Uninsured loss provision £m	Provision for loss on swap closure £m	Total £m
At 1 April 2006	5 3	4 5	7 5	17 3
Charged/(released) to Income Statement	(3 9)	4 3		0 4
Utilised in year	(0 3)	(1 3)	(0 6)	(2 2)
At 31 March 2007	<u>1 1</u>	<u>7 5</u>	<u>6 9</u>	<u>15 5</u>

#### Restructuring provision

This provision is in respect of payments to be made relating to estimated dilapidation costs, which will be utilised over the next three years

## Notes to the financial statements cont'd

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### 15. Provisions cont'd

#### Provision for uninsured losses

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

#### Provision for loss on swap closure

This provision is in respect of a liability that arose on the cancellation of certain interest rate swap contracts. These contracts were redeemed early and loss arising on redemption was settled by setting a higher rate on another swap contract. This provision is being released to the Income Statement over the life of the revised swap, which expires on 31 March 2031.

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### 16. Deferred tax

Deferred tax is calculated in full on temporary differences under the liability method using a tax rate of 30% (2006 30%).

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

	2007	2006
	£m	£m
At 1 April	311.6	308.3
Income Statement charge / (credit)	8.2	3.3
<b>At 31 March</b>	<b>319.8</b>	<b>311.6</b>

Deferred tax assets have been recognised in respect of all tax losses and other temporary differences giving rise to deferred tax assets because it is probable that these assets will be recovered.

	2007	2006
	£m	£m
Effect of tax allowances over depreciation	345.0	307.0
Other tax differences	(25.2)	4.6
<b>Provision for deferred tax</b>	<b>319.8</b>	<b>311.6</b>

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### 17. Called up share capital

		£m
2007	Authorised	
	501,050,000 ordinary shares of £1 each	<u>501.1</u>
		<u>501.1</u>
	Allotted, called up and fully paid	
	309,876,374 ordinary shares of £1 each	<u>309.0</u>
		<u>309.0</u>
2006	Authorised	
	501,050,000 ordinary shares of £1 each	<u>501.1</u>
		<u>501.1</u>
	Allotted, called up and fully paid	
	309,876,374 ordinary shares of £1 each	<u>309.0</u>
		<u>309.0</u>

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## Notes to the financial statements cont'd

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### 18. Cash generated from operations

Reconciliation of operating profit to cash generated from operations

	2007	2006
	£m	£m
Operating profit	153 5	194 8
Adjustments for		
Depreciation and amortisation	111 8	97 5
Profit on disposals of fixed assets	-	(0 8)
Changes in working capital		
Increase in trade and other receivables	(3 4)	(17 9)
Decrease in trade and other payables	(13 4)	(12 5)
Decrease in pension deficit	(1 1)	(1 2)
Decrease in provisions	(1 8)	(0 6)
<b>Cash generated from operations</b>	<b>245 6</b>	<b>259 3</b>

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### 19. Analysis and reconciliation of net debt

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

	2007	2006
	£m	£m
Cash and cash equivalents	157 5	13 9
Debt owed by parent company after one year	370 5	370 5
	<u>528 0</u>	<u>384 4</u>
Debt due after one year	(1,734 6)	(1,489 8)
Debt due within one year	(4 7)	(120 7)
Finance leases	(766 8)	(740 1)
Accrued interest	(81 0)	(19 0)
	<u>(2,587 1)</u>	<u>(2,369 6)</u>
<b>Net debt</b>	<b>(2,059 1)</b>	<b>(1,985 2)</b>



## Notes to the financial statements cont'd

### 19. Analysis and reconciliation of net debt cont'd

b) The movement in net debt during the period may be summarised as	2007	2006
	£m	£m
Net debt at start period	(1,985 2)	(1,925 0)
Increase/(Decrease) in net cash	143 6	(221 0)
Decrease in group receivables	-	(0 8)
Decrease in financial assets	-	(89 1)
(Increase)/decrease in debt	(130 8)	271 6
<b>Decrease/(increase) in net debt arising from cashflows</b>	<b>12 8</b>	<b>(39 3)</b>
Non cash movement on group debt	(24 7)	(20 0)
Movement in accrued interest	(62 0)	(0 9)
<b>Movement in net debt during the period</b>	<b>(73 9)</b>	<b>(60 2)</b>
<b>Net debt at end of period</b>	<b>(2,059 1)</b>	<b>(1,985 2)</b>

### 20. Employees and directors

#### a) Directors' emoluments

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

	2007	2006
	£'000	Restated £'000
Salary (including benefits in kind)	920	805
Compensation for loss of office	179	-
Fees	412	389
	<u>1,511</u>	<u>1,194</u>
Long term incentive plan	<u>207</u>	<u>214</u>
<b>Highest paid Director (2007 and 2006 NC Annett)</b>		
Aggregate emoluments	<u>332</u>	<u>374</u>
Accrued pension under defined benefit scheme	<u>73</u>	<u>51</u>
Long term incentive plan	<u>90</u>	<u>97</u>

Retirement benefits are accruing to three Directors (2006 – two) under defined benefit schemes. Benefits are accruing to no Directors (2006 – one) under a defined contribution scheme.

- i) The financial statements for the year ended 31 March 2007 include a provision of £301,298 (2006 £241,833) for bonus potentially payable to Executive Directors for performance in the financial year 2006/07. The final amount to be paid to each Director will be determined when Ofwat publishes its Overall Performance Assessment (OPA) results for 2006/07 in the Autumn of 2007 and could be higher or lower. An amount of £206,644 (2006 £213,844) has also been provided under the terms of the Executive Directors' Long Term Incentive Plan.
- ii) The comparatives have been restated to reflect the final performance bonus for 2005/06. The actual performance bonus in respect of 2005/06 was paid in November 2006 following the publication of Ofwat's OPA report for 2005/06, and amounted to £316,002 compared to the amount accrued at 31 March 2006.

## Notes to the financial statements cont'd

### 20. Employees and directors cont'd

of £241,833. The aggregate emoluments of the highest paid Director increased by £41,839 to £373,511 and total emoluments increased by £74,169 to £1,193,900

b) Staff costs during the year	2007	2006
	£m	£m
Wages and salaries	8 0	7 7
Severance programme and termination costs	0 2	-
Social security costs	0 9	0 7
Other pension costs (note 22)	2 6	1 0
	<u>11 7</u>	<u>9 4</u>

Average monthly number of people (including executive directors) employed by the company	2007	2006
	Number	Number
Regulated water and sewerage activities	<u>159</u>	<u>136</u>

Of the above, £4.7 million (2006: £3.7 million) has been charged to capital. Other pension costs include £nil (2006: £0.4 million) in respect of the severance programme and termination costs. Other pension costs includes £0.4m (2006: £0.5m) in respect of the directors' unfunded pension liabilities.

### 21. Pension commitments

Following the acquisition of Dŵr Cymru Cyfyngedig by Glas Cymru Cyfyngedig, a new funded defined benefit pension scheme for current employees (based on final pensionable salary and pensionable service) was introduced on 1 December 2001, the DCWW Pension Scheme. The assets of the scheme are held in a separate trustee administered fund.

The DCWW Pension Scheme was closed to new members from the 31 December 2005 and a new defined contribution scheme, the Dŵr Cymru Defined Contribution Scheme, was introduced from the 1 January 2006.

Total pension costs in the year were as follows:

	2007	2006
	£'000	£'000
Defined contribution scheme	150	24
Defined benefit scheme – excluding actuarial gains/losses	<u>1,518</u>	<u>2,447</u>
	1,668	2,471
Net actuarial losses/(gains) recognised in year	<u>921</u>	<u>(1,497)</u>
	<u>2,589</u>	<u>974</u>

The total charge of £2,589m (2006: £0,974m) is included within operating costs.

#### Defined benefit scheme

A full actuarial valuation of the scheme was undertaken as at 31 March 2006 by Quantum Advisory, an independent, professionally qualified actuary, using the attained age method. This valuation was updated at 31 March 2007 and the principal assumptions made by the actuaries were:

	2007	2006
Rate of increase in pensionable salaries	<u>4.0%</u>	<u>3.75%</u>
Rate of increase in pensions in payment	3.0%	2.75%
Discount rate	5.4%	5.10%
Inflation assumption	3.0%	2.75%

Life expectancy assumptions are based on those in published actuarial tables "PA92", projected to 2020.

## Notes to the financial statements cont'd

### 21. Pension commitments cont'd

The major categories of plan assets, as a percentage of total assets and the expected rates of return thereon, were as follows

	2007		2006	
	Expected long term return	Percentage of total assets	Expected long term return	Percentage of total assets
Equities	7.0%	57%	6.50%	56%
Bonds	5.5%	36%	5.00%	44%
Other	4.5%	7%	4.50%	-

#### Pensions and other post-retirement obligations

The amounts recognised in the income statement are as follows

	2007 £'000	2006 £'000
Current service cost (excluding members contribution)	1,083	1,271
Interest cost	1,927	1,779
Expected return on plan assets	(1,858)	(1,502)
Past service cost	366	899
Total excluding net actuarial losses/(gains)	1,518	2,447
Net actuarial losses/(gains) recognised in year	921	(1,497)
Total included within staff costs	2,439	950

The amounts recognised in the balance sheet are determined as follows

	2007 £'000	2006 £'000
Present value of funded obligations	(41,009)	(37,197)
Fair value of plan assets	35,520	30,561
Net liability recognised in the balance sheet	(5,489)	(6,636)

Changes in the present value of the defined benefit obligation are as follows

	2007 £'000	2006 £'000
At 1 April	37,197	32,406
Current service cost (including members contribution)	1,421	1,612
Past service cost	366	899
Interest cost	1,927	1,779
Benefits paid	(594)	(1,452)
Actuarial losses	692	1,953
31 March	41,009	37,197

Changes in the fair value of plan assets are as follows

	2007 £'000	2006 £'000
At 1 April	30,561	24,637
Expected return on plan assets	1,858	1,502
Contributions (including members contribution)	3,924	2,424
Benefits paid	(594)	(1,452)
Actuarial (loss)/gain on plan assets	(229)	3,450
31 March	35,520	30,561

## Notes to the financial statements cont'd

### 21. Pension commitments cont'd

Analysis of the movement in the balance sheet liability

	2007 £'000	2006 £'000
At 1 April	6,636	7,769
Total expense as above	2,439	950
Contributions paid (excluding members contribution)	(3,586)	(2,083)
31 March	5,489	6,636

	2007 £'000	2006 £'000
Expected return on plan assets	1,858	1,502
Actuarial (loss)/gain on plan assets	(229)	3,450
Actual return on plan assets	1,629	4,952

Cumulative actuarial gains and losses recognised in equity

	2007	2006	2005	2004
Experience adjustments arising on scheme assets				
Amount (£m)	(0.2)	3.5	0.9	2.0
Percentage of scheme assets	1%	11%	4%	11%
Experience adjustments arising on scheme liabilities				
Amount (£m)	(2.0)	0.3	(0.3)	-
Percentage of the present value of scheme liabilities	5%	1%	(1%)	0%
Present value of scheme liabilities (£m)	41.0	37.2	32.4	26.7
Fair value of scheme assets (£m)	35.5	30.6	24.6	18.9
Deficit (£m)	(5.5)	(6.6)	(7.8)	(7.8)

The contributions paid in the year to 31 March 2007 include a special contribution of £2.0 million. The contribution expected to be paid during the financial year ended 31 March 2008 amounts to £1.8 million.

### 22. Operating lease commitments – minimum lease payments

	Land and buildings	
	2007 £m	2006 £m
At 31 March 2006 there were revenue commitments, in the ordinary course of business in the next year for the payment of rentals on non cancellable operating leases expiring		
After five years	-	0.4

### 23. Contingent liabilities

The Company is liable under its inter-company loan arrangements with Dŵr Cymru (Financing) Limited ("Financing") for any cash liabilities that may arise in Financing to the extent that such cash liabilities are not already included in fixed interest rates under the tranches of the inter-company loan. An amount equal to any such cash liabilities is recharged by Financing as fees under these inter-company loan arrangements.

On 10 May 2001, Financing had entered into £625 million notional of interest rate swaps. The purpose of these interest rate swaps was to fix the interest rate on an equivalent amount of floating rate bonds of Financing. The floating rate borrowings and the interest rate swaps were matched and re-charged as fixed interest tranches of the inter-company loan of the same date.

## Notes to the financial statements cont'd

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### 23. Contingent liabilities cont'd

Financing's floating rate bonds, and the related fixed interest rate tranches of the inter-company loan, were repaid on 31 March 2005 (£100 m), 30 June 2005 (£425 m) and 31 March 2006 (£100 m). Financing's interest rate swaps remain in place to hedge other floating rate liabilities of the Company, in accordance with the Group's hedging strategy.

Accordingly, the Company will be liable for any future cash liabilities under these interest rate swaps under these inter-company loan arrangements. As at 31 March 2007 the mark to market value of these interest rate swaps was £56 million (2006: £98 million). The average interest rate and maturity of these swaps is 5.73% and 19 years respectively (2006: 5.73% and 20 years).

In April 2007 £433 million of these swaps were terminated and, under the provisions of the intercompany loan account, the company paid £32.5 million to Financing.

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### 24. Capital and other financial commitments

The Company's business plan at 31 March 2007 shows net capital expenditure and infrastructure renewals expenditure of £293m (2006: £280m) during the next financial year. While only a portion of this amount has been formally contracted for, the Company is effectively committed to the total as part of its overall capital expenditure programme approved by its Regulator.

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### 25. Related party transactions

The Company had the following transactions with other companies that are part of the Glas Cymru Cyfyngedig group:

Interest payable on intercompany loans to Dŵr Cymru Financing Limited - £114.6m

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### 26. Immediate and ultimate holding company

The immediate parent company is Dŵr Cymru (Holdings) Limited and the ultimate holding company and controlling party is Glas Cymru Cyfyngedig, both of which are registered in England and Wales. The largest and smallest group within which the results of the Company are consolidated is that headed by Glas Cymru Cyfyngedig, whose consolidated financial statements can be obtained from the Company Secretary at Pentwyn Road, Nelson, Treharris, Mid Glamorgan, CF46 6LY.

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### 27. Directors' and officers' loans and transactions

No loans or credit transactions with any Directors, officers or connected persons existed during the year or were outstanding at the balance sheet date.

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### 28. Elan Valley Trust Fund

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

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

The assets of the fund are not included in these financial statements.

Interest receivable includes £2.7 million (2005: £2.1 million) in respect of the Elan Valley Trust Fund.

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