Severn Trent Water

02366686

Annual Report and Accounts 2006

Your water. *Safe in our hands.*

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Managing Director's review

Tony Wray | Managing Director

Introduction

We have completed the first year of our regulatory contract Asset Management Plan ('AMP') 4, which covers the period 2005-10. It has been a challenging year all round. We delivered a solid financial performance in a period that has seen significant changes to our business.

Ofwat has set exacting efficiency targets for this period and during the year we began to implement the organisational changes necessary to achieve them. Progress was good. We reduced employee numbers; removed management layers improving information flow; reviewed and consolidated office accommodation enhancing overhead control; and began a programme to streamline procurement processes. The last of these measures involves establishing long-term relationships with a reduced number of suppliers, incentivising them to make continuous improvements and standardising designs where possible. As a result of these actions our operating expenditure is now, after the first year, ahead of plan and less than £4 million from the Ofwat determination.

However, in common with the rest of the industry, we face a significant challenge with rising energy prices. This did not impact performance in 2005/06 as our energy contracts were mostly fixed. We are on track to improve energy efficiency and thus buy less electricity this year. Nevertheless, energy price increases are likely to raise costs by approximately £25 million in 2006/07. We will continue efforts to improve efficiency and outperform the Ofwat determination in other areas to compensate for the increase in energy cost.

A dry summer, followed by a winter with short but severe cold periods creating ground movement, has driven higher volumes of pipe bursts over the winter period. This resulted in 2005/06 being a particularly challenging year for leakage management. Reported actual leakage has increased by approximately 17Mld, 3% greater than 2004/05. A recovery plan has been in place for several months to drive down work backlogs and reduce repair times. Already a leakage reduction of around 20Mld has been recorded in April. We are confident that these plans will deliver the AMP4 leakage targets.

Despite the dry summer, we maintained water supply to our customers. We do not envisage introducing any special measures for customers over this summer period. We continued to promote water efficiency among domestic and business customers. Since evidence suggests that dry years are likely to become more frequent, the AMP4 programme includes measures to improve security of water supply and to make sure that we have sufficient water resources to meet customers' foreseeable future needs.

The AMP4 contract for 2005-10 includes a capital investment programme of approximately £2.6 billion. This includes:

- more than £400 million on maintaining water supplies
- £150 million on improving drinking water quality
- around £850 million on maintaining and improving river quality
- more than £350 million improving sewers and dealing with sewer flooding, and
- more than £260 million to reduce leakage

Our focus this year was to implement the new procurement and supply chain processes that will be used in the programme, and to mobilise the first of the 900 projects that it is due to manage. Net capital expenditure, excluding spending on infrastructure maintenance of £95 million, was £305 million for the year. Adjusting for the changes to the programme, to be agreed with Ofwat through the change control process, and for timing differences, we have generated approximately 6% efficiencies over and above the determination.

This was largely driven by the use of better technologies, better designs and greater efficiencies. It is still early days in AMP4, but we aim to maintain similar out-performance over the rest of AMP4.

Improvements continued to be made in delivering our core activities of providing safe, clean drinking water and effectively removing and treating sewage.

Drinking water standards improved, with compliance standards increasing from 99.91% to 99.96%.

Our performance on sewer flooding met or exceeded our targets for most measures and we overcame problems with the supply of phosphate removal chemicals to achieve 99.9% compliance of sewage treatment effluents.

As a result of a referral by Ofwat, the Serious Fraud Office is undertaking a criminal investigation into alleged reporting irregularities made to Ofwat by Severn Trent Water between 2000 and 2003 concerning leakage. Severn Trent is supporting Ofwat in its review of these allegations and will co-operate fully with the Serious Fraud Office.

In March 2006, the Ofwat interim report into allegations of false reporting found that we had overcharged customers during 2004/05 and had set prices too high for 2005-2010. Immediately following the report, we apologised unreservedly to all our customers. We had already voluntarily proposed to reduce the Ofwat allowed price increases by £7 million and, on receipt of the report, agreed with Ofwat a mechanism for rebating to customers all remaining amounts as quickly as possible.

At the end of February 2006, we also began an investigation into misreporting of customer relations data to Ofwat. The data concerns the handling of customer billing queries and telephone contacts over several years. We have kept Ofwat fully informed on the progress of the investigation. They have been involved in the drafting of the Terms of Reference for our internal investigation. In May 2006 we jointly appointed independent forensic accountants (Ernst & Young LLP) to verify our findings and where necessary undertake further investigations.

Further details are set out in note 16d) to the financial statements on page 32.

We continue to work with many customer and environmental groups to promote a sustainable environment.

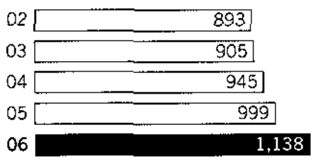
Our teams in conservation, access and recreation have achieved many successes in reintroducing species by creating suitable habitats.

High profile stories such as the reintroduction of black grouse to the Upper Derwent Valley have raised awareness of our conservation activities with key stakeholders while the creation of habitats for bats, hedgehogs and owls have helped reinforce our commitment to the environment.

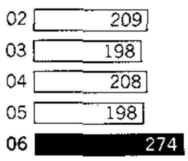
The 'Be Smart' scheme has recently been introduced by the education team. It has enabled us to liaise with schools and to help them as customers to reduce their consumption as well as to raise awareness of the importance of water conservation with our customers of tomorrow. This scheme is run in line with the national curriculum and is a voluntary scheme which has generated a great deal of positive response from participants and local press.

We also support our local communities through a range of activities including sponsorship, staff volunteering and charitable donations.

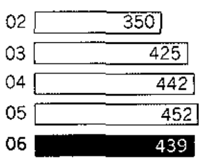
Turnover – £m



Profit before tax – £m
(excluding exceptional items)



Investment – £m



Customers continue to be our priority and we are committed to delivering the high standards of service our customers expect and deserve.

Financial review

The financial statements on pages 15 to 36 report both the company and consolidated results of the Severn Trent Water Limited group of companies. The group report provides a complete view of activities, as certain financing arrangements for the benefit of the group are facilitated through the company's subsidiaries. This financial review therefore refers to the consolidated results of the Severn Trent Water Limited group.

Turnover rose by 13.8%, to £1,137.7 million (2005: £999.3 million). Prices to our customers rose by 15.2% reflecting the increase arising out the price determination set by Ofwat in 2005 and in RPI.

We continued to experience growth in income including new customers and income initiatives following the introduction of a new billing system, however, this increase is offset by a reduction in income due to reduced consumption and to more customers switching to metering.

Operating profits increased by £76.1 million to £403.6 million (2005: £327.5 million) before exceptional charges of £0.7 million (2005: £10.6 million). This was after a charge for £10.6 million, the expected cost relating to 2006 and prior years of the agreement made with Ofwat to credit each customer account during 2006/07, following the regulator's interim report of 7 March 2006. Profit on ordinary activities before taxation was £276.0 million (2005: £194.5 million).

Operating costs (before exceptional items, depreciation and release of deferred income) were £451.5 million, an increase of £32.1 million (2005: £419.4 million).

Depreciation, including infrastructure renewals expenditure, increased by £30.7 million to £289.1 million (2005: £258.4 million). This increase reflects the continued effect of our level of investment.

Gross capital expenditure, including spending on infrastructure maintenance, in the year was £439.1 million (2005: £452.4 million).

Capital expenditure is expected to be around £500 million in the year ending 31 March 2007.

Total net group borrowing at 31 March 2006 amounted to £2,484.8 million (2005: £2,386.7 million). Of this, 72.0% (2005: 66.3%) was represented by fixed interest borrowings, and 61.4% (2005: 68.9%) was represented by amounts repayable after five years. Net interest payable reduced by £0.6 million to £129.4 million, reflecting the favourable interest rates being achieved on our additional borrowings which are being made to finance our continued high level of investment.

Customer relations

Customers continue to be our priority and we are committed to delivering the high standards of service our customers expect and deserve. We do however acknowledge that some customers have had to wait longer than we would want in order to speak to us. This in turn has led to more customers abandoning calls. We also acknowledge that the number of customers receiving an engaged tone has risen.

As part of our process review, our investigations have identified that we have been misstating our customer service data to Ofwat. This has resulted in revised figures for performance which are below target. Our estimate of the corrected figures show that our performance in customer service is unsatisfactory, and improving performance will be a high priority for 2006/07. We are reviewing our methodologies to ensure that they are compliant with the Ofwat guidelines and have implemented a new reporting regime.

Collecting the correct information for our bills assists with reducing the level of customer enquiries and complaints, and also minimises the need for, and cost of, reconciliation. As such we are going to read customer meters on a six monthly basis. Previously, meters were read annually and an estimate was generated six months later. To support this initiative, recruitment will commence in the early part of the 2006/07 financial year to employ additional meter readers. This financial year, meter reading was brought back within the company.

The vast majority of customers have been transferred onto our new billing system, Target. The functionality of Target broadly matches that of its predecessor but it has proved a very different system to operate and the service improvements that were initially envisaged have not been entirely realised. Our new system ICE, or Improving Customer Experience, has gone live at our billing contact centre in Derby and as new ICE applications develop, this will help our teams to resolve more customer enquiries at the point of contact.

Last year cash collections amounted to £1,077 million, which was ahead of target. During 2006 our overall trade debt increased by 24.2% to £99.0 million which is well in excess of our 2006 price increase and also takes into account the continued impact of customers switching from unmeasured to measured charges.

The increase in customer debt has been almost entirely restricted to a growth in the debt less than 1 year old category, reflecting the impact that the operational issues within our Customer Relations directorate have had on our billing and collection performance. There has been a slight reduction in the value of debt falling within the over 1 year old category, reflecting the continued success of our tailored debt recovery approach. We continue to target those customers who have an ability to pay, through the use of the court system. The tailored approach is facilitated by the ongoing use of third party data providers to supplement our own internally captured data.

In addition to this, the Severn Trent Water Trust Fund is made available to those customers who are unable to pay. Although funding is limited and is not available in every instance, customers are given the necessary information through our employees and can apply to the Trust for assistance.

During the year 2006, we have made a donation of £3.5 million to the Trust which is £0.5 million greater than that made in 2005.

Whilst our processes are significant, our people are the key to our service delivery. To improve service levels we are putting in place a training programme for our customer service teams, focusing on the quality of service delivered to ensure customers are always provided with the appropriate response to their enquiries. We are currently piloting a customer focus team in the contact centre to allow individual agents to own a customer query and follow it through to resolution. With the collection of knowledge and skills in this team, we are hoping to resolve more customer queries at the initial point of contact.

Operational review

2005/06 has been a challenging year particularly in relation to our leakage performance. Notwithstanding this, our overall performance on delivery of water and sewerage services has been *maintained at a high standard.*

The leakage target for 2005/06 was 505 Ml/d and our year end reported performance was 542 Ml/d. This is estimated to be an actual increase in leakage of 17 Ml/d with the remainder of the increase due to improved data and new assumptions. The rate of mains bursts increased by 6% during the year end due to problems with resourcing the repair work, backlogs and response times were increased. We have mobilised additional resources and excellent progress is being made through the early part of 2006/07 with backlogs now down to historic levels, reducing volumes of water into supply and leakage levels declining. Despite the decline in leakage performance during 2005/06, we ended the year with full reservoirs and no prospects of a hosepipe ban in 2006/07.

Compliance with all drinking water standards was maintained during 2005 with an improvement from the previous year from 99.91% to 99.96%.

We have put a strong focus on health and safety during the year, which has resulted in a 23% reduction in the number of reportable accidents. Our focus for 2006/07 is to achieve a further substantial reduction through addressing the safety behaviour of our employees.

Compliance with all drinking water standards was maintained during 2005 with an improvement from the previous year from 99.91% to 99.96%. Of the eighteen schemes in our capital investment programme targeted to improve water quality, all but three were delivered during the year. The late schemes were completed by the end of June 2006. We are also embarking on a number of studies to establish customer perceptions of the taste, odour and hardness of our water before delivery improvements within the chosen study area. This work will help inform our thinking on *our future water treatment standards.*

Our performance on sewage treatment effluents continues at a very high standard. We did have a problem with the supply of chemical for phosphate removal for a relatively short period and this resulted in a reduction of overall compliance for 2005 from 100% in the previous year to 99.9%. This problem has been fully resolved. Our performance on sewer flooding for 2005/06 has met or exceeded our targets for most measures.

We continue to make significant investment in renewable energy generation. In addition to contributing to achievement of our sustainability objectives, the importance of these projects has been increased by the rise in energy prices. As much of the energy generated is used on our sites, this has resulted in an overall reduction in energy imported from the grid during the year. Our sites generated about 18% of our energy needs from Combined Heat and Power (CHP) and hydro power generation.

From sustainability to corporate responsibility

We produced our first environmental action plan in 1992 and since then have maintained an excellent and improving level of environmental performance linked to our principal activities. Throughout this period we have built upon our successes and extended our environmental action plan to cover the wider sustainability agenda.

This year we have taken another step forward and developed this work into a fully integrated corporate responsibility policy. In doing this, we have considered our impact not only in the environment and community, but also within the workplace and marketplace. Building on this we have produced a five year action plan for AMP4, 'Delivering Corporate Responsibility', that encapsulates what my executive team consider is important to the company in this area and shows our continued commitment to achieving more than just compliance. Each year we will publish an update which will chart progress on the delivery of our targets and provide detailed information on our performance.

We have also extended our corporate responsibility agenda to cover our annual in-house Awards. This year the awards categories have been updated *to take account of the full range and diversity of* issues that our corporate responsibility agenda spans within the business. The event celebrates the achievements of employees who have incorporated the principles of corporate responsibility into their everyday work. Each year, those employees receiving awards also gain monetary prizes to donate to local and national community and environmental projects or charities of their choice.

Climate change continues to pose an immense challenge to the viability of a water company's long term water resources. We have been involved in a number of regional and national level groups to establish the impact that climate change may have on us and to ensure we are prepared. However, as water quality standards continue to become ever tighter, we are having to invest in increasingly energy intensive treatment processes, and are therefore indirectly contributing to global warming ourselves. To ensure long term sustainability we need to work with our regulators to maximise the benefits to customers and the communities we serve by ensuring that a holistic view is taken of the impact of raising environmental standards.

To help mitigate our impact on climate change we are taking great steps not only to minimise our demand for energy by implementing efficiency measures at both operational and non-operational sites but also by generating our own electricity from renewable sources. Our renewables programme has continued to grow with energy production increasing from 110 Gwh in 2004/05 to 153 Gwh in 2005/06. At present the majority of this is produced from the combustion of methane arising from the anaerobic digestion of sewage sludge with a small amount of hydro electricity generation. Over the coming AMP period we plan to maximise both these renewable sources while investigating other options such as solar and wind power.

Looking to the future, we see the implementation of the Water Framework Directive as being of fundamental importance to developments in the aquatic environment. We are fully engaged with the development of this work nationally and are expecting to play active roles in the River Basin Planning Liaison Panels currently being established. We are also looking at the potential impact this could have on our business and have developed a number of forward looking scenarios which we are using to inform our business planning process that is looking well beyond the end of this Asset Management Plan period.

Biodiversity

As this is the first year of AMP4, much of our effort has gone into the early stages of planning those schemes which will improve river water quality downstream of some 100 sewage treatment works and 176 intermittent discharges. We will also be investigating the impact of discharges to rivers and groundwaters at more than 30 locations. We have already delivered improved sewage treatment at 10 sewage works, including provision of phosphorus removal at 3 sites. In addition 32, intermittent discharges have been improved or shown to be satisfactory.

Our Biodiversity Action Plan (BAP) sets a number of biodiversity targets in our 2005-2010 Action Plan for Delivering Corporate Responsibility. This includes reviewing and updating the BAP to ensure that we incorporate the lessons we have learned over the first five years of its operation.

We will report our progress against these targets each year in line with other targets in our action plan.

Following a review by English Nature of all SSSI boundaries in England the number of sites we wholly or partly own has dropped to 25. An assessment of these sites by English Nature shows 60.6% (by area) to be in favourable condition or unfavourable and recovering. We have agreed with English Nature the remedial action necessary to bring about favourable conditions in our other SSSI's. However at some of these sites we will need to work with partner organisations as external conditions outside our control need to be addressed. For instance diffuse pollution originating from agricultural and other land uses which flow into our catchments can have significant impacts on the SSSI's within our ownership. We are currently on target to address the remedial action for which we are responsible and are working with our partner organisations to secure an overall improvement.

We carry out significant biodiversity work following engineering schemes undertaken as part of our five year Asset Management Plan. To ensure that the potential for biodiversity improvement is maximised, we have been working on the production of a booklet 'Landscaping for Biodiversity' providing best practice guidance for our engineers on landscaping schemes. The booklet advises on the use of native floral species that will maximise habitat creation for fauna and invertebrates.

Sewage treatment sites using reed beds as a tertiary treatment process continue to play an important role in our management of target habitats. This supports species within our region that are on the UK Biodiversity Action Plan. A new project has been started this year looking at the management of these vital habitats, and we will report on its successes in future years. We have also continued our work with species over the last year with special attention being given to black grouse, otters, tree sparrows and water voles. A major reintroduction of water voles at our Netheridge sewage works has been undertaken with the release of 60 baby voles at the site. Some of these have been fitted with radio tags so we can monitor their progress, and to date they seem to have responded well to their new surroundings.

We believe we are on track to deliver the AMP4 programme and meet our regulatory obligations.

Our people

We have reaffirmed our company value as 'we care', for colleagues, customers, communities, compliance and company. We take the colleagues element of this very seriously and it underpins much of our thinking around staff motivation, recruitment and retention. This year has seen us reset our leadership agenda for the business. We have worked hard with the executive and senior management teams to establish a culture and leadership style appropriate to the challenges ahead.

We continue to promote equality of opportunity and ensure we have a diverse workforce which reflects the communities that we serve. We have been working closely with community organisations and using more innovative approaches to recruitment. We also encourage employees to meet through both formal and informal networks to discuss diversity related topics outside of work and this has proved helpful in raising the profile of this issue. We receive a 'silver certificate standard' from the Race for Opportunity organisation for our work in this during 2006.

We continue to work in partnership with our Trade Union colleagues. This includes joint working on business change proposals and the maintenance of a positive industrial relations climate. We have differentiated pay for all levels of our staff based on personal performance driven by a new pay model which determines the amount of pay available for distribution dependent upon the company's financial performance, safety performance and staff absence rates.

We have focussed much time and attention on ensuring we have the right people in the right place at the right time not only for today but also for our future requirements. To this end, we have undertaken succession management activities at all levels of our organisation.

We have also maintained tight control over our manpower numbers during the course of the year. In January 2005, following our price determination, we announced manpower efficiencies of up to 350 posts to be achieved over the five year regulatory period. By March 2006, we have reduced our like-for-like manpower by around 200 of these posts, after taking into account transfers in of staff from our associated engineering consulting business, Charles Haswell and Partners Limited and our IT systems business, Severn Trent Systems Limited.

These reductions have been achieved through a combination of limiting external recruitment, voluntary staff turnover and redundancy and we have been successful in actively seeking redeployment opportunities for many of those who would have otherwise been affected by the changes.

Health and safety

Improving the health and safety of our operations continues to be a critical element in our strategy. We believe that effective health and safety management comes from implementation of robust health and safety management systems and we are therefore pleased that we have again secured recognition from the British Safety Council for our progress in this area through the award of 10 'five star' ratings (the highest score available) from each of the audits conducted during the course of the year on our sites.

Outlook

In 2005/06 we made a good start to AMP4. Although it is too early, after just one year of the five year period, to forecast our eventual performance on the contract, we are confident about our ability to control operating costs and deliver our five year capital programme. We believe we are on track to deliver the AMP4 programme and meet our regulatory obligations.

We must rebuild our reputation with customers and all of our stakeholders to ensure we deliver the high standards that they expect and deserve. We will be working hard over the forthcoming year to ensure all that we do is done in a 'safe' manner, safe for everyone that comes into contact with Severn Trent Water and safe for the environment and the heritage for which we are responsible.

Tony Wray – Managing Director

The Directors present their report, together with the audited financial statements for the year ended 31 March 2006.

Principal activities

The principal activities of the company and its subsidiary undertakings are the supply of water and the treatment and disposal of sewage.

Results

The results prepared are for Severn Trent Water Limited and its subsidiary undertakings.

The group's turnover was £1,137.7 million (2005: £999.3 million), and operating profit was £402.9 million (2005: £316.9 million). Profit on ordinary activities before taxation was £276.0 million (2005: £194.5 million).

Business review and future developments

A review of business activities and future developments is contained within the Managing Director's review on pages 2 to 8.

A review of activities is also contained within the Annual Report and Accounts of Severn Trent Plc. A copy of this report can be obtained on written request to the Company Secretary, Severn Trent Plc, 2297 Coventry Road, Birmingham B26 3PU, (there is no charge for this publication). Alternatively, the report can be viewed and downloaded from Severn Trent Plc's website at www.severntrent.com/reports2006.

In May 2004 an employee of Severn Trent Water Limited (the company) raised a number of allegations relating, in particular, to alleged accounting inaccuracies and regulatory returns.

On 31 October 2005, as a result of a referral by Ofwat, the Serious Fraud Office (SFO) informed the company that it was undertaking a criminal investigation into alleged reporting irregularities made to Ofwat by the company between 2000 and 2003. Ofwat had been conducting its own investigation following the allegations made by the employee of the company. The matter reported to the SFO concerned data on leakage.

The company's internal investigation and Ofwat's investigation were thorough and lengthy, requiring complex judgements. Severn Trent's judgements have not been identical to Ofwat's in every aspect, but in the interests of making amends as soon as possible, the board believed it was sensible to proceed by agreement.

In March 2006, the Ofwat interim report into allegations of false reporting found that we had overcharged our customers during 2004/05 and had set prices too high for 2005-10. Immediately following the report, we apologised unreservedly to all our customers and we have agreed with Ofwat a mechanism for rebating them. We had already voluntarily proposed to raise prices by £7 million less than allowed under the 2006/07 price limits for each of the four years to 2009-10.

Ofwat measures the service that we provide to customers by a series of indicators known as DG2 to DG9. These cover: water supply pressure, interruptions and restrictions; sewer flooding problems; speed of response to three types of contact with customers; and the proportion of metered customers who receive a bill based on an actual meter reading. Further details, along with the levels of service for the water industry can be found in the Ofwat annual report on www.ofwat.gov.uk.

At the end of February 2006, we also began an investigation into misreporting of our DG6, DG7 and DG9 customer relations data to Ofwat. The data concerns the handling of customer billing queries and telephone contacts over several years. We have kept Ofwat fully informed on the progress of the investigation.

On 7 April 2006 the company announced it was giving Ofwat an interim report on misreporting of customer relations data.

On 8 June 2006 Ofwat announced that it proposed to levy a financial penalty, yet to be determined, on the company for customer service failures.

Further details are set out in note 16d) to the financial statements on page 32.

Dividends and reserves

The company's dividend policy is to declare dividends which are consistent with the company's regulatory obligations and at a level which is decided each year after consideration of a number of factors, including regulatory uncertainty, market expectations, actual and potential efficiencies, future cash flow requirements and balance sheet considerations.

The amount declared is expected to vary each year as the impact of these factors changes. Consistent with this policy, the dividend declared by the company in 2006 amounted to £154.7 million (2005: £147.1 million).

Transfers to reserves are set out in note 15 to the financial statements on page 31.

Directors

The Directors of the company who served during the year and up to the date of this report are set out below:

J H Bailey	
I Elliott	Resigned 30 June 2005
R S S Martin	
C S Matthews	
G C Messham	
S H Reilly	
P F Stephenson	
S K Stubbs	
M R Wilson	Resigned 13 December 2005
A P Wray	

Subsequent to the year end Mr M W Keogh was appointed as a Director with effect from 3 May 2006 and Mr J H Bailey resigned as a Director on 3 May 2006.

Directors' interests

The interests of the Directors at the year end in the share capital of Severn Trent Plc, according to the register maintained under the provisions of the United Kingdom Companies Act 1985, are set out in note 3 to the financial statements on page 22.

None of the Directors retains any notifiable interest in the shares of the company or any other subsidaries as at 31 March 2006.

Directors' remuneration Annual bonus plan

Executive directors are eligible for annual bonuses to encourage improved performance, measured by reference to both financial and non-financial factors. Performance targets are established by the Severn Trent Plc remuneration committee to align executive directors' interests with shareholders and comprise profitability, specific targets relating to health and safety performance and the achievement of personal objectives. The maximum bonus entitlement for any director is 50% of salary.

Given the prime importance which the board and the remuneration committee place on health and safety issues, the indicative bonus is then adjusted by a multiplier based on health and safety performance but, in all cases, subject to the overall bonus maximum. The maximum bonus payable to executives below board level differs but, in all cases, is no higher than the bonus opportunity enjoyed by the executive director to whom they report. The remuneration committee considers that the performance requirements are stretching.

The annual bonus scheme comprises of two elements, company and personal, and operates as follows:

(1) Company bonus is linked to the company's (i.e. Severn Trent Water's) financial performance based on achievement of profit before interest, tax and amortisation (PBITA) targets. The maximum bonus that can be achieved under this category is 33% of salary.

(2) Personal bonus is based on the Managing Director's assessment of the director's achievement of personal targets relevant to their line duties within the company. These are reviewed as part of an annual performance appraisal process. The maximum bonus that can be achieved under this category is 17% of salary.

With regard to the Managing Director, the assessment is made by the Group Chief Executive and the Remuneration Committee of Severn Trent Plc.

Any bonus achievement based on the above elements of the scheme is subject to a health and safety multiplier. Health and safety has been identified as a priority area for the company and directors have been set targets based on two factors:

A minimum of nine British Safety Council audits of company sites, with bonus dependent upon audit performance; and a 20% reduction in the number of RIDDOR accidents per 1,000 employees against the previous financial year.

Maximum performance under the above two categories would result in earnings from company performance and personal targets being multiplied by up to 1.5 (but not exceeding the total bonus cap of 50% of salary). Failure to achieve threshold levels under the above targets would result in zero bonus being paid.

In 2005/06 the company outperformed against its PBITA target and achieved a full health and safety multiplier. These outcomes were subject to an independent audit. However, in recognition that the company had performed unsatisfactorily in some areas during 2005/06 the Managing Director recommended a discretionary overview to the Severn Trent Plc Remuneration Committee of any bonus earned under the above scheme and reduced the bonus cap to 30% of salary. The Plc Remuneration Committee approved this recommendation.

In addition to the above variable remuneration, directors of the company also receive a base salary, a company pension, the option of a fully expensed company car and an opportunity to participate in the Severn Trent Plc Long Term Incentive Plan ('LTIP' scheme). Details of the latter are set out in note 3 to the financial statements on page 22.

Annual bonus payments are not taken into account in calculating executive directors' pension entitlements, except for those directors who are members of the Severn Trent Pension Scheme. For these directors a bonus of up to 25% of salary is allowed for in determining pensionable earnings.

Directors' and officers' indemnities

Directors and officers are indemnified by the company against any costs incurred by them in carrying out their duties including defending any proceedings brought against them arising out of their positions as directors in which they are acquitted or judgement is given in their favour or relief from any liability is granted to them by the court.

Directors' responsibilities

Each of the persons who is a director at the date of approval of this report confirms that:

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

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

This confirmation is given and should be interpreted in accordance with the provisions of s234ZA of the Companies Act 1985.

Policy on the payment of creditors

The company either uses its own standard terms and conditions entitled 'General Conditions of Contract relating to the supply of Goods/Services or the Execution of Work' (copies are available from the Purchasing Department, Severn Trent Water Limited, 2297 Coventry Road, Birmingham, B26 3PU) or nationally agreed terms and conditions of contract such as ICE 6th Edition for Civil Engineering Works and G90 terms and conditions for Mechanical and Electrical Works.

Each purchase order issued by the company has stated on it the terms of payment. Suppliers are able to negotiate their own payment terms which can differ from these, as part of the tender process. Trade creditors at year end reflected 37 days purchases (2005: 46 days).

Research and development

Expenditure on research and development was £5.2 million including £0.7 million spent on fixed assets, compared to £4.7 million in 2004/05, (including £0.9 million on fixed assets).

Expenditure on improvements to drinking water during the last year has concentrated on making the best use of our existing assets by introducing a standardised approach across the company to produce excellent, consistent drinking water. Work has also continued on minimising the occurrence of disinfection by-products in distribution by removing precursor compounds at the waterworks. Extensive work has also taken place in evaluating the most suitable processes to meet the water standards required over the next four years and in the longer term.

In the waste water area the major focus has been on developing biological systems to reduce nutrient levels in sewage. This has become more important because of the increasing cost of chemicals and the need to reduce the levels of these chemicals in rivers. Work has been undertaken on the removal of heavy metals from sewage and an experimental programme to investigate methods for the removal of endocrine disrupting compounds has started.

Other work has included the use of developments in sensors and IT to improve our remote monitoring capability for both water and sewage treatment works; investigation of process enhancements to improve gas yield from digesters; projects to reduce energy usage on our sites and to develop small sewage treatment works that operate without an external power supply and participation in a major industry project to mitigate the problems associated with fats, oils and greases in sewers and on sewage treatment works.

Employees

The average number of employees during the year was 5,023 (2005: 4,927).

In January 2005, following Ofwat's price determination, we announced manpower efficiencies of up to 350 posts to be achieved over the 5 year regulatory period, the majority of these savings being achieved in the first 2 years of the cycle. By the end of March 2006, 200 severances have taken place.

Wherever possible we have reduced numbers by not recruiting to vacant positions through natural staff turnover, (although certain business critical roles are safeguarded) and, where appropriate, carefully considering requests from employees for voluntary redundancy to help achieve our resourcing objectives. We actively consider redeployment opportunities for those who are displaced.

In the spirit of our Partnership Agreement with the Trade Unions we have consulted and involved them in the process at an early stage to ensure both managers and employee representatives work together to enable delivery of change plans.

We have a range of attractive work/life balance policies, including part time working for many employees which help to retain staff whilst also improving customer service. We are also developing policies to enable some employees to work from home in the future.

We have continued with Harmony, our health and well-being programme for all employees.

Lifestyle, our flexible benefits programme, is available to all employees and is valued as an important part of our employment package. This differentiates us from many other companies in our sector.

Our performance management appraisal process is used to provide regular feedback to all staff on their contribution and personal development and also links directly to our business values and goals. It is also the foundation of our reward framework, successfully introduced in 2004, allowing employees to be recognised and rewarded for their contribution. This has enabled recognition of individual performance, taking away the history of 'across the board' pay settlements and has been well received by employees across the business. The framework was introduced following a major planning and communications exercise to ensure understanding amongst all employees. The amount of money available for pay increases in 2005/06 was driven by the company's financial performance, our reportable injury performance (where we achieved a reduction of 23.4% against the previous year's figures) and by our staff absence rates (which have also reduced).

Our succession planning processes enable us to proactively foresee and plan for any areas of resource vulnerability and enable career moves for talented people. Despite our forecast manpower reductions we continue with our graduate and apprentice recruitment campaigns to fuel talent for the future.

Our excellent management development portfolio operates via a range of providers from leading European business schools such as Insead and Warwick to in house providers.

We work hard to make learning opportunities available and accessible to all employees and now have two learning resource centres providing materials and resources for employees to access. We make use of e-learning opportunities where possible via our company intranet and have also produced a Career Guide which helps employees understand our succession management process and provides information to help them continue their career development.

We have continued to extend the use of our Human Resources information system and have improved our Human Resources processes in recruitment, training and reporting. We have now implemented Self Service for Managers, giving them access to their employee records, and we will shortly be introducing Employee Self Service to enable all employees to view and amend their personal details. This will provide the foundation for further process improvements such as on-line expenses and overtime claims.

We have well structured arrangements for internal communications including monthly 'Teamtalk' meetings and our re-launched in-house magazine 'Pulse'. Our intranet site 'Streamline' covers a wide range of topics including news, announcements, reference materials and contact information.

Diversity in Employment

We remain committed to creating an environment which values diversity and enhances the contribution made by each of our employees. We regularly review our working practices to ensure equality of opportunity for all our employees regardless of race, gender, religious belief, sexual orientation, disability, age or any other status unrelated to an individual's ability to perform their job. Reasonable adjustments are made to ensure the workplace is accessible to both current employees and potential recruits.

We are committed to promoting equality and welcome diversity in all aspects of business practices. Our regular monitoring helps us track levels and trends which continue to improve.

With our diversity strategy and policy in place we have made important progress by working closely with community organisations and using more innovative approaches. This has resulted in a more diverse range of applicants and subsequent appointments. We continue to benchmark and develop our policies and practices in this area, taking guidance from best practice advisors such as Race for Opportunity and the Employers' Forum on Disability.

Our dedicated Access Team continues to manage and review services offered to customers with individual needs.

Post balance sheet events

On 7 April 2006 the company announced it was giving Ofwat an interim report into misreporting of customer relations data.

On 8 June 2006 Ofwat announced that it proposed to levy a financial penalty, yet to be determined, on the company for customer service failures.

Further details are set out in note 16d) to the financial statements on page 32.

Regulation: 'Ring Fencing'

In accordance with the requirements of the Director General of Water Services, the Board confirmed, that as at 31 March 2006, it had available to it sufficient rights and assets, not including financial resources, which would enable a special administrator to manage the affairs, business and property of the company in order that the purposes of a special administration order could be achieved if such an order were made.

Regulation: 'Cross Directorships'

It is the policy of the company that Directors and employees of the company may be Directors of related companies when this is in the best interests of the company, and where appropriate arrangements are in place to avoid conflicts of interest.

Auditors

In accordance with Section 386 of the Companies Act 1985, the company has elected to dispense with the obligation to appoint auditors annually. Deloitte & Touche LLP will, therefore, remain as auditors until further notice.

C. Mottram

By Order of the Board
C J Mottram
Company Secretary
14 July 2006

C. Mottram

All the group's trading activities are conducted through Severn Trent Water Limited and consequently the matters relating to corporate governance refer to the activities of that company.

Internal control and risk management

The board has overall responsibility for the company's system of internal control and for reviewing its effectiveness. The board has formally established policies and processes for identifying and evaluating the significant risks faced by the company. The policies and processes are designed to manage risks rather than eliminate them and can only provide reasonable but not absolute assurance against material errors, losses or fraud or breaches of laws or regulations.

There are procedures for managing these significant risks, of which the key elements are: an organisation structure with clear lines of accountability; regular, structured reviews of business risk by senior management; a scheme of delegated authority; pre-approval of plans, budgets and significant investments; monthly reporting and monitoring of financial results and other key business measures and independent assurance provided by both internal and external auditors. The senior management teams of each of the functions have identified the risks facing their activities and have made an assessment of the impact and likelihood of those risks. They also have a process to identify changes to the risk profile and to identify weaknesses in internal control. The controls that are in place to manage each of the more significant risks in each unit have been identified and an assessment has been made of the effectiveness of these controls.

The company also reports regularly to the Severn Trent Plc Group Chief Executive on its risks and controls. The Severn Trent Plc Executive Committee reviews these risks as well as carrying out a process to identify any other significant risks affecting the group, considers the controls in place to mitigate the risks faced by the group and ensures that its focus is on managing the most important risks and meeting any changes in the risk profile.

The Severn Trent Plc board (Plc Board) reviews risk management and the effectiveness of the system of internal control through the Severn Trent Plc Audit Committee (Plc Audit Committee). They also keep under review ways in which to enhance the control and audit arrangements in the group. The Plc Audit Committee receives reports every six months from the Group Chief Executive on the significant risks faced by the group, an assessment of the effectiveness of controls over each of those risks and an action plan to improve controls where this has been assessed as necessary. Any significant control weaknesses that have been identified are also reported to the Plc Audit Committee. The external auditors also report on significant control issues to this committee. The internal audit department provides objective assurance and advice on risk management and control and monitors the risk management process.

During the year the company reported to the Plc Audit Committee and the Plc Board certain weaknesses in controls. In particular, on 31 October 2005 the company announced that the Serious Fraud Office was undertaking a criminal investigation into alleged false reporting of leakage figures to Ofwat and that it is co-operating fully with the Serious Fraud Office. On 7 March 2006 the conclusions of Ofwat's interim report concerning allegations of false reporting made against the company in 2004 were accepted and on 7 April 2006 it was announced that the company was giving Ofwat an interim report into misreporting of customer relations data. To address these issues a thorough review of control processes in the company was embarked upon and substantial action has already been taken to implement its recommendations. This work continues to improve processes and behaviour. As part of this Deloitte & Touche LLP conducted a review of key controls in the company and substantially all their recommendations have now been implemented. The remainder will be completed during this year.

The directors confirm that there is an ongoing process for the identification, evaluation and management of the significant risks faced by the company. This process has been in place throughout the year ended 31 March 2006 and up to the date of approval of the Annual Report and Accounts. It accords with the guidance in the report on Guidance on Internal Control (The Turnbull Guidance).

Principal risks

The company is exposed to a number of commercial risks and uncertainties, which could have a material impact on our business, financial condition, operations and reputation, as well as the value and liquidity of our securities. Not all of these factors are within our control and, in addition, other factors besides those listed below may have an adverse effect on the company.

In 2006/07 the most significant risks that the company faces will be to deliver our financial and operational performance. This will be the key focus of our risk management process. In this context the following specific risks have been identified:

Changes in law or regulation in the areas in which we operate could have an adverse effect on our business and operations

Regulatory decisions in relation to our businesses, e.g. on whether licences or approvals to operate are renewed, whether market developments have been satisfactorily implemented, on the level of permitted revenues for our businesses, whether there has been any breach of the terms of a licence or an approval, could have an adverse impact on the results of our operations, cash flows, financial condition of our businesses and the ability to develop our business in the future.

The results of our operations depend on a number of factors relating to business performance, including the ability to outperform regulatory targets and deliver anticipated cost and efficiency savings

Our earnings will be affected by our ability to meet or better our regulatory targets set by Ofwat, Environment Agency, Drinking Water Inspectorate and other regulators. To meet these targets, we must continue to improve management and operational performance. In addition, our earnings also depend on meeting service quality standards set by regulators. To meet these standards we must improve service reliability and customer service. If we do not meet these targets and standards, both our results and our reputation may be adversely affected.

Various government environmental protection and health and safety laws and regulations govern our businesses

These laws and regulations establish, amongst other things, standards for drinking water and discharges into the environment which affect our operations. In addition we are required to obtain various environmental permissions from regulatory agencies for their operation. Environmental laws and regulations are complex and change frequently. These laws and their enforcement have tended to become more stringent over time both in relation to their requirements and in the levels of proof required to demonstrate compliance and, whilst we believe we have taken account of the future capital and operating expenditure necessary to achieve and maintain compliance with current and foreseeable changes in laws and regulations, it is possible that new or stricter standards could be imposed or current interpretation of existing legislation amended, which will increase our operating costs or capital expenditure by requiring changes and modifications to our operations in order to comply with any new environmental laws and regulations.

The failure of our assets or our inability to carry out critical operations could have a significant impact on our financial position and our reputation

We may suffer a major failure in our assets which could arise from a failure to deliver the capital investment programme for our businesses or to maintain the health of our systems. Any failure could cause us to be in breach of a licence or approval and even incidents that do not amount to a breach could result in adverse regulatory action and financial consequences, as well as harming our reputation. Our business controls and operates water and sewerage networks and undertakes maintenance of the associated assets with the objective of providing a continuous service. The failure of a key asset could cause a significant interruption to the supply of services, which may have an adverse effect on our operating results or financial position. In addition, water supplies may, inter alia, be subject to contamination, including contamination from the development of naturally occurring compounds and pollution from man-made sources and these may have an adverse effect on our operating results or financial position. We could also be held liable for human exposure to hazardous substances or other environmental damage. In addition, we are subject to other risks which are largely outside our control, such as the energy costs, impact of climate change, weather or unlawful acts of third parties, including terrorist attacks, sabotage or other intentional acts which may also physically damage our business or otherwise significantly affect corporate activities and, as a consequence, affect the results of our operations.

Statement of Directors' responsibilities

The Directors are required by the United Kingdom Companies Act 1985 to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and group as at the end of the financial year and of the profit or loss for the financial year.

The Directors consider that in preparing the financial statements, the company and the group have used appropriate accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates, and that all United Kingdom Accounting Standards which they consider applicable have been followed, any material departures being disclosed and explained in the financial statements.

The Directors are required to prepare the financial statements on a going concern basis, unless it is inappropriate to presume that the company and group will continue in business.

The Directors have responsibility for ensuring that the company keeps accounting records which disclose with reasonable accuracy at any time the financial position of the company and the group which enable them to ensure that the financial statements comply with the United Kingdom Companies Act 1985.

The Directors have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and the group and to prevent and detect fraud and other irregularities.

Independent auditors' report to the members of Severn Trent Water Limited

We have audited the financial statements of Severn Trent Water Limited for the year ended 31 March 2006 which comprise the consolidated and company profit and loss accounts, the statement of total recognised gains and losses, the reconciliation of movements in shareholder's funds, the balance sheets, the group cash flow statement, the reconciliation of net cash flow to movement in net debt and the related notes 1 to 19. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

As described in the statement of directors' responsibilities, the company's directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice). Our responsibility is to audit the financial statements in accordance with relevant United Kingdom legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view, in accordance with the relevant financial reporting framework, and are 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 the other information contained in the annual report for the above year, which comprises the managing director's review and the statement of directors' responsibilities, and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

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 judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's and group'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 United Kingdom Generally Accepted Accounting Practice, of the state of the group and individual company's affairs as at 31 March 2006 and of the group and individual company's profits 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.

Deloitte & Touche LLP Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
London, 14 July 2006

The maintenance and integrity of Severn Trent Water's website is the responsibility of the Directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Severn Trent Water Limited Profit and loss accounts

Year ended 31 March 2006

		Notes	Group 2006 £m	Group (restated) 2005 £m	Company 2006 £m	Company (restated) 2005 £m
Turnover			1,137.7	999.3	1,137.7	999.3
Operating costs before exceptional items		2	(737.6)	(674.6)	(751.1)	(686.9)
Exceptional restructuring costs		2	(0.7)	(10.6)	(0.7)	(10.6)
Total operating costs		2	(738.3)	(685.2)	(751.8)	(697.5)
Other income			3.5	2.8	3.5	2.8
Operating profit			402.9	316.9	389.4	304.6
Exceptional profit on disposal of assets		2	2.5	7.6	2.5	7.6
Net interest payable		4	(129.4)	(130.0)	(116.2)	(116.3)
Profit on ordinary activities before taxation			276.0	194.5	275.7	195.9
Taxation on profit on ordinary activities	current tax	5	(57.8)	10.4	(57.6)	9.0
	deferred tax	5	(39.7)	(38.5)	(38.6)	(38.5)
Taxation		5	(97.5)	(28.1)	(96.2)	(29.5)
Profit for the financial year			178.5	166.4	179.5	166.4
Dividends		6	(154.7)	(147.1)	(154.7)	(147.1)
Retained profit for the financial year		15	23.8	19.3	24.8	19.3

The results for the year ended 31 March 2005 have been restated as a result of applying FRS 17 'Retirement benefits' and for the treatment of infrastructure connection charges (note 1a).
The results arise from continuing operations in both the current and preceeding year.

Statement of total recognised gains and losses

	Group 2006 £m	Group (restated) 2005 £m	Company 2006 £m	Company (restated) 2005 £m
Profit for the financial year	23.8	19.3	24.8	19.3
FRS 17 actuarial gain	26.0	35.3	26.0	35.3
Deferred tax on actuarial gain	(7.8)	(10.6)	(7.8)	(10.6)
Total recognised gains and losses for the financial year	42.0	44.0	43.0	44.0
Prior year restatement (note 1a)	(215.0)		(215.0)	
Total recognised gains and losses since last annual report and financial statements	(173.0)		(172.0)	

Reconciliation of movements in shareholder's funds

	Group 2006 £m	Group (restated) 2005 £m	Company 2006 £m	Company (restated) 2005 £m
Opening shareholder's funds as previously reported	1,693.1	1,884.3	1,927.2	2,118.4
Prior year adjustment (note 1a)	-	(235.2)	-	(235.2)
Opening shareholder's funds as restated	1,693.1	1,649.1	1,927.2	1,883.2
Profit for the financial year as previously stated	178.5	170.9	179.5	170.9
Prior year adjustment (note 1a)	-	(4.5)	-	(4.5)
Profit for the financial year as restated	178.5	166.4	179.5	166.4
Dividends	(154.7)	(147.1)	(154.7)	(147.1)
Retained profit for the financial year	23.8	19.3	24.8	19.3
Other recognised gains and losses relating to the year	18.2	24.7	18.2	24.7
Net addition to shareholder's funds	42.0	44.0	43.0	44.0
Closing shareholder's funds	1,735.1	1,693.1	1,970.2	1,927.2

The reconciliation of movements in shareholder's funds for the year ended 31 March 2005 have been restated as a result of applying FRS 17 'Retirement benefits' and for the treatment of infrastructure connection charges (note 1a).

Balance sheets

As at 31 March 2006

	Notes	Group 2006 £m	Group (restated) 2005 £m	Company 2006 £m	Company (restated) 2005 £m
Fixed assets					
Tangible assets	7	**5,083.3**	4,975.5	**5,081.3**	4,973.5
Investments	8	**0.1**	0.2	**236.8**	66.9
		5,083.4	4,975.7	**5,318.1**	5,040.4
Current assets					
Stocks		**6.1**	4.4	**6.1**	4.4
Debtors: amounts falling due within one year	9a	**204.7**	198.1	**200.0**	198.1
Debtors: amounts falling due after more than one year	9b	**3.4**	5.5	**26.2**	24.3
Short-term deposits	12b	**2.1**	2.3	**2.1**	2.3
Cash at bank and in hand		**-**	0.1	**-**	0.1
		216.3	210.4	**234.4**	229.2
Creditors: amounts falling due within one year	10	**(857.8)**	(642.7)	**(875.5)**	(656.2)
Net current liabilities		**(641.5)**	(432.3)	**(641.1)**	(427.0)
Total assets less current liabilities		**4,441.9**	4,543.4	**4,677.0**	4,613.4
Creditors: amounts falling due after more than one year	11	**(2,049.1)**	(2,169.0)	**(2,049.1)**	(2,003.8)
Provisions for liabilities and charges	13	**(550.5)**	(527.7)	**(550.5)**	(528.8)
Net assets excluding pension deficit		**1,842.3**	1,846.7	**2,077.4**	2,080.8
Pension deficit	17	**(107.2)**	(153.6)	**(107.2)**	(153.6)
Net assets including pension deficit		**1,735.1**	1,693.1	**1,970.2**	1,927.2
Capital and reserves					
Called up share capital	14	**1,000.0**	1,000.0	**1,000.0**	1,000.0
Profit and loss account	15	**735.1**	693.1	**970.2**	927.2
Equity shareholder's funds		**1,735.1**	1,693.1	**1,970.2**	1,927.2

The group and company balance sheets for the year ended 31 March 2005 have been restated as a result of applying FRS 17 'Retirement benefits' and for the treatment of infrastructure connection charges (note 1a).

Signed on behalf of the Board who approved the accounts on 14 July 2006.

A P Wray
Managing Director

M W Keogh
Director

Group cash flow statement

Year ended 31 March 2006

	Notes	2006 £m	2006 £m	2005 £m	2005 £m
Net cash inflow from operating activities	18a		644.0		575.1
Returns on investments and servicing of finance					
Interest received		0.4		0.4	
Interest paid		(104.0)		(101.6)	
Interest element of finance lease rental payments		(41.6)		(12.8)	
			(145.2)		(114.0)
Taxation			(58.3)		0.5
Capital expenditure and financial investment					
Purchase of tangible fixed assets		(444.9)		(443.7)	
Grants and contributions received		38.8		36.7	
Sale of tangible fixed assets		6.2		12.1	
Sale of other fixed asset investments		0.1		1.9	
			(399.8)		(393.0)
Equity dividends paid			(154.7)		(147.1)
Net cash outflow before financing			(114.0)		(78.5)
Management of liquid resources			0.2		(2.3)
Financing					
Receipt from sale and leaseback transaction		170.2		-	
Finance leases repaid		(159.2)		-	
Loans advanced		31.9		172.4	
Loans repaid		(159.3)		(88.0)	
			(116.4)		84.4
Net (decrease)/increase in cash			(230.2)		3.6

Reconciliation of net cash flow to movement in net debt

	Notes	2006 £m	2006 £m	2005 £m	2005 £m
Net (decrease)/increase in cash as above		(230.2)		3.6	
Cash flow from movement in net debt and financing		116.4		(84.4)	
Cash flow from movement in liquid resources		(0.2)		2.3	
Change in net debt resulting from cash flows			(114.0)		(78.5)
Rolled up interest on debt			(3.0)		(8.5)
Movement in rolled up interest on finance leases			18.9		(7.4)
Increase in net debt			(98.1)		(94.4)
Opening net debt			(2,386.7)		(2,292.3)
Closing net debt	18b		(2,484.8)		(2,386.7)

1 Accounting policies

a) Accounting convention

The financial statements have been prepared under the historical cost convention in accordance with applicable United Kingdom Accounting Standards and except for the treatment of certain grants and contributions, comply with the requirements of the United Kingdom Companies Act 1985 ('the Act'). An explanation of this departure from the requirements of the Act is given in the policy on grants and contributions below.

In preparing these financial statements the group and company have taken the exemption in UITF17 and not applied this to Inland Revenue approved Save As You Earn schemes.

The group and company have fully adopted the provisions of FRS 17 'Retirement benefits'. As at 1 April 2004 this reduced net assets by £185.8 million, operating profit in 2004/05 increased by £12.3 million, net interest payable decreased by £0.8 million, deferred taxation increased by £3.2 million and reserves decreased by £151.2 million.

The group and company have changed their treatment of infrastructure connection charges from that adopted in previous years (the AMP3 period) which offset the charges against the infrastructure renewals charge in the profit and loss account. Instead these are now treated as capital contributions.

Prior year figures have been restated so that the opening balance sheet position (for 1 April 2004) reflects the situation that would have existed if the group and company had treated these contributions as capital throughout the AMP3 period. Consequently, cumulative depreciation on fixed assets has increased by £63.8 million.

The restated 2004/05 profit and loss account therefore shows a revised (higher) infrastructure renewals charge than reported last year, of £72.5 million as compared to £58.1 million, as previously shown, due to adoption of the new policy.

b) Basis of preparation

The Directors have not taken advantage of the exemption available under Section 228 of the United Kingdom Companies Act 1985 from preparing group accounts.

The Directors have decided to prepare group accounts for Severn Trent Water Limited, including its subsidiary undertakings, in order to be consistent with the regulatory accounts. The group accounts presented also include the company profit and loss account.

The consolidated profit and loss account and balance sheet include the results of the company and its subsidiary undertakings listed in note 8 prepared for the year ended made up to 31 March 2006. Inter group sales and profits are eliminated fully on consolidation.

The company has taken advantage of the exemption in FRS1 'Cash flow statements' and not presented a cash flow statement.

c) Turnover

Turnover represents income receivable, excluding value added tax and trade discounts, in the ordinary course of business for services provided within the United Kingdom.

Income includes an estimation of the amount of mains water and wastewater charges unbilled at the year end. The accrual is estimated using a defined methodology based upon a measure of unbilled water consumed by tariff, which is calculated from historical billing information.

d) Tangible fixed assets and depreciation

Tangible fixed assets comprise:

i) Infrastructure assets

Infrastructure assets comprise a network of systems being mains and sewers, impounding and pumped raw water storage reservoirs, dams and sludge pipelines.

Expenditure on infrastructure assets relating to increases in capacity or enhancements of the network and on maintaining the operating capability of the network in accordance with the defined standards of service is treated as an addition and included at cost after deducting grants and contributions (1f).

The depreciation charged for infrastructure assets is the estimated, anticipated level of annual expenditure required to maintain the operating capability of the network less the estimated, anticipated level of relevant annual grants and contributions, based on the company's independently certified asset management plan (1f).

ii) Other assets

Other assets are included at cost less accumulated depreciation. Additions are included at cost.
Freehold land is not depreciated. Other assets are depreciated on a straight line basis over their estimated economic lives, which are principally as follows:

	Years
Buildings	30-60
Operational structures	40-80
Fixed plant	20-40
Vehicles, mobile plant and computers	2-15

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

1 Accounting policies continued

e) 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 accounted for as if they had been purchased and the fair value of the minimum lease payments is shown as an obligation to the lessor. Lease payments are treated as consisting of a capital element and a finance charge, the capital element reducing the obligation to the lessor and the finance charge being written off to the profit and loss account over the period of the lease in proportion to the capital amount outstanding. Depreciation is charged over the shorter of the estimated useful life and the lease period.

All other leases are accounted for as operating leases. Rental costs arising under operating leases are charged to the profit and loss account on a straight line basis over life of the lease

f) Grants and contributions

Grants and contributions received in respect of non-infrastructure assets are treated as deferred income and are recognised in the profit and loss account over the useful economic life of those assets.

In accordance with industry practice, grants and contributions relating to infrastructure assets have been deducted from the cost of fixed assets.This is not in accordance with Schedule 4 to the Companies Act 1985, which requires assets to be shown at their purchase price or production cost and hence grants and contributions to be presented as deferred income. This departure from the requirements of the Act is, in the opinion of the Directors, necessary to give a true and fair view as, while a provision is made for depreciation of infrastructure assets, finite lives have not been determined for these assets, and therefore no basis exists on which to recognise grants and contributions as deferred income. The effect of this departure is that the cost of fixed assets is £437.9 million lower than it would otherwise have been (2005: £398.5 million).

Those grants and contributions relating to the maintenance of the operating capability of the infrastructure network are taken into account in determining the depreciation charged for infrastructure assets.

g) Impairment of goodwill and fixed assets

Impairments of goodwill and fixed assets are calculated as the difference between the carrying value of the net assets of income generating units, including where appropriate investments and goodwill, and their recoverable amounts. Recoverable amount is defined as the higher of net realisable value or estimated value in use at the date the impairment review is undertaken.

Net realisable value represents the net amount that can be generated through sale of assets. Value in use represents the present value of expected future cash flows discounted on a pre-tax basis, using the estimated cost of capital of the income generating unit.

Impairment reviews are carried out if there is some indication that an impairment may have occurred, or, where otherwise required, to ensure that goodwill and fixed assets are not carried above their estimated recoverable amounts.

Impairments are recognised in the profit and loss account and, where material, are disclosed as exceptional.

h) Investments

Investments held as fixed assets are stated at cost less amounts written off.

i) Stocks

Stocks are stated at cost less any provision necessary to account for any damage and obsolescence. Work in progress is valued at the lower of cost and net realisable value. Cost includes labour, materials, transport and an element of overheads.

j) Insurance

Provision is made for claims notified and for claims incurred but which have not yet been notified, based on advice from the group's external insurance advisers.

k) Pension costs

The group operates both defined benefit and defined contribution pension schemes.

For defined benefit schemes the amounts charged to operating profit are the current service costs and gains and losses on settlements and curtailments. They are included as part of staff costs. Past service costs are recognised immediately in the profit and loss account if the benefits have vested. If the benefits have not vested immediately the costs are recognised over the period until vesting occurs. The interest cost and the expected return on assets is shown as a net amount of other finance costs or credits adjacent to interest. Actuarial gains and losses are recognised immediately in the statement of total recognised gains and losses.

Defined benefit schemes are funded, with the assets of the scheme held separately from those of the group, in separate trustee administered funds. Pension scheme assets are measured at fair value and liabilities are measured on an actuarial basis using the projected unit method and discounted at a rate equivalent to the current rate of return on a high quality corporate bond of equivalent currency and term to the scheme liabilities. The actuarial valuations are obtained at least triennially and are updated at each balance sheet date. The resulting defined benefit asset or liability, net of the related deferred tax, is presented separately after other net assets on the face of the balance sheet.

Costs of defined contribution pension schemes are charged to the profit and loss account in the period in which they fall due.

l) Research and development

Expenditure on tangible fixed assets relating to research and development projects is capitalised and written off over the expected useful life of those assets.

Other research and development expenditure is charged to the profit and loss account in the year in which it is incurred.

1 Accounting policies continued

m) Current and deferred taxation

Current taxation is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantially enacted by the balance sheet date.

Deferred taxation is provided in respect of timing differences between the treatment of certain items for taxation and accounting purposes only to the extent that the group has an obligation to pay more tax in the future or a right to pay less tax in the future. Material deferred taxation balances arising are discounted by applying an appropriate risk free discount rate. For the purposes of discounting, the period over which accelerated capital allowances in respect of infrastructure assets reverse is determined by the estimated annual cost of maintaining the operating capability of the network, based on an allocation of the infrastructure renewals charge to existing and future infrastructure assets.

n) Goodwill

Goodwill represents the excess of the fair value of purchase consideration over the fair value of the net assets acquired.

Goodwill arising on acquisitions prior to 1 April 1998 remains eliminated against reserves. Purchased goodwill arising on acquisitions after 31 March 1998 is treated as an intangible asset in the balance sheet and stated at cost less accumulated amortisation. Capitalised goodwill is amortised on a straight line basis over its useful economic life.

o) Derivatives and other financial instruments

Debt instruments

The financial costs of debt instruments are charged to the profit and loss account over the term of the debt at a constant rate on the carrying amount. Such costs include the cost of issue and any discount to face value arising on issue, or any premium arising on maturity.

Derivative financial instruments

Financial instruments, in particular, interest rate swaps and to a lesser extent currency swaps, are used to manage the financial risks arising from the business activities of the group and the financing of those activities. There is no trading activity in financial instruments.

Financial instruments are accounted for as follows:

Interest rate swaps are used to hedge the group's exposure to movements in interest rates. The interest payable or receivable on such swaps is accrued in the same way as interest arising on deposits or borrowings. Interest rate swaps are not revalued to fair value prior to maturity.

Currency swaps are used to hedge the group's exposure to movements in foreign exchange rates. The interest payable or receivable on such swaps is accrued in the same way as interest arising on deposits or borrowings. Currency swaps are not revalued to fair value prior to maturity.

The aggregate fair value at the balance sheet date of the hedging instruments described above are disclosed in note 12 to the accounts.

p) Pre-contract costs

Pre-contract costs incurred are written off as an expense, until such time as award of the contract becomes virtually certain. These costs are amortised over the life of the contract.

Year ended 31 March 2006

2 Analysis of operating costs and exceptional items

	Group 2006 £m	Group (restated) 2005 £m	Company 2006 £m	Company (restated) 2005 £m
Analysis of total operating costs				
Raw materials and consumables	**30.6**	31.7	**30.6**	31.7
Staff costs	**188.7**	176.8	**188.7**	176.8
Depreciation and other amounts written off tangible assets	**289.1**	258.4	**289.1**	258.4
Other operating costs	**301.2**	279.2	**314.7**	291.5
Own work capitalised	**(71.3)**	(60.9)	**(71.3)**	(60.9)
Total operating costs	**738.3**	685.2	**751.8**	697.5
Staff costs comprise:				
Wages and salaries	**139.0**	136.8	**139.0**	136.8
Social security costs	**11.3**	9.7	**11.3**	9.7
Pension costs (note 17)	**38.4**	30.3	**38.4**	30.3
Total staff costs	**188.7**	176.8	**188.7**	176.8
Depreciation and other amounts written off tangible assets comprises:				
Depreciation on owned assets: non-infrastructure	**187.4**	178.6	**187.4**	178.6
Depreciation on owned assets: infrastructure	**91.2**	72.5	**91.2**	72.5
Depreciation on assets held under finance leases	**10.5**	7.3	**10.5**	7.3
	289.1	258.4	**289.1**	258.4
Other operating costs comprises:				
Power	**33.3**	31.9	**33.3**	31.9
Rates	**55.7**	49.7	**55.7**	49.7
Service charges	**27.5**	25.7	**27.5**	25.7
Other operating costs	**81.8**	91.1	**81.8**	91.1
Deferred income released	**(3.0)**	(3.2)	**(3.0)**	(3.2)
Hired and contracted services	**95.9**	75.2	**95.9**	75.2
Hire of plant and machinery	**3.4**	3.9	**3.4**	3.9
Other operating leases	**2.1**	1.1	**15.6**	13.4
Research and development expenditure	**4.5**	3.8	**4.5**	3.8
Total other operating costs	**301.2**	279.2	**314.7**	291.5

The group and company analyses of operating costs for the year ended 31 March 2005 have been restated as a result of applying FRS 17 'Retirement benefits' and for the treatment of infrastructure connection charges (note 1a).

A net exceptional credit of £1.8 million (2005: £3.0 million charge) arose in 2005/06. This comprises:

- A £0.7 million (2005: £10.6 million) exceptional charge in respect of restructuring costs in wages and salaries.
- An exceptional profit of £2.5 million (2005: £7.6 million) from the disposal of fixed assets consisted of a £2.3 million (2005: £6.1 million) profit on the sale of land and buildings and a £0.2 million (2005: £1.5 million) profit on disposal of a fixed asset investment.

During the year Deloitte & Touche LLP (2005: PricewaterhouseCoopers LLP) earned the following fees:	Group 2006 £m	Group 2005 £m	Company 2006 £m	Company 2005 £m
Audit related				
Statutory	**0.2**	0.2	**0.2**	0.2
Regulatory	**0.1**	0.1	**0.1**	0.1
	0.3	0.3	**0.3**	0.3
Other services	**0.3**	1.6	**0.3**	1.6
Total fees	**0.6**	1.9	**0.6**	1.9

Fees in respect of other services relate to a review of internal controls (2005: independent forensic investigations).

3 Information regarding Directors and employees

Directors:

a) The interests of the Directors at the year end in the ordinary share capital of the ultimate parent undertaking, Severn Trent Plc, according to the register maintained under the provisions of the United Kingdom Companies Act 1985, were as follows:

	Beneficial holdings in ordinary shares		Share options under approved schemes				
	1 April 2005	**31 March 2006**					
	Ordinary shares of 65⁵/₁₉p each	**Ordinary shares of 65⁵/₁₉p each**	1 April 2005	Exercised during the year	Cancelled during the year	Granted during the year	**31 March 2006**
J H Bailey	2,733	**9,786**	6,197	(2,140)	-	-	**4,057**
R S S Martin	3,093	**6,915**	-	-	-	1,956	**1,956**
G C Messham	7,148	**13,643**	14,544	(3,200)	-	-	**11,344**
S H Reilly	135	**101**	-	-	-	-	-
P F Stephenson	259	**132**	4,815	(3,567)	-	-	**1,248**
S K Stubbs	-	-	-	-	-	-	-

i) Messrs Matthews and Wray are Directors of Severn Trent Plc, the ultimate parent undertaking, and their interests in the share capital of that company are disclosed in the Annual Report and Accounts of that company for the year ended 31 March 2006. Share options were granted and exercised in accordance with the Severn Trent Share Option Scheme and the Severn Trent Sharesave Scheme as appropriate.

ii) The executive Directors have further interests in Severn Trent Plc ordinary shares of 65 ⁵/₁₉ p each by virtue of having received contingent awards of shares under the Severn Trent Plc Long Term Incentive Plan (the 'LTIP') on 13 August 2003, 15 December 2004 and 5 September 2005. The LTIP operates on a three year rolling basis. The Severn Trent Employee Share Ownership Trust is operated in conjunction with the LTIP. Awards do not vest until they have been held in trust for three years and specific performance criteria have been satisfied. The performance criteria for the awards are based on a combination of Severn Trent Plc's Total Shareholders Return ('TSR') and Economic Profit Targets.

The individual interests, which represent the maximum aggregate number of shares to which each individual could become entitled, are as follows:

	At 1 April 2005							**At 31 March 2006**
	Number of ordinary shares of 65⁵/₁₉p each	Awards vested during year	Market price at time of vesting (p)	Gain on vesting (£'000)	Awards lapsed during year	Awarded during year	Market price at time of award (p)	**Number of ordinary shares of 65⁵/₁₉p each**
J H Bailey	23,957	(8,286)	1,029.75	85.3	-	6,923	1,017	**22,594**
R S S Martin	18,873	(6,436)	1,029.75	66.3	-	7,410	1,017	**19,847**
G C Messham	15,929	(5,215)	1,029.75	53.7	-	6,256	1,017	**16,970**
S H Reilly	25,597	(8,764)	1,029.75	90.2	-	7,307	1,017	**24,140**
P F Stephenson	23,347	(7,968)	1,029.75	82.1	-	6,653	1,017	**22,032**

The performance period for allocation of shares in 2003 ended on 31 March 2006. Severn Trent Plc's Remuneration Committee has subsequently determined, based on that company's TSR and Economic Profit Targets over the three year performance period, that participants are not entitled to an award.

3 Information regarding Directors and employees continued

	2006 £'000	2005 £'000
b) Emoluments		
Aggregate emoluments (excluding pension contributions)	**1,384.7**	2,323.5

i) Non cash benefits included in aggregate emoluments consist mainly of the provision of cars and health care insurance.

ii) No emoluments were paid by the company to certain of the Directors in respect of their services to the company. Their emoluments are paid by other companies within the Severn Trent group.

iii) Retirement benefits are accruing to six Directors (2005: seven Directors) under a defined benefit scheme.

iv) In addition to the emoluments disclosed above a payment of £309,115, was made to a Director in 2005 for early termination of his contract. He also retained options over 7,013 shares (granted under the Severn Trent Plc Incentive Plan on 15 December 2004), 8,074 shares (granted on 13 August 2003) and 8,286 shares (granted on 24 September 2002). Additionally he also retained options over 3,567 shares granted in accordance with approved schemes.

v) Mr B Duckworth remained employed in a consultancy capacity until 31 March 2005. His total emoluments from the date of his resignation from the Board (31 August 2004) to 31 March 2005 were £189,092 and his bonus relating to this period was £77,583.

c) Highest paid Director	2006 £'000	2005 £'000
Aggregate emoluments (excluding pension contributions)	**415.3**	383.4

The highest paid Director in 2006 differs from that in 2005.
The accrued pension at 31 March 2006 for the highest paid Director was £3,749 (2005: £1,928). The pension entitlement is that which would be paid annually on retirement based on service to the end of the year. The highest paid Director did not exercise any share options during the year.

	Group and company	
Employees:	2006 Number	2005 Number
Average number of employees during the year (full time equivalent):	**5,023**	4,927

4 Net interest payable

	Group 2006 £m	Group (restated) 2005 £m	Company 2006 £m	Company (restated) 2005 £m
Interest receivable and similar income	**0.4**	0.4	**0.2**	0.3
Net finance income on defined benefit pension scheme	**4.6**	0.8	**4.6**	0.8
Interest payable and similar charges:				
Bank loans and overdrafts	**(27.8)**	(30.4)	**(27.8)**	(30.4)
Other loans	**(83.9)**	(80.6)	**(12.3)**	(12.0)
Finance leases	**(22.7)**	(20.2)	**(13.3)**	(10.4)
To subsidiary undertaking	-	-	**(67.6)**	(64.6)
	(129.4)	(130.0)	**(116.2)**	(116.3)

Year ended 31 March 2006

5 Taxation on profit on ordinary activities

	Group 2006 £m	Group (restated) 2005 £m	Company 2006 £m	Company (restated) 2005 £m
a) Analysis of charge in the year				
Current tax				
UK corporation tax at 30% (2005: 30%)				
Current year	**62.8**	18.1	**62.8**	18.1
Adjustment in respect of prior year	**3.1**	(21.7)	**3.1**	(21.7)
Group relief payable at 30% (2005: 30%)				
Current year	**6.0**	15.4	**7.2**	16.7
Adjustment in respect of prior year	**(14.1)**	(22.2)	**(15.5)**	(22.1)
Total current tax	**57.8**	(10.4)	**57.6**	(9.0)
Deferred tax				
Origination and reversal of timing differences				
Current year	**18.3**	37.3	**18.3**	37.3
Adjustment in respect of prior year	**8.4**	12.6	**7.3**	12.6
Decrease/(increase) in discount	**20.8**	(0.8)	**20.8**	(0.8)
Total deferred tax charge	**47.5**	49.1	**46.4**	49.1
Less deferred tax included in statement of recognised gains and losses (FRS17 pension)	**(7.8)**	(10.6)	**(7.8)**	(10.6)
Deferred tax charge included in profit and loss account	**39.7**	38.5	**38.6**	38.5
Total tax charge	**97.5**	28.1	**96.2**	29.5

b) Factors affecting the tax charge in the year

The current tax assessed for the year is lower than the standard rate of corporation tax in the United Kingdom (30%). The differences are explained below:	Group 2006 £m	Group (restated) 2005 £m	Company 2006 £m	Company (restated) 2005 £m
Profit on ordinary activities before tax	**276.0**	194.5	**275.7**	195.9
Profit on ordinary activities multiplied by the standard rate of corporation tax of 30% (2005: 30%)	**82.8**	58.4	**82.7**	58.8
Effects of:				
Items not taxable and not deductible for tax purposes	**(6.1)**	(1.4)	**(4.8)**	(0.5)
Capital allowances for period in excess of depreciation	**0.7**	(29.1)	**0.7**	(29.1)
Utilisation of/movement in short-term timing difference	**(8.6)**	5.6	**(8.6)**	5.6
Adjustment to tax charge in respect of prior periods	**(11.0)**	(43.9)	**(12.4)**	(43.8)
	57.8	(10.4)	**57.6**	(9.0)

Of the current year charge, £0.2 million (2005: £0.1million) relates to tax charges arising on exceptional items.

c) Factors affecting future tax rates

The group's current tax charge of £68.8 million (2005: £33.6 million) before adjustments to the tax charge in respect of prior periods represents 25% (2005: 17%) of the group's profit before tax.

The company's current tax charge of £70.0 million (2005: £34.8 million) before adjustments to the tax charge in respect of prior periods represents 25% (2005: 18%) of the company's profit before tax.

The group and company's current tax charge will be affected in future years by the requirements of AMP4 which will impact both depreciation and the *timing of tax relief for capital allowances.*

The group and company's deferred tax charge in future years is difficult to predict as it is impacted by changes to interest rates from one balance sheet date to the next.

6 Dividends

	Group 2006 £m	Group 2005 £m	Company 2006 £m	Company 2005 £m
Dividend paid	**154.7**	147.1	**154.7**	147.1

The company's dividend policy is to declare dividends which are consistent with the company's regulatory obligations and at a level which is decided each year after consideration of a number of factors, including regulatory uncertainty, market expectations, actual and potential efficiencies, future cash flow requirements and balance sheet considerations.

The amount declared is expected to vary each year as the impact of these factors changes. Consistent with this policy, the dividend declared and paid *by the company in 2005/06 amounted to £154.7 million, being 15.47 pence per share (2005: 14.71 pence per share).*

7 Tangible fixed assets

	Group				Company			
	Land and buildings £m	Infrastructure assets £m	Plant and equipment £m	Total £m	Land and buildings £m	Infrastructure assets £m	Plant and equipment £m	Total £m
Cost								
At 1 April 2005	1,892.7	3,341.3	2,504.4	7,738.4	1,892.7	3,339.0	2,504.5	7,736.2
Additions	79.4	182.0	177.7	439.1	79.4	182.0	177.7	439.1
Transfers from fellow subsidiary undertakings	-	-	0.9	0.9	-	-	0.9	0.9
Grants and contributions	-	(39.4)	-	(39.4)	-	(39.4)	-	(39.4)
Assets sold or written off	(4.9)	(1.4)	(52.3)	(58.6)	(4.9)	(1.4)	(52.3)	(58.6)
At 31 March 2006	**1,967.2**	**3,482.5**	**2,630.7**	**8,080.4**	**1,967.2**	**3,480.2**	**2,630.8**	**8,078.2**
Depreciation								
At 1 April 2005	566.0	996.8	1,136.3	2,699.1	566.0	996.6	1,136.3	2,698.9
Prior year adjustment (see note 1a)	-	63.8	-	63.8	-	63.8	-	63.8
At 1 April 2005 (as restated)	566.0	1,060.6	1,136.3	2,762.9	566.0	1,060.4	1,136.3	2,762.7
Charge for year	39.6	91.2	158.3	289.1	39.6	91.2	158.3	289.1
Assets sold or written off	(4.9)	(1.4)	(48.6)	(54.9)	(4.9)	(1.4)	(48.6)	(54.9)
At 31 March 2006	**600.7**	**1,150.4**	**1,246.0**	**2,997.1**	**600.7**	**1,150.2**	**1,246.0**	**2,996.9**
Net book value								
At 31 March 2006	***1,366.5***	***2,332.1***	***1,384.7***	***5,083.3***	***1,366.5***	***2,330.0***	***1,384.8***	***5,081.3***
At 31 March 2005 (as restated)	1,326.7	2,280.7	1,368.1	4,975.5	1,326.7	2,278.6	1,368.2	4,973.5

	Group		Company	
	2006 £m	2005 £m	**2006 £m**	2005 £m
i) Included in tangible fixed assets are assets held under finance leases as follows:				
Cost	**425.0**	275.8	**422.6**	273.4
Accumulated depreciation	**(84.7)**	(79.0)	**(84.4)**	(78.7)
Net book value	**340.3**	196.8	**338.2**	194.7

ii) Grants and contributions received relating to infrastructure assets have been deducted from the cost of fixed assets in order to show a true and fair view as set out in note 1f.

iii) The net book value of land and buildings is analysed as follows:

Freehold	**1,366.2**	1,326.4	**1,366.2**	1,326.4
Short leasehold	**0.3**	0.3	**0.3**	0.3
	1,366.5	1,326.7	**1,366.5**	1,326.7

iv) Depreciation incurred during the year has been charged as follows:

Owned assets non infrastructure	**187.4**	178.6	**187.4**	178.6
Owned assets infrastructure	**91.2**	72.5	**91.2**	72.5
Assets held under finance leases	**10.5**	7.3	**10.5**	7.3
	289.1	258.4	**289.1**	258.4

The group and company charges for owned asset depreciation for the year ended 31 March 2005 of £258.4 million have been restated as a result of the change in treatment of infrastructure connection charges (note 1a). In 2004/05 this amount was reported as £244.0 million.

v) Included in the above are the following tangible fixed assets not subject to depreciation:

Land	**24.9**	27.0	**24.9**	27.0
Assets in the course of construction	**209.2**	230.7	**209.2**	230.7
	234.1	257.7	**234.1**	257.7

8 Investments

	Other investments £m	Group Total £m
Cost and net book value at 1 April 2005	0.2	0.2
Disposals	(0.1)	(0.1)
Cost and net book value at 31 March 2006	**0.1**	**0.1**

	Shares in subsidiary undertakings £m	*Loans in* subsidiary undertakings £m	Other investments £m	Company Total £m
Cost and net book value at 1 April 2005	1.2	65.5	0.2	66.9
Additions	170.0	-	-	170.0
Disposals	-	-	(0.1)	(0.1)
Cost and net book value at 31 March 2006	**171.2**	**65.5**	**0.1**	**236.8**

The additions of £170.0 million represents an additional investment in East Worcester Water Plc.

	Country of registration *and operation*	Percentage and class of share *capital held*	*Nature of business*
Subsidiary undertakings (all directly held)			
Biogas Generation Limited	England	100% ordinary	Power generation
East Worcester Water Plc	England	100% ordinary 100% non voting ordinary	Water undertaking
Grafham Carbons Limited	England	100% ordinary	Carbon regeneration
Severn Trent Power Generation Limited	England	100% ordinary	Power generation
Severn Trent Water Reservoirs Limited	England	100% ordinary	Finance company
Severn Trent Water Utilities Finance Plc	England	100% ordinary	Finance company

In the opinion of the Directors the value of the group and company's investments is not less than the amount at which they are stated in the balance sheet.

9a Debtors: amounts falling due within one year

	Group 2006 £m	Group (restated) 2005 £m	Company 2006 £m	Company (restated) 2005 £m
Trade debtors	**99.0**	79.7	**99.0**	79.7
Amounts owed by parent and fellow subsidiary undertakings	**4.3**	3.7	**3.2**	9.3
Other debtors	**0.2**	8.9	**0.2**	8.9
Prepayments and accrued income	**101.2**	105.8	**97.6**	100.2
	204.7	198.1	**200.0**	198.1

9b Debtors: amounts falling due after more than one year

	Group 2006 £m	Group 2005 £m	Company 2006 £m	Company 2005 £m
Amounts owed by parent and fellow subsidiary undertakings	-	-	**22.8**	18.8
Prepayments and accrued income	**3.4**	5.5	**3.4**	5.5
	3.4	5.5	**26.2**	24.3
Total debtors	**208.1**	203.6	**226.2**	222.4

10 Creditors: amounts falling due within one year

	Group 2006 £m	Group 2005 £m	Company 2006 £m	Company 2005 £m
Bank overdrafts	**390.3**	160.2	**396.9**	163.3
Bank loans	**50.0**	79.3	**50.0**	79.3
Amounts owed to subsidiary undertakings	**-**	-	**6.7**	15.0
Other loans	**6.7**	15.0	**-**	-
Obligations under finance leases	**35.7**	14.9	**35.7**	12.0
Borrowings (note 12)	**482.7**	*269.4*	**489.3**	*269.6*
Trade creditors	**21.7**	26.7	**21.7**	26.7
Amounts owed to parent and fellow subsidiary undertakings	**7.0**	61.3	**7.0**	64.1
Amounts owed to subsidiary undertakings	**-**	-	**41.0**	39.6
Other creditors	**26.3**	7.4	**26.3**	7.4
Taxation and social security	**3.7**	3.4	**3.7**	3.4
Corporation tax payable	**54.4**	20.8	**54.4**	20.8
Accruals and deferred income	**262.0**	253.7	**232.1**	224.6
	857.8	642.7	**875.5**	656.2

11 Creditors: amounts falling due after more than one year

	Group 2006 £m	Group 2005 £m	Company 2006 £m	Company 2005 £m
Bank loans	**306.3**	352.7	**306.3**	352.7
Amounts owed to subsidiary undertakings	**-**	-	**1,291.8**	1,332.2
Other loans	**1,291.8**	1,332.2	**-**	-
Obligations under finance leases	**406.1**	434.8	**406.1**	269.6
Borrowings (note 12)	**2,004.2**	2,119.7	**2,004.2**	1,954.5
Deferred income	**41.6**	44.0	**41.6**	44.0
Other creditors	**3.3**	5.3	**3.3**	5.3
	2,049.1	2,169.0	**2,049.1**	2,003.8

12 Financial instruments

The groups policy in respect of interest rate risk management and the related use of financial instruments are set out in the Accounting policy note 1o) on page 20. Short-term debtors and creditors have been excluded from disclosures.

	Overdrafts £m	Loans repayable by installments *any of which* are payable after five years £m	Loans with *other* repayment terms £m	Finance leases £m	Group 2006 £m	Group 2005 £m
a) Borrowings analysed by maturity date						
Financial liabilities due within one year (note 10)	**390.3**	**-**	**56.7**	**35.7**	**482.7**	269.4
Between one and two years	**-**	**-**	**102.2**	**32.7**	**134.9**	60.3
Between two and five years	**-**	**-**	**210.7**	**133.1**	**343.8**	415.1
After more than five years	**-**	**-**	**1,285.2**	**240.3**	**1,525.5**	1,644.3
Total financial liabilities after one year	**-**	**-**	**1,598.1**	**406.1**	**2,004.2**	2,119.7
	390.3	**-**	**1,654.8**	**441.8**	**2,486.9**	2,389.1

Loans repayable partly or wholly after five years comprise:

	Rate of interest %	2006 £m	2005 £m
European Investment Bank loans – 2013	3.1	**131.3**	127.7
European medium term loan notes – 2011-2028	4.1-5.3	**445.2**	409.2
Sterling bonds – 2024-2029	6.125-6.25	**708.7**	711.9
		1,285.2	1,248.8

12 Financial instruments continued

	Overdrafts £m	Loans repayable by installments any of which are payable after five years £m	Loans with other repayment terms £m	Finance leases £m	Company 2006 £m	Company 2005 £m
Financial liabilities due within one year (note 10)	396.9	-	56.7	35.7	489.3	269.6
Between one and two years	-	-	102.2	32.7	134.9	57.0
Between two and five years	-	-	210.7	133.1	343.8	398.6
After more than five years	-	-	1,285.2	240.3	1,525.5	1,498.9
Total financial liabilities after one year	-	-	1,598.1	406.1	2,004.2	1,954.5
	396.9	-	1,654.8	441.8	2,493.5	2,224.1

Loans repayable partly or wholly after five years comprise:

	Rate of interest %	2006 £m	2005 £m
European Investment Bank loans – 2013	3.1	131.3	127.7
Amounts owed to subsidiary undertakings – 2011-2029	4.1-6.25	1,153.9	1,121.1
		1,285.2	1,248.8

	Group 2006 £m	Group 2005 £m	Company 2006 £m	Company 2005 £m
b) Investment in interest earning assets				
Sterling deposits	2.1	2.3	2.1	2.3

The above sterling deposits are held on short-term deposit with a maturity date of less than one year as security for self insurance obligations.

Sterling deposits receive interest based on LIBID.

12 Financial instruments continued

c) Borrowings analysed by interest rate after taking into account of various interest rate swaps entered into by the group and company

	Group					Company				
			Fixed borrowings					Fixed borrowings		
	Total £m	Floating interest rate £m	Fixed interest rate £m	Weighted average interest rate %	Weighted average period for which interest is fixed Years	Total £m	Floating interest rate £m	Fixed interest rate £m	Weighted average interest rate %	Weighted average period for which interest is fixed Years
Total borrowings as at 31 March 2006	**2,486.9**	**695.2**	**1,791.7**	**5.64**	**16.78**	**2,493.5**	**701.8**	**1,791.7**	**5.64**	**16.78**
Total borrowings as at 31 March 2005	2,389.1	806.0	1,583.1	5.90	18.80	2,224.1	641.0	1,583.1	5.90	18.80

In addition to the fixed debt above, the group has entered into a number of forward start accruing interest rate swaps. These had an initial notional value of £17.0 million and commence accreting notional value between 31 March 2005 and 2032. The maximum notional value of these swaps is £135 million. These swaps are floating to fixed and bear fixed interest at between 5.26% and 5.52%.

The group has also entered into £318 million of forward start interest rate swaps (floating to fixed) that commence between May 2006 and May 2009. These swaps all terminate in 2010 and 2011. These interest rate swaps bear interest between 4.53% and 4.87%.

Floating rate borrowings bear interest based on LIBOR.

d) Fair value of financial instruments

The group and company uses financial derivatives solely for the purposes of managing the interest rate and currency risks associated with financing business activities. The group's policy for the management of interest rate risk is to have a balanced portfolio of debt with a mix of term and interest rate structures that diversifies its risk and is appropriate to the long life of its asset base. The details are periodically reviewed to respond to changing market conditions and to have regard to regulatory pronouncements. At 31 March 2006 interest rates on 72.0% of the group's borrowings were fixed for periods up to 28 years.

The group and company's business does not involve significant exposure to foreign exchange transactions. Cross currency swaps are employed to exchange foreign currency borrowings for Sterling.

	Group				Company			
	2006		2005		**2006**		2005	
Financial instruments by category: Asset / (liability)	**Book value £m**	**Fair value £m**	Book value £m	Fair value £m	**Book value £m**	**Fair value £m**	Book value £m	Fair value £m
Primary financial instruments held or issued to finance business activities								
Short-term deposits	**2.1**	**2.1**	2.3	2.3	**2.1**	**2.1**	2.3	2.3
Cash at bank and in hand	**-**	**-**	0.1	0.1	**-**	**-**	0.1	0.1
Borrowings falling due within one year	**(481.5)**	**(482.3)**	(269.4)	(271.0)	**(488.1)**	**(488.9)**	(269.6)	(271.2)
Borrowings falling due after more than one year	**(1,998.7)**	**(2,148.2)**	(2,110.6)	(2,250.3)	**(1,998.7)**	**(2,148.2)**	(1,945.4)	(2,085.1)
Derivative financial instruments held to manage the currency and interest rate profile								
Interest rate swaps and similar instruments	**-**	**(65.4)**	-	(32.8)	**-**	**(65.4)**	-	(32.8)
Currency instruments - cross currency swaps	**(6.7)**	**(14.2)**	(9.1)	(11.3)	**(6.7)**	**(14.2)**	(9.1)	(11.3)
Total net debt	**(2,484.8)**	**(2,708.0)**	(2,386.7)	(2,563.0)	**(2,491.4)**	**(2,714.6)**	(2,221.7)	(2,398.0)
Other long-term assets								
Other fixed asset investments	**0.1**	**0.1**	0.2	0.2	**0.1**	**0.1**	0.2	0.2

Where available, market rates have been used to determine fair values. When market prices are not available, fair values have been calculated by discounting cash flows at prevailing interest rates.

e) Borrowings facilities

The group and company had the following undrawn committed facilities available at 31 March 2006:

	Group and company	
	2006 £m	2005 £m
Expiring within one year	**-**	-
Expiring in more than one year but not more than two years	**-**	200.0
Expiring after two years but less than five years	**500.0**	500.0
	500.0	700.0

12 Financial instruments continued

f) Unrecognised gains and losses on hedges at 31 March 2006

Gains or losses on derivative instruments are not recognised until the exposure that is being hedged is itself recognised. Unrecognised gains or losses on hedges at the balance sheet date are summarised in the table below. These gains or losses represent the expected future benefit of interest rate hedges to the group and company at 31 March 2006 given prevailing economic conditions.

			Group and company
	Gains £m	Losses £m	Total net *gains/* (losses) £m
Unrecognised gains and losses on hedges 1 April 2005	1.6	(36.6)	(35.0)
Arising in previous years that were recognised in the year	-	-	-
Arising before 1 April 2005 that were not recognised in the financial year	1.6	(36.6)	(35.0)
Unrecognised gains and losses arising during the financial year	5.9	(43.7)	(37.8)
Unrecognised gains and losses at 31 March 2006	**7.5**	**(80.3)**	**(72.8)**
Expected to be recognised			
In one year or less	**0.6**	**-**	**0.6**
In later years	**6.9**	**(80.3)**	**(73.4)**

13 Provisions

	Balance at 1 April 2005 as previously reported £m	Prior year adjustment (note 1a) £m	Balance at 1 April 2005 (restated) £m	Charged to profit and loss account £m	Utilised £m	*Group* **Balance at 31 March 2006 £m**
Provisions for liabilities and charges comprise:						
Deferred tax	516.2	-	516.2	27.7	-	**543.9**
Restructuring	11.5	(2.4)	9.1	0.7	(4.7)	**5.1**
Insurance	2.4	-	2.4	(0.6)	(0.3)	**1.5**
	530.1	(2.4)	527.7	27.8	(5.0)	**550.5**

	Balance at 1 April 2005 as previously reported £m	Prior year adjustment (note 1a) £m	Balance at 1 April 2005 (restated) £m	Charged to profit and loss account £m	Utilised £m	Company **Balance at 31 March 2006 £m**
Deferred tax	517.3	-	517.3	26.6	-	**543.9**
Restructuring	11.5	(2.4)	9.1	0.7	(4.7)	**5.1**
Insurance	2.4	-	2.4	(0.6)	(0.3)	**1.5**
	531.2	(2.4)	528.8	26.7	(5.0)	**550.5**

The prior year adjustment noted above restates the restructuring provision for the effect of the adoption of FRS17 'Retirement benefits' (note 1a).

13 Provisions continued

	Group 2006 £m	Group (restated) 2005 £m	Company 2006 £m	Company (restated) 2005 £m
Deferred tax				
The full deferred tax liability, calculated at a tax rate of 30% (2005: 30%), is:				
Capital allowances	**931.8**	922.5	**931.8**	922.5
Other timing differences	**(12.1)**	(9.7)	**(12.1)**	(8.6)
Pension liability FRS17	**(46.0)**	(65.8)	**(46.0)**	(65.8)
Undiscounted provision for deferred tax	**873.7**	847.0	**873.7**	848.1
Discount	**(375.8)**	(396.6)	**(375.8)**	(396.6)
Total discounted provision for deferred tax	**497.9**	450.4	**497.9**	451.5
Adjustment for deferred tax asset relating to pension liability FRS17 (included in note 17 pensions)	**46.0**	65.8	**46.0**	65.8
Deferred tax as disclosed in provisions	**543.9**	516.2	**543.9**	517.3

	Group 2006 £m	Group (restated) 2005 £m	Company 2006 £m	Company (restated) 2005 £m
Provision at start of year	**516.2**	480.9	**517.3**	482.0
Deferred tax charge included in the profit and loss account	**39.7**	38.5	**38.6**	38.5
Deferred tax charge included in the statement of recognised gains and losses	**7.8**	10.6	**7.8**	10.6
Adjustment for deferred tax relating to pension liability FRS17 (included in note 17 pensions)				
Included in profit and loss account charge	**(12.0)**	(3.2)	**(12.0)**	(3.2)
Included in statement of recognised gains and losses charge	**(7.8)**	(10.6)	**(7.8)**	(10.6)
Provision at end of year	**543.9**	516.2	**543.9**	517.3

Other provisions

The restructuring provision reflects costs to be incurred in respect of committed programmes. All of the associated outflows are estimated to occur within one year (2005: two years) of the balance sheet date.

Provision is made for insurance claims notified and for claims incurred but which have not yet been notified. The associated outflows are expected to arise over a period of up to two years (2005: three years) from the balance sheet date.

14 Share capital

	Group 2006 £m	Group 2005 £m	Company 2006 £m	Company 2005 £m
Authorised				
1,000,000,000 ordinary shares of £1 each (2005: 1,000,000,000)	**1,000.0**	1,000.0	**1,000.0**	1,000.0
Issued and fully paid				
1,000,000,000 ordinary shares of £1 each (2005: 1,000,000,000)	**1,000.0**	1,000.0	**1,000.0**	1,000.0

15 Profit and loss account

	Group £m	Company £m
At 1 April 2005 as previously reported	908.1	1,142.2
Prior year adjustment (note 1a):		
FRS17 retirement benefits	(151.2)	(151.2)
Infrastructure connection charges	(63.8)	(63.8)
At 1 April 2005 as restated	693.1	927.2
Profit for the financial year	23.8	24.8
FRS17 actuarial gain	26.0	26.0
Deferred tax on actuarial gain	(7.8)	(7.8)
At 31 March 2006	**735.1**	**970.2**

At 31 March 2006 cumulative goodwill written off against group reserves amounted to £29.2 million (2005: £29.2 million).

16 Commitments and contingent liabilities

	Group and company 2006 £m	2005 £m
a) Investment expenditure commitments		
Contracted for but not provided in the financial statements	141.9	163.7

In addition to these commitments, the group and company has longer term expenditure plans which include investments to achieve improvements in performance mandated by the Director General of Water Services and to provide for growth in demand for water and sewerage services.

b) Operating lease commitments

The group is committed to making the following payments during the next year in respect of operating leases which expire as follows:	2006 Land and buildings £m	2006 Other £m	2005 Land and buildings £m	2005 Other £m
Within one year	0.2	0.2	-	0.2
Between one and five years	0.1	0.7	0.1	0.7
After five years	0.9	0.1	0.3	-
	1.2	1.0	0.4	0.9

The company is committed to making the following payments during the next year in respect of operating leases which expire as follows:	2006 Land and buildings £m	2006 Other £m	2005 Land and buildings £m	2005 Other £m
Within one year	0.2	0.2	-	0.2
Between one and five years	0.1	0.7	0.1	0.7
After five years	0.9	14.0	0.3	13.8
	1.2	14.9	0.4	14.7

c) Banking

The banking arrangements for both the group and company operate on a pooled basis with certain other group undertakings. Under these arrangements participating companies guarantee each others' overdrawn balances to the extent of their credit balances. Credit balances can be offset against overdrawn balances of participating companies. The contingent liability as at 31 March 2006 is nil (2005: nil).

d) Regulatory matters

In May 2004 an employee of Severn Trent Water raised a number of allegations relating, in particular, to alleged accounting inaccuracies and regulatory returns.

On 31 October 2005, as a result of a referral by Ofwat, the Serious Fraud Office (SFO) informed the Company that it was undertaking a criminal investigation into alleged reporting irregularities made to Ofwat by Severn Trent Water Limited between 2000 and 2003. Ofwat had been conducting its own investigation following the allegations made by the employee of Severn Trent Water. The matter reported to the SFO concerned data on leakage.

On 7 March 2006 Ofwat published its interim report concerning the allegations of false reporting made against Severn Trent Water in 2004.

The Company's internal investigation and Ofwat's investigation were thorough and lengthy, requiring complex judgements. Severn Trent's judgements have not been identical to Ofwat's in every aspect, but in the interests of making amends as soon as possible, the board believed it was sensible to proceed by agreement.

Having considered Ofwat's findings, the board of Severn Trent Water Limited agreed that customer accounts should be credited as soon as possible. In 2006/07, on average, this credit will be around £4 per customer in addition to the £2 to £3 already rebated. In the following three years the rebate will be £2 to £3 per customer. A charge of £10.6 million has been included in these financial statements in respect of amounts relating to 2005/06 and prior.

The Company also acknowledged that Ofwat may expect further amends to be made to customers. Ofwat has stated that this penalty will be discussed with Severn Trent Water on completion of the SFO investigation into leakage.

On 7 April 2006 the Company announced that as a result of an ongoing comprehensive review by its managing director, Tony Wray, and his new management team, the Company believed there was prima facie evidence of customer relations data being misstated by Severn Trent Water in submissions to Ofwat. The data concerned the handling of customer billing queries and telephone contacts over several years. An interim report on these matters was issued to Ofwat on 7 April 2006 and further information was delivered on 10 July 2006.

On 8 June 2006 Ofwat announced that it proposed to levy a financial penalty, yet to be determined, on the company for customer service failures.

Ofwat is carrying out an independent verification of the internal Severn Trent investigation and reports relating to customer relations data submitted to it using forensic accountants who will report to both Severn Trent Water and Ofwat on their conclusions.

No reliable estimate can currently be made of the amounts that might become payable as a result of the SFO enquiry, Ofwat's final conclusion in respect of the allegations of false reporting or its review of customer relations data. Consequently, except as noted above, no provision has been included in these financial statements in respect of these matters.

17 Pensions

Defined benefit schemes

In November 2000, the Accounting Standards Board issued FRS 17 'Retirement Benefits', which replaced SSAP 24. During the year, the Severn Trent Water group has adopted the full provisions of FRS17. This has led to a restatement of the prior year results. Further details are given in note 1a.

The group and company participate in the Severn Trent Pension Scheme (STPS) and the Severn Trent Mirror Image Scheme (STMIS) and the Severn Trent Senior Staff Pension Scheme (STSSPS) (together 'the Schemes'), all of which are defined benefit schemes and are fully funded to cover future salary and pension increases. The assets of the schemes are held in a separate fund administered by trustees. In addition, benefits were also provided by the group and company on an unfunded and unapproved basis to senior staff recruited since June 1989, whose benefits would otherwise be restricted by the Finance Act 1989 earning cap.

As from 1 April 2004, the Severn Trent Pension Scheme was amended with new defined benefit and defined contribution sections introduced.

The UK defined benefit schemes and the date of their last formal actuarial valuation are as follows:

UK defined benefit scheme	Date of last formal actuarial valuation
Severn Trent Pension Scheme *	31 March 2004
Severn Trent Senior Staff Pension Scheme	31 March 2004
Severn Trent Mirror Image Pension Scheme	31 March 2003

* The STPS is by far the largest of the group's UK defined benefit schemes.

The unfunded supplemental scheme is valued each year using the assumptions used in the most recent actuarial valuation of the Seven Trent Senior Staff Pension Scheme.

Following the valuation of the STPS scheme, the Employer's contribution rates have been increased to 33.24%, 27.70% or 16.62% of pensionable pay. STPS members contributions continue at a rate of 6%, 5% or 3% of pensionable pay.

The STMIS and STSSPS schemes are closed to new entrants and hence the current service cost for these schemes is expected to increase as members in the scheme approach retirement.

The actuarial liabilities and the market values of the assets at 31 March 2006 of the group's defined benefit schemes, details of which are provided above, have been assessed by the group's actuaries in accordance with the requirements of FRS 17.

In 2004/05 and 2005/06 the group and company contributed to these defined benefit schemes, STPS, STMIS and STSSPS. All schemes were accounted for as multi-employer schemes as defined by FRS 17 prior to 2004/05 as neither the group nor company was able to identify its share of the underlying assets and liabilities.

Following work performed during 2004/05 it has been possible to identify the group and company's share of the underlying assets and liabilities, accordingly the necessary disclosures under FRS17 for the group and company, which are one and the same, are detailed below.

The weighted average of the major assumptions used by the actuary to calculate scheme liabilities under FRS 17 are:	31 March 2006	31 March 2005
Valuation method	Projected Unit	Projected Unit
Price inflation	2.70%	2.75%
Salary increases	4.20%	4.25%
Pension increases	2.70%	2.75%
Discount rate	4.90%	5.50%

The fair value of assets, the present value of liabilities in the schemes and the expected rates of return were:

At 31 March 2006	Long-term rate of return expected at 31 March 2006	STPS £m	Others £m	**Total fair value at 31 March 2006 £m**
Equities	8.00%	662.5	48.1	**710.6**
Gilts	4.17%	154.1	42.1	**196.2**
Corporate bonds	4.90%	47.6	12.2	**59.8**
Property	6.20%	58.4	4.4	**62.8**
Cash	3.70%	68.6	3.4	**72.0**
Total market value of assets		991.2	110.2	**1,101.4**
Present value of scheme liabilities		(1,137.8)	(116.8)	**(1,254.6)**
Net deficit in schemes before deferred tax		(146.6)	(6.6)	**(153.2)**

	Total recoverable deficit £m	Deferred tax asset £m	**Net group total after deferred tax £m**
Total schemes at 31 March 2006	*(153.2)*	*46.0*	***(107.2)***

17 Pensions continued

	Long-term rate of return expected at 31 March 2005	STPS £m	Others £m	Total fair value at 31 March 2005 £m
Equities	8.25%	511.4	48.0	559.4
Gilts	4.66%	104.0	38.6	142.6
Corporate bonds	5.50%	39.1	3.6	42.7
Property	6.46%	44.1	4.1	48.2
Cash	3.75%	20.9	2.2	23.1
Total market value of assets		719.5	96.5	816.0
Present value of scheme liabilities		(928.1)	(107.3)	(1,035.4)
Net deficit in schemes before deferred tax		(208.6)	(10.8)	(219.4)

	Total recoverable deficit £m	Deferred tax asset £m	Net group total after deferred tax £m
Total schemes at 31 March 2005	(219.4)	65.8	(153.6)

The amounts recognised in the profit and loss account and statement of total recognised gains and losses in respect of the pension schemes in the year to 31 March 2006 under FRS 17 are as follows:

Analysis of amounts that are charged to operating profit for the year ended 31 March 2006:

	STPS £m	Others £m	**Total £m**
Current service cost	24.2	1.0	**25.2**
Loss on settlements and curtailment	-	0.8	**0.8**
Membership movements	12.1	(0.3)	**11.8**
Net return	36.3	1.5	**37.8**

The loss on settlement and curtailment relates to charges in respect of the restructuring of Severn Trent Water Limited.

The loss on membership movements reflects the transfer of employees from Charles Haswell and Partners Limited and Severn Trent Systems Limited into the Severn Trent Water group.

Analysis of amounts that are included as other finance income for the year ended 31 March 2006:

	STPS £m	Others £m	**Total £m**
Expected return on scheme assets	56.2	6.2	**62.4**
Interest on scheme liabilities	(52.1)	(5.7)	**(57.8)**
Net return	4.1	0.5	**4.6**

Analysis of amounts that have been charged to operating profit for the year ended 31 March 2005:

	STPS £m	Others £m	Total £m
Loss on settlement and curtailment	(2.8)	(1.2)	(4.0)
Current service cost	(24.0)	(1.4)	(25.4)
Total operating charge	(26.8)	(2.6)	(29.4)

The loss on settlement and curtailment relates to charges in respect of the restructuring of Severn Trent Water Limited.

Analysis of amounts that have been included as other finance income for the year ended 31 March 2005:

	STPS £m	Others £m	Total £m
Expected return on scheme assets	48.0	5.9	53.9
Interest on scheme liabilities	(47.6)	(5.5)	(53.1)
Net return	0.4	0.4	0.8

17 Pensions continued

History of experience gains and losses and analysis of amounts that would have been recognised in the statement of total recognised gains and losses for the year ended 31 March 2006:

	STPS	Others	Total
Actual return less expected return on scheme assets			
Amount (£m)	127.7	9.8	**137.5**
Percentage of scheme assets	12.9%	8.9%	**12.5%**
Experience gains and losses arising on the scheme liabilities			
Amount (£m)	(1.9)	0.4	**(1.5)**
Percentage of scheme liabilities	(0.2%)	0.3%	**0.1%**
Changes in assumptions underlying the present value of scheme liabilities			
Amount (£m)	(101.3)	(8.7)	**(110.0)**
Actuarial gain recognised in the statement of total recognised gains and losses			
Amount (£m)	24.5	1.5	**26.0**
Percentage of scheme liabilities	2.2%	1.3%	**2.1%**

History of experience gains and losses and analysis of amounts that would have been recognised in the statement of total recognised gains and losses for the year ended 31 March 2005:

	STPS	Others	Total
Actual return less expected return on scheme assets			
Amount (£m)	27.9	1.6	29.5
Percentage of scheme assets	3.9%	1.7%	3.6%
Experience gains and losses arising on the scheme liabilities			
Amount (£m)	5.4	0.4	5.8
Percentage of scheme liabilities	0.6%	0.4%	0.6%
Changes in assumptions underlying the present value of scheme liabilities			
Amount (£m)	-	-	-
Actuarial gain recognised in the statement of total recognised gains and losses			
Amount (£m)	33.3	2.0	35.3
Percentage of scheme liabilities	3.6%	1.9%	3.4%

The following table reconciles the movements in pension scheme deficits for the year ended 31 March 2006:

	STPS £m	Others £m	**Total £m**
Deficit in the scheme at the beginning of the year	(208.6)	(10.8)	**(219.4)**
Contributions	69.7	3.7	**73.4**
Current service cost	(24.2)	(1.0)	**(25.2)**
Loss on settlement and curtailment	-	(0.8)	**(0.8)**
Loss on membership movements	(12.1)	0.3	**(11.8)**
Other financial income	4.1	0.5	**4.6**
Actuarial gain	24.5	1.5	**26.0**
Deficit in the scheme at end of year	(146.6)	(6.6)	**(153.2)**

The following table reconciles the movements in pension scheme deficits for the year ended 31 March 2005:

	STPS £m	Others £m	Total £m
Deficit in the scheme at the beginning of the year	(250.7)	(14.7)	(265.4)
Contributions	35.2	4.1	39.3
Current service cost	(24.0)	(1.4)	(25.4)
Loss on settlement and curtailment	(2.8)	(1.2)	(4.0)
Other financial income	0.4	0.4	0.8
Actuarial gain	33.3	2.0	35.3
Deficit in the scheme at end of year	(208.6)	(10.8)	(219.4)

17 Pensions continued

Defined contribution schemes

The group also operates defined contribution arrangements for certain of its UK employees. In September 2001, the Severn Trent Group Pension Scheme (an occupational defined contribution scheme) was established to ensure compliance with stakeholder legislation and to provide the group with an alternative pension arrangement. This was closed to new entrants on 1 April 2005 and replaced by the Severn Trent Stakeholder Pension Scheme.

The total cost charged to operating costs of £0.6 million (2005: £0.9 million) represents contributions payable to these schemes by the group at rates specified in the rules of the schemes. As at 31 March 2006 nil (2005: nil) due in respect of the current reporting period had not been paid over to the schemes.

18 Group cash flow statement

	2006 £m	(restated) 2005 £m
a) Reconciliation of operating profit to net cash inflow from operating activities		
Operating profit	**402.9**	316.9
Depreciation charge (note 7iv)	**289.1**	258.4
Deferred income received	**0.5**	1.9
Deferred income credited to profit and loss account	**(3.0)**	(3.2)
Movement in provision for liabilities and charges	**0.1**	13.0
Utilisation of provisions for liabilities and charges	**(5.0)**	(1.8)
Movement in pension scheme	**(35.6)**	(9.9)
Increase in stocks	**(1.7)**	(0.3)
Increase in debtors	**(19.3)**	(20.7)
Increase in creditors	**16.0**	20.8
Net cash inflow from operating activities	**644.0**	575.1

b) Analysis of changes in net debt	At 1 April 2005 £m	Cash flow £m	Other non cash changes £m	At 31 March 2006 £m
Cash at bank and in hand	0.1	(0.1)	-	-
Overdrafts (note 10)	(160.2)	(230.1)	-	**(390.3)**
	(160.1)	(230.2)	-	**(390.3)**
Debt due within one year (note 10)	(94.3)	37.6	-	**(56.7)**
Debt due after one year (note 11)	(1,684.9)	89.8	(3.0)	**(1,598.1)**
Finance leases (notes 10 and 11)	(449.7)	(11.0)	18.9	**(441.8)**
	(2,228.9)	116.4	15.9	**(2,096.6)**
Short-term deposits (note 12b)	2.3	(0.2)	-	**2.1**
	(2,386.7)	(114.0)	15.9	**(2,484.8)**

19 Ultimate and immediate parent company and related party transactions

The ultimate parent undertaking is Severn Trent Plc which is registered in England. The immediate parent undertaking is Severn Trent Water Services Plc which is registered in England. Copies of the Annual Report and Accounts of Severn Trent Plc are available from the Company Secretary, Severn Trent Plc, 2297 Coventry Road, Birmingham B26 3PU.

Alternatively, the report can be viewed and downloaded from Severn Trent Plc's website at www.severntrent.com/reports2006.

As a wholly owned subsidiary, the company has taken advantage of the exemption not to disclose related party transactions with other group undertakings in accordance with the accounting standard FRS 8 'Related party disclosures'.

Regulatory accounts index

Water Industry Act 1991

Further to the requirements of company law, the Directors are required to prepare financial statements which comply with the requirements of Condition F of the Instrument of Appointment of the company as a Water and Sewerage Undertaker under the Water Industry Act 1991 and Regulatory Accounting Guidelines issued by the Water Services Regulation Authority. This additionally requires the Directors to:

a) Confirm that, in their opinion, the company has sufficient financial and management resources for the next twelve months

b) Confirm that, in their opinion, the company has sufficient rights and assets which would enable a special administrator to manage the affairs, business and property of the company

c) *Report to the Water Services Regulation Authority changes in the company's activities which may be material in relation to the company's ability* to finance its regulated activities

d) Undertake transactions entered into by the appointed business, with or for the benefit of associated companies or other businesses or activities of the appointed business, at arms length

e) Keep proper accounting records which comply with Condition F.

Diversification and the protection of the core business – Condition F6a

Severn Trent Water Limited and its subsidiary East Worcester Water Plc (together referred to as 'the Appointees') hereby advise:

a) *That in the opinion of the Directors, the Appointees will have available to them sufficient financial resources and facilities to enable them to carry* out, for at least the next 12 months, the Regulated Activity (including the investment programme necessary to fulfil the Appointees' obligations under the Appointment); and

b) That in the opinion of the Directors, the Appointees will for at least the next 12 months, have available to them management resources which are sufficient to enable them to carry out those functions.

A P Wray
Managing Director
For and on behalf of the Board
14 July 2006

Year ended 31 March 2006

Independent Auditors' report to the Water Services Regulation Authority ('the Regulator') and Severn Trent Water Limited ('the Company')

We have audited the Regulatory Accounts of the Company which incorporates East Worcester Water Plc and its other subsidiary undertakings, for the year ended 31 March 2006 set out on pages 40 to 51 which comprise;

- the regulatory historical cost accounting statements for the group, comprising the regulatory historical cost profit and loss account, the regulatory historical cost balance sheet; and
- the regulatory current cost accounting statements for the Appointed Business, comprising the current cost profit and loss account, the current cost balance sheet, the current cost cash flow statement and the related notes numbered 1 to 9 to the current cost financial statements including the statement of accounting policies on which the Regulatory Accounts have been prepared.

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

Basis of preparation

The Regulatory Accounts have been prepared in accordance with Condition F of the Regulatory Licence and the Regulatory Accounting Guidelines (being versions 1.03, 2.03, 3.05, 4.02 and 5.04), the accounting policies set out in the statement of accounting policies and, in the case of the regulatory historical cost accounting statements, under the historical cost convention.

The Regulatory Accounts are separate from the statutory financial statements of the Company. There are differences between United Kingdom Generally Accepted Accounting Principles ('UK GAAP') and the basis of preparation of information provided in the Regulatory Accounts because the Regulatory Accounting Guidelines specify alternative treatment or disclosure in certain respects. Where the Regulatory Accounting Guidelines do not specifically address an accounting issue, then they require UK GAAP to be followed. Financial information other than that prepared wholly on the basis of UK GAAP may not necessarily represent a true and fair view of the financial performance or financial position of a Company as shown in financial statements prepared in accordance with the Companies Act 1985.

Respective responsibilities of the Regulator, the Directors and auditors

The nature, form and content of Regulatory Accounts are determined by the Regulator. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the Regulator's purposes. Accordingly we make no such assessment.

The Directors' responsibilities for preparing the Regulatory Accounts in accordance with Regulatory Accounting Guidelines are set out in the statement of directors' responsibilities for regulatory information on page 37.

Our responsibility is to audit the Regulatory Accounts in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board, except as stated in the 'Basis of opinion', below and having regard to the guidance contained in Audit Technical Release 05/03 'Reporting to Regulators of Regulated Entities'.

We report to you our opinion as to whether the regulatory historical cost accounting statements present fairly, under the historical cost convention, the revenues and costs, asset and liabilities of the Company and the Appointed Business in accordance with the Company's Instrument of Appointment and Regulatory Accounting Guideline 2.03 (Guidelines for the classification of expenditure), Regulatory Accounting Guideline 3.05 (Guideline for the contents of regulatory accounts) and Regulatory Accounting Guideline 4.02 (Guideline for the analysis of operating costs and assets) and whether the regulatory current cost accounting statements on pages 42 to 51 have been properly prepared in accordance with Regulatory Accounting Guideline 1.03 (Guideline for accounting for current costs and regulatory capital values), Regulatory Accounting Guideline 3.05 and Regulatory Accounting Guideline 4.02. We also report to you if, in our opinion, the Company has not kept proper accounting records as required by paragraph 3 of Condition F of the Regulatory Licence and whether the information is in agreement with the Appointee's underlying accounting records and has been properly prepared in accordance with the requirements of Condition F and, as appropriate, Regulatory Accounting Guideline 1.03, Regulatory Accounting Guideline 2.03, Regulatory Accounting Guideline 3.05, and Regulatory Accounting Guideline 4.02.

We read the other information contained within the Regulatory Accounts, including any supplementary schedules on which we do not express an audit opinion, and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Regulatory Accounts. The other information comprises the five year summary and the supplementary regulatory accounting disclosures on pages 52 and 53.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the UK Auditing Practices Board, except as noted below. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Regulatory Accounts. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Regulatory Accounts, and of whether the accounting policies are appropriate to the Company 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 Regulatory Accounts are free from material misstatement, whether caused by fraud or other irregularity or error. However, as the nature, form and content of Regulatory Accounts are determined by the Regulator, we did not evaluate the overall adequacy of the presentation of the information, which would have been required if we were to express an audit opinion under Auditing Standards.

Our opinion on the Regulatory Accounts is separate from our opinion on the statutory accounts of the Company on which we report, which are prepared for a different purpose. Our audit report in relation to the statutory accounts of the Company (our 'Statutory audit') was made solely to the Company members, as a body, in accordance with section 235 of the Companies Act 1985. Our Statutory audit work was undertaken so that we might state to the Company members those matters we are required to state to them in a statutory auditors' report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume any responsibility to anyone other than the Company and the Company's members as a body, for our Statutory audit work, for our Statutory audit report, or for the opinions we have formed in respect of that Statutory audit.

The regulatory historical cost accounting statements on pages 40 to 41 have been drawn up in accordance with Regulatory Accounting Guideline 3.05 in that infrastructure renewals accounting as applied in previous years should continue to be applied and accordingly that the relevant sections of Financial Reporting Standards 12 and 15 be disapplied. The effect of this departure from Generally Accepted Accounting Principles, and a reconciliation of the balance sheet drawn up on this basis with that drawn up under Companies Act 1985 is given in note 8.

Audit opinion

In our opinion the Regulatory Accounts of the Company for the year ended 31 March 2006 fairly present in accordance with Condition F of the Instrument of Appointment granted by the Secretary of State for the Environment to the Company as a water and sewerage undertaker under the Water Industry Act 1991, the Regulatory Accounting Guidelines issued by the Regulator and the accounting policies set out in note 1 to the Regulatory Accounts, the state of the Company's affairs at 31 March 2006 on an historical cost and current cost basis, the historical cost and current cost profit for the year and the current cost cash flow for the year and have been properly prepared in accordance with those Conditions, Guidelines and accounting policies.

We are also required to report in respect of various specific obligations of the Company as set out in its Instrument of Appointment. In respect of these obligations, we report that in our opinion:-

(a) proper accounting records have been kept by the Appointee as required by paragraph 3 of Condition F of the instrument;

(b) the information is in agreement with the Appointee's accounting records and has been properly prepared in accordance with the requirements of Condition F and, as appropriate, Regulatory Accounting Guideline 1.03, Regulatory Accounting Guideline 2.03, Regulatory Accounting guideline 3.05 and Regulatory Accounting Guideline 4.02 issued by the Regulator;

(c) the regulatory historical cost accounting statements on pages 40 to 41 present fairly, under the historical cost convention, the revenues and costs, assets and liabilities of the Company and its appointed business in accordance with the Appointee's Instrument of Appointment and Regulatory Accounting Guideline 2.03, Regulatory Accounting Guideline 3.05 and Regulatory Accounting Guideline 4.02 issued by the Regulator;

(d) the regulatory current cost accounting statements on pages 42 to 51 have been properly prepared in accordance with Regulatory Accounting Guideline 1.03, Regulatory Accounting Guideline 3.05 and Regulatory Accounting Guideline 4.02 issued by the Regulator.

Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
London
14 July 2006

The maintenance and integrity of Severn Trent Water's website is the responsibility of the Directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Group profit and loss account

Year ended 31 March 2006	Appointed business 2006 £m	Non appointed business 2006 £m	Inter segment 2006 £m	2006 £m	Appointed business (restated) 2005 £m	Non appointed business 2005 £m	Inter segment 2005 £m	(restated) 2005 £m
Turnover	1,127.5	11.5	(1.3)	1,137.7	990.9	10.1	(1.7)	999.3
Operating costs	(729.0)	(10.6)	1.3	(738.3)	(677.8)	(9.1)	1.7	(685.2)
Other operating income	2.5	-	-	2.5	7.6	-	-	7.6
Operating profit	401.0	0.9	-	401.9	320.7	1.0	-	321.7
Other income	3.3	0.2	-	3.5	2.7	0.1	-	2.8
Net interest payable	(129.4)	-	-	(129.4)	(130.0)	-	-	(130.0)
Profit on ordinary activities before taxation	274.9	1.1	-	276.0	193.4	1.1	-	194.5
Taxation on profit on ordinary activities								
Current tax	(57.8)	-	-	(57.8)	10.7	(0.3)	-	10.4
Deferred tax	(39.7)	-	-	(39.7)	(38.5)	-	-	(38.5)
Taxation	(97.5)	-	-	(97.5)	(27.8)	(0.3)	-	(28.1)
Profit on ordinary activities after taxation	177.4	1.1	-	178.5	165.6	0.8	-	166.4
Dividend	(152.8)	(1.9)	-	(154.7)	(147.1)	-	-	(147.1)
Retained profit for the financial year	24.6	(0.8)	-	23.8	18.5	0.8	-	19.3

The results for the year ended 31 March 2005 have been restated as a result of applying FRS 17 'Retirement benefits' and for the treatment of infrastructure connection charges (note 1a to the statutory accounts on page 19).

Statement of total recognised gains and losses

Year ended 31 March 2006	Appointed business 2006 £m	Non appointed business 2006 £m	Inter segment 2006 £m	2006 £m	Appointed business (restated) 2005 £m	Non appointed business 2005 £m	Inter segment 2005 £m	(restated) 2005 £m
Profit for the financial year	24.6	(0.8)	-	23.8	18.5	0.8	-	19.3
FRS 17 actuarial gain	26.0	-	-	26.0	35.3	-	-	35.3
Deferred tax on actuarial gain	(7.8)	-	-	(7.8)	(10.6)	-	-	(10.6)
Total recognised gains and losses for the financial year	42.8	(0.8)	-	42.0	43.2	0.8	-	44.0
Prior year restatement (note 1a)	(215.0)	-	-	(215.0)	-	-	-	-
Total recognised gains and losses since last *annual report and regulatory accounts*	(172.2)	(0.8)	-	(173.0)	-	-	-	-

The group results presented are for Severn Trent Water Limited and its subsidiary undertakings including East Worcester Water Plc.

Group balance sheet

As at 31 March 2006

	Notes	Appointed business 2006 £m	Non appointed business 2006 £m	Inter segment 2006 £m	2006 £m	Appointed business (restated) 2005 £m	Non appointed business 2005 £m	Inter segment 2005 £m	(restated) 2005 £m
Fixed assets									
Tangible assets	8	5,075.6	-	-	5,075.6	4,971.1	-	-	4,971.1
Investments		0.1	-	-	0.1	0.2	-	-	0.2
		5,075.7	-	-	5,075.7	4,971.3	-	-	4,971.3
Current assets									
Stocks		6.1	-	-	6.1	4.4	-	-	4.4
Debtors	8	215.4	1.5	(1.1)	215.8	208.0	0.8	(0.8)	208.0
Short-term deposits		2.1	-	-	2.1	2.3	-	-	2.3
Cash at bank and in hand		-	-	-	-	0.1	-	-	0.1
		223.6	1.5	(1.1)	224.0	214.8	0.8	(0.8)	214.8
Creditors: amounts falling due within one year									
Borrowings		(482.7)	-	-	(482.7)	(269.4)	-	-	(269.4)
Other creditors		(371.9)	(1.5)	1.1	(372.3)	(371.2)	-	0.8	(370.4)
		(854.6)	(1.5)	1.1	(855.0)	(640.6)	-	0.8	(639.8)
Net current (liabilities)/assets		(631.0)	-	-	(631.0)	(425.8)	0.8	-	(425.0)
Total assets less current liabilities		4,444.7	-	-	4,444.7	4,545.5	0.8	-	4,546.3
Creditors: amounts falling due after more than one year									
Borrowings		(2,004.2)	-	-	(2,004.2)	(2,119.7)	-	-	(2,119.7)
Other creditors		(3.3)	-	-	(3.3)	(5.3)	-	-	(5.3)
		(2,007.5)	-	-	(2,007.5)	(2,125.0)	-	-	(2,125.0)
Provisions for liabilities and charges									
- Deferred taxation		(543.9)	-	-	(543.9)	(516.2)	-	-	(516.2)
- Other provisions		(6.6)	-	-	(6.6)	(11.5)	-	-	(11.5)
Deferred income		(44.4)	-	-	(44.4)	(46.9)	-	-	(46.9)
Pension deficit		(107.2)	-	-	(107.2)	(153.6)	-	-	(153.6)
Net assets		1,735.1	-	-	1,735.1	1,692.3	0.8	-	1,693.1
Capital and reserves									
Called up share capital		1,000.0	-	-	1,000.0	1,000.0	-	-	1,000.0
Profit and loss account		735.1	-	-	735.1	692.3	0.8	-	693.1
Shareholder's funds		1,735.1	-	-	1,735.1	1,692.3	0.8	-	1,693.1

The balance sheet for the year ended 31 March 2005 has been restated as a result of applying FRS 17 'Retirement benefits' and for the treatment of infrastructure connection charges (note 1a to the statutory accounts on page 19).

Group profit and loss account: appointed business

Year ended 31 March 2006	Notes	2006 £m	(restated) 2005 £m
Turnover	2a	1,127.5	990.9
Current cost operating costs	2d	(773.7)	(726.7)
Other operating income	2b	3.1	8.2
		356.9	272.4
Working capital adjustment	2c	1.6	2.0
Current cost operating profit		358.5	274.4
Other income		3.3	2.7
Net interest payable		(129.4)	(130.0)
Financing adjustment		74.7	92.1
Current cost profit before taxation		307.1	239.2
Taxation on profit on ordinary activities			
Current tax		(57.8)	10.7
Deferred tax		(39.7)	(38.5)
Taxation		(97.5)	(27.8)
Current cost profit attributable to shareholder after taxation		209.6	211.4
Dividend		(152.8)	(147.1)
Current cost profit retained		56.8	64.3

The results for the year ended 31 March 2005 have been restated as a result of applying FRS 17 'Retirement benefits' and for the treatment of infrastucture connection charges (note 1a to the statutory accounts on page 19).

Statement of total recognised gains and losses: appointed business

Year ended 31 March 2006	2006 £m	(restated) 2005 £m
Current cost profit for the financial year	56.8	64.3
FRS 17 actuarial gain	26.0	35.3
Deferred tax on actuarial gain	(7.8)	(10.6)
Total recognised gains and losses for the financial year	75.0	89.0
Prior year restatement (note 1a to the statutory accounts on page 19)	(215.0)	-
Total recognised gains and losses since last annual report and regulatory accounts	(140.0)	-

Group balance sheet: appointed business

As at 31 March 2006	Notes	2006 £m	(restated) 2005 £m
Fixed assets			
Tangible assets	3	27,194.9	26,454.4
Third party contributions since 1989/90		(1,267.8)	(1,181.3)
Working capital	4	(62.1)	(69.2)
Net operating assets		25,865.0	25,203.9
Cash and investments		2.2	2.6
Non-trade debtors		1.5	9.9
Non-trade creditors due within one year		(572.6)	(368.7)
Creditors due after one year		(2,007.5)	(2,125.0)
Provisions for liabilities and charges:			
Deferred taxation		(543.9)	(516.2)
Other provisions		(6.6)	(11.5)
Pension deficit		(107.2)	(153.6)
Net assets employed		22,630.9	22,041.4
Capital and reserves			
Called up share capital		1,000.0	1,000.0
Profit and loss account	5	92.6	17.6
Current cost reserve	6	21,538.3	21,023.8
		22,630.9	22,041.4

The balance sheet for the year ended 31 March 2005 has been restated as a result of applying FRS 17 'Retirement benefits' and for the treatment of infrastructure connection charges (note1a to the statutory accounts on page 19).

Group cash flow statement

Year ended 31 March 2006	Notes	2006 £m	Appointed business 2006 £m	2006 £m	Non appointed business 2006 £m	2006 £m	Total 2006 £m	2005 £m	Total 2005 £m
Net cash inflow from operating activities	7		642.1		1.9		644.0		575.1
Returns on investments and servicing of finance									
Interest received		0.4		-		0.4		0.4	
Interest paid		(104.0)		-		(104.0)		(101.6)	
Interest element of finance lease rental payments		(41.6)		-		(41.6)		(12.8)	
			(145.2)		-		(145.2)		(114.0)
Taxation			(58.3)		-		(58.3)		0.5
Capital expenditure									
Purchase of tangible fixed assets		(343.8)		-		(343.8)		(361.6)	
Grants and contributions received		38.8		-		38.8		36.7	
Infrastructure renewals expenditure		(101.1)		-		(101.1)		(82.1)	
Disposal of fixed assets		6.2		-		6.2		12.1	
Sale of other fixed asset investments		0.1		-		0.1		1.9	
			(399.8)		-		(399.8)		(393.0)
Equity dividends paid			(152.8)		(1.9)		(154.7)		(147.1)
Net cash outflow before financing			(114.0)		-		(114.0)		(78.5)
Management of liquid resources			0.2		-		0.2		(2.3)
Financing									
Receipt from sale and leaseback transaction		170.2		-		170.2		-	
Finance leases repaid		(159.2)		-		(159.2)		-	
Loans advanced		31.9		-		31.9		172.4	
Loans repaid		(159.3)		-		(159.3)		(88.0)	
			(116.4)		-		(116.4)		84.4
Net (decrease)/increase in cash			(230.2)		-		(230.2)		3.6

Reconciliation of net cash flow to movement in net debt

	2006 £m	Appointed business 2006 £m	2006 £m	Non appointed business 2006 £m	2006 £m	Total 2006 £m	2005 £m	2005 £m
Net (decrease)/increase in cash as above	(230.2)		-		(230.2)		3.6	
Cash flow from movement in net debt and financing	116.4		-		116.4		(84.4)	
Cash flow from movement in liquid resources	(0.2)		-		(0.2)		2.3	
Change in net debt resulting from cash flows		(114.0)		-		(114.0)		(78.5)
Rolled up interest on debt		(3.0)		-		(3.0)		(8.5)
Rolled up interest on finance leases		18.9		-		18.9		(7.4)
Increase in net debt		(98.1)		-		(98.1)		(94.4)
Opening net debt		(2,386.7)		-		(2,386.7)		(2,292.3)
Closing net debt		(2,484.8)		-		(2,484.8)		(2,386.7)

Notes to the current cost financial statements

Year ended 31 March 2006

1 Accounting policies

a) Basis of preparation

The regulatory financial statements have been prepared on a group basis for Severn Trent Water Limited and its subsidiary undertakings to meet the requirements of the Water Services Regulation Authority (WSRA).

The regulatory financial statements have been prepared in accordance with Condition F of the Instruments of Appointment of the Water and Sewerage Undertakers and the Regulatory Accounting Guidelines as issued by the WSRA, the accounting policies set out in the statement of accounting policies and, in the case of the regulatory historical cost accounting statements, under the historical cost convention.

These accounts have been prepared in accordance with guidance issued by the WSRA for modified real terms financial statements suitable for regulation in the water industry. They measure profitability on the basis of real financial capital maintenance, in the context of assets which are valued at their current cost value to the business, with the exception of specialised operational and infrastructure assets.

The regulatory financial statements are separate from the statutory financial statements of the company. There are differences between United Kingdom Generally Accepted Accounting Principles (UK GAAP) and the basis of preparation of information provided in the regulatory accounts because the Regulatory Accounting Guidelines specify alternative treatment or disclosure in certain respects. Where the Regulatory Accounting Guidelines do not specifically address an accounting issue, then they require UK GAAP to be followed. Financial information other than that prepared wholly on the basis of UK GAAP may not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in financial statements prepared in accordance with the Companies Act 1985.

b) General

The accounting policies used are the same as those adopted in the statutory historical cost financial statements on pages 15 to 36, except as set out below.

c) Tangible fixed assets

Assets in operational use are valued at the replacement cost of their operating capability. To the extent that the regulatory regime does not allow such assets to earn the return high enough to justify that value, this represents a modification of the value to the business principle. Also, no provision is made for the possible funding of future replacements of assets by contributions from third parties and, to the extent that some of the tangible fixed assets would on replacement be so funded, replacement cost again differs from value to the business. Redundant assets are valued at their recoverable amounts.

An Asset Management Plan (AMP) survey of existing assets as at 31 March 1998 was undertaken during 1998/99 and the adjustments to asset values as a result of that exercise were included within the tangible fixed asset note. In the intervening years, between AMP surveys, values are restated to take account of changes in the general level of inflation, as measured by changes in Retail Price Index (RPI), and any other significant changes in asset records identified during the year.

i) Non-infrastructure assets

Specialised operational assets:

The gross replacement cost of specialised operational assets has been derived using the latest cost information provided by the AMP.

The unamortised portion of third party contributions received is deducted in arriving at net operating assets (as described below in note 1d).

Non specialised operational assets:

Non specialised operational assets are valued on the basis of open market value for existing use at 31 March 1991 and have been expressed in current terms by adjusting for movements in property values.

ii) Infrastructure assets

Mains, sewers, impounding and pumped raw water storage reservoirs, dams and sludge pipelines are valued at replacement cost, determined principally on the basis of unit cost data provided by the AMP.

iii) Other assets

All other assets are valued on the basis of data provided by the AMP.

iv) Surplus land

Surplus land was valued at current market value for the purposes of the AMP. Any proceeds on disposal to be passed onto customers will be taken into account, in accordance with the requirements contained in Condition B of the Instruments of Appointment as Water and Sewerage Undertakers.

d) Grants and other third party contributions

Grants, infrastructure and other third party contributions received since 31 March 1990 are carried forward to the extent that any balance has not been credited to revenue. The balance carried forward is restated for the change in RPI for the year.

e) Real financial capital maintenance adjustments

These adjustments are made to historical cost operating profit in order to arrive at profit after the maintenance of financial capital in real terms:

Working capital adjustment – this is calculated by applying the change in RPI over the year to the opening total of trade debtors and stock, less trade creditors.

Financing adjustment – this is calculated by applying the change in RPI over the year to the opening balance of net finance, which comprises all monetary assets and liabilities in the balance sheet apart from those included in working capital and dividends payable.

2 Analysis of current cost turnover and operating costs

	2006			2005		
	Water services £m	Sewerage services £m	Total £m	(restated) Water services £m	(restated) Sewerage services £m	(restated) Total £m
a) Turnover						
Unmeasured - household	300.3	313.3	613.6	276.7	282.5	559.2
Unmeasured - non household	2.9	12.1	15.0	3.9	3.9	7.8
Unmeasured	303.2	325.4	628.6	280.6	286.4	567.0
Measured - household	92.3	96.7	189.0	73.3	77.4	150.7
Measured - non household	102.5	122.0	224.5	101.2	104.7	205.9
Measured	194.8	218.7	413.5	174.5	182.1	356.6
Trade effluent	-	8.6	8.6	-	9.9	9.9
Large user tariffs and special agreements	23.8	31.8	55.6	16.0	20.8	36.8
Revenue grants	-	0.2	0.2	-	0.2	0.2
Rechargeable works	1.9	0.6	2.5	1.6	0.4	2.0
Bulk supplies/inter company	3.6	0.4	4.0	3.3	-	3.3
Other	6.3	1.6	7.9	5.5	2.0	7.5
Third parties	11.8	2.6	14.4	10.4	2.4	12.8
Other sources	2.4	4.2	6.6	3.1	4.5	7.6
Total turnover	536.0	591.5	1,127.5	484.6	506.3	990.9
b) Other operating income						
Current cost profit on disposal of tangible fixed assets	1.7	1.2	2.9	3.4	3.3	6.7
Other operating income	0.1	0.1	0.2	0.7	0.8	1.5
Total	1.8	1.3	3.1	4.1	4.1	8.2
c) Working capital adjustment	(0.1)	1.7	1.6	(0.2)	2.2	2.0

The analysis of turnover for the year ended 31 March 2005 has been restated as a result of applying the new Ofwat reporting disclosure requirements, bringing the regulatory accounts disclosures in line with those of the Principle Statement.

Notes to the current cost financial statements

Year ended 31 March 2006

2 Analysis of current cost turnover and operating costs continued

	Water services			Sewerage services					Business analysis			2006 Total
	Resources and treatment £m	Distribution £m	Water services sub-total £m	Sewerage £m	Sewage treatment £m	Sludge treatment and disposal £m	Sewage treatment /disposal sub-total £m	Sewerage services sub-total £m	Customer services £m	Scientific services £m	Cost of regulation £m	£m
d) Analysis of operating costs and tangible fixed assets												
Direct costs												
Employment costs	6.5	17.4	23.9	7.2	11.9	6.8	18.7	25.9				
Power	7.4	12.0	19.4	3.1	7.8	1.1	8.9	12.0				
Agencies	-	-	-	-	-	-	-	-				
Hired and contracted	1.6	12.5	14.1	7.3	2.6	8.6	11.2	18.5				
Associated companies	1.5	0.1	1.6	2.7	0.3	1.9	2.2	4.9				
Materials and consumables	4.8	2.9	7.7	1.1	3.1	5.8	8.9	10.0				
Service charges	9.5	-	9.5	1.6	6.1	-	6.1	7.7				
Bulk supply imports	8.3	-	8.3	-	-	-	-	-				
Other direct costs	0.6	3.2	3.8	2.7	0.4	0.1	0.5	3.2				
Total direct costs	40.2	48.1	88.3	25.7	32.2	24.3	56.5	82.2	33.0	12.5	3.2	219.2
General and support	25.5	20.4	45.9	16.7	37.7	12.7	50.4	67.1	11.2	4.3	1.0	129.5
Functional expenditure	65.7	68.5	134.2	42.4	69.9	37.0	106.9	149.3	44.2	16.8	4.2	348.7
Business activities recharge			30.4					34.8	(44.2)	(16.8)	(4.2)	-
Rates			35.8					19.9				55.7
Doubtful debts			12.2					13.6				25.8
Exceptional items			0.4					0.3				0.7
			213.0					217.9				430.9
Services for third parties			9.7					2.3				12.0
Total operating expenditure			222.7					220.2				442.9
Capital costs												
Infrastructure renewals:												
Expenditure	1.3	52.9	54.2	40.3	-	-	-	40.3				94.5
Accrual	0.2	6.7	6.9	(10.2)	-	-	-	(10.2)				(3.3)
Current cost depreciation	54.4	47.2	101.6	23.2	86.6	30.7	117.3	140.5				242.1
Amortisation of deferred income			(1.4)					(1.6)				(3.0)
Business activity capital costs			-					-				-
			161.3					169.0				330.3
Services for third parties depreciation			0.5					-				0.5
Total capital maintenance			161.8					169.0				330.8
Total operating costs			384.5					389.2				773.7
Analysis of tangible fixed assets												
Service activities	1,549.5	6,659.2	8,208.7	16,771.3	1,458.1	327.9	1,786.0	18,557.3				26,766.0
Business activities			133.9	23.6			105.0	128.6				262.5
Service totals			8,342.6	16,794.9			1,891.0	18,685.9				27,028.5
Services for third parties			166.4					-				166.4
Total			8,509.0					18,685.9				27,194.9

Included within customer services costs are payments amounting to £3.5 million (2005: £3.0 million) to the Severn Trent Water Charitable Trust Fund.

The tables on the analysis of operating costs have been prepared in accordance with Regulatory Accounting Guideline number 4.02 on the analysis of operating costs and assets. Direct costs have been charged directly to the service to which they relate. General and support costs are where possible charged directly to the service to which they relate; any remaining general and support costs which cannot be directly allocated to a service are apportioned across all services.

2 Analysis of current cost turnover and operating costs continued

												(restated) 2005
	Water services			*Sewerage services*					*Business analysis*			*Total*
	Resources and treatment £m	Distrib-ution £m	Water services sub-total £m	Sewerage £m	Sewage treatment £m	Sludge treatment and disposal £m	Sewage treatment /disposal sub-total £m	Sewerage services sub-total £m	Customer services £m	Scientific services £m	Cost of regulation £m	£m
d) Analysis of operating costs and tangible fixed assets												
Direct costs												
Employment costs	7.4	16.3	23.7	6.9	11.6	5.9	17.5	24.4				
Power	6.3	12.3	18.6	3.1	8.2	0.6	8.8	11.9				
Agencies	-	-	-	-	-	-	-	-				
Hired and contracted	2.3	11.3	13.6	6.6	2.2	12.5	14.7	21.3				
Associated companies	1.4	0.3	1.7	3.3	-	2.2	2.2	5.5				
Materials and consumables	4.9	3.0	7.9	0.8	2.7	5.1	7.8	8.6				
Service charges	9.2	-	9.2	1.5	6.0	-	6.0	7.5				
Bulk supply imports	7.3	-	7.3	-	-	-	-	-				
Other direct costs	0.8	1.9	2.7	2.5	0.3	0.2	0.5	3.0				
Total direct costs	39.6	45.1	84.7	24.7	31.0	26.5	57.5	82.2	31.2	13.8	3.0	214.9
General and support	23.4	19.3	42.7	11.7	36.2	11.9	48.1	59.8	9.1	4.7	0.8	117.1
Functional expenditure	63.0	64.4	127.4	36.4	67.2	38.4	105.6	142.0	40.3	18.5	3.8	332.0
Business activity recharge			28.9					33.7	(40.3)	(18.5)	(3.8)	-
Rates			31.8					17.9				49.7
Doubtful debts			8.9					9.4				18.3
Exceptional items			5.4					5.2				10.6
			202.4					208.2				410.6
Services for third parties			9.5					2.5				12.0
Total operating expenditure			*211.9*					*210.7*				422.6
Capital costs												
Infrastructure renewals:												
Expenditure	1.4	32.4	33.8	43.4	-	-	-	43.4				77.2
Accrual	0.1	6.4	6.5	(11.2)	-	-	-	(11.2)				(4.7)
Current cost depreciation	55.9	44.3	100.2	21.0	83.5	29.5	113.0	134.0				234.2
Amortisation of deferred income			(1.6)					(1.6)				(3.2)
Business activity capital costs			-					-				-
			138.9					164.6				303.5
Services for third parties depreciation			0.6					-				0.6
Total capital maintenance			139.5					164.6				304.1
Total operating costs			351.4					375.3				726.7
Analysis of tangible fixed assets												
Service activities	1,528.5	6,472.9	8,001.4	16,307.4	1,399.8	313.6	1,713.4	18,020.8				26,022.2
Business activities			137.3	24.3			107.7	132.0				269.3
Service totals			8,138.7	16,331.7			1,821.1	18,152.8				26,291.5
Services for third parties			162.9					-				162.9
Total			8,301.6					18,152.8				26,454.4

The analysis of operating costs for the year ended 31 March 2005 has been restated as a result of applying FRS17 'Retirement benefits' and for the treatment of infrastructure connection charges (note 1a to the statutory accounts on page 19).

e) Reactive and planned maintenance

Expenditure on reactive and planned maintenance included in operating costs for 2006 in respect of infrastructure assets amounted to £20.8 million on water services (2005: £18.3 million) and £16.6 million for sewerage services (2005: £13.4 million).

Expenditure on reactive and planned maintenance included in operating costs for 2006 in respect of non-infrastructure assets amounted to £9.7 million on water services (2005 £9.5 million) and £29.3 million for sewerage services (2005: £28.7 million).

Notes to the current cost financial statements

Year ended 31 March 2006

3 Analysis of tangible fixed assets by asset type within service

	Specialised operational assets £m	Non specialised operational assets £m	Infra-structure assets £m	Other assets £m	Total £m
a) Water services tangible fixed assets analysed by asset type					
Gross replacement cost					
At 1 April 2005	1,912.7	106.0	7,224.5	288.3	9,531.5
RPI and other adjustments	44.6	2.4	170.1	6.1	223.2
Additions	55.9	1.2	36.4	23.3	116.8
Disposals and amounts written off	(6.8)	(0.3)	-	(17.3)	(24.4)
At 31 March 2006	**2,006.4**	**109.3**	**7,431.0**	**300.4**	**9,847.1**
Depreciation					
At 1 April 2005	1,018.0	32.0	-	179.9	1,229.9
RPI and other adjustments	24.1	0.8	-	4.0	28.9
Charge for year	71.8	1.9	-	28.4	102.1
Disposals and amounts written off	(6.8)	(0.3)	-	(15.7)	(22.8)
At 31 March 2006	**1,107.1**	**34.4**	**-**	**196.6**	**1,338.1**
Net book value					
At 31 March 2006	**899.3**	**74.9**	**7,431.0**	**103.8**	**8,509.0**
At 1 April 2005	894.7	74.0	7,224.5	108.4	8,301.6
b) Sewerage services tangible fixed assets analysed by asset type					
Gross replacement cost					
At 1 April 2005	3,638.4	122.5	16,110.6	260.8	20,132.3
RPI and other adjustments	83.0	2.9	379.5	5.8	471.2
Additions	158.2	0.9	67.8	24.0	250.9
Disposals and amounts written off	(45.3)	(0.3)	-	(14.0)	(59.6)
At 31 March 2006	**3,834.3**	**126.0**	**16,557.9**	**276.6**	**20,794.8**
Depreciation					
At 1 April 2005	1,805.4	30.4	-	143.7	1,979.5
RPI and other adjustments	42.5	0.7	-	3.6	46.8
Charge for year	110.1	1.9	-	28.5	140.5
Disposals and amounts written off	(45.2)	(0.3)	-	(12.4)	(57.9)
At 31 March 2006	**1,912.8**	**32.7**	**-**	**163.4**	**2,108.9**
Net book value					
At 31 March 2006	**1,921.5**	**93.3**	**16,557.9**	**113.2**	**18,685.9**
At 1 April 2005	1,833.0	92.1	16,110.6	117.1	18,152.8

3 Analysis of tangible fixed assets by asset type within service continued

	Specialised *operational* assets £m	Non specialised *operational* assets £m	Infra-*structure* assets £m	*Other* assets £m	Total £m
c) Total tangible fixed assets analysed by asset type					
Gross replacement cost					
At 1 April 2005	5,551.1	228.5	23,335.1	549.1	29,663.8
RPI and other adjustments	127.6	5.3	549.6	11.9	694.4
Additions	214.1	2.1	104.2	47.3	367.7
Disposals and amounts written off	(52.1)	(0.6)	-	(31.3)	(84.0)
At 31 March 2006	**5,840.7**	**235.3**	**23,988.9**	**577.0**	**30,641.9**
Depreciation					
At 1 April 2005	2,823.4	62.4	-	323.6	3,209.4
RPI and other adjustments	66.6	1.5	-	7.6	75.7
Charge for year	181.9	3.8	-	56.9	242.6
Disposals and amounts written off	(52.0)	(0.6)	-	(28.1)	(80.7)
At 31 March 2006	***3,019.9***	***67.1***	-	***360.0***	***3,447.0***
Net book value					
At 31 March 2006	**2,820.8**	**168.2**	**23,988.9**	**217.0**	**27,194.9**
At 1 April 2005	2,727.7	166.1	23,335.1	225.5	26,454.4

4 Working capital

	2006 £m	2005 £m
Stocks	**6.1**	4.4
Trade debtors	**98.5**	79.7
Trade creditors	**(10.4)**	(7.7)
Short-term capital creditors	**(11.3)**	(10.6)
Infrastructure renewals prepayment	**7.7**	4.4
Accruals	**(156.6)**	(123.1)
Payments in advance	**(85.1)**	(89.6)
Tax and social security	**(3.7)**	(3.4)
Group trade debtors/(creditors)	**(4.1)**	(26.1)
Prepayments	**96.8**	102.8
	(62.1)	(69.2)

5 Reserves – profit and loss account

	£m
At 1 April 2005 as previously reported	232.6
Prior year adjustment (note 1a to the statutory accounts on page 19):	
FRS17 pension adjustments	(151.2)
Infrastructure connection charges	(63.8)
At 1 April 2005 as restated	17.6
Retained current cost profit for the year	56.8
FRS 17 actuarial gain	26.0
Deferred tax on actuarial gain	(7.8)
At 31 March 2006	**92.6**

Notes to the current cost financial statements

Year ended 31 March 2006

6 Reserves – *current cost reserves*

	2006 £m	2005 £m
At 1 April	21,023.8	20,343.9
AMP adjustment		
RPI adjustments:		
Fixed assets	618.7	807.4
Working capital	(1.6)	(2.0)
Financing	(74.7)	(92.1)
Grants and third party contributions	(27.9)	(33.4)
At 31 March	21,538.3	21,023.8

7 Reconciliation of current cost operating profit to net cash inflow from operating activities

	2006 £m	2005 £m
Current cost operating profit	358.5	274.4
Working capital adjustment	(1.6)	(2.0)
Other income	3.3	2.7
Current cost depreciation after amortisation of deferred income	239.6	231.6
Current cost profit on disposal of tangible fixed assets	(3.1)	(8.2)
Increase in stocks	(1.7)	(0.3)
Increase in debtors	(19.3)	(20.7)
Increase in creditors	15.2	21.9
Movement in provisions	(14.8)	1.6
Movement in pension scheme	(35.6)	(9.9)
Infrastructure renewals expenditure	101.1	82.1
Effect of other deferrals and accruals on operating activity cash flow	0.5	1.9
Net cash inflow from operating activities	642.1	575.1

8 Reconciliation of historic cost balance sheet per statutory accounts to historic cost balance sheet in regulatory accounts

In preparation of its statutory accounts, the company has followed common industry practice and adopted the infrastructure renewals accounting basis as set out in FRS15 'Tangible fixed assets'. However, for the purposes of the Regulatory Accounts, Ofwat has requested that FRS15 is not applied for infrastructure renewals accounting, thereby providing a basis consistent with prior years. A reconciliation to the balance sheet shown in the statutory accounts is set out below:

	2006 £m	2005 £m
Fixed assets		
Infrastructure assets - cost		
As per regulatory accounts	6,922.3	6,673.4
Adjustment to opening balance	1,065.0	988.3
Disposals in year	(1.4)	(0.6)
Infrastructure renewals expenditure capitalised in the year	94.5	77.3
Cost as per statutory accounts	8,080.4	7,738.4
Infrastructure assets - depreciation		
As per regulatory accounts	1,846.7	1,702.3
Adjustment to opening balance	1,060.6	988.7
Disposals in year	(1.4)	(0.6)
Depreciation charge in year	91.2	72.5
Depreciation as per statutory accounts	2,997.1	2,762.9
Infrastructure assets - net		
As per regulatory accounts	5,075.6	4,971.1
Infrastructure renewals prepayment	7.7	4.4
Net book value as per statutory accounts	5,083.3	4,975.5
Total debtors		
As per regulatory accounts	215.4	208.0
Non appointed business debtors	0.4	-
Less infrastructure renewals prepayment	(7.7)	(4.4)
Total debtors as per statutory accounts	208.1	203.6

9 Regulatory capital values

At each price review, The Office of Water Services sets price limits which it considers will enable companies to earn a reasonable return on capital. The Office of Water Services bases that return on the Regulatory Capital Value (RCV).

The projected outturn for the Company's RCV from the December 2004 determination is as follows:

As at 31 March	2006 £m	2007 £m	2008 £m	2009 £m	2010 £m
Per determination (at 2002/03 prices)	4,853	4,981	5,107	5,191	5,292
Actual/estimated outturn	5,209	5,480	5,760	6,001	6,270

	2006 £m
Regulatory capital values at 2005/06 prices	
Opening regulatory capital value for the year	**5,147**
Capital expenditure	**395**
Infrastructure renewals expenditure	**85**
Grants and contributions	**(38)**
Depreciation	**(248)**
Infrastructure renewals charge	**(85)**
Outperformance of regulatory assumptions	**(47)**
Closing regulatory capital value	**5,209**
Average regulatory capital value	**5,178**

The RCVs in this table are based on those published by Ofwat in its letter RD08/06, inflated to 2005/06 prices. The value of the RCV is protected against inflation by increasing the value each year by RPI.

The RCV started with a measure of the value placed on each company's capital and debt by the financial markets following privatisation.

Capital expenditure and infrastructure renewals expenditure assumed in setting price limits are added to the RCV. Price-setting assumptions on current cost depreciation, the infrastructure renewals charge, and capital grants and contributions received are deducted each year.

A company has an incentive to outperform Ofwat's regulatory assumptions and earn a higher rate of return than was assumed when setting price limits. The RCV is the mechanism used to reflect past capital outperformance and transfer the benefit of this to customers through lower price limits. The level of outperformance is assessed by comparing net actual capital expenditure in the year with Ofwat projections, with the outperformance adjustment deducted from the RCV. The benefits of the outperformance are passed on to customers five years after it has been achieved.

The RCV grows in real terms in the period to 2010, reflecting the scale of the capital programme.

Five year summary – unaudited

At 2005/06 outturn prices

	2006 £m	(restated) 2005 £m	(restated) 2004 £m	(restated) 2003 £m	(restated) 2002 £m
Turnover	**1,127.5**	1,016.7	1,000.0	984.5	991.8
Current cost operating costs	**(773.7)**	(745.6)	(704.5)	(698.8)	(677.8)
Other operating income	**3.1**	8.4	19.9	6.0	3.8
	356.9	279.5	315.4	291.7	317.8
Working capital adjustment	**1.6**	2.1	2.2	3.4	1.4
Current cost operating profit	**358.5**	281.6	317.6	295.1	319.2
Other income	**3.3**	2.8	2.8	3.2	1.0
Net interest payable	**(129.4)**	(133.4)	(131.0)	(129.3)	(132.6)
Financing adjustment	**74.7**	94.5	74.4	72.1	30.6
Current cost profit before taxation	**307.1**	245.5	263.8	241.1	218.2
Taxation	**(57.8)**	11.0	(22.9)	(9.6)	(1.3)
Deferred tax	**(39.7)**	(39.5)	(42.6)	(60.3)	(40.5)
Current cost profit attributable to shareholders	**209.6**	217.0	198.3	171.2	176.4
Dividend	**(152.8)**	(150.9)	(167.2)	(154.4)	(154.5)
Current cost profit retained	**56.8**	66.1	31.1	16.8	21.9

	2006 £m	(restated) 2005 £m	(restated) 2004 £m	(restated) 2003 £m	(restated) 2002 £m
Balance sheet					
Fixed assets					
Tangible assets	**27,194.9**	27,079.3	26,926.7	26,769.9	26,604.4
Third party contributions since 1989/90	**(1,267.8)**	(1,209.2)	(1,153.2)	(1,093.8)	(1,024.4)
Working capital	**(62.1)**	(70.8)	(66.5)	(88.2)	(110.0)
Net operating assets	**25,865.0**	25,799.3	25,707.0	25,587.9	25,470.0
Cash and investments	**2.2**	2.7	0.7	0.8	0.8
Non-trade debtors	**1.5**	10.1	10.8	6.6	10.4
Non-trade creditors due within one year	**(572.6)**	(377.4)	(385.4)	(436.7)	(344.0)
Creditors due after one year	**(2,007.5)**	(2,175.2)	(2,157.5)	(2,022.1)	(2,055.6)
Provision for liabilities and charges:					
Deferred taxation	**(543.9)**	(528.4)	(508.0)	(477.5)	(430.5)
Other provisions	**(6.6)**	(11.8)	(0.3)	(0.8)	(2.0)
Pension deficit	**(107.2)**	(157.2)	-	-	-
Net assets employed	**22,630.9**	22,562.1	22,667.3	22,658.2	22,649.1
Capital and reserves					
Called up share capital	**1,000.0**	1,023.6	1,056.3	1,083.9	1,117.5
Profit and loss account	**92.6**	18.0	121.0	108.0	107.9
Current cost reserve	**21,538.3**	21,520.5	21,490.0	21,466.3	21,423.7
	22,630.9	22,562.1	22,667.3	22,658.2	22,649.1

The profit and loss account and balance sheet for the year ended 31 March 2005 have been restated as a result of applying FRS 17 'Retirement benefits' and for the treatment of infrastructure connection charges (note 1a to the statutory accounts on page 19).

The profit and loss accounts and balance sheets for the years ended 31 March 2004, 31 March 2003 and 31 March 2002 have been restated for the treatment of infrastructure connection charges only (note 1a to the statutory accounts on page 19).

Commentary

Profit and loss account
Turnover has increased over that reported in 2005 due to the price increases allowed under the recent price determination (PR04).

Current cost operating profit has increased in 2006 as a result of the increase in turnover.

Operating costs have increased in 2006 due to additional pension costs and the increased level of depreciation being charged as a consequence of the company's investment programme. However, the company continues to make reductions in operating costs through efficiency improvements, which are having a positive impact despite the continuing upward cost pressures.

Net interest payable has decreased, the effects of the increased level of borrowing by the company to finance its investment programme being offset by the benefit arising as a consequence of low interest rates, and the net finance income on defined benefit pension schemes.

Balance sheet
The most significant movements have occurred in fixed assets due to the investment programme that the company has undertaken over the last five years. During that period, creditors due after one year have also increased significantly, this is primarily due to the increased borrowings of the group, required to finance the investment programme. In 2006, creditors due after one year reduced due to reclassification of loans to non-trade creditors due within one year. Non-trade creditors due within one year have also increased due to a higher bank overdraft.

Year ended 31 March 2006

Information in respect of transactions during the year with any other business or activity of the Appointee or any Associated Company

a) Borrowings or sums lent

Sums borrowed by the Appointee during the year from associated companies were:

		Principal amount £m	Repayment date	Interest Rate %
Severn Trent Water Utilities Finance Plc	Borrowed	31.9	2011/2015	4.8% - 5.2%

Sums borrowed repaid by the Appointee during the year to associated companies were:

Severn Trent Water Utilities Finance Plc	Repaid	15.0

b) Dividends paid to associated companies

The company's dividend policy is to declare dividends which are consistent with the company's regulatory obligations and at a level which is decided each year after consideration of a number of factors, including regulatory uncertainty, market expectations, actual and potential efficiencies, future cash flow requirements and balance sheet considerations.

The amount declared is expected to vary each year as the impact of these factors changes. Consistent with this policy, the dividend declared by the appointed business in 2006 amounted to £152.8 million (2005: £147.1 million).

c) Transfer of assets/liabilities

During the course of the year the Appointee acquired assets from Severn Trent Systems Limited in respect of computer and other equipment following the assimilation of the IT function into the Appointee for £0.7 million.

The asset valuation was based on cost in situ and was carried out by independent valuers.

The Appointee also acquired £0.2 million assets from Charles Haswell and Partners Limited in respect of other equipment following the assimilation of the activities of that business relating to the Appointee into the Appointee's activities.

The asset valuation was based on net book value.

d) Supply of services

Services supplied by the appointee to associated companies

Nature of transactions	Company	Terms	£m
Rental of office accommodation	Various	Market rent	0.8
Service charges in respect of payroll, legal, transport and other	Various	Cost including overheads	1.5
Water, tankering, reception, treatment and disposal of waste	Various	Market rates	1.0
			3.3

Services supplied to the appointee by associated companies

Nature of transactions	Company	Terms	Amount £m	Total UK turnover £m
Provision of waste services	Biffa Waste Services Ltd	Competitive letting/no market	5.6	712.3
Provision of engineering and design services	Charles Haswell and Partners Ltd	Other market testing/no market	3.0	4.6
Asset management	Cognica Ltd	Competitive letting/no market	0.1	1.0
Provision of customer care facilities	Complete Credit Management Ltd	Other market testing	1.4	4.3
Insurance services	Derwent Insurance Ltd	Other market testing	5.5	10.5
Analytical services	Severn Trent Laboratories Ltd	Other market testing	7.2	32.3
Supply of materials	Severn Trent Metering Services Ltd	Competitive letting/no market	13.1	22.8
Management fee	Severn Trent Plc	No market	5.5	
Management fee	Severn Trent Property Ltd	No market	0.1	16.9
Meter installation and provision of other engineering services	Severn Trent Services Ltd	Competitive letting/no market	2.1	13.5
Project development and managed service contract	Severn Trent Systems Ltd	Other market testing/no market	13.4	19.0
			57.0	

Of the £57.0 million (2005: £87.2 million), £21.7 million (2005: £38.7million) was spent on investment expenditure.

e) Omission of rights

None

f) Waivers

None

g) Guarantees

None

Unaudited financial and operating statistics

Severn Trent Water has made a commitment to publish information on its financial, customer service, operational and quality performance. This statistical section uses information primarily from this report and accounts, the company's annual drinking water quality report and information submitted to the Water Services Regulation Authority as part of the company's 'June 2006 return'.

The financial information contained in this section does not constitute statutory accounts within the meaning of the United Kingdom Companies Act 1985.

Contents	*Page*

Unaudited financial information

Group profit and loss accounts

	2002 £m	2003 £m	2004 £m	(restated) 2005 £m	**2006 £m**
Turnover	893.2	905.0	945.1	999.3	**1,137.7**
Operating profit	328.5	316.9	351.8[1]	324.5[2]	**405.4[3]**
Net interest payable	(119.4)	(118.9)	(123.8)	(130.0)	**(129.4)**
Profit for the financial year	209.1	198.0	228.0[1]	194.5[2]	**276.0[3]**
Taxation	(1.2)	(8.8)	(21.6)	10.4	**(57.8)**
Deferred taxation	(36.5)	(55.4)	(40.3)	(38.5)	**(39.7)**
Dividend	(139.1)	(141.9)	(158.0)	(147.1)	**(154.7)**
Retained profit/(loss)	*32.3*	*(8.1)*	*8.1*	*19.3*	***23.8***

1. After exceptional profit on disposal of assets £19.7 million.
2. After exceptional profit on disposal of assets £7.6 million and restructuring provision of £10.6 million.
3. After exceptional profit on disposal of assets £2.5 million and restructuring provision of £0.7 million.

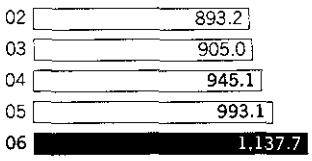
Group balance sheets

	2002 £m	2003 £m	2004 £m	(restated) 2005 £m	**2006 £m**
Fixed assets	4,560.6	4,711.2	4,873.9	4,971.3	**5,075.7**
Net current liabilities	(371.0)	(469.7)	(417.4)	(425.0)	**(631.0)**
	4,189.6	4,241.5	4,456.5	4,546.3	**4,444.7**
Creditors: amounts falling due after more than one year	(1,839.5)	(1,865.3)	(2,042.4)	(2,278.6)	**(2,114.7)**
Provisions for liabilities, charges and deferred income	(465.8)	(500.0)	(529.8)	(574.6)	**(594.9)**
	1,884.3	1,876.2	1,884.3	1,693.1	**1,735.1**
Capital and reserves					
Called up share capital	1,000.0	1,000.0	1,000.0	1,000.0	**1,000.0**
Profit and loss account	884.3	876.2	884.3	693.1	**735.1**
	1,884.3	1,876.2	1,884.3	1,693.1	**1,735.1**

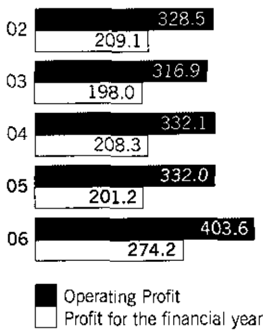
Turnover by category

	2002 £m	2003 £m	2004 £m	2005 £m	2006 £m
Measured charges	316.5	328.1	344.4	379.1	**448.9**
Unmeasured charges	536.4	529.0	549.7	567.0	**628.6**
Trade effluent	24.7	25.2	26.2	25.7	**27.1**
Other	15.6	22.7	24.8	27.5	**33.1**
	893.2	905.0	945.1	999.3	**1,137.7**

Turnover – £m



Profit – £m
(excluding exceptional items)



Net borrowings

	2002 £m	2003 £m	2004 £m	2005 £m	**2006 £m**
Cash at bank and in hand	0.1	0.1	0.1	2.4	**2.1**
Borrowings	(2,058.7)	(2,174.8)	(2,292.4)	(2,389.1)	**(2,486.9)**
	(2,058.6)	(2,174.7)	(2,292.3)	(2,386.7)	**(2,484.8)**

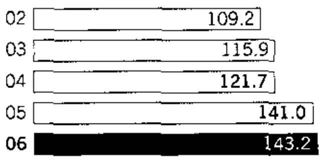
Key ratios

	2002 £m	2003 £m	2004 £m	(restated) 2005 £m	**2006 £m**
Liquidity					
Current ratio (times)	0.3	0.3	0.3	0.3	**0.3**
Profitability					
Gross profit margin (%)	36.8	35.0	37.2	32.5	**35.6**
Return on capital employed (%) : Historic cost	7.8	7.5	7.9	7.1	**9.1**
Return on fixed assets (%) : Historic cost	7.2	6.7	7.2	6.5	**8.0**
Return on fixed assets (%) : Current cost	1.2	1.1	1.2	1.0	**1.3**
Gearing					
Debt to equity (%)	109.2	115.9	121.7	141.0	**143.2**
Other					
Turnover per employee (£)	191,962	191,575	194,987	201,563	**274,139**
Operating profit per employee (£)	70,600	67,083	72,581	65,862	**80,729**

Employee numbers

	2002 No.	2003 No.	2004 No.	2005 No.	**2006 No.**
Employee number (average)	4,653	4,724	4,847	4,927	**5,023**
Employee number (year end)	4,698	4,819	4,935	4,872	**5,078**

Gearing – %
The gearing ratio is used as an indicator of the amount of debt compared to the company's equity i.e. shareholder's funds.



Customer service

Charges 2006/07

	Water £	Sewerage £	Total £
Severn Trent Water	140	133	**273**
Average of other 9 water and sewerage companies	156	195	351

Equivalent cost per day per household

Severn Trent Water	**75 pence**
Other water and sewerage companies average	96 pence

Measured charges

Water supply	**108.77 pence/cubic metre**
Sewerage	**73.23 pence/cubic metre**

Average household bill (including measured and unmeasured water charges)

Severn Trent Water	**£267**
Average of other 9 water and sewerage companies	£319

Customer payment statistics

	2002 '000	2003 '000	2004 '000	2005 '000	**2006 '000**
Number of customers paying by installments	1,666	1,710	1,759	1,689	**1,678**
Number of summonses	97	83	61	81	**80**
Percentage of unmeasured customers summoned	2.8%	2.5%	2.1%	2.6%	**2.5%**

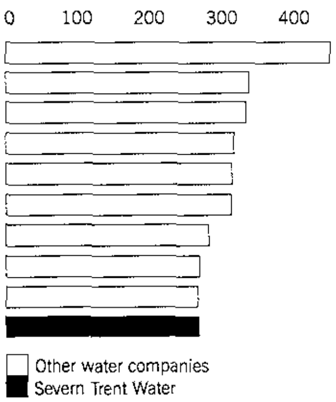
Disconnections

	No.	No.	No.	No.	No.
Domestic	0	0	0	0	**0**
Non domestic	594	990	732	489	**569**
Percentage of customers disconnected	0.01%	0.02%	0.02%	0.01%	**0.01%**

Customer complaints

	'000	'000	'000	'000	'000
	21	24	21	21	**36**

Customer service – £
Average annual household bill for 2006/07



Customer contacts

	2002 No. '000	2003 No. '000	2004 No. '000	2005 No. '000	**2006 No. '000**
By letter	948	847	779	346	**415**
Telephone calls	2,447	2,227	2,172	2,474	**3,057**
Total	3,395	3,074	2,951	2,820	**3,472**

Population

	2002	2003	2004	2005	2006
Water Supply	7,407	7,271	7,281	7,293	**7,411**
Sewerage	8,290	8,290	8,189	8,234	**8,764**

Billed properties

	2002	2003	2004	2005	2006
Water					
Unmeasured domestic	2,355	2,331	2,308	2,286	**2,264**
Unmeasured non-domestic	14	15	17	21	**14**
Sub-total	2,369	2,346	2,325	2,307	**2,278**
Measured domestic	602	646	688	731	**792**
Measured non-domestic	209	211	211	207	**186**
Sub-total	811	857	899	938	**978**
Total	3,180	3,203	3,224	3,245	**3,256**
Sewerage	3,563	3,606	3,626	3,654	**3,676**

New connections during year

	2002	2003	2004	2005	2006
Water supply	23	25	25	27	**19**
Sewerage	28	27	28	28	**18**

Levels of service

Under Condition J of the Instrument of the Appointment of the Water and Sewerage Undertakers, the Water Services Regulation Authority requires the company to provide information on a series of levels of service indicators which compare the service provided to specified performance criteria.

Company performance against Ofwat service indicators (properties/population meeting DG reference levels)

	2002 %	2003 %	2004 %	2005 %	**2006 %**
(DG2) Pressure of mains water Percentage of properties not at risk of receiving water at a pressure less than one and a half atmospheres at the stop tap on the boundary of the property	99.92	99.96	99.97	99.99	**100.00**
(DG3) Interruption to supply Percentage of properties not experiencing an unwarned loss of supply for more than twelve hours	99.62 (1)	99.93	99.99	99.99	**99.94**

Note 1 99.95% excluding single event at Telford

	2002 %	2003 %	2004 %	2005 %	**2006 %**
(DG4) Water usage restrictions Percentage of properties not affected by:					
Ban on hosepipes	100.00	100.00	100.00	100.00	**100.00**
Drought orders	100.00	100.00	100.00	100.00	**100.00**
(DG5) Flooding from sewers Percentage of properties where there is no risk of flooding from public sewers at a frequency of more than twice in ten years	99.98	99.98	99.99	99.99	**99.98**
(DG6) Response to billing contacts (see footnote at bottom of page 61) Response time for replies to billing contacts					
Under 5 days	99.2	99.96	99.98	99.55	**64.20**
Under 10 days	99.9	100.0	100.0	100.0	**69.6**
Over 10 days	100.0	100.0	100.0	100.0	**100.0**

In 2005/06 there were 2.3 million customer contacts. The company's performance in 2005/06 based on Ofwat's 2005/06 criteria would meet the 'poor' category.

	2002 %	2003 %	2004 %	2005 %	**2006 %**
(DG7) Response to written complaints (see footnote at bottom of page 61) Response time for replies to written complaints					
Under 10 days	99.5	99.9	100.0	100.0	**88.7**
Under 20 days	99.9	100.0	100.0	100.0	**88.7**
Over 20 days	0.1	0.0	0.0	0.0	**11.3**

The number of customer complaints received in 2005/06 has increased from those received in 2004/05.
The company's performance in 2005/06 based on Ofwat's 2005/06 criteria would meet the 'poor' category.

Levels of service continued

(DG8) Billing of metered customers
Percentage of customers who receive bills for metered accounts during the year based on actual readings as opposed to those based on estimates.

	2002 %	2003 %	2004 %	2005 %	**2006 %**
Company read	96.9	98.80	99.10	98.92	**97.54**
Customer read	1.4	0.96	0.74	0.81	**0.95**
Total read and billed in year	98.3	99.76	99.84	99.73	**98.49**

The company's performance in 2005/06 based on Ofwat's 2005/06 criteria would meet the 'acceptable' category.

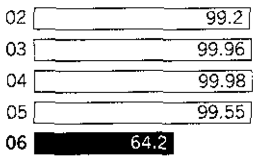
(DG9) Telephone contacts (see footnote at bottom of page)
Ease with which customers can make telephone contact and their satisfaction with the way the we handle their telephone call.

Percentage of calls from customers who receive an engaged tone	n/a	0.31	0.42	0.33	**20.93**
Percentage of customers who abandoned calls	n/a	1.19	0.61	0.86	**13.72**
Call handling satisfaction (score out of 5)	n/a	n/a	n/a	n/a	**4.29**

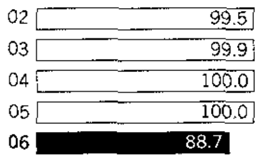
Guaranteed Standards Scheme	2002	2003	2004	2005	**2006**
Complaints answered within the guaranteed standards scheme time period	99.5%	99.9%	100.0%	100.0%	**88.7%**
Number of GSS claims automatically accepted for guaranteed standard payments	2,408	2,810	1,926	1,208	**1,784**

DG 6,7 and 9 as presented above for the years 2002 to 2005 are as previously reported but as noted elsewhere in the annual report and accounts, these are subject to investigation.

Response to billing queries within 5 days – %



Response to written complaints queries within 10 days – %

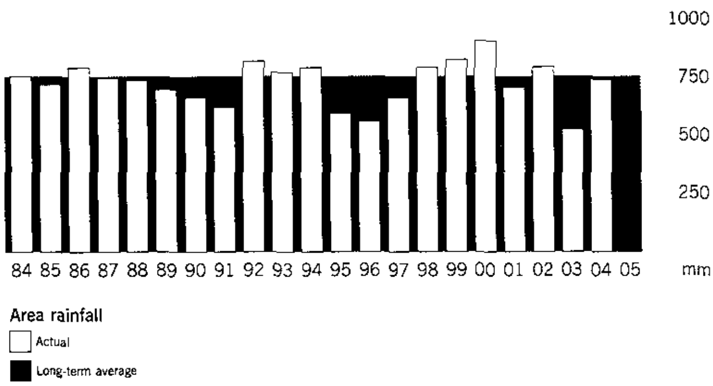


Climate

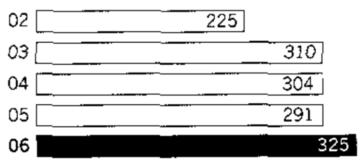
Rainfall

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	**2005**
Severn Trent region – area rainfall																					
Severn Trent region																					
– Rainfall (mm)	741	814	769	759	718	683	639	842	792	814	631	579	684	815	849	970	729	817	569	740	**602**
– % long-term average	96	105	99	98	93	88	83	110	102	105	81	75	88	108	113	129	97	109	76	98	**80**
Severn basin																					
– Rainfall (mm)	813	856	805	811	777	732	702	872	797	844	674	624	716	857	931	1013	761	863	601	790	**657**
– % long-term average	98	103	97	98	94	88	87	108	99	104	83	76	87	108	117	127	96	109	76	100	**83**
Trent basin																					
– Rainfall (mm)	685	790	747	723	676	647	576	808	781	785	585	540	661	783	777	861	706	781	498	699	**552**
– % long-term average	93	103	101	98	92	88	78	110	106	107	80	73	90	109	108	120	93	108	69	97	**77**

Note: % long-term average for data is based on figures from 1941 to 1970 up to 1997 and on figures from 1961 to 1990 since 1998.
Figures relate to calendar year.



Company leakage



Demand

Analysis of water supply sources

	2002 Ml/d	2003 Ml/d	2004 Ml/d	2005 Ml/d	**2006 Ml/d**
Reservoirs	527	534	503	521	**505**
River intakes	734	769	841	789	**784**
Groundwater	593	610	612	605	**646**
Total production	1,854	1,913	1,956	1,915	**1,935**
Treated water imports	23	23	18	18	**18**
Treated water exports	(7)	(7)	(7)	(8)	**(7)**
Total water into supply	1,870	1,929	1,967	1,925	**1,946**

Water demand

	2002 Ml/d	2003 Ml/d	2004 Ml/d	2005 Ml/d	**2006 Ml/d**
Household demand	1,143	1,118	1,168	1,140	**1,164**
Non-household demand	471	470	462	460	**424**
Water delivered to billed customers	1,614	1,588	1,630	1,600	**1,588**
Total water into supply	1,870	1,929	1,967	1,925	**1,946**
Company unaccounted for water *	225	310	304	291	**325**

* Since 2003 company unaccounted for water has been based on a revised method of assessment.

Operational statistics

	2002	2003	2004	2005	**2006**
Number of repairs carried out on mains pipes	6,902	6,667	7,513	6,462	**6,895**
Average time taken to repair bursts on mains pipes (days)	0.35	0.32	0.34	0.19	**0.12**
Number of repairs carried out on communication pipes	13,736	16,072	16,702	21,357	**20,547**
Average time taken to repair bursts on communication pipes (days)	0.15	0.15	0.15	0.13	**0.09**
Number of repairs carried out on customers supply pipes	8,100	8,345	8,556	7,332	**6,796**

Investment expenditure

Investment expenditure	1990 £m	1991 £m	1992 £m	1993 £m	1994 £m	1995 £m	1996 £m	1997 £m	1998 £m	1999 £m	2000 £m	2001 £m	2002 £m	2003 £m	2004 £m	2005 £m	**2006 £m**
Resources and treatment	37	57	96	116	117	89	79	72	47	56	54	27	40	47	25	14	**30**
Distribution	74	97	161	137	107	104	97	141	160	152	170	85	93	108	102	87	**106**
Sewerage	47	67	108	90	76	73	45	57	68	88	75	51	69	93	111	112	**108**
Sewage treatment	74	126	152	147	108	85	61	91	165	176	162	89	79	120	143	175	**135**
Recreation and amenity	0	1	11	4	2	2	1	1	1	1	1	1	1	1	1	2	**1**
Operational support	19	38	46	49	32	30	16	21	21	14	18	6	14	9	7	17	**9**
Other	10	9	11	7	3	3	23	29	54	80	76	61	54	47	53	45	**50**
	261	395	585	550	445	386	322	412	516	567	556	320	350	425	442	452	**439**

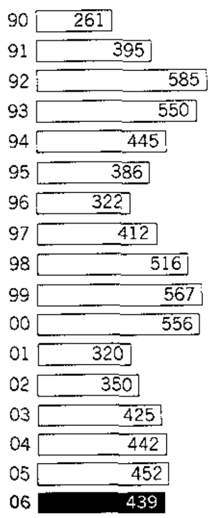
Analysis of investment expenditure

Analysis of investment expenditure	1990 £m	1991 £m	1992 £m	1993 £m	1994 £m	1995 £m	1996 £m	1997 £m	1998 £m	1999 £m	2000 £m	2001 £m	2002 £m	2003 £m	2004 £m	2005 £m	**2006 £m**
Capital expenditure	225	348	482	462	380	320	252	335	437	480	545	246	264	337	360	372	**338**
Gross infrastructure expenditure	36	47	103	88	65	66	70	77	79	87	11	74	86	88	82	80	**101**
	261	395	585	550	445	386	322	412	516	567	556	320	350	425	442	452	**439**
Cumulative investment since 1990	261	656	1,241	1,791	2,236	2,622	2,944	3,356	3,872	4,439	4,995	5,315	5,665	6,090	6,532	6,984	**7,423**

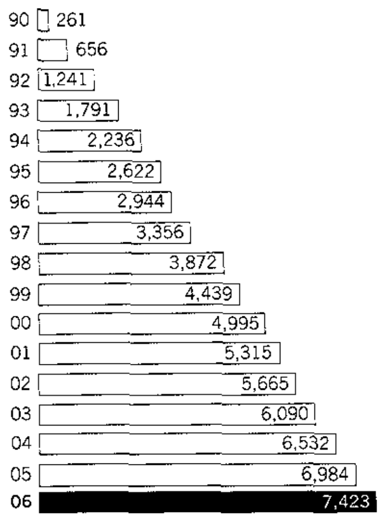
Physical outputs

Physical outputs	2002	2003	2004	2005	**2006**
Mains – added (Km)	103	109	178	151	**132**
– renewals (Km)	143	410	373	164	**267**
– relined (Km)	316	101	125	10	**0**
– number of communication pipes replaced	11,927	13,598	11,468	15,819	**25,640**
Sewers – added (Km)	354	265	239	221	**174**
– improved (Km)	10	28	22	7	**11**
Number of properties where problems of poor pressure alleviated by investment	1,156	3,478	1,172	1,000	**452**
Number of properties where risk of flooding from sewers has been removed	282	445	400	421	**206**

Investment – £m
Annual investment expenditure since privatisation



Investment – £m
Cumulative investment expenditure since privatisation



Major operational schemes carried out during year

Major operational schemes carried out during year	2006 Total £m
Monkmore sewage treatment works new ASP	8.9
Coleshill and Roundhill WID	8.8
Blackminister sewage treatment works RQO improvements	7.7
Nottinghamshire additional sludge digestion	3.9
Kenilworth, Mill End area flood alleviation	3.6
Derby SW Sinfin flooding alleviation	3.6
Derby sewage treatment works digestion	3.5
Maltby sewage treatment works (Abbey Lathe)	
UWWTD and asset renewal	3.3
Rugby Paynes Lane pumping station CSO UID	3.0
Titford Road foul water sewer	2.8

Operational assets

Operational assets	2006 No.
Impounding reservoirs	13
Groundwater sources	148
River water intakes	21
Surface water treatment works	19
Water supply booster stations	697
Service reservoirs sites	517
Mains (Km)	46,300
Sewers (Km)	54,151
Sewage treatment works	1,052
Sewage pumping stations	3,075
Sludge treatment facilities	66

Quality

Water supply

Water supply	2001	2002	2003	2004[2]	2005[2]
Overall quality of drinking water					
Number of determinations	273,907	279,891	277,419	188,277	**242,888**
% compliance with standards	99.9%	99.9%	99.9%	>99.9%	**>99.9%**
Quality of drinking water					
Water leaving treatment works					
Number of determinations	29,102	30,018	30,914	34,866	**34,902**
% compliance with standards	>99.9%	>99.9%	>99.9%	>99.9%	**>99.9%**
Water at service reservoirs					
Number of determinations	62,648	62,426	62,126	59,638	**58,632**
% compliance with standards	>99.9%	>99.9%	>99.9%	>99.9%	**>99.9%**
Water at customers' taps [1]					
Number of determinations (bacteriological)	39,890	39,196	38,388	-	-
% compliance with standards	99.8%	99.8%	99.8%	-	-
Number of determinations (chemical) [1]	106,267	148,251	145,991	-	-
% compliance with standards	99.9%	99.9%	>99.9%	-	-
Mean zonal compliance	-	-	-	99.96%	**99.95%**

Notes: Information on quality is based on calendar year in accordance with current Drinking Water Regulations. Percentage compliance up to 2003 is in accordance with standards as detailed in the Water Supply (Water Quality) regulations 1989.

In 2004 the basis of compliance was amended, and is now assessed on the Drinking Water Standards the Water Supply (Water Quality) Regulations 2000.

1. Water at customers' taps from 2004 is assessed on Mean Zonal Compliance.

2. Mandatory parameters only.

Sewage treatment quality

Overall compliance with standards	2001	2002	2003	2004	2005
Total number of sewage treatment works	1,016	1,014	1,017	1,053	**1,052**
Number of sewage treatment works failing consents	16	18	19	17	**16**
Information on compliance is based on calender year.					

Number of prosecutions by Environment Agency (EA) resulting in convictions	2002	2003	2004	2005	2006
Discharge from sewerage system	0	0	0	2	**2**
Sewage treatment works	0	0	0	1	**0**
Water treatment works	0	0	0	0	**0**
Other	0	2	0	2	**0**

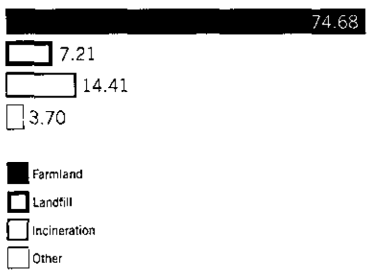
Compliance of numerically consented work	2001	2002	2003	2004	2005
Number of works with numeric consents	694	750	738	752	**752**
Compliance with sanitary standards (95 percentile) By tests to measure quality	99.3%	99.5%	99.5%	99.7%	**99.4%**
Compliance with sanitary standards (upper tier) By tests to measure quality	>99.9%	>99.9%	>99.9%	>99.9%	**>99.9%**
Compliance with non-sanitary standards By tests to measure quality	99.8%	99.8%	99.6%	99.7%	**99.7%**

Sewage

Sludge disposal	2002 tds	2003 tds	2004 tds	2005 tds	2006 tds
Farmland	81,400	82,800	135,500	125,500	**158,904**
Landfill	36,600	42,700	20,200	24,000	**15,341**
Incineration	27,200	24,600	37,200	33,400	**30,662**
Sea	0	0	0	0	**0**
Other	67,400	68,400	42,900	28,700	**7,873**
Total	212,600	218,500	235,800	211,600	**212,780**

tds = tonnes dry solids

Methods of sludge disposal – %



Community education

Our community education programmes continue to raise awareness of the benefits of using water wisely at home and in the workplace. School visits to our five education centres are still very popular particularly with Key Stage two pupils studying the Geography unit on water.

In 2004 we launched the pilot version of the 'Be Smart Award' for schools. This award is now into it's second year; from the twenty two schools in the pilot scheme we have now opened up the scheme to a further fifty schools.

We have trained over seventy volunteer Severn Trent mentors to work alongside these schools to achieve the award and thirty schools have already completed the scheme and received their Be Smart Trophy. In December 2005 we held the first Be Smart School of the Year competition and St Bernadettes R & C School from Birmingham won the prize of one thousand pounds to spend on environmental improvements around their school. We filled our allocation of fifty schools for the 2005/06 school year and are now recruiting schools to start the scheme in September 2006.

One of the goals of the Be Smart scheme is to study water issues both locally and globally. To support schools with this aspect of the scheme we worked in partnership with TIDE (Teachers in Development Education) and DFID (Department for International Development) to produce a new photo pack resource for schools. This was launched in October 2005 and is now included in the Be Smart resource pack. The website www.thewaterfamily.co.uk is now well established and is a popular activity for pupils both at school and on line at home. The enhanced CD version which has additional features including sound makes the activity available to a wider group of children at school.

Education centres

Health and sustainability continues to provide the focus for the work in our five education centres. This year we hosted visits from over 23,000 pupils and 1,000 teachers who spent a full day at one of our operational sites. The Good Food show at the NEC was another great success this year and once again we gave away over 60,000 refreshing drinks of water to a very receptive audience.

Projects for 2006/07

This year we wish to improve the experience of pupils visiting our education centres by developing new activities and opening a sixth centre at Trimpley near Bewdley on a part time basis. Our other projects are designed to maximise the use of our STwater website we are creating a site to allow schools to participate in the Be Smart scheme on line and developing a pupil and teacher research site called Waterwise which should support teachers to plan lessons on water and pupils to use for their water projects.

Our education centres these are based at:
Barston sewage treatment works
Carsington reservoir
Cropston water treatment works
Hayden sewage treatment works
Stoke Bardolph sewage treatment works

For further information on how to arrange a visit to one of our centres please contact Community education, Severn Trent Water Limited, 2297 Coventry Road, Birmingham B26 3PU.

	2002 No.	2003 No.	2004 No.	2005 No.	**2006** **No.**
Community Education visitor numbers					
Visitors to Severn Trent Water sites:					
Number of pupils visits	29,973	35,084	37,935	34,320	**22,117**
Number of adult/teachers visits	8,230	7,544	8,055	8,560	**4,070**
Talks given at non Severn Trent Water sites:					
Number of pupils	8,195	11,290	9,039	10,921	**3,378**
Number of adults	2,555	2,112	2,159	3,150	**1,566**

Main offices

Information on the company may be obtained at any of the following main Severn Trent Water offices:

Registered Office
Severn Trent Water Limited
2297 Coventry Road
Birmingham B26 3PU

Company number: 2366686

Directors
M W Keogh
R S S Martin
C S Matthews
G C Messham
S H Reilly
P F Stephenson
S K Stubbs
A P Wray

Business telephone numbers
Billing enquiries:
Tel: 08457 500 500

Operations and emergencies:
Tel: 0800 783 4444

All other enquiries:
Tel: 0121 722 4000

Company website
www.stwater.co.uk

Group website
www.severntrent.com

E-mail
customer.relations@severntrent.co.uk

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Finham
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Severn Trent Water Limited
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www.stwater.co.uk

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