Registered Nº. 2366777

Dŵr Cymru Cyfyngedig

Directors' report and financial statements

for the year ended 31 March 2008

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COMPANIES HOUSE

Registered Office
Pentwyn Road
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Mid Glamorgan
CF46 6LY

Contents | Page

Foreword

These financial statements for Dŵr Cymru Cyfyngedig cover the year to 31 March 2008 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 2008 is included in the published report and accounts for Glas Cymru Cyfyngedig

Directors and advisors

Directors

Lord Burns	Chairman
Nigel Annett	Managing Director
Chris Jones	Finance Director
Peter Perry	Operations Director
John Bryant	Non-executive Director
Alison Carnwath	Non-executive Director (resigned 13 August 2007)
Geraint Talfan Davies	Non-executive Director
Dame Deidre Hine	Non-executive Director
Tony Hobson	Non-executive Director
James Strachan	Non-executive Director (appointed 1 June 2007)
Robert Ayling	Non-executive Director (appointed 3 April 2008)

Company Secretary
Richard Curtis

Auditors
PricewaterhouseCoopers LLP
Cardiff

Solicitors
Linklaters LLP
London

Edwards Geldard
Cardiff

Principal bankers
National Westminster Bank Plc
Brecon

Directors' report

The directors have pleasure in presenting their annual report to the shareholders, together with the audited financial statements for the year ended 31 March 2008 on pages 9 to 39

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 2008 was £623 million (2007 £578 million) – an increase of 8% The increase primarily reflects the price increase of 7 7% in the year as well as variances due to customers switching to metered charging and changes in consumption The effect of 'customer dividends' in the year was that turnover was some £27 million (2007 £25 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 over 17,000 customers (2007 nearly 22,000 customers), whilst some 10,000 new customers (2007 9,000 customers) were added during the year, all of whom are metered

The net interest charge for the year was £188 million (2007 £151 million) including the £33m swap termination payment made in April 2007 Despite interest rate increases, the average cost of net debt during the period was 6 4% (2007 6 2%) In addition, a charge of £24 million was made to the income statement for the movement in the fair value of financial instruments (2007 £11 million credit), which is a non-cash item

Loss after tax was £7 million (2007 profit of £6 million) This loss was made after funding the 'customer dividend' of £20 for customers receiving both water and wastewater services The Board of Welsh Water has decided to increase the 'customer dividend' for 2008-09 to £21

The tax credit for the period was £31 million (2007 charge of £7 million), comprising a £31 million deferred tax credit

Directors and Employees

The directors who held office during the year are listed on page 1

At 31 March 2008 Welsh Water employed 178 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

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')

Health and safety

Welsh Water's process of health and safety management achieved accreditation to the OHSAS-18001 standard during the year The performance of Welsh Water and its contract partners in 2007-08 and our current challenges and goals are described in our 2008 Health and Safety Report A copy of this report is available on request

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 2007-08, the average payment period was 49 days (2007 43 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 (2007 £nil)

Donations

During the year, charitable donations amounted to £18,559 (2007 £32,874), of which £17,350 was donated to WaterAid There were no other donations above £500 It is company policy not to make donations to political parties or to incur political expenditure, and during 2007/08 no donations or payments (in cash or kind) have been made which 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

Directors' report cont'd

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 of this information will be published on Dŵr Cymru Cyfyngedig's website or will otherwise be available on request from the Company Secretary after 15 July 2008

Auditors

PricewaterhouseCoopers LLP acted as auditors to Dŵr Cymru Cyfyngedig for the accounts for the year ended 31 March 2008 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 2008 annual general meeting

By order of the Board

R.G Curtis

R G Curtis LLB ACIS
Company Secretary

6 June 2008

Directors' responsibilities for the financial statements

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

RG Curtis

R G Curtis LLB ACIS
Company Secretary

6 June 2008

Independent auditors' report to the members of Dŵr Cymru Cyfyngedig

We have audited the financial statements of Dŵr Cymru Cyfyngedig for the year ended 31 March 2008 which comprise the Income Statement, the Statement of Changes in Shareholder's 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 2008 and of its loss 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

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Cardiff

6 June 2008

Income statement for the year ended 31 March 2008

	Note		2008 £m		2007 £m
Revenue			**622.9**		578 0
Operating costs					
- Operational expenditure			**(230 8)**		(228 6)
- Infrastructure renewals expenditure			**(97 5)**		(84 1)
- Depreciation			**(122 3)**		(111 8)
- Profit on disposal of fixed assets			**0 8**		-
Operating profit			**173 1**		153 5
Financing costs					
- Interest payable and similar charges	3a	**(199 7)**		(158 5)	
- Interest receivable	3a	**12.2**		7 4	
- Fair value (losses)/gains on financial instruments	3b	**(23 7)**		10 8	
			(211 2)		(140 3)
(Loss)/profit before taxation	4		**(38.1)**		13 2
Taxation credit/(charge)	5a		**31 4**		(7 3)
(Loss)/profit for the year			**(6.7)**		5 9

Statement of changes in shareholder's equity for the year ended 31 March 2008

	Share capital	Capital redemption reserve	Retained earnings	Total Reserves
	£m	£m	£m	£m
At 1 April 2006	309 9	166 2	(37 9)	438 2
Profit for year	-	-	5 9	5 9
At 31 March 2007	309 9	166 2	(32 0)	444 1
Loss for year	-	-	(6 7)	(6 7)
At 31 March 2008	**309 9**	**166 2**	**(38 7)**	**437 4**

The company has no other recognised gains or losses in the period (2007 nil) and accordingly a statement of recognised income and expenses has not been presented

Balance sheet as at 31 March 2008

	Note	2008 £m	2007 £m
Assets			
Non-current assets			
Property, plant and equipment	7	**2,893 4**	2,846 9
Intangible assets	6	**25 1**	7 0
Investments	8	**0 1**	0 1
Financial assets			
- derivative financial instruments	13	**2 5**	14 7
Retirement benefit obligations	20	**2 0**	-
Trade and other receivables	9b	**370 5**	370 5
		3,293 6	3,239 2
Current assets			
Trade and other receivables	9a	**118 3**	92 9
Financial assets			
- derivative financial instruments	13	**2 7**	-
Cash and cash equivalents	10	**123 6**	157 5
		244 6	250 4
Liabilities			
Current liabilities			
Trade and other payables	11	**(127 6)**	(107 7)
Financial liabilities			
- borrowings	12	**(25 3)**	(65 8)
- derivative financial instruments	13	**(1 8)**	(2 3)
		(154 7)	(175 8)
Net current assets		**89 9**	74 6
Non-current liabilities			
Trade and other payables	11	**(2 3)**	(2 5)
Financial liabilities			
- borrowings	12	**(2,623 3)**	(2,521 3)
- derivative financial instruments	13	**(19 8)**	(5 1)
Retirement benefit obligations	20	**-**	(5 5)
Provisions	15	**(11 0)**	(15 5)
		(2,656 4)	(2,549 9)
Net assets before deferred tax		**727 1**	763 9
Deferred tax	5b	**(289 7)**	(319 8)
Net assets		**437 4**	444 1
Shareholder's equity			
Called up share capital	16	**309 9**	309 9
Capital redemption reserve		**166 2**	166 2
Retained earnings		**(38 7)**	(32 0)
Total equity		**437 4**	444 1

The financial statements on pages 9 to 39 were approved by the Board of Directors on 6 June 2008 and were signed on its behalf by

N C Annett NCAnnett
Managing Director

C A Jones C. A. Jones
Finance Director

Cash flow statement for the year ended 31 March 2008

	Note	2008 £m	2007 £m
Cash generated from operations	17	**264.5**	245 6
Interest received		**11 0**	7 1
Interest paid		**(207 9)**	(73 7)
Net cash inflow from operating activities		**67 6**	179 0
Cash flows from investing activities			
Purchase of property, plant and equipment		**(191.0)**	(188 7)
Grants and contributions received		**17 7**	22 5
Proceeds from sale of property, plant and equipment		**0.8**	-
Net cash used in investing activities		**(172 5)**	(166 2)
Net cash (outflow)/inflow before financing activities		**(104 9)**	12 8
Cash flows from financing activities			
Long term loans and finance leases received		**85 0**	255 3
Loan repaid to group undertaking		**(4 4)**	(120 3)
Capital element of finance lease payments		**(9.3)**	(3 7)
Other loan repayments		**(0 3)**	(0 5)
Net cash generated from financing activities		**71 0**	130 8
(Decrease)/increase in net cash	18b	**(33 9)**	143 6
Net cash at 1 April		**157 5**	13 9
Net cash at 31 March	10	**123 6**	157 5

Principal accounting policies

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

IFRS 7, "Financial instruments disclosures", and the complementary amendment to IAS 1, "Presentation of financial statements – capital disclosures", have been adopted in the year to 31 March 2008 (and comparatives included accordingly) IFRS 7 introduces new disclosures relating to financial instruments This standard does not have any impact on the classification and valuation of the company's financial statements

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

IAS 1	Presentation of Financial Statements (revision)
IAS 23	Borrowing Costs (revision)
IAS 24	Related Party Disclosures (revision)
IFRS 8	Operating Segments
IFRIC 12	Service Concession Arrangements
IFRIC 13	Customer Loyalty Programmes
IFRIC 14	The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction

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 company in the period of initial application

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 2008

The principal accounting policies adopted in the preparation of these financial statements are set out below These policies have been applied consistently 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 value is included in revenue See the critical accounting estimates section for further details

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

Property, plant and 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

Infrastructure assets

Infrastructure assets comprise principally of impounding reservoirs and a network of underground water and wastewater systems For accounting purposes, the water system is segmented into components representing categories of asset classes with similar characteristics and asset lives The wastewater system is segmented into components representing geographical operating areas reflecting the way the 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 principally 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	8 – 40 years
Vehicles, mobile plant, equipment and computer hardware and 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

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 and equipment" with the corresponding liability to the lessor included within "financial 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

Trade receivables and their impairment

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost less provision for impairment They 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 based on their ageing Movements in the provision for impairment are recorded in the income statement

Cash and cash equivalents

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

Principal accounting policies cont'd

Pension costs

A majority of the company's employees belongs to the company's defined benefit pension scheme, which is funded by both employer's and employees' contributions 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

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
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

The company also operates a defined contribution scheme for those employees who are not members of the defined benefit scheme Obligations for contributions to the scheme are recognised as an expense in the Income Statement in the period in which they arise

Financial liabilities

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 There were no foreign borrowings as at 31 March 2008 (2007 £nil)

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 interest rate, inflation and currency 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 subsequently re-measured at fair value

During the year to 31 March 2008, none of the company's derivatives qualified for hedge accounting under IAS 39 (2007 none) These instruments are carried at fair value through profit or loss with changes in fair value being recognised immediately in the income statement

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 substantially enacted at the balance sheet date (2008 28%, 2007 30%)

Principal accounting policies cont'd

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

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

The company has a prudent policy for investing cash and short term bank deposits ("cash investments") Counterparties for cash investments must meet minimum short term and/or long term credit ratings as published by Standard & Poor's ("S&P"), Moody's Investor Service Limited ("Moody's") and Fitch Ratings Limited ("Fitch") The minimum short term rating, for cash deposits of up to one year, is A1/P1/F1 and the minimum long term rating, for cash deposits over one year, is AA-/A3/AA- each for S&P, Moody's and Fitch respectively The Board reviews counterparties for cash investments and the credit limit assigned to each annually

During the year, the company has decided to temporarily tighten its credit criteria for investing cash deposits as a response to the situation in the banking market In consequence, all new cash investments must meet the minimum long term rating and have a maximum investment period of three months As at 31 March 2008, all cash investments met these new criteria and the maximum cash investment with a single counterparty was £24 8m (2007 £27 0m)

Interest rate and currency risk

The group 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 exposes 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 company analyses its interest rate exposure on a dynamic basis Various scenarios are simulated taking into consideration refinancing, renewal of existing positions, alternative financing and hedging Of total borrowings of £2,649m as at 31 March 2008 (2007 £2,586m), only £162m related to floating rate debt (2007 £141m) The company therefore considers overall interest rate exposure at the balance sheet date to be minimal As at 31 March 2008, 94% (2007 95%) of the group's gross debt was at fixed or index-linked ('RPI') rates of interest after taking into account interest rate and RPI swaps The "hedges" established to manage these 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

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 There were no foreign currency borrowings as at 31 March 2008 (2007 £nil)

Refinancing risk

Refinancing risk is managed by maintaining a balance between the continuity of funding and flexibility through the use of borrowings across a range of 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 of £2 6bn can fall due in any 24 month period

Liquidity risk

We maintain committed banking facilities in order to provide flexibility in the management of the company's liquidity Under the Common Terms Agreement, the group is required to have cash available to fund operations for a duration of 18 months As at 31 March 2008, the group had committed undrawn borrowing facilities of £345m (2007 £345m) and cash and cash equivalents (excluding debt service payments account) of £112m (2007 £106m)

There is also a special liquidity facility of £150m, this is required in order to meet certain interest and other obligations that cannot be funded through operating cash flow in the event of a standstill being declared by the Security Trustee, following an event of default under the group's debt financing covenants

Financing risk management objectives and policies cont'd

Capital risk management

The company's objective when managing capital is to safeguard its ability to continue as a going concern Given the regulatory environment in which the group operates, the group monitors capital on the basis of the gearing ratio, this is calculated as net debt (as defined in the group's borrowing covenants) as a proportion of its Regulatory Capital Value (RCV) as determined by Ofwat

The Board considers that it is in the best long-term interests of Welsh Water's customers to continue to reduce the level of gearing, with a view to achieving further reductions in its cost of finance The Board intends to reduce gearing to around 70% and to keep it at that level going forward The Board believes that this can be achieved whilst maintaining the current progressive 'customer dividend' policy

In respect of the risks detailed above, further quantitative disclosures are provided in note 14

Critical accounting estimates

The preparation of financial statements to conform to 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

Provision for impairment of trade receivables

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 provision for impairment would increase or decrease by £4 3 million (2007 £3 7 million)

Pension benefits

The present value of the defined benefit 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 company 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 (2007 £0 8 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 8 million (2007 £2 3 million)

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

3. Financing costs

a) Net interest before fair value losses on financial instruments

	2008	2007
	£m	£m
Interest payable on loans	(119 0)	(114 9)
Interest payable on finance leases	(45 7)	(33 8)
Net fees payable to group company on swap termination	(28 2)	(0 6)
Other interest payable and financing costs	(6 1)	(8 3)
Amortisation of bond issue costs	(0.7)	(0 9)
Total interest payable	(199 7)	(158 5)
Interest receivable	12 2	7 4
Net interest payable before fair value adjustments	(187.5)	(151 1)

Included within interest payable are amounts payable to group undertakings of £155 0m (2007 £114 7m)

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

Whilst the group employs an economically effective policy using interest rate and index-linked swaps, this policy does not satisfy the hedge accounting criteria of IAS 39 Consequently, the company's interest rate and currency swaps are fair valued at each balance sheet date with the movement (net loss or gain) disclosed in the income statement Over the life of these swaps, if held to maturity, these fair value adjustments will reverse and reduce to zero (See note 13 in respect of derivative financial instruments recognised in the balance sheet)

	2008	2007
	£m	£m
Fair value (losses)/gains on index-linked swaps	(21 9)	10 8
Fair value losses on interest rate swaps	(1.8)	-
Total fair value (losses)/gains on financial instruments	(23 7)	10 8
Deferred tax effect at 28% (2007 30%) of fair value (losses)/gains	6.6	(3 2)
Net of tax impact of fair value (losses)/gains	(17 1)	7 6

4. Profit before taxation

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

	2008	2007
	£m	£m
Operating charges from outsourced activities		
- Operating services agreement	**114 1**	115 9
- Customer services agreement	**19 0**	18 6
- Laboratories and analytical services	**6 3**	7 6
- Other contracts	**15 9**	14 2
	155 3	156 3
Employee costs (note 19)		
- Wages and salaries	**9 2**	8 0
- Social security	**1 0**	0 9
- Severance programme and other termination costs	**-**	0 2
- Net actuarial (gain)/loss (note 20)	**(3 3)**	0 9
- Pension costs (excluding actuarial loss/gain)	**1 6**	1 7
Research and development expenditure	**0 5**	0 4
Trade receivables impairment	**13 4**	11 0
Rates	**24 1**	21 0
Environment agency charges	**14.3**	13 5
Fees paid to auditors (see below)	**0.2**	0 2
Staff costs capitalised	**(5 2)**	(4 7)
Other operating charges	**19 7**	19 2
	230 8	228 6
Depreciation of property, plant and equipment		
- Owned assets	**81 2**	75 1
- Under finance leases	**40 2**	35 0
Amortisation of intangible assets	**0 9**	1 7
Infrastructure renewals expenditure	**97.5**	84 1
Profit on disposal of fixed assets	**(0 8)**	-
	449 8	424 5

Notes to the financial statements cont'd

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

	2008 £'000	2007 £'000
Audit services	**63**	61
Other services		
- Regulatory audit services pursuant to legislation	**29**	49
- Tax advisory services	**27**	1
- Interim review	**20**	20
- Bond issue	**-**	24
- Other	**4**	3
	143	158

Regulatory audit services include 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 £11,000 (2007 £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

5. Taxation

a) Analysis of credit/(charge) in the year

	2008 £m	2007 £m
Current tax		
- current year movements	**-**	-
- adjustment in respect of prior years	**1.3**	0 9
Deferred tax		
- current year movements	**6 7**	(8 9)
- adjustment in respect of prior years	**2 2**	0 7
- effect of tax rate change on opening balance	**21 2**	-
Taxation credit/(charge)	**31 4**	(7 3)

The 21 March 2007 budget report announced that a reduction in the main rate of corporation tax, from 30% to 28%, would be effective from 6 April 2008 The deferred tax calculation therefore takes into account this reduction, resulting in a release of £21 2m to the Income Statement during the year to 31 March 2008

Notes to the financial statements cont'd

5. Taxation cont'd

The effective rate of tax for the year is lower (2007 lower) than the standard rate of corporation tax in the UK (30%) The differences are explained below

	2008 £m	2007 £m
(Loss)/profit before tax	**(38 1)**	13 2
(Loss)/profit before tax multiplied by the corporation tax rate in the UK of 30% (2007 30%)	**(11 4)**	3 9
Effects of		
- adjustments to tax in respect of prior years	**(3 6)**	(1 7)
- expenses not deductible for tax purposes	**0.1**	0 3
- other permanent differences	**4.2**	4 8
- change in tax rate on opening balance	**(20 7)**	-
Total taxation (credit)/charge	**(31 4)**	7 3

b) Deferred tax

Deferred tax is calculated in full on temporary differences under the liability method using a tax rate of 28% (2007 30%)

The movement in the deferred tax provision is as shown below

	2008 £m	2007 £m
At 1 April	**319 8**	311 6
Income statement (credit)/charge	**(30 1)**	8 2
At 31 March	**289.7**	319 8

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

	2008 £m	2007 £m
Effect of tax allowances in excess of depreciation	**319 2**	345 0
Other tax differences	**(29 5)**	(25 2)
Provision for deferred tax	**289 7**	319 8

The proposed abolition of Industrial Building Allowances announced in last year's Budget is not reflected in these financial statements, but it is anticipated that this will result in a significant increase in the deferred tax provision

Notes to the financial statements cont'd

6. Intangible fixed assets

Intangible fixed assets comprise computer software and related system developments

2008	Cost £m	Amortisation £m	Net book value £m
At 1 April 2007	**57 7**	**(50 7)**	**7 0**
Additions	**19 0**	**-**	**19 0**
Charge for the year	**-**	**(0 9)**	**(0.9)**
At 31 March 2008	**76 7**	**(51 6)**	**25 1**

2007	Cost £m	Amortisation £m	Net book value £m
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

The net book value of intangible assets includes £19 0m in respect of assets in the course of construction (2007 £nil)

7. Property, plant and equipment

2008	Freehold land and buildings £m	Infrastructure assets £m	Operational structures £m	Plant, equipment, computer hardware £m	Total £m
Cost					
At 1 April 2007	**32 9**	**1,412.7**	**2,118 1**	**218 2**	**3,781 9**
Additions net of grants and contributions	**0 1**	**133 7**	**114.4**	**4 7**	**252 9**
Disposals	**-**	**(89 0)**	**-**	**-**	**(89 0)**
At 31 March 2008	**33 0**	**1,457 4**	**2,232 5**	**222 9**	**3,945 8**
Accumulated depreciation					
At 1 April 2007	**15 9**	**71 2**	**691.1**	**156 8**	**935.0**
Charge for the year	**0 4**	**31 6**	**81.8**	**7 6**	**121.4**
Released on disposal	**-**	**(4 0)**	**-**	**-**	**(4 0)**
At 31 March 2008	**16 3**	**98 8**	**772 9**	**164 4**	**1,052 4**
Net book value					
At 31 March 2008	**16 7**	**1,358 6**	**1,459 6**	**58 5**	**2,893 4**

The net book value of property, plant and equipment includes £158 1m in respect of assets in the course of construction (2007 £157 6m)

Notes to the financial statements cont'd

7. Property, plant and equipment cont'd

2007	Freehold land and buildings £m	Infrastructure assets £m	Operational structures £m	Plant, equipment, computer hardware £m	Total £m
Cost					
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)
At 31 March 2007	32 9	1,412 7	2,118 1	218 2	3,781 9
Accumulated depreciation					
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)
At 31 March 2007	15 9	71 2	691 1	156 8	935 0
Net book value					
At 31 March 2007	17 0	1,341 5	1,427 0	61 4	2,846 9

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

2008	Infrastructure assets £m	Operational structures £m	Total £m
Cost			
At 1 April 2007	**526 8**	**598 1**	**1,124 9**
Additions	**85.0**	**-**	**85 0**
At 31 March 2008	**611 8**	**598 1**	**1,209.9**
Accumulated depreciation			
At 1 April 2007	**36.7**	**154 5**	**191.2**
Charge for the year	**7.2**	**33 0**	**40 2**
At 31 March 2008	**43 9**	**187 5**	**231 4**
Net book value			
At 31 March 2008	**567.9**	**410 6**	**978 5**

Notes to the financial statements cont'd

7. Property, plant and equipment cont'd

2007	Infrastructure assets £m	Operational structures £m	Total £m
Cost			
At 1 April 2006	526 8	565 9	1,092 7
Additions	-	32 2	32 2
At 31 March 2007	526 8	598 1	1,124 9
Accumulated depreciation			
At 1 April 2006	30 1	126 1	156 2
Charge for the year	6 6	28 4	35 0
At 31 March 2007	36 7	154 5	191 2
Net book value			
At 31 March 2007	490 1	443 6	933 7

8. Fixed asset investments

Cost and net book value	2008 £m	2007 £m
At 1 April and 31 March	**0 1**	0 1

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

	Principal activity	Country of Incorporation	Holding
Water Research Centre (1989) Plc	Water research	England and Wales	"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%

Notes to the financial statements cont'd

9. Trade and other receivables

	2008 £m	2007 £m
(a) Amounts falling due within one year		
Trade receivables	**101 0**	87 1
Less provision for impairment of receivables	**(58 8)**	(53 0)
Trade receivables - net	**42.2**	34 1
Prepayments and accrued income	**62.9**	53 5
Amounts owed by group undertakings	**-**	0 1
Other receivables	**13 2**	5 2
	118.3	92 9
(b) Amounts falling due after more than one year:		
Amounts owed by group undertakings	**370 5**	370 5
	488 8	463 4

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

As at 31 March 2008, it was considered that £58 8m of trade receivables were impaired and these have therefore been provided for (2007 £53 0m) The impaired receivables mainly relate to measured and unmeasured water supply debtors

The ageing of these receivables was as follows

2008 **Trade receivables**	**Total £m**	**Provided for £m**	**Net £m**
Under one month	**14 2**	**3.4**	**10 8**
Between one and six months	**18 7**	**7 1**	**11 6**
Between six months and one year	**17 3**	**6 2**	**11 1**
Between one and two years	**20 9**	**14 3**	**6 6**
Between two and three years	**13 3**	**11 2**	**2 1**
Over three years	**16 6**	**16 6**	**-**
	101 0	**58 8**	**42 2**

As of 31 March 2008, all net trade receivables aged over one month (2008 £31 4m, 2007 £24 3m) were past due but not considered impaired, based on a review of cash collection rates

2007 **Trade receivables**	**Total £m**	**Provided for £m**	**Net £m**
Under one month	12 6	2 8	9 8
Between one and six months	9 4	3 6	5 8
Between six months and one year	20 9	8 0	12 9
Between one and two years	18 2	12 6	5 6
Between two and three years	9 6	9 6	-
Over three years	16 4	16 4	-
	87 1	53 0	34 1

Notes to the financial statements cont'd

9. Trade and other receivables cont'd

Movements on the provision for impairment of trade receivables are as follows

	2008 £m	2007 £m
At 1 April	**53 0**	49 6
Charge to Income Statement	**13 0**	10 4
Receivables written off during the year as uncollectible	**(7 2)**	(7 0)
At 31 March	**58 8**	53 0

The creation and release of provision for impaired receivables have been included in operational expenditure in the income statement

The other classes within trade and other receivables do not contain impaired assets All trade and other receivables are denominated in sterling

10. Cash and cash equivalents

	2008 £m	2007 £m
Cash at bank and in hand	**2 9**	3 8
Short-term bank deposits	**120 7**	153 7
	123 6	157 5

The effective interest rate on short-term deposits as at 31 March 2008 was 5 5% (2007 5 4%) and these deposits have an average maturity of 13 days (2007 30 days) All cash and cash equivalents were held in sterling

11. Trade and other payables

Current	2008 £m	2007 £m
Trade payables	**16 1**	12 2
Capital payables	**55 6**	42 0
Amounts due to group undertakings	**3 7**	3 8
Other taxation and social security	**0 4**	0 3
Accruals and deferred income	**51 8**	49 4
	127 6	107 7

Non-current	2008 £m	2007 £m
Deferred income	**2 3**	2 5

Notes to the financial statements cont'd

12. Financial liabilities – borrowings

Current	**2008**	2007
	£m	£m
Interest accruals	**12 6**	56 4
Loans due to group undertakings	**4 4**	4 4
Other unsecured loans	**0 3**	0 3
Finance lease obligations	**8 0**	4 7
	25 3	65 8

Non-current	**2008**	2007
	£m	£m
Interest accruals	**29 7**	24 6
Loans due to group undertakings	**1,756 5**	1,731 7
Other unsecured loans	**2 6**	2 9
Finance lease obligations	**834 5**	762 1
	2,623 3	2,521 3

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 companies' assets including, in the case of Dŵr Cymru (Holdings) Limited, a first fixed charge over its shares in DCC

The group's Class A Bonds benefit from a guarantee from MBIA Assurance SA On 7 April 2008 Fitch Ratings downgraded the ratings of MBIA and, in consequence, the group's Class A Bonds, from AAA to AA The ratings of the group's Class B and C Bonds were unaffected by this review and remain stable

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)

2008	**Fair Values**	
	Assets	**Liabilities**
	£m	**£m**
Current		
Index-linked swaps	**2 7**	**-**
Interest rate swaps	**-**	**(1.8)**
	2.7	**(1.8)**
Non-Current		
Index-linked swaps	**2 5**	**(19 8)**
	5.2	**(21.6)**

13. Derivative financial instruments cont'd

2007	Fair Values	
	Assets	Liabilities
	£m	£m
Current		
Index-linked swaps	-	(2 3)
Non-Current		
Index-linked swaps	14 7	(5 1)
	14 7	(7 4)

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 accounted for separately if they do not meet certain requirements set out in the standard Dŵr Cymru Cyfyngedig has no embedded derivatives as per IAS 39

Interest rate swaps

£571m (2007 £nil) of finance lease liabilities are converted from 3 month to 12 month floating for a period of one year, the swaps expire on 31 March 2009

Index-linked swaps

The index-linked swaps have the effect of fixing the interest rate on £622 million (2007 £626 million) of finance lease liabilities by reference to the retail price index ("RPI")

The notional amount of the swaps as at 31 March 2008 is £571 million (2007 £579 million), representing the average balance on the finance leases subject to floating interest rates for the year to 31 March 2009 The notional amount amortises over the life of the swaps to match the average floating rate balances of the leases These swaps are matched against the same liabilities as the finance lease interest rate swaps noted above

The principal terms are as follows

Notional Amount	£571 million (amortising)
Average swap maturity	24 years
Average interest rate	1 64% (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 17 The numerical financial instrument disclosures as required by IFRS 7 are set out below

a) Interest rate risk

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

	2008	2007
Assets		
Cash and cash equivalents	**5 5%**	5 4%
Amounts owed by group undertakings	**12 0%**	12 0%
Liabilities		
Inter-company loans	**5 5%**	5 5%
Finance lease obligations	**5 6%**	4 5%
Other unsecured loans	**5 8%**	6 5%

Trade and other receivables and payables are not interest bearing
Interest due on the intercompany loan of £44 6m (2007 £44 6m) has been waived by the company during the year
The effective interest rates ignore the effect of the index-linked swaps set out in note 13

Notes to the financial statements cont'd

14. Financial risk management cont'd

b) Liquidity risk

2008	Within 1yr £m	1-2 years £m	2-5 years £m	> 5 years £m	Total £m
Assets					
Cash and cash equivalents	123.6	-	-	-	123.6
Trade and other receivables	118 3	-	-	370 5	488 8
	241 9	-	-	370 5	612.4
Liabilities					
Trade and other payables	127 6	0.3	0 3	1 7	129 9
Inter-company loan	4 4	4.4	160 9	1,591 2	1,760 9
Local Authority loans	0 3	0.4	1.1	1 1	2 9
Finance leases	8 0	7 0	33.1	794 4	842 5
	140 3	12 1	195.4	2,388 4	2,736 2

2007	Within 1yr £m	1-2 years £m	2-5 years £m	> 5 years £m	Total £m
Assets					
Cash and cash equivalents	157 5	-	-	-	157 5
Trade and other receivables	92 9	-	-	370 5	463 4
	250 4	-	-	370 5	620 9
Liabilities					
Trade and other payables	107 7	0 4	1 1	1 0	110 2
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
	117 1	11 0	180 0	2,308 2	2,616 3

The minimum lease payments under finance leases fall due as follows

	2008 £m	2007 £m
Not later than one year	55.5	39 4
Later than one year but not more than five	194.4	180 2
More than five years	1,436 8	1,336 1
	1,686 7	1,555 7
Future finance charges on finance leases	(806 8)	(763 5)
Present value of finance lease liabilities (including accrued interest)	879 9	792 2

14. Financial risk management cont'd

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 £1,908 9m (2007 £2,010 1m) The fair value of the company's other non-derivative financial instruments are equal to the book values

d) Borrowing facilities

As at 31 March 2008, the company had available undrawn committed borrowing facilities of £345m expiring in more than one year, in respect of which all conditions precedent had been met (2007 £345m)

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 cash flow 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

All of the above facilities, including the liquidity facility, are at floating rates of interest

e) Capital risk management

Gearing ratios (group)

	2008	2007
	£m	£m
Total borrowings	2,649	2,586
Less cash and cash equivalents	(124)	(158)
Net debt	2,525	2,428
RCV	3,529	3,310
Total capital	1,004	882
Less unamortised bond costs	(6)	(6)
Total capital per bond covenants	998	876
Gearing ratio	72%	74%

As set out on page 18, the group monitors its capital structure based on a regulatory gearing ratio which compares its net debt with the Ofwat-determined RCV The decrease in the gearing ratio during the year to 31 March 2008 is the result of increases in the RCV exceeding the rise in net debt

15. Provisions

	Restructuring provision	Uninsured loss provision	Provision for loss on swap closure	Total
	£m	£m	£m	£m
At 1 April 2007	1.1	7 5	6 9	15 5
Charged/(released) to Income Statement	0.1	1 1	-	1 2
Utilised in year	-	(1 4)	(4.3)	(5 7)
At 31 March 2008	1.2	7 2	2 6	11 0

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

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

Notes to the financial statements cont'd

15. Provisions cont'd

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 a 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

16. Called up share capital

		£m
2008	Authorised	
	501,050,000 ordinary shares of £1 each	**501 1**
		501 1
	Allotted, called up and fully paid	
	309,876,374 ordinary shares of £1 each	**309 9**
		309 9
2007	Authorised	
	501,050,000 ordinary shares of £1 each	501 1
		501 1
	Allotted, called up and fully paid	
	309,876,374 ordinary shares of £1 each	309 9
		309 9

17. Cash generated from operations

Reconciliation of operating profit to cash generated from operations

	2008 £m	2007 £m
Operating profit	**173 1**	153 5
Adjustments for		
Depreciation and amortisation	**122 3**	111 8
Profit on disposals of fixed assets	**(0 8)**	-
Changes in working capital		
Increase in trade and other receivables	**(24 2)**	(3 4)
Increase/(decrease) in trade and other payables	**6 1**	(13 4)
Decrease in pension deficit	**(7 5)**	(1 1)
Decrease in provisions	**(4 5)**	(1 8)
Cash generated from operations	**264 5**	245 6

Notes to the financial statements cont'd

18. Analysis and reconciliation of net debt

a) Net debt at the balance sheet date may be analysed as.	2008	2007
	£m	£m
Cash and cash equivalents	**123 6**	157 5
Debt owed by parent company after one year	**370 5**	370 5
	494 1	528 0
Debt due after one year	**(1,759 1)**	(1,734 6)
Debt due within one year	**(4 7)**	(4 7)
Finance leases	**(842.5)**	(766 8)
Accrued interest	**(42 3)**	(81 0)
	(2,648 6)	(2,587 1)
Net debt	**(2,154 5)**	(2,059 1)

b) The movement in net debt during the period may be summarised as	2008 £m	2007 £m
Net debt at start period	**(2,059 1)**	(1,985 2)
(Decrease)/increase in net cash	**(33 9)**	143 6
Increase in debt	**(71.0)**	(130 8)
(Increase)/decrease in net debt arising from cash flows	**(104 9)**	12 8
Non cash movement on group debt	**(29.4)**	(24 7)
Movement in accrued interest	**38 1**	(62 0)
Movement in net debt during the period	**(95.4)**	(73 9)
Net debt at end of period	**(2,154 5)**	(2,059 1)

Notes to the financial statements cont'd

19. 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

	2008	2007
	£'000	£'000
Salary (including benefits in kind)	927	926
Compensation for loss of office	-	179
Fees	440	412
	1,367	1,517
Long term incentive plan	186	207
Highest paid director (2008 and 2007. N C Annett)		
Aggregate emoluments	364	335
Accrued pension under defined benefit scheme	89	73
Long term incentive plan	73	90

Retirement benefits are accruing to three directors (2007 – three) under defined benefit schemes None of the directors is a member of the defined contribution scheme (2007 none)

i) The financial statements for the year ended 31 March 2008 include a provision of £315,172 (2007 £301,298) for bonus potentially payable to executive directors for performance in the financial year 2007/08 The final amount to be paid to each director will be determined when Ofwat publishes its Overall Performance Assessment (OPA) results for 2007/08 in the Autumn of 2008 and could be higher or lower An amount of £185,683 (2007 £206,644) 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 2006/07 The actual performance bonus in respect of 2006/07 was paid in November 2007 following the publication of Ofwat's OPA performance report for 2006/07, and amounted to £307,111 compared to the amount of £301,298 accrued at 31 March 2007 The aggregate emoluments of the highest paid director increased by £2,541 to £334,904 and total directors' emoluments increased by £5,813 to £1,517,231

b) Staff costs during the year	2008	2007
	£m	£m
Wages and salaries	9 2	8 0
Severance programme and termination costs	-	0 2
Social security costs	1 0	0 9
Other pension costs (note 20)	(1.7)	2 6
	8 5	11 7

Average monthly number of people (including executive directors) employed by the company	2008 Number	2007 Number
Regulated water and sewerage activities	173	159

Of the above, £5 2 million (2007 £4 7 million) has been charged to capital Other pension costs include £nil (2007 £0 4m) in respect of the directors' unfunded pension liabilities and an actuarial gain on the defined benefit scheme for the year of £3 3m (2007 loss of £0 9m)

Notes to the financial statements cont'd

20. Pension commitments

The company operates a funded defined benefit pension scheme for current employees (based on final pensionable salary and pensionable service), the DCWW Pension Scheme The assets of the scheme are held in a separate trustee administered fund

The 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

	2008 £'000	2007 £'000
Defined contribution scheme	**591**	150
Defined benefit scheme – excluding actuarial gains/losses	**1,065**	1,518
	1,656	1,668
Net actuarial (gains)/losses recognised in year	**(3,339)**	921
	(1,683)	2,589

The total credit of £1 683m (2007 charge of £2 589m) is included within operating costs

Defined benefit scheme

A full actuarial valuation of the scheme was undertaken as at 31 March 2006 by Robert Davies of Quantum Advisory, an independent, professionally qualified actuary, using the attained age method This valuation was updated at 31 March 2008 and the principal assumptions made by the actuaries were

	2008	2007
Rate of increase in pensionable salaries	**4 0%**	4 0%
Rate of increase in pensions in payment	**3.0%**	3 0%
Discount rate	**6.3%**	5 4%
Inflation assumption	**3.0%**	3 0%
Life expectancy of a 65 year old woman at 31 March	**87.9 years**	87 8 years
Life expectancy of a 65 year old man at 31 March	**84 8 years**	84 9 years

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

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

	2008		2007	
	Expected long term return	**Percentage of total assets**	Expected long term return	Percentage of total assets
Equities	**7.0%**	**59.5%**	7 0%	57%
Bonds	**6.0%**	**38 5%**	5 5%	36%
Other	**4 5%**	**2 0%**	4 5%	7%

Notes to the financial statements cont'd

20. Pension commitments cont'd

Pensions and other post-retirement obligations

The amounts recognised in the income statement are as follows

	2008 £'000	2007 £'000
Current service cost (excluding members' contribution)	**1,074**	1,083
Interest cost	**2,273**	1,927
Expected return on plan assets	**(2,407)**	(1,858)
Past service cost	**125**	366
Total excluding net actuarial (gain)/loss	**1,065**	1,518
Net actuarial (gain)/loss recognised in year	**(3,339)**	921
Total (credit)/charge included within staff costs	**(2,274)**	2,439

The amounts recognised in the balance sheet are determined as follows

	2008 £'000	2007 £'000
Present value of funded obligations	**(36,739)**	(41,009)
Fair value of plan assets	**38,786**	35,520
Net asset/(liability) recognised in the balance sheet	**2,047**	(5,489)

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

	2008 £'000	2007 £'000
At 1 April	**41,009**	37,197
Current service cost – employer contributions	**1,074**	1,083
Current service cost – member contributions	**347**	338
Past service cost – vested benefits	**125**	366
Interest cost	**2,273**	1,927
Benefits paid	**(46)**	(594)
Actuarial (gain)/loss	**(8,043)**	692
At 31 March	**36,739**	41,009

Changes in the fair value of plan assets are as follows

	2008 £'000	2007 £'000
At 1 April	**35,520**	30,561
Expected return on plan assets	**2,407**	1,858
Employer contributions	**5,262**	3,586
Member contributions	**347**	338
Benefits paid	**(46)**	(594)
Actuarial (losses)/gains on plan assets	**(4,704)**	(229)
At 31 March	**38,786**	35,520

Notes to the financial statements cont'd

20. Pension commitments cont'd

Analysis of the movement in the balance sheet liability

	2008 £'000	2007 £'000
At 1 April	**5,489**	6,636
Total (credit)/charge to Income Statement	**(2,274)**	2,439
Contributions paid (excluding member contributions)	**(5,262)**	(3,586)
At 31 March	**(2,047)**	5,489

Cumulative actuarial gains and losses recognised in equity

	2008	2007	2006	2005	2004
Experience adjustments arising on scheme assets					
Amount (£m)	**(4 7)**	(0 2)	3 5	0 9	2 0
Percentage of scheme assets	**(12%)**	1%	11%	4%	11%
Experience adjustments arising on scheme liabilities					
Amount (£m)	**8 0**	(0 7)	(2 0)	(0 9)	(0 1)
Percentage of the present value of scheme liabilities	**22%**	(2%)	(5%)	(3%)	0%
Present value of scheme liabilities (£m)	**36.8**	41 0	37 2	32 4	26 7
Fair value of scheme assets (£m)	**38 8**	35 5	30 6	24 6	18 9
Surplus/(deficit) (£m)	**2 0**	(5 5)	(6 6)	(7 8)	(7 8)

The contributions paid in the year to 31 March 2008 include a special contribution of £4 0m (2007 £2 0m) The contribution expected to be paid during the financial year ended 31 March 2009 amounts to £1 4 million

21. 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 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 such cash liabilities is recharged by Financing as fees under the inter-company loan arrangements

On 10 May 2001, Financing had entered into £625m 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 issued by Financing The floating rate borrowings and the interest rate swaps were matched and re-charged to the company as fixed interest tranches of the inter-company loan of the same date

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

In April 2007, £433m notional of these interest rate swaps were terminated and, under the provisions of the inter-company loan account, the company paid fees to Financing of £32 5m (see note 15, as disclosed net of the release of a provision of £4 3m)

The company remains liable, under the inter-company loan arrangements, for any future cash liabilities under the remaining interest rate swap of £192m (2007 £625m) notional As at 31 March 2008, the mark to market value of this interest rate swap was £25m (2007 £56m), and the interest rate and maturity of swap are 5 67% and 23 years (2007 5 73% and 19 years) respectively

Notes to the financial statements cont'd

22. Capital and other financial commitments

The company's business plan at 31 March 2008 shows net capital expenditure and infrastructure renewals expenditure of £320m (2007 £293m) 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

23. 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 during the year was £155 0m (2007 £114 7m)

24. 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

25. 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

26. 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 1m (2007 £2 7m) in respect of distributions from the Elan Valley Trust Fund