

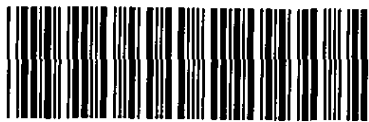
Severn Trent Water Limited

Financial Statements

For the year ended 31 March 2007

Registered number 2366686

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Cautionary statement

From March 2007, Severn Trent Water Limited is required to publish an Operating and Financial Review in accordance with best practice requirements for Water Company Annual Reporting, as stated by Ofwat. The OFR follows the Accounting Standards Board guidelines set out in January 2006.

In preparing this Operating and Financial Review, we are required to advise the reader that by their nature, all forward looking statements made involve uncertainty since future events often cause outcomes and results different to those anticipated.

Operating and financial review

What we do

Severn Trent Water is part of Severn Trent Plc, a FTSE 100 group focused on water

Turnover

£1,206.9 million

5,154 employees

We supply water and waste water services to over

3.7 million household and business customers

Our region covers some

21,000 square kilometres

in the Midlands and mid-Wales

Regulatory and monitoring environment

Regulation

The water industry is monitored and controlled by government-appointed regulators who report each year on standards and progress

Drinking water quality is regulated by the Drinking Water Inspectorate (DWI). Compliance with EU and UK environmental standards is regulated by the Environment Agency (EA)

The industry's economic regulator is the Water Services Regulation Authority (Ofwat). Ofwat ensure that we finance and carry out our functions properly, and also sets our price limits

Monitoring our performance and position

The DWI publishes an annual report assessing the quality of water supplied by us. It also reviews our standards in the previous calendar year

The report includes the results of thousands of tests carried out across our region. According to these we have consistently achieved 99.9% compliance with water quality standards since 1997. DWI annual reports are published on the Inspectorate's website www.dwi.gov.uk

Ofwat measure our customer and operational service against a number of 'DG' performance indicators. Compliance with these indicators are measured annually and compared across the industry to compile league tables

Additionally Ofwat request the submission of an annual 'June Return', reporting a range of activities in the previous financial year

Both DG standards and the June Return enable monitoring of performance and progress, and ensure that customers' standards of service are protected. They also enable comparison of performance and costs across the industry. More information can be found at www.ofwat.gov.uk

Ofwat also control our pricing. The current price limits were set in 2004, for the period April 2005 to March 2010, the current Asset Management Plan period (AMP4). Price reviews take place every five years, the next review being in 2009

Coverage

Our region stretches from mid-Wales to Rutland and from the Bristol Channel to the Humber. We deliver nearly 2 billion litres of water a day to homes and businesses through 46,000 km of pipes. A further 54,000 km of sewers take waste water away to over 1,000 sewerage works

Our physical assets include:

- > 181 ground water treatment works
- > 18 surface water treatment works
- > 27 impounding reservoirs
- > 679 water supply booster stations
- > 547 service reservoirs and towers
- > 1,017 waste water treatment works
- > 2,953 sewerage pumping stations
- > 39 sludge treatment facilities
- > 46,000 kilometres of water mains
- > 54,000 kilometres of sewers

Focused activities

> Recovering customer service levels

We recruited more staff in our customer service contact centres and expanded their training. We also fixed problems with the billing IT system and streamlined our 24 hour, 7 days a week operational management centres. By March 2007 we were beginning to approach the levels of customer service that customers and regulators expect from us

> Reservoir levels and water supply

Despite a long dry summer and a dry winter in 2006/07, reservoir levels were normal for the time of year at the end of March 2007. We did not impose any hosepipe bans

> Regulatory investigations

In response to Ofwat's interim report of March 2006 regarding allegations of false reporting made in 2004, we credited customer accounts. We also made appropriate alterations to bills for subsequent years

> A more efficient organisation

We have effected organisational improvements. We are well on the way to completing the integration of the Plc and Water teams, bringing cost efficiencies, cutting management layers and sharpening our focus on what is happening on the front line

Our strategy in practice

Our strategy takes into account the needs of many different stakeholders. Our plans for higher standards will help us satisfy the expectations of all the different groups. For example, greater operational efficiency will help us keep charges to customers low, meet our regulators' standards and targets, create a safe and motivating environment for our employees, and produce good returns for shareholders.

Our goal is to have highest standards, lowest charges and great people. Phase one of achieving that goal was to restructure the group so we could focus on water. With that done, we have moved into phase two – the drive to achieve higher standards and continuous improvement in all we do.

Measuring our performance

Radical plans for improvement

Over and beyond these basic requirements, management is fully engaged in implementing plans for fundamental improvement across all areas of the business. The successful execution of these improvement activities will radically change our business over a period of years.

We have already effected organisational improvements. In addition to the integration of the Severn Trent Plc and Severn Trent Water Executive teams we have changed the divisional structure. In place of our previous 'functional' structure, which had distinct teams working on planning, engineering and operations, we have created integrated teams, one focused on clean water, one focused on waste water and one focused on customer relations. This new structure is designed to raise standards and drive greater efficiency. It also aligns the organisation with the processes that matter to our customers.

During 2006/07 we examined every aspect of our current performance. We benchmarked it against companies in the water and sewerage sector, and also in other sectors. The benchmarking exercise was detailed and thorough. We used a range of publicly available and internally generated data to identify the population that we should compare ourselves to. This process involved a number of judgements being exercised to ensure that we used appropriately comparable data points for each measure.

We have identified 20 critical success factors against which we will measure our performance and progress. We have chosen these indicators with great care, because they represent what we believe are the key concerns for our customers, regulators, employees and shareholders. These 20 factors will be represented by 20 KPIs. In all but two cases, we have defined our actual performance based on our benchmarking exercise and we propose to use these as a basis for assessing our performance going forward. Two KPIs are new (first time job resolution and capital process quality) and we need time to assess our current performance and define our objectives. For all other KPIs, we have shown where our starting point is on a relative scale based on the results of our benchmarking exercise. For each indicator, we have set ourselves ambitious targets for the coming years, and drawn up action plans for achieving them. Some improvements will be effected relatively quickly and easily, others are longer term, going beyond the current AMP4 period.

The table on the next page sets out our actual performance for the period under review. Based on our benchmarking exercise, our performance is shown in one of three categories, of what we consider to be lower quartile performance, upper quartile performance or median (representing 2nd and 3rd quartile performance).

Higher standards

Continuous improvement

Greater efficiency

Key performance indicators

Key area	Objective	Basis	Measure	Performance Lower quartile	Median	Upper quartile
Employee	Provide a safe working environment	MAT	Lost time incidents per 100 000 hrs worked ¹			0.50
	Develop a confident and productive workforce	Annual Survey	Employee motivation ²			76%
Customer	Provide a high quality product	MAA	Water quality (mean zonal compliance) ^{3,4}			99.98%
	Quality interaction with the customer	MAT	Customer written complaints per 1,000 properties ³	19.06		
		MAT	First time call resolution for billing % ⁵			80%
		MAT	Unplanned interruptions per 1,000 properties ³	6.95		
	Provide a high standard of operational service		Properties at risk of low pressure per 1,000 properties ^{3,6}			0.09
			First time job resolution ⁷	To be determined		
	Development of a sustainable service		Performance against regulatory obligations ^{8,9}		26%	
Financial	Asset base enhancement	MAT	Capex (gross) vs final determination ^{3,9}			2.7%
			Capital process quality ⁷	To be determined		
	Manage trade debt		Debtor days ^{6,9}		37.5	
	Management of cost base	MAT	Opex vs final determination £m ³	479.1		
		MAT	Cost to serve per property £ ¹⁰		226.93	
Environment	Minimise environmental impact	MAT	Pollution incidents per 1,000 properties ^{3,4}		0.08	
		MAT	Sewer flooding – other causes per 1,000 properties ³		0.16	
		MAT	Sewage treatment works – breach of consents ³			0.00%
	Optimise use of resources	MAA	Raw water storage ^{5,6}			90%
		MAT	Net energy use Kwh/MI ³		618	
			Leakage MI/d – current DMA ¹¹	446		

Notes

All measures are for the period to 31 March 2007, except as stated

MAT = Moving Annual Total

MAA = Moving Annual Average

1 Actual performance across all employees and agency staff

2 Performance based on annual all employee survey and quarterly survey of 10% of permanent employees

3 As reported in June Return to Ofwat. Performance figures are provisional at this stage as the June Return will be submitted to Ofwat on 15 June 2007

4 Measure for calendar year to 31 December 2006

5 Actual performance based on internal data

6 Measure as at 31 March 2007

7 Measure and relative performance to be determined

8 Measure for quarter ended 31 March 2007

9 Actual performance based on audited UK GAAP financial statements for the year ended 31 March 2007

10 Actual performance based on audited UK GAAP financial statements and regulatory accounts for the year ended 31 March 2007

11 DMA leakage performance measured monthly. Month of March 2007 DMA performance disclosed in table above. Annual measure is MLE leakage the calculation of which has not been completed as at 5 June 2007

For a number of KPIs, we have only commenced capturing the data and measuring our performance during the current financial year and therefore corresponding amounts for the previous financial year are not available

For others, the corresponding amounts are available and these are as follows,

> Water quality	99.95%
> Customer written complaints	10.04
> Unplanned interruptions	4.5
> Properties at risk of low pressure	0.10
> Capex vs final determination	6%
> Debtor days	31.76
> Opex vs final determination	£446.5m
> Cost to serve per property	£219.56
> Pollution incidents	0.11
> Sewer flooding incidents	0.14
> Sewage treatment works breach of consents	0.31%

It is not statistically realistic to expect any company to be at the top of every single league table, but nevertheless, we aim to achieve upper quartile performance over the next 3 to 5 years

Of course, the goal posts will move, as companies in our sector or elsewhere redefine what upper quartile means, so we expect our target to move with it

We will report on these measures in future results announcements

Operating and financial review continued

Managing Director's review | Tony Wray

2006/07 was a pivotal year for Severn Trent Water. The company has undergone a significant degree of change, restructuring and scrutiny. Whilst the additional activity has been challenging, I am delighted to report that we completed the year with a renewed organisation, a new management team and a refreshed mission to raise standards and deliver low charges for our customers.

We started the year with the legacy of our new billing system implementation and difficulties with our ability to answer customer telephone calls and queries. Our leakage had increased above our target. We were in the process of carrying out investigations into regulatory reporting of our customer service data and we faced the continuing challenge of dramatically increasing our capital investments in our networks.

In all of these areas we have made significant improvement and we are beginning to see the benefits of the process improvements we have launched during the year.

With regard to our billing and call handling we have progressively fixed our computer systems, we have recruited more staff and we have invested in quality training to improve the point of service to our customers. In the final quarter of the year we began to see the benefits with improved availability of representatives for our customers and complaints beginning to reduce. In addition, we have created a single control and customer contact centre for all of our operational customer contacts, which is making a significant contribution to improving our speed of response and resolution of water supply and sewerage issues.

On leakage we have invested heavily throughout the year. We have employed more staff to find and fix leaks more quickly and reduced leakage in the year. This effort has reduced our leakage this year but it was not until the month of March 2007 that we attained a monthly level of leakage commensurate with our Ofwat annual target. Therefore, notwithstanding this reduction, we believe that we will not attain the annual average target level of leakage.

We have completed our investigations into the customer relations issues discovered by us and reported to Ofwat. Co-operating fully with Ofwat and independent forensic accountants Ernst & Young LLP (appointed jointly by us and Ofwat), we have provided our final reports to Ofwat and we await their deliberation and decision on any sanction they may apply.

With regard to capital investment we increased our commitment to our networks with a total investment of approximately £502 million. This included the replacement of mains and sewers, sewer flooding relief schemes, new sewage treatment schemes and water quality improvements to safeguard the highest standards of drinking water and water discharge to waterways in our region.

Whilst undertaking these changes our staff have continued to maintain the highest levels of drinking water quality, sewage treatment, environmental stewardship and community involvement in our region. We have not faltered in the delivery of our primary duty to provide high quality and safe drinking water and sanitation at cost effective levels.

Another area where high standards are paramount is in our Corporate Responsibility (CR). Our CR strategy is at the heart of our business and includes several subject areas. These subjects, including, health and

safety, climate change, the local environment, engagement with local communities, business ethics, diversity and investment in people, are referred to across several areas within this review. This reflects the cross functional nature of the strategy and demonstrates the ways that we have embedded and managed CR across the company.

In 2006/07 we examined every aspect of our current performance. We benchmarked it against companies in the water and sewerage sector and also in other sectors. We identified major opportunities for improvement and we drew up detailed action plans for achieving those improvements. We have identified 20 critical success factors, against which we will measure our performance and progress. We have chosen these with great care because they represent the key concerns for our customers, regulators, employees and shareholders. These 20 factors will be represented by 20 KPIs. In all but two cases, we have defined our actual performance based on our benchmarking exercise and we propose to use these as a basis for assessing our performance going forward. For each indicator we will set ourselves ambitious targets for the coming years and draw up action plans for achieving them. Some improvements will be effected relatively quickly, others are longer-term, going beyond the current AMP4 period.

2006/07 saw major internal restructuring with the Severn Trent group becoming focused on water. The integration of the Severn Trent Water and Severn Trent Plc teams has cut management layers and sharpened focus on our frontline activities.

Process improvements as well as the integration of teams are expected to result in staffing levels (permanent and agency) being reduced by around 600 posts (10%) over the next five years. However, within this overall trend, it is sometimes desirable to increase staffing levels in certain key areas. In 2006/07, for example, we recruited additional staff in three key areas: in our customer service call centres, to work on leakage control and in our domestic meter reading teams. By investing in such areas as and when necessary we seek to ensure we can give the best possible service levels to customers and regulators.

In the final quarter of the year we implemented our internal restructuring, delivering an organisation based on clear processes, improvement and responsibility for customers, the water network and the waste network. This provides the basis for continuing performance improvement through 2007/08 to contribute to our aim of improved standards, lowest charges for our customers and great employees delivering for all of our stakeholders.

Outlook

In the first two years of the AMP4 contract we have made good progress on the outputs set by Ofwat. Maintaining this activity will govern our activities for 2007/08 and beyond. In order to meet our efficiency targets, we will also continue our work to improve leakage and customer service performance.

Our ability to achieve significant operational improvements in 2007/08 and to achieve our AMP4 objectives will be boosted by the introduction of our 20 KPIs. They give us clear year by year objectives, as well as establishing robust action and improvement plans for achieving them. This will assist both internal and external scrutiny of activities and deliver our strategy of focus on water.

Operational performance

Water quality

Our customers' top priority is the safety and reliability of their drinking water supply. We have a strong track record in this area, having consistently achieved 99.9% compliance with water quality standards set by the DWI since 1997. This represents one of the best compliance records in the industry.

We and our regulators measure water quality in a number of ways. Our water quality KPI is based on 'mean zonal compliance'. This is an overall measure used by the DWI to measure the extent to which samples taken at customers' taps comply with all the requirements of the Water Supply (Water Quality) Regulations 2000.

The DWI's performance tables for the 2006 calendar year, which are based on more than 500,000 tests from samples of our water, showed that we achieved 99.98% mean zonal compliance. This is an improvement on the previous year's performance.

During 2006/07 we delivered a number of programmes designed to maintain and improve water quality. They included schemes to secure compliance with mandatory standards for cryptosporidium and for nitrate reduction. In addition we carried out an extensive and targeted mains cleaning programme to improve the aesthetic quality of the water we supply.

We are continuing to develop drinking water safety plans for our treatment works and our investment programme for water quality in 2007/08 includes further mains cleaning, more nitrate reduction schemes and lead removal schemes. This will ensure we maintain our high levels of water quality throughout the distribution system.

Water supply

We have chosen two KPI's relating to water supply to our customers. These are Ofwat's DG2 and DG3 indicators on risk of low pressure and unplanned interruptions to supply.

In 2005/06 Ofwat deemed our performance on unplanned interruptions to supply 'good'. However in 2006/07 our figures deteriorated, primarily because of five operational events in the summer. This year, using the DG3 definition, around 36,100 properties experienced an unplanned supply interruption, compared to around 15,200 in 2005/06. This represents 1.07% of the properties connected to our network, compared to 0.45% in 2005/06. We have put in place an action plan to improve performance focusing on our network assets, our processes for responding to problems with water supply and our contingency planning for events such as power outages.

With regards to water pressure, we continued our performance in 2006/07, with 314 properties across our region at risk of experiencing poor pressure at year end compared to 313 properties in 2005/06. This represents less than 0.01% of the properties we serve.

During 2007/08 we will install several thousand fixed pressure loggers which will provide much better data on our network, enabling us to improve our performance further.

Leakage

Our leakage increased in the prior year 2005/06. As we announced in this last year, 2006/07, we devoted greater resources to leakage management. We employed more people, invested in new leak detection technology and fixed 37,000 leaks, 8,000 more than the previous year. We invested almost £20m more than the previous year. This effort has reduced our leakage this year but it was not until the month of March 2007 that we attained a monthly level of leakage commensurate with our Ofwat annual target. Therefore, notwithstanding this reduction, we believe that we will not attain the annual average target level of leakage.

We have kept Ofwat fully informed of our progress and we are in the process of finalising and verifying our leakage data for submission in our annual June Return, which will be submitted in a few weeks. In due course we will be discussing with Ofwat our ongoing plans and commitments to maintain our progress in reducing leakage.

The largest single element of our investment in leakage management is incurred in our mains renewal programme. The Ofwat Determination for AMP4 assumed around £184 million of expenditure over 5 years (in nominal terms). We have already invested around £85 million in the first two years and we expect to invest a total of around £231 million, some 26% more than assumed in the Determination, over the whole AMP4 period on mains renewals alone.

Reducing leakage will remain a priority in 2007/08 and we are determined to maintain the good progress we have made in the second half of 2006/07. We are in a good position going into this new year.

Sewer flooding

The flooding of a home or property with raw sewage is viewed by many as one of the most unpleasant problems our customers may endure. Overall, for the first two years of the AMP4 programme, we are ahead of our Ofwat target in this area. We will continue working to achieve a net reduction year on year in the number of properties at risk of flooding from sewers.

Our own KPI on sewer flooding is to reduce the number of incidents from blockages, sewer collapses etc in the next five years.

In 2007/08 we will remain focused on permanently reducing the risk of internal and external flooding with the aim of benefiting an estimated 1,600 properties.

Our 2006/07 performance in terms of actual sewer flooding incidents shows figures rising slightly from 2005/06. Changes in weather patterns with increased numbers of intense storms, have been one of the contributing factors to increases in flooding.

There are two main routes for achieving both measures of reduction. One will be the completion of schemes already underway, such as the £14 million scheme to alleviate sewer flooding in Kenilworth. The second is solutions such as better targeted routine sewer cleansing programmes to prevent blocked sewers flooding after storms.

Operating and financial review continued

Operational performance continued

Sewage treatment works compliance

Our KPI in this area measures our compliance with the discharge consents for our sewage treatment works. We have a good history of performance in this area, although a poorly performing sewage works at Stratford upon Avon reduced our overall performance figures for 2005 (based on calendar year). In 2006, with that specific problem remedied, our compliance levels were excellent and we achieved a compliance rate of over 99.9%. This level of compliance is amongst the best in the industry.

Pollution incidents

Another KPI which relates to our handling of waste water is the number of EA reported category 1, 2 and 3 incidents. Our total number of such pollution incidents was 530 in 2006 calendar year, which was lower than 2005 but was still too high. The EA measures incidents on a scale of one to three and of the total recorded, two of our incidents were of the most severe in category 1 and eight were category 2. This performance is comparable to the industry average using 2005 data.

Within the total number of pollution incidents, 98% (520) were category 3 incidents which are classified as having very limited and localised environmental impact. This particular aspect of performance was similar to our 2005 performance (519), placing us in the lower quartile for the industry. We have taken positive steps in developing an action plan to deliver pollution reductions. Whilst we only have the first quarter performance for 2007 the results are encouraging, showing a decrease of almost 35% for category 3 incidents compared to the first quarter of March 2006.

The action plan is linked to our proactive and reactive work on the sewerage network and we have kept both Ofwat and the EA informed, with meetings scheduled throughout the current reporting year to update them on progress.

We have also instigated an initiative to raise customer awareness around the impact of depositing fats, oils and greases in to the sewerage system. Significant numbers of our sewer blockages are caused by fat build up which in turn contributes to the number of pollution incidents. We plan to educate customers about the potential problems of pouring fat down sinks and drains and offer to provide and distribute free 'fat traps'. These are small containers to hold cooled fat for easy disposal with household waste. We raised awareness of this initiative through our annual Source magazine which accompanied all of our annual bills distributed in February and March 2007.

Across the region we have a number of large scale construction and upgrade projects at a number of sewage treatment works. These upgrades are already underway as part of our AMP4 capital programme and when completed will result in environmental improvements. We are pleased to report that work is currently on schedule.

Health and safety

We have stressed repeatedly that health and safety is one of our key priorities. At business level, it is also an important indicator of quality and at workplace level, the physical well-being of our employees is paramount. This is why we have developed a KPI specifically relating to health and safety.

Overall, we reported a 20% reduction in the RIDDOR accident rate per 1,000 employees in 2006/07 achieving our target for the year. For the current year we are targeting a 15% reduction in lost time injuries. This is a broader measure than we have used previously as it includes all injuries that result in time off work, not just the serious longer term injuries.

We have run and continue to run two major safety initiatives, the first concerning behavioural change and individual engagement with the aim of improving safety and general business performance. We encourage our employees to share and debate their ideas about safety and to put these ideas into practice. Towards the end of 2005/06 we began to develop a behavioural safety programme based on SUSA (Safe and Unsafe Acts) principles. This is a one-to-one work based observation and discussion process in which SUSA trained managers talk regularly with their team members about the way in which they and their team do their jobs. It is based around encouraging the employee to see the behavioural hazards in the job they are doing and sharing the management values that require the job to be done safely.

By the end of March 2007, over 80% of managers had received SUSA training. The remaining 20% will receive the training in 2007/08 and there will also be a rolling programme to give SUSA training to new managers. There is also a target for each manager to have at least one SUSA discussion every week.

The second major initiative for completion is completing a safety process review of all of our UK water and waste water sites. A survey is being carried out at each site, with a target date for completion of April 2008 to identify any intrinsic health and safety hazards which create risk for our maintenance staff and operatives. Each survey generates an action plan to reduce or eliminate the hazard with some improvements being made immediately and larger improvements being incorporated into our capital investment plan.

As well as completing the safety process review, our plans for 2007/08 include setting up a new technical verification function. This team will independently assess the quality of our operations against company technical and operational standards and industry best practice. The objectives are to bring together our behavioral and process initiatives in the best manner and to bring continuous improvement to our technical and operational activities and reporting.

In 2006/07 we were awarded an Institution of Occupational Safety and Health (IOSH) Achievement Award for excellence in our internal health and safety communications. Also, in 2006, our safety management system was externally audited at a sample of six operational sites by the British Safety Council. We received four and five star status for achieving 'very good' and 'excellent' health and safety standards on site. This provided us with a real endorsement of current health and safety standards as well as ideas for reducing accidents and improving productivity in the future.

Energy efficiency

Energy costs are a major element of our cost base and were especially so in 2006/07 following price rises. Managing energy consumption is also an essential element in mitigating our environmental impact. We have developed a KPI on net energy use to help us to tackle both of these issues, measuring how much energy (net of renewable energy generated by us) we consume per mega litre of water or waste water treated.

In 2006/07 we continued to manage our net energy consumption in two principal ways. First, we maintained our renewable energy production at around 155,000 MWh, this represents 16% of total electricity used.

Secondly, we managed net energy consumption through energy efficiency programmes. In 2006/07 we completed on schedule site energy reviews of all of our top 407 sites that accounted for 85% of our electricity use. The review resulted in individual Site Energy Management Plans (SEMP) for 330 sites, which include local actions to improve plant/process optimisation and identify potential 'spend to save' opportunities. The review has identified generic approaches required to manage energy on the remaining sites, we believe these plans will enable us to save up to 10,000 MWh of electricity during 2007/08.

In forthcoming years, implementation of regulations such as the Urban Waste Water Directive and the Water Framework Directive will increase our energy requirements. In order to offset that, we plan to expand our renewable energy production even further. We are planning a number of new opportunities and will continue to work on this in 2007/08 and beyond. In addition to extending our current Combined Heat and Power (CHP) biogas production, the opportunities we are planning include biomass energy crops, micro-generation, wind turbines and extending hydropower.

Management of resources

Physical resources

During the financial year we invested £103 million (£98 million net of grants received) in maintaining our infrastructure network. Capital expenditure, excluding spending on infrastructure maintenance, was £399 million. Gross capital expenditure under UK GAAP (including infrastructure maintenance expenditure) was £502 million.

The KPI capex (gross) vs final determination, measures our performance on managing the financial aspects of the delivery of our investment programme. This measures the percentage variance between our capital expenditure and Ofwat's final determination for AMP4. This assesses one aspect of performance against our objective of delivering services to our customers at the lowest cost. Other KPIs (most notably the capital process quality measure) will assess our delivery of high quality services.

Adjusting for minor timing differences and modifications to the AMP4 capital programme (notified to Ofwat through the change control process), we are on track to deliver the programme over the AMP4 period. We continue to be in line to achieve around 6% efficiencies compared to Ofwat's final determination for AMP4.

Serving customers means looking after their long term interests as well as immediate concerns and so we must take a long term view of our physical assets. Our main aim is to ensure that we are maintaining the serviceability of our assets. This means carrying out the necessary work to make sure our water and sewerage systems deliver reliable service in the future for our customers and the environment. Two of the major aspects Ofwat take into consideration are the condition and deterioration of our above and below ground water and sewerage assets and the most recent assessment shows that we have stable serviceability across our asset base.

We will aim to improve continuously the delivery of our capital programme. We are in the process of developing a KPI that will measure the quality of capex delivery.

Costs

We recognise that controlling our operating costs is a key component in our success. We continued work started in 2005/06, to make process improvements leading to a reduction in employee numbers and removal of management layers.

We have developed two KPIs to measure our performance on managing costs. The first measures the variance between our latest formal forecast of operating costs vs Ofwat's final determination for AMP4.

The second indicator is the total cost (including operating costs, depreciation, infrastructure renewals and third party costs) associated with serving each customer property.

Natural resources

Our water supplies are fundamental to our business. We therefore have a KPI focused on raw water storage, comparing the percentage of raw water available at our reservoirs against our three year rolling average.

In 2006/07 our raw water storage levels were good despite a dry summer and we did not impose a hosepipe ban during the year. Storage levels at year-end were normal for the time of year.

Our Water Resources Plan sets out our water resources investment programme until 2010 and gives a 25 year development plan to 2030. Whilst we have committed to delivering a 17 Ml/d reduction in leakage over the AMP4 period, our analysis for the period 2030 shows there is a potential need for new strategic water resource developments and further leakage reductions to counter the effects of climate change on the supply/demand balance for water. We therefore aim to carry out work during AMP4 and AMP5 to better understand the climate change impacts and to plan longer term feasibility studies that will ensure water supply to our customers at least cost to them, whilst still considering the longer term social and environmental impact of future increased water abstraction. A key part of this process will be to continue to reduce demand and promote water efficiency.

Reputation

We and our stakeholders are very much aware of the unacceptable mistakes that were made within the company between 2000 and 2004. The board and management team, alongside Severn Trent Plc, are determined that those mistakes will not be repeated. Our ambition is to restore the trust of our customers and Ofwat.

We are waiting to learn from Ofwat and the Serious Fraud Office the conclusion of investigations into reporting irregularities. We acknowledge that further amends may be made to customers and a penalty may be payable, depending on the outcome of the investigations.

In response to Ofwat's interim report of March 2006 concerning allegations of false reporting made against us in 2004, we have already credited customer accounts and altered bills appropriately for subsequent years.

In June 2006, Ofwat issued a notice under S22A (4) of the Water Industry Act, stating its intention to fine us for failure to meet customer services standards under the Guaranteed Standards Scheme (GSS) for water companies. The notice covered performance since June 2005. In addition, we have fully co-operated with Ofwat and Ernst & Young LLP on their independent investigations into customer service performance and misreporting which includes performance prior to June 2005.

We await the conclusions of those investigations and details of the financial penalties that will be imposed on us. In June 2006 Ofwat also issued a notice under section 203 of the Water Industry Act requiring further information to be provided about the misreporting of data and our performance against DG standards and the GSS scheme. Data for these areas has been provided to Ofwat going back as far as 1995 and we have answered their detailed questions. Our final response was submitted on 31st January 2007. We anticipate that Ofwat will respond with a further S22A notice of intention to impose a penalty for misreporting of data since June 2005.

In the meantime we have done much to improve current customer service standards. This is detailed in pages 8, 9, 10 and 11 of this review.

Customer research

In 2006/07 three out of four planned phases of customer 'willingness to pay' research were completed. The aim of the research was to ascertain customer priorities and their willingness to pay for service improvements over and above base levels. The final phase will be completed in 2007/08 and the results will be used in the forward planning stages for PRO9 cost benefit analysis.

We also continued with our customer tracking research, collecting information on perceptions of our business and activities, in July 2006 and January 2007. Tracking research will be developed in 2007/08 to reflect changing business needs and to include the measures of willingness to pay. It will continue to be a valuable tool in measuring customer satisfaction and in identifying areas where we need to make improvements.

Research and development

Our 2006/07 expenditure on research and development was £5.3 million, including £0.8 million spent on fixed assets compared to £5.2 million in 2005/06 (including £0.7 million on fixed assets).

We have continued our work on improving water quality and consistency from major water treatment works. In addition we have started work on a sophisticated programme to optimise chemical conditions ensuring that residual levels of organic compounds are minimised. Earlier work on nitrate removal and hardness reduction has now resulted in full scale installations which are producing water to the new standards.

In the area of waste water treatment we have been rolling out a nutrient removal programme and building on existing expertise to reduce dependence on chemical usage. A major demonstration plant has been constructed to investigate the options for the removal of endocrine disrupting compounds and work has commenced on a joint research project to optimise removal of these compounds using conventional treatment.

We have increased research and development surrounding leakage reduction and have also advanced our ability to control chemical addition automatically.

We have continued our environmental research and development work with sustainability technologies being introduced to enable us to generate more power from sewage sludge. In 2007/08 we will be evaluating low energy sewage and sludge treatment processes in order to develop our work further.

Employee policies

We are committed to investing in our people, promoting ongoing training and development. We believe that this will create the in-house capabilities we need to meet the challenges of the future whilst providing a rewarding workplace. We are committed to providing access to training and development for all our employees, balancing the needs of both the individual and the business.

Our staff will often have the opportunity to gain access to a wide range of valuable and confidential information, as well as business critical systems during the normal course of their employment. It is therefore very important that we make relevant investigations into the background of all new employees (whether temporary or permanent).

Details of Group employee policies can be found in the Severn Trent Plc annual report and accounts.

Training

During 2006/07 we continued to work towards strengthening our internal business culture and ethics, making our culture open and transparent and removing barriers to evaluating performance, whether good or bad.

We designed and introduced a training workshop on ethical decision making with the help of the Institute of Business Ethics. By the end of March 2007, over 550 of our senior and middle managers had attended the workshop, giving them a set of principles and tools to deal with ethical challenges in their day-to-day work. The next phase will be to extend this training across the organisation, to reach all employees.

2006/07 saw the launch of 'Developing Talent', a structured and inclusive development plan for people with high potential in the early stages of their career. Unlike its predecessor, the old graduate scheme, it is now open to current employees, graduates and non graduates as well as externally recruited graduates.

In addition we extended the 2006 apprenticeship recruitment campaign and received 1,000 applications for 40 roles. The apprentices chosen joined 49 other trainees in distribution and sewerage who began their development programmes earlier in the year. Some of these apprentices will be the first in the UK to take qualifications under the proposed Water Apprenticeship Framework.

In January 2006 the 2005/06 apprentice recruitment campaign won awards in 2 categories at the industry's Recruitment Advertising Awards – best campaign and best employer website.

Engagement and diversity

The engagement and skills of our workforce are key to our success and benchmarking and measuring this engagement is important if we are to track our performance. We have therefore introduced a KPI on employee motivation which will be measured in terms of employees being positive, committed and putting discretionary effort into their work. We have recently introduced a quarterly survey which selects a random sample of 10% of employees at each wave. This is in addition to the annual employee survey that we have undertaken since 1993. The surveys are anonymous and will be independently assessed, giving us an ongoing measure of staff morale and motivation which we can benchmark against other organisations. Our objective for 2007/08 will be to achieve a 4% improvement on 2006/07's performance, to reach a figure of 80% engagement.

The existence of a diverse workforce is also important to the success of the company and we promote this in our working practices. There is always scope to improve our diversity performance and our measures to do this include monitoring diversity profiles, targeted recruitment initiatives, diversity awareness training, and benchmarking our policies and practices against best-practice organisations.

Operating and financial review continued

Management of resources continued

Working arrangements

As in previous years we have retained our differentiated pay scheme for all levels of staff, based on personal performance. We use a pay model that determines the amount of pay available for distribution dependent upon the company's financial performance, safety performance and customer service standards. We have also retained positive working relationships with recognised trade unions.

We provide flexible working arrangements, in line with and above levels of government legislation, to enable our employees to achieve a positive work life balance. In 2007/08 we will be extending the right to request flexible working arrangements to all staff with 26 weeks of service. This means that there will be a single process for all staff making a request to change their working arrangements and that all staff can benefit from arrangements such as 'flexitime', part time working, career breaks, job sharing and hot desking. We will also retain the 'Lifestyle' benefits package, allowing employees to tailor some of their employment package to their needs.

Suppliers

We have been working to develop our supply chain assessment processes throughout 2005/06 and 2006/07. Significant suppliers/contractors have been required for some years to provide information on their health and safety performance and on their environmental qualifications and performance. In 2006 we recognised a need to build on that. Therefore, in 2006/07 we began developing a new standardised risk based approach to supply chain assessment, not just on health and safety and environment, but also on human rights, bribery and corruption.

We have been working with Nottingham Trent University in the development of a Diploma in Management Studies in Supply Chain Management, a first in the Utility sector. The course participants represent all areas of the supply chain, both internal and external.

During the year we have made improvements in our procurement process, focused around effectiveness and controls. In 2007/08 further improvements will be made primarily in the system and management of our supplier/contractor base.

Customer contact

In addition to receiving excellent operational services from us, our customers expect to interact with us in a satisfactory way. If they have a query about billing, they expect it to be resolved on their first call. If they write to us, they expect a quick response to their letter. It is well documented that we have not reached high enough customer service standards in recent years and 2006/07 has seen a great deal done to improve customer service standards.

Many of the customer service failures of 2005/06 were due to the introduction of a major new IT system (TARGET) for billing customers. We acknowledge that, when introducing that system, we underestimated the amount of training required to transfer our contact centre operators to the new system. We also underestimated the extent to which any major new IT system is prone to problems.

During the second half of 2005/06 and the start of 2006/07, our IT problems were increasingly apparent to us, to our customers, and to Ofwat. In July 2006, the Consumer Council for Water (CCW) issued a report showing that complaints about us increased by 54% during the six months from October 2005 to March 2006. Their report for the period April 2006 to March 2007 showed a further rise in complaints of 36%. In 2006/07 we began work on an action plan to fix the problems, to recruit 70 additional staff in our billing division and to extend the training given to contact centre operators.

The results of that work are now being seen in steady improvements. Customer service performance in the first eight months of 2006/07 remained unsatisfactory, while figures for the last four months, as a result of the action, were starting to show improvement.

In order to record and track our improvements we have developed two KPIs around customer service. Issues with continuing poor performance on answering telephone calls in 2006/07 caused many customers to turn to written complaints and the first of the KPIs aims to reduce the amount of written customer complaints per 1,000 properties. This is a new measure for 2007/08 – in previous years we have tracked DG7, a measure of response to written complaints. DG7 performance in 2006/07 was 99.76% (falling into the Ofwat 'good' category) compared with 88.7% in 2005/06. Against our new measure, quarter three performance was 25.9 complaints per 1,000 properties, recovering to 17.5 in the last quarter, giving performance in the year of 19.06. Whilst both the quality and timeliness of response have improved in the year, continuing issues on answering telephone calls caused customers to write in and complain.

The second KPI aims to improve the rate of first time call resolution for a billing contact, which shows the proportion of calls resolved at that point. As well as giving the best standard of service to customers, first-time call resolution is also the most cost effective option for us. This is again a new measure and we have calculated performance for 2006/07 at 80%. This KPI relates closely to the DG6 indicator, the number of billing contacts received during the report year and the time taken to respond to them which includes both a quality and timeliness component. The focus during 2006/07 has been on improving the quality of our responses to meet the requirements of the standard. In 2007/08 we will concentrate on maintaining quality and improving the speed of response such that both aspects of the standard are delivered.

In parallel with improving performance against the two KPI's we will continue with our programme of performance improvements measured specifically against DG6, 7, 8 and 9.

Performance against DG8 for 2006/07 was within the Ofwat "acceptable" category. This indicator shows the percentage of metered customers who receive at least one bill during the year based on an actual meter reading.

For DG9, ease of telephone contact, our 2006/07 focus was on improving the quality of our responses to telephone enquiries. This resulted in more time being taken per call and has caused a high level of engaged tone and abandoned calls during the year. Actions have concentrated on building the capability of existing staff, recruiting new staff and improving the performance of our billing system.

Our recruitment, training and competency programme for billing staff will continue in 2007/08 and beyond. Our target in 2007/08 is to sustain the improvements we are now seeing, so we once again meet industry standards in this area. Beyond that, we will set ourselves higher aspirations of being an industry leader in customer service.

The other main area of customer interaction relates to our operational water and waste water services. We completed a reorganisation of this process in 2006/07 with the closure of our two, twenty four hour, seven days a week (24/7) regional operational management centres. We have established a new 24/7 customer operations service centre in Coventry, at the heart of our operational area. All customer contacts related to water and waste water matters are now handled alongside and as part of, our operational management capability.

This enables us to diagnose operational failures more effectively and promptly and also allows us to use our remote monitoring systems to keep our customer contact teams better informed thus providing a higher standard of service on operational matters. We are working on improving process efficiency to increase customer satisfaction in order to deliver first time job resolution for field and network problems.

We are encouraged that in the first six month period since establishing the new centre (October 2006 to March 2007), we have improved by 13% to 72% the number of customers who, through our service delivery survey, have told us we have met or exceeded their expectations. We are confident that these results demonstrate we can make further sustainable improvements to service on operational customer service in 2007/08 and beyond.

Accessibility

Interaction with customers is not just about how we perform in terms of specific figures and measures. It is also about fitting in with different customers' ways of life and giving them flexibility in how they contact us. During 2006/07 we redeveloped our website in order to give customers self service options for dealing with us. Transactions such as requesting a meter, reporting a leak or telling us about a change of address can now be done online 24/7 whereas previously customers had to telephone our contact centre.

We provide alternative formats of our printed communications, such as large print and Braille, to ensure that all of our customers can gain access to information. We also offer a textphone service and can provide translations of documents in to a number of languages.

Customer debt recovery

Last year direct cash collections amounted to £1123 million, which was slightly behind target. During 2007 our overall trade debt increased by 28% to £124 million which is in excess of our 2007 price increase and also takes into account the continued impact of customers switching from unmeasured to measured charges.

We have seen increases in customer debt across all debt aging bands. This reflects the impact that the operational issues within our Customer Relations directorate have had on our billing and collection performance.

Customer debt recovery directly impacts our trade debtors and our financial performance. We have therefore introduced the debtor days KPI as a measure by which our performance will be tracked and benchmarked. Assuming that our year on year billing and collection performance for each of our various income streams remains constant, we would expect our debtor days to increase on an annual basis by approximately two days. This is due to the continued impact of customers switching from the unmeasured to measured basis of charge. As measured bills are sent to customers throughout the year, there will inevitably be a number of recently issued bills that remain unpaid at year end. The number of water meters installed increased by over 65,500 in 2006/07.

Our debtor days performance has deteriorated from 31 days in 2005/06 to 37 days in 2006/07. This deterioration is above the two day expected increase described above and has been driven by operational performance issues within the billing and collection process.

We intend to position ourselves within the upper quartile of industry performance by 2011/12. This is to be delivered through a stepped performance improvement in our billing and collection activities. In particular, we will improve the performance of our billing contact centre, reduce our current work in progress backlogs and introduce further billing system improvements.

In addition to this, the Severn Trent Water Trust Fund is made available to those customers who are unable to pay their bills. Although funding is limited and is not available in every instance, customers are given the necessary information by our employees and can apply to the Trust for assistance. During 2006/07, we made a donation of £3.6 million to the Trust which is in line with that made in 2005/06.

New connections

Our New Connections department manage, from application to delivery, the connection of customers to water and waste water services. In 2006/07 we have worked closely with developers and customers to understand how we can improve our service to them and make interaction with us easier. Consequently, we have changed our organisation design, introduced new web based applications and improved our performance on water service connections completed within 21 working days from 45% to 81%. We are aiming to build on these improvements through 2007/08.

Business customers

The Water Supply Licensing regime allows business customers, using more than 50,000 litres of water a year, the opportunity to choose their water supplier. Our access code provides relevant information regarding the regime and how prospective participants can access our services.

Community

Our relationship with the regional community is part of our wider CR strategy. We invest in our communities in three main areas: health and well-being, education and the natural environment.

In 2006/07 we continued our work with nine partner charities that operate at a local and international level. We aim to continue this work in 2007/08.

We also continued to develop and promote our education programme via our two main initiatives: our educational centres and the award winning BeSmart scheme. In 2006/07 around 25,000 children visited our education centres, while 46 schools took part in BeSmart. BeSmart aims to raise awareness amongst school children of the importance of water and water efficiency. In 2006/07 the BeSmart programme won a West Midlands Business in the Community Big Tick award for investing in young people. It also won a Utility Week award for best community initiative.

Independent research into both educational initiatives, commissioned in 2006/07, has been encouraging. Results show that they are successful in promoting the health aspects of drinking water and the importance of water efficiency. 'It is clear that children that have direct experience of a Severn Trent Water education initiative are more engaged, active and vocal about their water behaviours,' concluded the researchers.

Management of resources continued

Environment

CR and the local environment is especially important for us as a water company. How we abstract water, how we manage waste water discharges, how we operate over 1,000 treatment sites and how we manage resources – all have a huge potential impact on the local environment. We have a responsibility to minimise that environmental impact and to maximise our use of resources.

The seriousness with which we take our responsibility is reflected in our KPIs. We have developed six separate indicators linked to environmental performance. They are: sewer flooding incidents, breach of consents at sewage treatment works, pollution incidents, raw water storage, net energy use and leakage. In addition to measuring our environmental impact, all six indicators (which are covered earlier in this review) give a sharp insight into our operational performance.

The wider environment is also a key concern and we welcome the fact that climate change has risen up the political and public agenda in 2006/07. We have been engaged in planning for a changing climate for a number of years and have built a leading reputation in this area with key stakeholders such as the Carbon Trust.

Our work on climate change focuses on two main aspects: mitigating our impact on climate change, and adapting to it. Mitigation has two main aspects: our energy efficiency initiatives and our in-house renewable energy production, primarily biogas CHP. The effects of our work in both these areas are reflected in our KPI on net energy use (detailed earlier in this report). Our work on adaptation involves assessing how climate change might impact our operations and strategic development with particular reference to water supply and sewer flooding. We will continue to work on this area in 2007/08.

Water efficiency

Promoting the efficient use of water is an important priority for us.

During 2006/07 we continued to adopt a twin track approach for promoting the efficient use of water with our customers. This included the promotion and distribution of water saving devices, together with education and the provision of advice to raise awareness of the need to use water wisely.

In the report year we have recorded increases in the distribution and installation of cistern displacement devices, our self audit guides and water butts. We increased distribution of cistern displacement devices by 45,622 (47%) and installation by 65,838 (144%). Self audit guide distribution increased by 15,278 (21%) and water butt distribution by 123 (2%). In addition, the number of pupils attending our education centres in 2006/07 increased by 3,332 (15%).

We have enhanced our education programme and commenced three trial projects including a household water efficiency trial, school water efficiency trial and a local government partnership investigating opportunities to promote water efficiency.

Consumer Council for Water research shows that there is still much work to be done to ensure our customers are sufficiently engaged with the issue and can make use of the tools and technology that we make available. Throughout 2007/08 we will continue our efforts to influence the attitudes of our customers through focused education and awareness activities. In addition we will continue to build our knowledge of the savings associated with water efficiency activities to ensure that future plans provide us with cost effective savings.

Environmental policy

We are operating an environmental management system, which integrates with our business activities so that environmental issues become part of our corporate culture. In this way we seek to maintain a continual improvement in our environmental performance and provide a sound basis of measurement from which we can review our environmental objectives and establish suitable targets.

We fully recognise our general duty to care for the environment. We will assess the environmental impact of all our activities and by active risk management, good operation and investment, strive to ensure the prevention or reduction of adverse effects. In addition, wherever possible we will enhance the biodiversity of our extensive landholdings and the aquatic ecosystems within our operating area. We are committed to open publication of environmental information and will work closely to develop environmental partnerships with key stakeholders, notably our customers, the community, regulatory bodies and environmental groups.

Biodiversity

The most recent condition assessment of our 24 Sites of Special Scientific Interest (SSSIs) by Natural England found 60.2% (by area) to be in either favourable or recovering condition. The Government target for SSSIs is to have 95% by area in favourable condition or recovering condition by 2010. We are taking major steps towards this on our own sites with the establishment of the Charnwood Transfer Group and the Charnwood Reservoirs Catchment Project. The former is a tripartite working group made up of ourselves, the EA and Natural England. The latter includes these three organisations plus the Farming & Wildlife Advisory Group, DEFRA and Leicestershire & Rutland Wildlife Trust. Together, the two initiatives aim to undertake action necessary to bring about favourable status.

Also in 2006/07 we ensured engagement with key stakeholders when planning a scheme to lay a new water mains along the side of the Elan Valley Aqueduct pipetrack. The pipetrack had become important for a variety of rare and endangered butterflies and moths, as well as adders and lizards and, had we not engaged with stakeholders at an early stage, our work would have had severe consequences for this vulnerable wildlife. Following extensive consultation and research we were able to settle on a route which not only avoided the most sensitive areas but also provided opportunities for habitat enhancements.

In addition we have had great success with our Upper Derwent Valley Black Grouse Project, with three captive bred females raising broods in the wild and twenty males vigorously lekking at five sites. Our Netheridge water voles also bred and the population began to colonise ditches surrounding the sewage treatment works. We continued to support the release of salmon parr into the rivers Trent and Dove, resulting in the Trent fast recovering its status as an important salmon river.

Financial performance

The financial statements on pages 23 to 44 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.

Critical accounting policies

In the process of applying the group's accounting policies, the group is required to make certain judgements, estimates and assumptions that it believes are reasonable based on the information available. The more significant judgements and key assumptions and sources of estimation uncertainty are summarised below.

Depreciation and carrying amounts of property, plant and equipment

Calculating the depreciation charge and hence the carrying value for property, plant and equipment requires estimates to be made of the useful lives of the assets. The estimates are based on engineering data and the group's experience of similar assets. Details are set out in note 1d.

Retirement benefit obligations

Determining the amount of the group's retirement benefit obligations and the net costs of providing such benefits requires assumptions to be made concerning long term interest rates, inflation, salary and pension increases, investment returns and longevity of current and future pensioners. Changes in these assumptions could significantly impact the amount of the obligations or the cost of providing such benefits. The group makes assumptions concerning these matters with the assistance of advice from independent qualified actuaries. Details of the assumptions made are set out in note 17 to the financial statements.

Tax provisions

Assessing the outcome of uncertain tax positions requires judgements to be made regarding the result of negotiations with and enquiries from tax authorities. The assessments made are based on advice from independent tax advisers and the status of ongoing discussions with the relevant tax authorities.

Results

The group's turnover increased by 6.1% in 2006/07 to £1,206.9 million. Sales prices of Severn Trent Water increased by 6.58% (including inflation) from 1 April 2006. The price rise represented the 7.23% allowed by Ofwat less a 0.65% voluntary abatement of K, previously announced in 2005/06. The growth impact of new customers was offset by the effect of conservation activities, such as more customers switching to metering.

Profit before interest and tax and exceptionals was up by £18.5 million on the previous year to £422.1 million.

Operating costs before exceptional items and depreciation were £479.2 million (2006 £448.5 million), an increase of £30.7 million. This was impacted by a number of factors including increased energy costs of £23.5 million caused by rising energy prices.

Depreciation before exceptional items was £309.2 million (2006 £289.1 million). This increase reflects the continued effect of our investment programme.

An exceptional charge of £14.9 million (2006 £0.7 million) was incurred in relation to restructuring costs. An exceptional profit on disposal of assets of £36.2 million (2006 £2.5 million) was recognised in the year.

The total tax charge for the year was £32.3 million (2006 £97.5 million) of which current tax represented a charge of £71.6 million (a debit of 2006 £57.8 million) and a deferred tax credit of £39.3 million (2006 a debit of £39.7 million). The current tax charge before adjustments in respect of prior years represents 22% (2006 25%) of the group's profits before tax. Profit for the financial year was £267.4 million (2006 £178.5 million).

Capital structure

Our balance sheet at 31 March 2007 can be summarised as set out in the table below.

	Assets £m	Liabilities £m	Net Assets £m
Fixed assets	5,220.2	-	5,220.2
Other current assets and liabilities	280.2	(443.2)	(163.0)
Other non current assets and liabilities	-	(46.5)	(46.5)
Deferred tax	-	(484.4)	(484.4)
Pension deficit	-	(73.8)	(73.8)
Total before net debt	5,500.4	(1,047.9)	4,452.5
Net debt	1.9	(3,121.8)	(3,119.9)
Total as at 31 March 2007	5,502.3	(4,169.7)	1,332.6
Total as at 31 March 2006	5,299.7	(3,564.6)	1,735.1

Net assets decreased by 23.2% to £1,332.6 million. The main movements in the balance sheet items were increases in fixed assets of £136.8 million relating to our continued investment in our capital programme (see Investment section) offset by increases in net debt (see Cashflow and Debt section below).

Cashflows and debt

Operating activities generated a net cash inflow of £644.3 million (2006 £644.0 million). An outflow of £137.3 million (2006 £145.2 million) was utilised in the servicing of financing arrangements. Net investing activities used £403.7 million (2006 £399.8 million) which mainly included the continuing capital expenditure to meet our obligations under the AMP4 capital programme. Dividend outflows amounted to £655.8 million (2006 £154.7 million), which included a special dividend of £576.0 million (2006 £nil). In order to meet the requirements of the above net outflow there was an increase in the financing requirement over the year.

Net debt at 31 March 2007 was £3,119.9 million (2006 £2,484.8 million). The increase in net debt was sourced both through an increase in net financial liabilities due within one year to £744.7 million at 31 March 2007 (2006 £480.6 million) and those due after one year to £2,375.2 million (2006 £2,004.2 million). Of the net debt 58% (2006 72.0%) was represented by fixed interest borrowings and 63.4% (2006 61.4%) was represented by amounts payable after five years. Net interest payable increased by £14.3 million to £143.7 million, this reflects the overall increase in the underlying debt levels.

£461 million of funding instruments contain certain financial covenants, breach of which can trigger early payment.

Severn Trent Water's Regulatory Capital Value (RCV) at 31 March 2007 was £5,546 million (2006 £5,209 million). The net debt to RCV ratio was 56.3% (2006 47.7%). This increase is reflective of the groups ongoing aim to optimise its balance sheet efficiency.

Operating and financial review continued

Financial performance continued

Treasury management

The Severn Trent Water groups treasury affairs are managed centrally as part of the Severn Trent Plc group and in accordance with its treasury procedures policy and manual statement. The treasury operation's primary role is to manage liquidity, funding, investment and the group's financial risk, including risk from volatility in interest and (to a lesser extent) currency rates and counterparty credit risk. Its activities are subject to a set of controls commensurate with the magnitude of the borrowings and investments under its management. The Board determines matters of treasury policy and its approval is required for certain treasury transactions.

It is the group's strategy to access a broad range of sources of finance to obtain the quantum and maturities required and the lowest cost compatible with the need for continued availability. The group uses financial derivatives solely for the purposes of managing risk associated with financing its normal business activities. The group does not hold or issue derivative financial instruments for financial trading purposes. The group uses a limited number of currency swaps and interest rate swaps to redenominate external borrowings into the currencies and interest rate coupon required for group purposes. 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 and regulatory conditions and with regard to regulatory pronouncements. At 31 March 2007 interest rates on 58% of the groups borrowings were fixed for periods up to 27 years. The group's business does not involve significant exposure to foreign exchange transactions. Cross currency swaps are employed to exchange foreign currency borrowings for sterling.

The long term credit ratings of Severn Trent Water Limited are
Moody's A2
Standard & Poor's A

Further details of the group's borrowings, investments and financial instruments are contained in note 12 to the accounts.

Investment

The financial year 2006/07 was the second year of the AMP4 period (covering 2005-2010). In the two years to date we have mobilised 2,852 projects of which 1,616 have been completed. We have invested just short of £200 million on our water production and distribution service, with the focus on improving levels of service to customers and upgrading our treatment works and distribution network. We have invested over £250 million on sewerage services, with a focus on repairing our ageing sewers and maintaining and upgrading our sewage treatment works to meet tighter quality standards. We are continuing to explore ways of exploiting our by-products to generate electricity. In addition we have spent £50 million on our support services to improve customer service and business services.

This year net capital expenditure, net of grants and contributions, excluding spending on infrastructure maintenance of £98 million, was £365 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.

Over the five year AMP 4 period we will continue to invest approximately £2.7 billion maintaining and improving the quality of service we provide to customers in our region. This includes

- > more than £400 million on maintaining water supplies
- > £150 million on improving drinking water quality
- > approximately £850 million on maintaining and improving river quality
- > more than £350 million improving sewers and dealing with sewer flooding
- > more than £260 million on reducing leakage

In 2007/08 we expect to maintain good progress on the AMP4 plan and on the improvement plans that we have set for ourselves. We have demanding targets in our capital programme, in water and waste quality, in customer service, and in other areas. We aim to achieve our targets cost effectively, providing value for our customers, and we have developed our own KPI in this area to support us in our goal.

We also have to invest to meet longer term targets such as the requirements of the Water Framework Directive, the challenges of adapting to climate change and of reducing our own carbon footprint.

Our investment in reaching our targets, in process improvements and in higher standards will go hand in hand with operational efficiency and improvement. So as we are implementing our investments for the AMP4 period and beyond, we are confident that they will lead to strong financial performance, as well as higher levels of customer satisfaction. Further details of our plans for AMP4 are published in our Monitoring Plan for 2005-2010, published on our website www.stwater.co.uk.

Tony Wray
Managing Director
5 June 2007

Directors' report

The Directors present their report, together with the audited financial statements for the year ended 31 March 2007

Principal activities

The company is a wholly owned subsidiary of Severn Trent Plc

The principal activities of the company and its subsidiary undertakings are the supply of water and the treatment and disposal of sewage in the UK. There have not been any significant changes to the company's principal activities in the year under review. The directors are not aware, at the date of this report, of any likely major changes in the company's activities in the next year.

Business review

The company is required to set out in this report a fair review of the business of the company during the financial year ended 31 March 2007 and of the position of the company at the end of the financial year and a description of the principal risks and uncertainties facing the company (known as a 'Business Review').

The information that fulfils the requirements of the business review can be found in the following sections of the Operating and Financial Review:

Review of results	Page 1-4, 13-14
Operational performance	Page 5-7
Financial performance	Page 13-14
KPIs	Page 2-3
Management of resources	Page 8-12
CR	Page 4, 11, 12

Risks and Uncertainties are detailed on pages 19 to 20 of Corporate Governance

Dividends and reserves

The company's dividend policy is to declare dividends which are consistent with the company's regulatory obligations. The amount declared is expected to vary each year further to consideration of these obligations. The ordinary dividend declared by the company in 2007 amounted to £79.8 million (2006: £154.7 million). In March 2007 an ordinary dividend of £63.1 million was proposed and paid in April 2007.

A special dividend of £576.0 million was paid on 4 September 2006.

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

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	Resigned 3 May 2006
B Bulkin*	Appointed 2 March 2007
R H Davey*	Appointed 2 March 2007
Sir John Egan*	Appointed 2 March 2007
M W Keogh	Appointed 3 May 2006
	Resigned 2 March 2007
M J Houston*	Appointed 2 March 2007
R S S Martin	Resigned 2 March 2007
C S Matthews	
M J E McKeon	Appointed 2 March 2007
G C Messham	Resigned 2 March 2007
S H Reilly	Resigned 30 September 2006
J B Smith*	Appointed 2 March 2007
P F Stephenson	Resigned 24 August 2006
S K Stubbs*	Resigned 31 October 2006
A P Wray	

*Non-executive directors

Directors' interests

All of the directors at the year end are also directors of Severn Trent Plc. Their interests in the share capital of Severn Trent Plc, according to the register maintained under the provisions of the United Kingdom Companies Act 1985, are disclosed in the Annual Report and Accounts of that company for the year ended 31 March 2007.

None of the directors retains any notifiable interest in the shares of the company or any other subsidiaries as at 31 March 2007.

Directors' remuneration and annual bonus plan

Remuneration for executive directors comprises the following elements:

- > Base salary and benefits
- > Annual bonus plan
- > Long term incentive plans

For all directors who are also directors of Severn Trent Plc, details of the emoluments can be found in the Annual Report and Accounts of Severn Trent Plc.

As outlined in the Severn Trent Plc Report and Accounts, the Chairman, Sir John Egan, and non-executive directors, do not participate in the company's incentive arrangements (i.e. annual bonus or share schemes).

Details of directors' emoluments are disclosed in note 3 to the financial statements.

Base salaries

Base salaries are reviewed annually for each director, and are determined with regard to the market median for similar roles in publicly quoted utility companies of a comparable size and so far as practicable, undertaking similar activities. Salaries are set with reference to individual performance, experience and contribution together with developments in the relevant employment market and internal relativities.

In addition, directors receive a benefits package which includes company car or allowance, fuel, membership of company pension scheme or cash allowance in lieu, private medical insurance, life assurance and incapacity benefits scheme.

Annual bonus plan 2006/07

Two bonus plans operated for directors in 2006/07 – one was the group based plan for Executive directors whose responsibilities span the whole of the Severn Trent group (i.e. Colin Matthews and Michael McKeon) The second bonus plan was for those executive and other directors whose primary role was focused on Severn Trent Water (i.e. Tony Wray, Richard Martin, Gren Messham, Mark Keogh, Stephen Reilly, Paul Stephenson and Jonathan Bailey)

Bonus targets were set and measured for the period 1 April 2006 to 31 March 2007

Group directors annual bonus plan (2006/07)

For the group directors' plan, financial and non-financial targets were established by the Remuneration Committee to encourage improved performance and to align executive directors' interests with shareholders In 2006/07 financial targets comprised group profitability (PBT) whilst the non financial targets comprised the achievement of personal objectives and specific targets relating to health and safety performance

The maximum bonus potential and target composition for group executive directors for 2006/07 is shown below

Director	Financial	Non financial	Max bonus value
Colin Matthews	53%	27%	80%
Michael McKeon	47%	23%	70%

Given the prime importance which the board and the committee place on health and safety issues, the indicative bonus was adjusted by a multiplier based on health and safety performance (the target being the reduction in group RIDDOR accidents per 1,000 employees against the previous year) This could lead to an increase or a reduction in bonus payable but, in all cases, is subject to the overall bonus maximum

The actual bonuses awarded by the committee for the year ended 31 March 2007 are shown in the table of directors' emoluments as disclosed in the Severn Trent Plc Annual Report and Accounts The following table shows how the split of the bonuses paid in respect of the year ended 31 March 2007 related to the targets set at the start of the year

	Achieved Financial	Achieved Non financial	Total bonus paid
Colin Matthews	53.0%	21.6%	74.6%
Michael McKeon	47.0%	19.0%	66.0%

Severn Trent Water directors' annual bonus plan (2006/07)

The Severn Trent Water annual bonus scheme seeks to drive sound financial performance, improved customer service levels and improved health and safety performance This links director remuneration to the standards of performance in connection with the carrying out of functions of a relevant undertaker

The maximum total bonus potential for the Managing Director is 70% of base salary (50% of base salary for other directors)

- (1) 80% of the maximum total bonus award is dependent on company performance Company performance measures comprise four equally weighted targets relating to profitability (PBIT), operating cash flow, a score arising from a Customer Event survey and an Overall Performance Assessment (OPA) score, based on a basket of measures covering operational performance, leakage and customer service
- (2) The remaining 20% of the maximum total bonus is awarded for personal performance 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 In the case of the Managing Director, the assessment of personal objectives is made by the Group Chief Executive and the Remuneration Committee of Severn Trent Plc

The total bonus arising from the above elements is then 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 a target of a 20% reduction in the number of Severn Trent Water RIDDOR accidents per 1,000 employees against the previous financial year

Maximum health and safety performance would result in earnings from company performance and personal targets being multiplied by up to 1.5 (but not exceeding the total bonus maximum) Failure to achieve threshold levels would result in zero bonus being paid for each individual target element

The health and safety outcome was subject to an independent audit by Acona

The table below shows how the split of bonuses relates to the achievement of targets set at the beginning of the year

PBIT			
% target achieved	% bonus	actual PBIT achieved	% bonus payable
105	20	99.9% of target	14.5%
100	15		
97 or less	0		

Operating Cash Flow (OCF)

% target achieved	% bonus	actual OCF achieved	% bonus payable
105	20	96%	0
100	15		
97 or less	0		

OPA

OPA score as at 31/3/07	% bonus	actual OPA score	% bonus payable
392.5	20	363.0	0
387.5	15		
377.5	0		

Customer Event Survey

% favourable response	% bonus	actual achieved	% bonus payable
80	20	68.0	0
75	10		
70	0		

Health and Safety

RIDDOR reduction	Multiplier	Actual RIDDOR achieved	Multiplier
30	1.5	46 (=20%)	1
20	1		
10	0.5		
0	0.3		

The total company bonus payable for 2006/07 is therefore 14.5% out of a maximum of 80%, this equates to 10.15% of base salary for the Managing Director of Severn Trent Water and 7.25% of salary for other directors

The personal bonus element payable equates to 10.9% of base salary for the Managing Director and between 4.0% and 9.0% for other directors

The above performance outturn has resulted in payment to directors as shown in the table below

Director	Achieved company bonus (%)	Achieved personal bonus (%)	Total bonus paid (%)	Total bonus paid (£)
Tony Wray	10.15	10.92	21.07	57,943
Richard Martin	7.25	6.65	13.90	21,448
Gren Messham	7.25	8.32	15.57	19,774
Mark Keogh	5.43	18.0	23.43	36,551
Paul Stephenson	7.25	4.0	5.63	7,572
Stephen Reilly	0	0	0	0
Jonathan Bailey	0	0	0	0

Note

- 1 Paul Stephenson left on 08/09/06. His bonus payment was subject to time prorating.
- 2 Stephen Reilly left on 30/09/06. He was not entitled to a bonus payment.
- 3 Jonathan Bailey left the company on 03/05/06. He was not entitled to a bonus payment.
- 4 Mark Keogh left on 31/03/07. The personal element of his bonus was paid on leaving the company.

Annual bonus plan 2007/08

The Remuneration Committee has recently undertaken a review of the balance of performance related remuneration for the executive directors. As a result, the committee concluded that over the next 2-3 years it is important for the executive directors to be focused on the achievement of specific strategic goals that are closely linked to the company's 20 KPIs which are intended to drive the creation of operational efficiencies.

Consequently for 2007/08 financial year, the annual bonus opportunity for all the executive directors has been increased to 120% of salary. For the achievement of target performance, 60% of salary will be earned, compared with 35% in 2006/07 for executive directors other than the Chief Executive. This increase reflects a reweighting of performance pay from longer term measures to more targeted annual measures and does not reflect a material increase in total target pay.

Colin Matthews' package is amended to reflect the fact that he is leaving the company. His annual bonus maximum for 2007/08 will be 150%, however he will not be invited to participate in the 2007 LTIP. He will be set specific personal targets. This approach is consistent with that taken previously for executive directors.

Director	Bonus Max	% salary for on target
Colin Matthews	120%	75%
Michael McKeon	120%	60%
Tony Wray	120%	60%

In addition, 50% of any bonus paid (with the exception of Colin Matthews) will be deferred into shares to be held for three years following payment and subject to continued employment unless the committee determines it is appropriate to release the shares in 'good leaver' cases.

The bonus outturn will operate on a balanced scorecard of measures, based on the 20 KPIs. All of the targets are considered by the board to have an impact on the longer term financial performance of the company and a number of them are reported to the Regulator.

The health & safety multiplier will not operate in respect of 2007/08 although the committee reserves the discretion to reduce (but not increase) bonus payments if health & safety targets are not fully met or if the company's overall financial performance is not felt to warrant the indicative level of bonus.

Consistent with the latest developments in institutional guidelines, the rules of the annual bonus plan now provide that the committee may reclaim some or all of the after tax part of any bonuses awarded to executive directors if it subsequently transpires that the bonus calculation was based on calculations which are subsequently demonstrated to be materially incorrect.

Long term incentive plan

Directors may also participate in the Severn Trent Plc Long Term Incentive Plan (LTIP). Under this plan conditional awards of performance shares are made to directors up to an annual maximum limit. This seeks to reward the creation of long term value and align the company's incentive arrangements with the interests of shareholders. Further details are contained in the Severn Trent Plc Annual Report and Accounts.

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.

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.

Terms of payment are stated on each purchase order issued by the company. 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 41 days purchases (2006 37 days).

Research and development

Expenditure on research and development was £5.3 million including £0.8 million spent on fixed assets, (2006 £5.2 million including £0.7 million on fixed assets). Details of the research and development activity undertaken by the company during the year are set out in the Operating and Financial Review on page 9.

Employees

The average number of employees during the year was 5,154 (2006 5,023).

Post balance sheet events

In March 2007 an ordinary dividend of £63.1 million, being 6.31 pence per share, was proposed. This was paid in April 2007.

Regulation 'Ring Fencing'

In accordance with the requirements of the Water Services Regulatory Authority, the board confirmed, that as at 31 March 2007, 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.

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 with the provisions of S2342A of the Companies Act 1985.



By Order of the Board

F B Smith
Company Secretary
5 June 2007

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

During the year, and as part of the strategy of focusing on water, all the current executive and non-executive directors of Severn Trent Plc were appointed to similar positions on Severn Trent Water Limited. Since March 2007, the boards of directors of Severn Trent Plc and Severn Trent Water Limited have been identical

Board committees

The Severn Trent Plc board has established an effective committee structure to assist in the discharge of its responsibilities to the group. The terms of reference of the Audit, Remuneration and Nominations Committees comply with the provisions of the Combined Code and are available for inspection on the Severn Trent Plc website (www.severntrent.com) or on written request from the company secretary at the address given on the back cover of this document

Further information on Severn Trent Plc's corporate governance procedures and adherence to best practice can be found in the Severn Trent Plc Report and Accounts for the year ended 31 March 2007. This document is also available from the website of Severn Trent Plc or on written request from the Company Secretary. There is no charge for this publication

Operating structure

Day-to-day operational priorities within Severn Trent Water are managed by the Operating Committee, led by the Managing Director. Members of the Operating Committee include the heads of new integrated teams, created in 2006/07. These teams focus on water, waste, customer relations, safety, quality and standards, finance and information systems

The new structure replaced the previous functional teams, which worked on areas like planning, engineering and operations. The new structure aligns the organisation with the processes that matter to customers and will drive greater efficiency

Internal control and risk management

The board has overall responsibility for the group's system of internal control and for reviewing its effectiveness

The board reviews the effectiveness of the system of internal control, including financial, operational, compliance and risk management, at least once annually in accordance with the requirements of the Combined Code and the guidance set out within it. The system of internal control is reviewed for effectiveness and adequacy

Such systems can only provide reasonable and not absolute assurance against material misstatement or loss, as they are designed to manage rather than eliminate the risk of failure to achieve business objectives

The board reviews risk management and the effectiveness of the system of internal control through the Audit Committee of Severn Trent Plc. The board also keeps under review ways in which to enhance the control and audit arrangements in the group. The Audit Committee receives reports every six months from the group Chief Executive on the significant risks, 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 as requiring remedy are also reported to the Audit Committee. The Auditors also report on significant control issues to this committee. The Internal Audit department provides objective assurance and advice on risk management and control

The board confirms that procedures providing an ongoing process for identifying, evaluating and managing the principal risks faced by the company, have been in place for the year to 31 March 2007 and up to the date of the approval of the Annual Report

Key elements of the company's processes and procedures 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, regulatory compliance and other key business measures and independent assurance provided by both internal and external auditors

Work continues to review and improve the system of internal controls across the group. Any controls weaknesses requiring remedy are addressed and progress monitored by the Audit Committee and the board

Principal risks

Through its business operations the company is exposed to a number of commercial risks and uncertainties which could have a material impact on our businesses, 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 group

Changes in law or regulation in the countries and types of business 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 those businesses 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

Earnings from our regulated water business will be affected by our ability to meet or better our regulatory targets set by Ofwat, the Environment Agency, Drinking Water Inspectorate and other regulators. To meet these targets, we must continue to improve management processes and operational performance. In addition, earnings from a regulated business 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 and fines could be imposed

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, our businesses 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. While 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 the company's operating costs or capital expenditure by requiring changes and modifications to its 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. We control and operate water and sewerage networks and undertake 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 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. The company 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 and our financial position.

External factors could affect the company's pension schemes and adversely impact on our financial position

Pension assets and liabilities (pre-tax) of £1,208.6 million and £1,314.1 million are held in the group's balance sheet as at 31 March 2007. Movements in equity markets, interest rates and life expectancy could materially affect the level of surpluses and deficits in the schemes and could prompt the need for the group to make additional pension contributions in the future. The key assumptions used to value our pension liabilities are set out in note 17.

The company's financial position and business results could be adversely affected if its existing funding arrangements are materially altered

The main risks faced by the company in its treasury operations relate to material external changes to current arrangements. In the debt markets, factors such as borrowing restrictions or changes to credit ratings could mean we were unable to finance ourselves or be forced to pay too high a price for that finance. In terms of our borrowings a proportion is subject to variable interest rates and any increase in those rates could increase our borrowing costs. In addition we undertake financial transactions with a number of institutions and we could suffer a financial loss if any of those counterparts were to fail.

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. They must also ensure the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions

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

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

Independent auditors' report

to the members of Severn Trent Water Limited

We have audited the group and parent company financial statements (the "financial statements") of Severn Trent Water Limited for the year ended 31 March 2007 which comprise the Group Profit and Loss Account, the Group and Company Balance Sheets, the Group Cash Flow Statement, the Group Statement of Total Recognised Gains and Losses and the related notes 1 to 20. 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

The directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements. The information given in the Directors' Report includes that specific information presented in the Operating and Financial Review that is cross referred from the Business Review section of the Directors' Report.

In addition we 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 other information contained in the Annual Report as described in the contents section, and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any further information outside the Annual Report.

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 group's and company's circumstances, consistently applied and adequately disclosed.

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

Opinion

In our opinion:

- > the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the group's and the parent company's affairs as at 31 March 2007 and of the group's profit 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
5 June 2007

Profit and loss accounts

Year ended 31 March 2007

	Notes	2007 £m	Group 2006 £m	2007 £m	Company 2006 £m
Turnover		1,206 9	1,137 7	1,206 9	1,137 7
Operating costs before exceptional items	2	(788 4)	(737 6)	(802 3)	(751 1)
Exceptional restructuring costs	2	(14 9)	(0 7)	(14 9)	(0 7)
Total operating costs	2	(803 3)	(738 3)	(817 2)	(751 8)
Other income		3 6	3 5	3 6	3 5
Operating profit		407 2	402 9	393 3	389 4
Exceptional profit on disposal of assets	2	36 2	2 5	36 2	2 5
Net interest payable	4	(143 7)	(129 4)	(140 5)	(116 2)
Profit on ordinary activities before taxation		299 7	276 0	289 0	275 7
Taxation on profit on ordinary activities – current tax	5	(71 6)	(57 8)	(72 0)	(57 6)
– deferred tax	5	39 3	(39 7)	39 3	(38 6)
Taxation	5	(32 3)	(97 5)	(32 7)	(96 2)
Profit for the financial year	15	267 4	178 5	256 3	179 5

The results arise from continuing operations in both the current and preceding year

Statement of total recognised gains and losses

	2007 £m	Group 2006 £m	2007 £m	Company 2006 £m
Profit for the financial year	267 4	178 5	256 3	179 5
FRS 17 actuarial (loss)/gain	(19 8)	26 0	(19 8)	26 0
Deferred tax on actuarial (loss)/gain	5 9	(7 8)	5 9	(7 8)
Total recognised gains and losses for the financial year	253 5	196 7	242 4	197 7

Reconciliation of movements in shareholder's funds

	Notes	2007 £m	Group 2006 £m	2007 £m	Company 2006 £m
Opening shareholder's funds		1,735 1	1,693 1	1,970 2	1,927 2
Profit for the financial year		267 4	178 5	256 3	179 5
Dividends	6	(655 8)	(154 7)	(655 8)	(154 7)
Retained (loss)/profit for the financial year		(388 4)	23 8	(399 5)	24 8
Share based payments		(0 2)	–	(0 2)	–
Net FRS17 actuarial (loss)/gain		(13 9)	18 2	(13 9)	18 2
Net (reduction)/addition to shareholder's funds		(402 5)	42 0	(413 6)	43 0
Closing shareholder's funds		1,332 6	1,735 1	1,556 6	1,970 2

Balance sheets

As at 31 March 2007

Fixed Assets

	Notes	2007 £m	Group 2006 £m	2007 £m	Company 2006 £m
Tangible assets	7	5,220.1	5,083.3	5,218.1	5,081.3
Investments	8	0.1	0.1	236.8	236.8
		5,220.2	5,083.4	5,454.9	5,318.1

Current assets

Stocks		6.0	6.1	6.0	6.1
Debtors amounts falling due within one year	9a	270.8	204.7	270.8	200.0
Debtors amounts falling due after more than one year	9b	3.4	3.4	27.0	26.2
Short-term deposits	12b	1.9	2.1	1.9	2.1

		282.1	216.3	305.7	234.4
Creditors amounts falling due within one year	10	(1,189.8)	(857.8)	(1,224.1)	(875.5)

Net current liabilities		(907.7)	(641.5)	(918.4)	(641.1)
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Total assets less current liabilities		4,312.5	4,441.9	4,536.5	4,677.0
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Creditors amounts falling due after more than one year	11	(2,417.1)	(2,049.1)	(2,417.1)	(2,049.1)
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Provisions for liabilities	13	(489.0)	(550.5)	(489.0)	(550.5)
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Net assets excluding pension deficit		1,406.4	1,842.3	1,630.4	2,077.4
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Pension deficit	17	(73.8)	(107.2)	(73.8)	(107.2)
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Net assets including pension deficit		1,332.6	1,735.1	1,556.6	1,970.2
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Capital and reserves

Called up share capital	14	1,000.0	1,000.0	1,000.0	1,000.0
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Profit and loss account	15	332.6	735.1	556.6	970.2
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Equity shareholder's funds		1,332.6	1,735.1	1,556.6	1,970.2
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Signed on behalf of the Board who approved the accounts on 5 June 2007



A P Wray
Managing Director



M J E McKeon
Finance Director

Group cash flow statement

Year ended 31 March 2007

	Notes	2007 £m	2007 £m	2006 £m	2006 £m
Net cash inflow from operating activities	19a		644 3		644 0
Returns on investments and servicing of finance					
Interest received		1 3		0 4	
Interest paid		(118 5)		(104 0)	
Interest element of finance lease rental payments		(20 1)		(41 6)	
			(137 3)		(145 2)
Taxation			(68 6)		(58 3)
Capital expenditure and financial investment					
Purchase of tangible fixed assets		(479 4)		(438 3)	
Grants and contributions received		34 5		32 2	
Sale of tangible fixed assets		41 2		6 2	
Sale of other fixed asset investments		-		0 1	
			(403 7)		(399 8)
Equity dividends paid			(655 8)		(154 7)
Net cash outflow before management of liquid resources and financing			(621 1)		(114 0)
Management of liquid resources			0 2		0 2
Financing					
Receipt from sale and leaseback transaction		-		170 2	
Finance leases repaid		(33 7)		(159 2)	
Loans advanced		490 2		31 9	
Loans repaid		(57 0)		(159 3)	
			399 5		(116 4)
Net decrease in cash			(221 4)		(230 2)
Reconciliation of net cash flow to movement in net debt					
	Notes	2007 £m	2007 £m	2006 £m	2006 £m
Net decrease in cash as above		(221 4)		(230 2)	
Cash flow from movement in net debt and financing		(399 5)		116 4	
Cash flow from movement in liquid resources		(0 2)		(0 2)	
Change in net debt resulting from cash flows			(621 1)		(114 0)
Rolled up interest on debt			(14 0)		(3 0)
Movement in rolled up interest on finance leases			-		18 9
Increase in net debt			(635 1)		(98 1)
Opening net debt			(2,484 8)		(2,386 7)
Closing net debt	19b		(3,119 9)		(2,484 8)

Notes to the financial statements

Year ended 31 March 2007

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

During the year the group and company have early adopted the amendments to FRS 17 'Retirement Benefits'. As required by the amendments to FRS 17 no restatement of the prior year comparatives have been made

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 2007. 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 from regulated water activities, 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 the 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 £476.8 million lower than it would otherwise have been (2006: £437.9 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 and company operates both defined benefit and defined contribution 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 services 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 costs 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.

Notes to the financial statements continued

Year ended 31 March 2007

1 Accounting policies continued

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

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 substantively 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 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

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

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

Deferred costs are amortised over the life of the contract

q) Share-based payments

The group operates a number of equity settled, share-based compensation plans for employees utilising the shares of the ultimate parent company. The fair value of the employee services received in exchange for the grant is recognised as an expense over the vesting period of the grant

The fair value of employee services is determined by reference to the fair value of the awards granted calculated using an appropriate pricing model, excluding the impact of any non market vesting conditions. The number of awards that are expected to vest takes into account non market vesting conditions including, where appropriate, continuing employment by the group. The change is adjusted to reflect shares that do not vest as a result of failing to meet a non-market condition

2 Analysis of total operating costs and exceptional items

	2007 £m	Group 2006 £m	2007 £m	Company 2006 £m
Analysis of total operating costs				
Raw materials and consumables	34 0	30 6	34 0	30 6
Staff costs	188 5	188 7	187 9	188 7
Depreciation and other amounts written off tangible assets	321 1	289 1	321 1	289 1
Other operating costs	336 6	301 2	351 1	314 7
Own work capitalised	(76 9)	(71 3)	(76 9)	(71 3)
Total operating costs	803 3	738 3	817 2	751 8
Staff costs comprise				
Wages and salaries	145 0	139 0	144 4	139 0
Social security costs	11 5	11 3	11 5	11 3
Pension costs (note 17)	32 0	38 4	32 0	38 4
Total staff costs	188 5	188 7	187 9	188 7
Depreciation and other amounts written off tangible assets comprises				
Depreciation on owned assets non-infrastructure	183 1	187 4	183 1	187 4
Depreciation on owned assets infrastructure	102 3	91 2	102 3	91 2
Depreciation on assets held under finance leases	23 8	10 5	23 8	10 5
Depreciation on assets treated as exceptional item	11 9	-	11 9	-
	321 1	289 1	321 1	289 1
Other operating costs comprises				
Power	56 8	33 3	56 8	33 3
Rates	56 6	55 7	56 6	55 7
Service charges	27 6	27 5	27 6	27 5
Other operating costs	81 5	81 8	81 7	81 8
Deferred income released	(2 8)	(3 0)	(2 8)	(3 0)
Hired and contracted services	103 9	95 9	103 9	95 9
Hire of plant and machinery	5 0	3 4	5 0	3 4
Other operating leases	3 5	2 1	17 8	15 6
Research and development expenditure	4 5	4 5	4 5	4 5
Total other operating costs	336 6	301 2	351 1	314 7

Exceptional items

A £14.9 million exceptional charge was incurred in the year ending 31 March 2007 arising from a programme to restructure and realign the business. This consisted of an £11.9 million write down of decommissioned assets and £3.0 million other restructuring costs.

In the year ended 31 March 2006 an £0.7 million exceptional charge arose in respect of restructuring costs in wages and salaries.

An exceptional profit of £36.2 million (2006 £2.5 million) from the disposal of fixed assets consisted of a £36.2 million (2006 £2.3 million) profit on the sale of land and buildings and a £nil (2006 £0.2 million) profit on disposal of a fixed asset investment.

During the year Deloitte & Touche LLP earned the following fees:

	2007 £m	Group 2006 £m	2007 £m	Company 2006 £m
Fees payable to the company's auditors for the audit of the company's annual accounts	0 2	0 2	0 2	0 2
Fees payable to the company's auditors and their associates for other services to the group	0 1	0 1	0 1	0 1
The audit of the company's subsidiaries pursuant to legislation	0 1	0 1	0 1	0 1
Total audit fees	0 3	0 3	0 3	0 3
Other services pursuant to legislation				
Other services	0 1	0 3	0 1	0 3
Total non-audit fees	0 1	0 3	0 1	0 3

Fees in respect of other services relate to a review of internal controls.

Notes to the financial statements continued

Year ended 31 March 2007

3 Information regarding Directors and employees

Directors

a) Directors' interests

All of the directors as at the end of the year are also 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 2007. Share options were granted and exercised in accordance with the Severn Trent Share Option Scheme and the Severn Trent Sharesave Scheme as appropriate.

The executive directors have further interests in Severn Trent Plc ordinary shares of 97½ pence each by virtue of having received contingent awards of shares under the Severn Trent Plc Long Term Incentive Plan (LTIP) on 15 December 2004, 5 September 2005 and 19 June 2006. 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 disclosed in the Annual Report and Accounts of Severn Trent Plc for the year ended 31 March 2007.

b) Emoluments

	2007 £000	2006 £000
Aggregate emoluments (excluding pension contributions)	1,487.3	1,384.7

- 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. Included in aggregate emoluments is the element of these directors emoluments which are recharged to the company, based on the relevant portion of their time.
- iii) Retirement benefits are accruing to seven directors (2006: six directors) under a defined benefit scheme.
- iv) In addition to the emoluments disclosed above payments totalling £466,302, were made to three directors for early termination of their contracts. Two retained options over 5,280 shares (granted under the Severn Trent Plc Incentive Plan on 19 June 2006), 15,487 shares (granted on 15 December 2004) and 13,960 shares (granted on 13 August 2003). Additionally one director also retained options over 1,188 shares granted in accordance with approved schemes.

c) Highest paid Director

	2007 £000	2006 £000
Aggregate emoluments (excluding pension contributions)	419.9	415.3

The highest paid director in 2007 is the same as that in 2006.

The accrued pension at 31 March 2007 for the highest paid director was £7,488 (2006: £3,749). 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.

Employees

	Group and Company 2007 Number	2006 Number
Average number of employees during the year (full time equivalent)	5,154	5,023

4 Net interest payable

	2007 £m	Group 2006 £m	2007 £m	Company 2006 £m
Interest receivable and similar income	1.3	0.4	4.5	0.2
Finance income on defined benefit pension schemes	72.3	62.4	72.3	62.4
Interest receivable	73.6	62.8	76.8	62.6
Interest payable and similar charges				
Bank loans and overdrafts	(50.8)	(27.8)	(50.8)	(27.8)
Other loans	(86.3)	(83.9)	(8.5)	(12.3)
Finance leases	(20.1)	(22.7)	(20.1)	(13.3)
To subsidiary undertaking	-	-	(77.8)	(67.6)
Interest cost on defined benefit pension schemes	(60.1)	(57.8)	(60.1)	(57.8)
Interest payable	(217.3)	(192.2)	(217.3)	(178.8)
	(143.7)	(129.4)	(140.5)	(116.2)

5 Taxation on profit on ordinary activities

	2007 £m	Group 2006 £m	2007 £m	Company 2006 £m
a) Analysis of charge in the year				
Current tax				
UK corporation tax at 30% (2006 30%)				
Current year	47 4	62 8	47 4	62 8
Adjustment in respect of prior years	0 1	3 1	0 1	3 1
Group relief payable at 30% (2006 30%)				
Current year	19 1	6 0	17 3	7 2
Adjustment in respect of prior years	5 0	(14 1)	7 2	(15 5)
Total current tax	71 6	57 8	72 0	57 6
Deferred tax				
Origination and reversal of timing differences				
Current year	16 9	18 3	16 9	18 3
Adjustment in respect of prior year	(27 8)	8 4	(27 8)	7 3
(Increase)/decrease in discount	(34 3)	20 8	(34 3)	20 8
Total deferred tax charge	(45 2)	47 5	(45 2)	46 4
Less deferred tax included in statement of recognised gains and losses (FRS 17 pension)	5 9	(7 8)	5 9	(7 8)
Deferred tax charge included in profit and loss account	(39 3)	39 7	(39 3)	38 6
Total tax charge	32 3	97 5	32 7	96 2

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

	2007 £m	Group 2006 £m	2007 £m	Company 2006 £m
Profit on ordinary activities before tax	299 7	276 0	289 0	275 7
Profit on ordinary activities multiplied by the standard rate of corporation tax of 30% (2006 30%)	89 9	82 8	86 7	82 7
Effects of				
Items not taxable and not deductible for tax purposes	(9 8)	(5 4)	(8 5)	(4 1)
Profit on disposal treated as exceptional on which no tax is payable due to rollover relief	(10 9)	(0 7)	(10 9)	(0 7)
Capital allowances for period in excess of depreciation	0 7	0 7	0 7	0 7
Utilisation of/movement in short-term timing difference	(3 3)	(8 6)	(3 3)	(8 6)
Adjustment to tax charge in respect of prior periods	5 0	(11 0)	7 3	(12 4)
	71 6	57 8	72 0	57 6

Of the current year charge, £nil (2006 £nil) relates to current tax charges on exceptional items and £3.0 million credit (2006 £0.2 million credit) in respect of deferred tax

c) Factors affecting future tax rates

The group's current tax charge of £66.5 million (2006 £68.8 million) before adjustments to the tax charge in respect of prior periods represents 22% (2006 25%) of the group's profit before tax

The company's current tax charge of £64.7 million (2006 £70.0 million) before adjustments to the tax charge in respect of prior periods represents 22% (2006 25%) 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 capital allowances

The Chancellor's budget announced proposed changes to the future rate of corporation tax and industrial buildings allowances that, if enacted in the Finance Act will impact the deferred tax provision and future tax charges. The group is currently assessing the likely impact of these changes

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

Notes to the financial statements continued

Year ended 31 March 2007

6 Dividends

	2007 £m	Group 2006 £m	2007 £m	Company 2006 £m
Dividend declared and paid	79 8	154 7	79 8	154 7
Special dividend declared and paid	576 0	-	576 0	-
Dividends paid	655 8	154 7	655 8	154 7

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. The ordinary dividend declared and paid by the company in 2006/07 amounted to £79.8 million, being 7.98 pence per share (2006 15.47 pence per share) and a special dividend of 57.6 pence per share

In March 2007 an ordinary dividend of £63.1 million, being 6.31 pence per share was proposed and paid in April 2007

7 Tangible fixed assets

	Land and buildings £m	Infrastructure assets £m	Plant and equipment £m	Vehicles and mobile plant £m	Group Total £m
Cost					
At 1 April 2006	1,967 2	3,482 5	2,580 4	50 3	8,080 4
Additions	94 2	201 1	199 8	6 7	501 8
Grants and contributions	-	(38 9)	-	-	(38 9)
Assets sold or written off	(11 6)	(1 4)	(48 5)	(8 8)	(70 3)
At 31 March 2007	2,049 8	3,643 3	2,731 7	48 2	8,473 0
Depreciation					
At 1 April 2006	600 7	1,150 4	1,225 2	20 8	2,997 1
Charge for year	43 6	102 3	169 3	5 9	321 1
Assets sold or written off	(8 8)	(1 4)	(48 3)	(6 8)	(65 3)
At 31 March 2007	635 5	1,251 3	1,346 2	19 9	3,252 9
Net book value					
At 31 March 2007	1,414 3	2,392 0	1,385 5	28 3	5,220 1
At 31 March 2006	1,366 5	2,332 1	1,355 2	29 5	5,083 3
Company					
Cost					
At 1 April 2006	1,967 2	3,480 2	2,580 5	50 3	8,078 2
Additions	94 2	201 1	199 8	6 7	501 8
Grants and contributions	-	(38 9)	-	-	(38 9)
Assets sold or written off	(11 6)	(1 4)	(48 5)	(8 8)	(70 3)
At 31 March 2007	2,049 8	3,641 0	2,731 8	48 2	8,470 8
Depreciation					
At 1 April 2006	600 7	1,150 2	1,225 2	20 8	2,996 9
Charge for year	43 6	102 3	169 3	5 9	321 1
Assets sold or written off	(8 8)	(1 4)	(48 3)	(6 8)	(65 3)
At 31 March 2007	635 5	1,251 1	1,346 2	19 9	3,252 7
Net book value					
At 31 March 2007	1,414 3	2,389 9	1,385 6	28 3	5,218 1
At 31 March 2006	1,366 5	2,330 0	1,355 3	29 5	5,081 3

7 Tangible fixed assets continued

	2007 £m	Group 2006 £m	2007 £m	Company 2006 £m
i) Included in tangible fixed assets are assets held under finance leases as follows				
Cost	419 6	425 0	417 2	422 6
Accumulated depreciation	(107 3)	(84 7)	(107 0)	(84 4)
Net book value	312 3	340 3	310 2	338 2
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	1,414 0	1,366 2	1,414 0	1,366 2
Short leasehold	0 3	0 3	0 3	0 3
	1,414 3	1,366 5	1,414 3	1,366 5
iv) Depreciation incurred during the year has been charged as follows				
Owned assets non infrastructure	183 1	187 4	183 1	187 4
Owned assets infrastructure	102 3	91 2	102 3	91 2
Depreciation on assets held under finance leases	23 8	10 5	23 8	10 5
Depreciation on assets treated as an exceptional item	11 9	-	11 9	-
	321 1	289 1	321 1	289 1
v) Included in the above are the following tangible fixed assets not subject to depreciation				
Land	24 6	24 9	24 6	24 9
Assets in the course of construction	320 0	209 2	320 0	209 2
	344 6	234 1	344 6	234 1

8 Investments

	Group		
	Shares in subsidiary undertakings £m	Loans in subsidiary undertakings £m	Other investments £m
Cost and net book value at 1 April 2006 and 31 March 2007			0 1
	Company		
	Shares in subsidiary undertakings £m	Loans in subsidiary undertakings £m	Other investments £m
Cost and net book value at 1 April 2006 and 31 March 2007	171 2	65 5	0 1

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

Notes to the financial statements continued

Year ended 31 March 2007

9a Debtors amounts falling due within one year

	2007 £m	Group 2006 £m	2007 £m	Company 2006 £m
Trade debtors	123 9	99 0	123 9	99 0
Amounts owed by parent and fellow subsidiary undertakings	4 5	4 3	4 5	3 2
Other debtors	21 9	0 2	21 9	0 2
Prepayments and accrued income	120 5	101 2	120 5	97 6
	270 8	204 7	270 8	200 0

9b Debtors amounts falling due after more than one year

	2007 £m	Group 2006 £m	2007 £m	Company 2006 £m
Amounts owed by parent and fellow subsidiary undertakings	-	-	26 9	22 8
Prepayments and accrued income	3 4	3 4	0 1	3 4
	3 4	3 4	27 0	26 2
Total debtors	274 2	208 1	297 8	226 2

10 Creditors' amounts falling due within one year

	2007 £m	Group 2006 £m	2007 £m	Company 2006 £m
Bank overdrafts	611 7	390 3	632 9	396 9
Bank loans	75 0	50 0	75 0	50 0
Amounts owed to subsidiary undertakings	-	-	27 6	6 7
Other loans	27 2	6 7	-	-
Obligations under finance leases	32 7	35 7	32 7	35 7
Borrowings (note 12)	746 6	482 7	768 2	489 3
Trade creditors	29 4	21 7	29 4	21 7
Amounts owed to parent and fellow subsidiary undertakings	97 8	7 0	98 9	7 0
Amounts owed to subsidiary undertakings	-	-	31 3	41 0
Other creditors	5 9	26 3	5 9	26 3
Taxation and social security	4 0	3 7	4 0	3 7
Corporation tax payable	44 1	54 4	44 1	54 4
Accruals and deferred income	262 0	262 0	242 3	232 1
	1,189 8	857 8	1,224 1	875 5

11 Creditors amounts falling due after more than one year

	2007 £m	Group 2006 £m	2007 £m	Company 2006 £m
Bank loans	385 9	306 3	385 9	306 3
Amounts owed to subsidiary undertakings	-	-	1,613 9	1,291 8
Other loans	1,613 9	1,291 8	-	-
Obligations under finance leases	375 4	406 1	375 4	406 1
Borrowings (note 12)	2,375 2	2,004 2	2,375 2	2,004 2
Deferred income	38 9	41 6	38 9	41 6
Other creditors	3 0	3 3	3 0	3 3
	2,417 1	2,049 1	2,417 1	2,049 1

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 10) on page 28

a) Borrowings analysed by maturity date

	Overdrafts £m	Loans repayable by instalments any of which are payable after five years £m	Loans with other repayment terms £m	Finance leases £m	2007 £m	2006 £m
Financial liabilities due within one year (note 10)	611.7	–	102.2	32.7	746.6	482.7
Between one and two years	–	–	78.6	40.9	119.5	134.9
Between two and five years	–	–	137.3	105.6	242.9	343.8
After more than five years	–	–	1,783.9	228.9	2,012.8	1,525.5
Total financial liabilities after one year	–	–	1,999.8	375.4	2,375.2	2,004.2
	611.7	–	2,102.0	408.1	3,121.8	2,486.9

£461 million of funding instruments contain certain financial covenants, breach of which can trigger early repayment

Loans repayable partly or wholly after five years comprise

	Rate of interest %	2007 £m	2006 £m
European Investment Bank loans – 2013-2016 (2006-2013)	3.1-3.3	285.9	131.3
European medium term loans notes – 2012-2057 (2006-2011-2028)	1.4-6.1	789.0	445.2
Sterling bonds – 2024-2029 (2006-2024-2029)	6.1-6.3	709.0	708.7
		1,783.9	1,285.2

	Overdrafts £m	Loans repayable by instalments any of which are payable after five years £m	Loans with other repayment terms £m	Finance leases £m	2007 £m	2006 £m
Financial liabilities due within one year (note 10)	632.9	–	102.6	32.7	768.2	489.3
Between one and two years	–	–	78.6	40.9	119.5	134.9
Between two and five years	–	–	137.3	105.6	242.9	343.8
After more than five years	–	–	1,783.9	228.9	2,012.8	1,525.5
Total financial liabilities after one year	–	–	1,999.8	375.4	2,375.2	2,004.2
	632.9	–	2,102.4	408.1	3,143.4	2,493.5

£461 million of funding instruments contain certain financial covenants, breach of which can trigger early repayment

Loans repayable partly or wholly after five years comprise

	Rate of interest %	2007 £m	2006 £m
European Investment Bank loans – 2013-2016 (2006-2013)	3.1-3.3	285.9	131.3
Amounts owed to subsidiary undertakings – 2012-2029 (2006-2011-2029)	4.1-6.3	1,498.0	1,153.9
		1,783.9	1,285.2

Notes to the financial statements continued

Year ended 31 March 2007

12 Financial instruments continued

b) Investment in interest earning assets

	2007 £m	Group 2006 £m	2007 £m	Company 2006 £m
Sterling deposits	19	21	19	21

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

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

	Total £m	Floating interest rate £m	Fixed interest rate £m	Weighted average interest rate %	Group Fixed borrowings Weighted average period for which interest is fixed Years	Total £m	Floating interest rate £m	Fixed interest rate £m	Weighted average interest rate %	Company Fixed borrowings Weighted average period for which interest is fixed Years
Total borrowings as at 31 March 2007	3,121.8	1,298.0	1,823.8	5.62	15.54	3,143.4	1,319.6	1,823.8	5.62	15.54
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

Included in 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 £19.6 million and commence accruing notional value between 31 March 2007 and 2032. The maximum notional value of these swaps is £135 million. These swaps are floating to fixed and bear fixed interest at between 5.32% and 5.52%.

The group has also entered into £236 million of forward start interest rate swaps (floating to fixed) that commence between May 2007 and May 2009. These swaps all terminate in 2010. These interest rate swaps bear interest between 4.54% 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 2007 interest rates on 58% of the group's borrowings were fixed for periods up to 27 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.

Financial instrument by category	Book value	2007 Fair value	Book value	Group 2006 Fair value	Book value	2007 Fair value	Book value	Company 2006 Fair value
Asset/(liability)	£m	£m	£m	£m	£m	£m	£m	£m
Primary financial instruments held or issued to finance business activities								
Short-term deposits	19	19	21	21	19	19	21	21
Cash at bank and in hand	-	-	-	-	-	-	-	-
Short term debtors and creditors	(177.2)	(177.2)	(177.0)	(177.0)	(189.9)	(189.9)	(192.8)	(192.8)
Borrowings falling due within one year	(740.7)	(708.6)	(481.5)	(482.3)	(761.9)	(729.8)	(488.1)	(488.9)
Borrowings falling due after more than one year	(2,350.2)	(2,307.2)	(1,998.7)	(2,148.2)	(2,350.2)	(2,307.2)	(1,998.7)	(2,148.2)
Derivative financial instruments held to manage the currency and interest rate profile								
Interest rate swaps and similar instruments	-	(25.9)	-	(65.4)	-	(25.9)	-	(65.4)
Currency instruments – cross currency swaps	(30.9)	(34.5)	(6.7)	(14.2)	(30.9)	(34.5)	(6.7)	(14.2)
Total net financial liabilities	(3,297.1)	(3,251.5)	(2,661.8)	(2,885.0)	(3,331.0)	(3,285.4)	(2,684.2)	(2,907.4)
Other long-term assets								
Other fixed asset investments	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1

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.

12 Financial instruments continued

e) Borrowings facilities

The group and company had the following undrawn committed facilities available at 31 March 2007

	Group and Company 2007 £m	2006 £m
Expiring within one year	-	-
Expiring in more than one year but not more than two years	-	-
Expiring after two years but less than five years	500 0	500 0
	500 0	500 0

f) Unrecognised gains and losses on hedges at 31 March 2007

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 2007 given prevailing economic conditions.

	Gains £m	Losses £m	Group and Company Total net gains/(losses) £m
Unrecognised gains and losses on hedges 1 April 2006	7 5	(80 3)	(72 8)
Arising in previous years that were recognised in the year	-	-	-
Arising before 1 April 2006 that were not recognised in the financial year	7 5	(80 3)	(72 8)
Unrecognised gains and losses arising during the financial year	9 8	33 5	43 3
Unrecognised gains and losses at 31 March 2007	17 3	(46 8)	(29 5)
Expected to be recognised			
In one year or less	-	-	-
In later years	17 3	(46 8)	(29 5)

13 Provisions

Provisions for liabilities comprise

	Balance at 1 April 2006 £m	Charged to profit and loss account £m	Utilised £m	Group Balance at 31 March 2007 £m
Deferred tax	543 9	(59 5)	-	484 4
Restructuring	5 1	0 6	(4 7)	1 0
Insurance	1 5	-	(0 3)	1 2
Dilapidation and onerous leasehold properties	-	2 4	-	2 4
	550 5	(56 5)	(5 0)	489 0

	Balance at 1 April 2006 £m	Charged to profit and loss account £m	Utilised £m	Company Balance at 31 March 2007 £m
Deferred tax	543 9	(59 5)	-	484 4
Restructuring	5 1	0 6	(4 7)	1 0
Insurance	1 5	-	(0 3)	1 2
Dilapidation and onerous leasehold properties	-	2 4	-	2 4
	550 5	(56 5)	(5 0)	489 0

Notes to the financial statements continued

Year ended 31 March 2007

13 Provisions continued

Deferred tax

The full deferred tax liability, calculated at a tax rate of 30% (2006 30%), is

	2007 £m	Group 2006 £m	2007 £m	Company 2006 £m
Capital allowance	901.5	931.8	901.5	931.8
Other timing differences	(7.0)	(12.1)	(7.0)	(12.1)
Deferred tax asset relating to FRS 17 pension liability	(31.7)	(46.0)	(31.7)	(46.0)
Undiscounted provision for deferred tax	862.8	873.7	862.8	873.7
Discount	(410.1)	(375.8)	(410.1)	(375.8)
Discounted provision for deferred tax	452.7	497.9	452.7	497.9
Adjustment for deferred tax asset relating to FRS 17 pension liability (included in note 17 pensions)	31.7	46.0	31.7	46.0
Deferred tax as disclosed in provisions	484.4	543.9	484.4	543.9
Provision at start of year	543.9	516.2	543.9	517.3
Deferred tax charge included in profit and loss account	(39.3)	39.7	(39.3)	38.6
Deferred tax charge included in statement of recognised gains and losses	(5.9)	7.8	(5.9)	7.8
Adjustment for deferred tax relating to pension liability FRS 17 (included in note 17 pensions) Included in profit and loss account charge	(20.2)	(12.0)	(20.2)	(12.0)
Included in statement of recognised gains and losses charge	5.9	(7.8)	5.9	(7.8)
Provision at end of year	484.4	543.9	484.4	543.9

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 (2006 one year) 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 a year (2006 two years) from the balance sheet date.

Provision is made for dilapidation costs and leasehold property costs. The associated outflows are expected to arise over a period of up to ten years from the balance sheet date.

14 Share capital

	2007 £m	Group 2006 £m	2007 £m	Company 2006 £m
Authorised				
1,000,000,000 ordinary shares of £1 each (2006 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 (2006 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 2006	735.1	970.2
Profit for the financial year	267.4	256.3
Share based payments	(0.2)	(0.2)
FRS 17 actuarial loss	(19.8)	(19.8)
Deferred tax on actuarial loss	5.9	5.9
Dividends paid	(655.8)	(655.8)
At 31 March 2007	332.6	556.6

At 31 March 2007 cumulative goodwill written off against group reserves amounted to £29.2 million (2006 £29.2 million)

16 Commitments and contingent liabilities

a) Investment expenditure commitments

	Group and company	
	2007 £m	2006 £m
Contracted for but not provided in the financial statements	242.7	141.9

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

	Land and buildings £m	2007 Other £m	Land and buildings £m	2006 Other £m
Within one year	0.2	-	0.2	0.2
Between one and five years	0.5	0.5	0.1	0.7
After five years	1.0	0.1	0.9	0.1
	1.7	0.6	1.2	1.0

The company is committed to making the following payments during the next year in respect of operating leases which expire as follows

	Land and buildings £m	2007 Other £m	Land and buildings £m	2006 Other £m
Within one year	0.2	-	0.2	0.2
Between one and five years	0.5	0.5	0.1	0.7
After five years	1.0	15.0	0.9	14.0
	1.7	15.5	1.2	14.9

c) Banking arrangements

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 2007 is nil (2006 £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 the company between 2000 and 2003. Ofwat had been conducting its own investigation following the allegations made by the employee of the company. Ofwat began its investigation into the allegations in January 2005. 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.

In responding to the report the company agreed to credit customers' accounts and reduce future tariffs.

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 the company on completion of the SFO investigation into leakage.

In April 2006 the Company announced that the board believed there was prima facie evidence of customer relations data being misstated by Severn Trent Water in submissions to Ofwat. We are working and co-operating fully with Ofwat and Ernst and Young LLP on their investigations into this. In June 2006 Ofwat issued a notice under section 22A(4) of the Water Industry Act stating its intention to fine Severn Trent Water for failure to meet customer service standards.

No reliable estimates can currently be made on 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 no provision has been included in these financial statements in respect of these matters.

Notes to the financial statements continued

Year ended 31 March 2007

17 Pensions

The group and company participates in the Severn Trent Water 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. The STSSPS now includes the unfunded defined benefit promise formerly held by the Severn Trent Supplementary Pension Scheme.

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 2006

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

Following the valuation of the STPS scheme, the Employer's contribution rates were 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 costs for these schemes is expected to increase as members in the scheme approach retirement.

The actuarial liabilities and market values of the assets at 31 March 2007 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.

The major assumptions used in the valuation of the STPS (also the approximate weighted average of assumptions used for the valuations of all group schemes) were as follows:

	2007	2006
Valuation Method	Projected Unit	Projected Unit
Price inflation	3.00%	2.70%
Salary increase	4.50%	4.20%
Pension increase in payment and deferment *	3.00%	2.70%
Discount rate	5.40%	4.90%
Longevity at age 65 for pensioners retiring now		
men	19.2	18.3
women	22.1	21.0
Longevity at age 65 for pensioners retiring in 20 years		
men	19.9	18.9
women	23.0	21.8

* In excess of any Guaranteed Minimum Pension (GMP).

Amounts recognised in the profit and loss account in respect of these defined benefit schemes are as follows:

	Group and Company 2007 £m	2006 £m
Amounts charged to operating costs		
Current service costs	(31.0)	(25.2)
Membership movements	-	(11.8)
Past service costs	(0.3)	-
Loss on settlement and curtailment	-	(0.8)
	(31.3)	(37.8)
Amounts charged to net finance costs		
Interest cost	(60.1)	(57.8)
Expected return on scheme assets	72.3	62.4
	12.2	4.6
Total amount charged in profit and loss account	(19.1)	(33.2)

Actuarial gains and losses have been reported in the statement of recognised gains and losses.

Of the amounts charged to the profit and loss account, an element is capitalised in line with our accounting policies.

17 Pensions continued

The amount included in the balance sheet arising from the group's obligations under defined benefit schemes is as follows

	Group and Company 2007 £m	2006 £m
Present value of defined benefit obligations – funded schemes	(1,314 1)	(1,254 6)
Total fair value of assets	1,208 6	1,101 4
Liability recognised in the balance sheet (before deferred tax)	(105 5)	(153 2)
Deferred tax	31 7	46 0
Liability recognised in the balance sheet	(73 8)	(107 2)

Movements in the present value of the defined obligation were as follows

	Group and Company 2007 £m	2006 £m
At 1 April	1,254 6	1,035 4
Service cost	31 0	25 2
Loss on settlement and curtailment	–	0 8
Past service costs	0 3	–
Interest cost	60 1	57 8
Membership movements	–	58 0
Contributions from scheme members	6 7	6 7
Actuarial (gain)/loss	8 9	111 5
Benefits paid	(47 5)	(40 8)
At 31 March	1,314 1	1,254 6

Movements in the fair value of the schemes assets were as follows

	Group and Company 2007 £m	2006 £m
At 1 April	1,101 4	816 0
Expected return on scheme assets	72 3	62 4
Contributions	10 6	73 4
Special contributions	76 0	–
Contributions from scheme members	6 7	6 7
Assets gain/(loss)	(10 9)	137 5
Membership movements	–	46 2
Benefits paid	(47 5)	(40 8)
At 31 March	1,208 6	1,101 4

The analysis of the assets in the schemes and the expected rates of return were

	Expected return	2007 Fair value of assets £m	Group and Company 2006 Expected return	2006 Fair value of assets £m
Equities	8 25%	664 8	8 00%	710 6
Gilts	4 65%	292 2	4 17%	196 2
Corporate bonds	5 40%	101 7	4 90%	59 8
Property	6 55%	64 8	6 20%	62 8
Cash	5 25%	85 1	3 70%	72 0
Total fair value of assets		1,208 6		1,101 4

The expected rate of return on scheme assets is based on market expectations at the beginning of the period for returns over the life of the benefit obligations. For gilts and corporate bonds the expected rates of return are based on market yields at the balance sheet date.

For equities, an equity risk premium has been added to the gilt rate.

The actual return on scheme assets was £61.3 million (2006: £199.9 million).

The estimated amount of contributions expected to be paid to the schemes in the normal course during the year ended 31 March 2008 is £45.5 million.

The history of the actual and expected performance of pension scheme assets and liabilities is

	Group and Company 2007 £m	2006 £m
Difference between actual and expected return on scheme assets	(10 9)	137 5
Experience adjustments on schemes liabilities	(8 9)	(111 5)

Notes to the financial statements continued

Year ended 31 March 2007

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 stakeholders 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 £0.7 million (2006: £0.6 million) represents contributions payable to these schemes by the group at rates specified in the rules of the schemes. As at 31 March 2007 nil (2006: nil) due in respect of the current reporting period has not been paid over to the schemes.

18 Share based payment

The group operates a number of share based remuneration schemes for employees and details of the share awards outstanding during the year are as follows:

	Employee Sharesave Scheme		Approved Share Option Scheme		Unapproved Share Option Scheme	
	Number of share options	Weighted average exercise price	Number of share options	Weighted average exercise price	Number of share options	Weighted average exercise price
Outstanding at 1 April 2005	4,549,467	577p	169,868	741p	288,684	731p
Granted during the year	712,216	823p	-	-	-	-
Forfeited during the year	(87,499)	620p	(6,505)	805p	-	-
Cancelled during the year	(128,775)	598p	-	-	-	-
Exercised during the year	(1,202,521)	500p	(60,639)	738p	(119,093)	754p
Expired during the year	(7,147)	674p	-	-	-	-
Outstanding at 1 April 2006	3,835,741	645p	102,824	739p	169,591	715p
Granted during the year	487,078	1172p	-	-	-	-
Forfeited during the year	(83,777)	693p	(39,096)	690p	(53,200)	693p
Cancelled during the year	(67,917)	768p	-	-	-	-
Exercised during the year	(745,913)	558p	(47,170)	758p	(96,099)	724p
Expired during the year	(10,445)	579p	-	-	-	-
Outstanding at 31 March 2007	3,414,767	736p	16,558	801p	20,292	729p

The weighted average share price during the period was £13.82 (2006: £10.29)

Share option schemes

The options outstanding at the end of the period are exercisable as shown below:

i) Employee Sharesave Scheme

Under the terms of the Sharesave Scheme, the board may grant those employees who have entered into an Inland Revenue approved Save As You Earn contract for a period of three, five or seven years, the right to purchase ordinary shares in the company. Options outstanding at 31 March 2007 were as follows:

Date of grant	Normal date of exercise	Option price	2007	Number of shares 2006
January 1999	2004 or 2006	831p	-	16,144
January 2000	2003, 2005 or 2007	473p	220,278	234,930
January 2001	2004, 2006 or 2008	568p	52,565	295,520
January 2002	2005, 2007 or 2009	548p	311,244	331,783
January 2003	2006, 2008 or 2010	536p	388,121	829,657
January 2004	2007, 2009 or 2011	592p	578,334	631,872
January 2005	2008, 2010 or 2012	759p	714,457	786,475
January 2006	2009, 2011 or 2013	823p	668,034	709,360
January 2007	2010, 2012 or 2014	1172p	481,734	-
			3,414,767	3,835,741

ii) Approved Share Option Scheme

Under the terms of the Share Option Scheme (formerly Executive Share Option Scheme), the board has granted directors and other executives options to purchase ordinary shares in the company. Options outstanding under this scheme at 31 March 2007 were as follows:

Date of grant	Normal date of exercise	Option price	2007	Number of shares 2006
June 1998	2001-2008	1005p	2,312	10,814
June 1999	2002-2009	934p	3,934	7,066
June 2000	2003-2010	688p	5,545	29,704
July 2001	2004-2011	738p	1,106	2,338
June 2002	2005-2012	720p	3,751	8,832
July 2003	2006-2013	680 5p	-	44,070
			16,558	102,824

iii) Unapproved Share Option Scheme

The board has granted executives options to purchase ordinary shares in the company under an unapproved share option scheme. Options outstanding under this scheme at 31 March 2007 were as follows:

Date of grant	Normal date of exercise	Option price	2007	Number of shares 2006
June 1998	2001-2008	1005p	-	4,003
June 1999	2002-2009	934p	1,973	7,030
June 2000	2003-2010	688p	9,082	50,177
July 2001	2004-2011	738p	2,574	16,581
June 2002	2005-2012	720p	6,663	36,030
July 2003	2006-2013	680 5p	-	55,070
			20,292	169,591

iv) Fair values of awards made in the year

	Number	2007 Fair value (£m)	Number	2006 Fair value (£m)
LTIP awards	80,534	0.5	180,020	1.3
Sharesave options	487,078	1.5	712,216	1.3
Share Incentive Plan (SIP)		-	115,825	1.2

The fair value of the LTIP awards was calculated using the Monte Carlo method. The principal assumptions were as follows:

LTIP award year	2006/07	2005/06	2004/05
Share price at grant date	1178p	1017p	903p
Number of shares awarded	80,534	180,020	263,807
Number of employees	16	57	71
Vesting period (years)	3	3	3
Expected volatility	15%	17%	20%
Expected life (years)	3	3	3
Expected dividend yield	n/a	n/a	6.5%
Proportion of employees expected to cease employment before vesting	0%	0%	0%
Expectation of meeting economic profit performance criteria	n/a	100%	100%
Fair value per share (EP scheme/TSR scheme)	604p	1017p/468p	484p

The fair value of the Sharesave options was calculated using the Black Scholes model. The principal assumptions were as follows:

Scheme year	2006/07			2005/06			2004/05		
	3 year	5 year	7 year	3 year	5 year	7 year	3 year	5 year	7 year
Share price at grant date	1428p	1428p	1428p	1069p	1069p	1069p	979p	979p	979p
Number of options granted	294,531	156,000	36,547	410,041	252,063	50,112	378,886	308,759	73,224
Number of employees	1,420	511	96	1,775	676	111	1,826	756	175
Vesting period (years)	3	5	7	3	5	7	3	5	7
Expected volatility	15%	15%	15%	17%	17%	17%	30%	30%	30%
Option life (years)	3.5	5.5	7.5	3.5	5.5	7.5	3.5	5.5	7.5
Expected life (years)	3.25	5.25	7.25	3.25	5.25	7.25	3.25	5.25	7.25
Risk free rate	5.19%	5.04%	4.92%	4.31%	4.28%	4.24%	4.52%	4.54%	4.56%
Expected dividend yield	4.0%	4.0%	4.0%	6.5%	6.5%	6.5%	6.5%	6.5%	6.5%
Proportion of employees expected to cease employment before vesting	15.0%	17.0%	13.0%	15.0%	17.0%	13.0%	15.0%	17.0%	13.0%
Fair value per share – sharesave	295p	305p	306p	189p	168p	149p	232p	227p	216p

The SIP shares are purchased on the open market and vest with the employees immediately and hence the value of the shares purchased is charged straight to the income statement. During the period, the group recognised total expenses of £1.1 million (2006: £2.1 million) related to equity settled share-based payment transactions. Volatility is based on historical observations as adjusted for unusual market fluctuations.

Notes to the financial statements continued

19 Group cash flow statement

a) Reconciliation of profit before interest to net cash inflow from operating activities

	2007 £m	2006 £m
Operating profit	407 2	402 9
Depreciation charge (note 7 iv)	321 1	289 1
Deferred income received	0 1	0 5
Deferred income credited to profit and loss account	(2 8)	(3 0)
Movement in provision for liabilities and charges	3 0	0 1
Utilisation of provisions for liabilities and charges	(5 0)	(5 0)
Movement in pension scheme	20 5	(35 6)
Decrease/(increase) in stocks	0 1	(1 7)
Increase in debtors	(67.7)	(19 3)
(Decrease)/increase in creditors	(32 2)	16 0
Net cash inflow from operating activities	644 3	644 0

b) Analysis of changes in net debt

	At 1 April 2006 £m	Cash flow £m	Other non cash changes £m	At 31 March 2007 £m
Overdrafts (note 10)	(390 3)	(221 4)	–	(611 7)
Debt due within one year (note 10)	(56 7)	(45 5)	–	(102 2)
Debt due after one year (note 11)	(1,598 1)	(387 7)	(14 0)	(1,999 8)
Finance leases (notes 10 and 11)	(441 8)	33 7	–	(408 1)
	(2,486 9)	(620 9)	(14 0)	(3,121 8)
Short-term deposits (note 12b)	2 1	(0 2)	–	1 9
	(2,484 8)	(621 1)	(14 0)	(3,119 9)

20 Ultimate and immediate parent company and related party transactions

The ultimate parent undertaking and controlling entity is Severn Trent Plc which is registered in England and Wales. The immediate parent undertaking is Severn Trent Water Services Plc which is registered in England and Wales. 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/reports2007

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

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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 Service 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

5 June 2007

Report of the auditors to the Water Services Regulation Authority

Year ended 31 March 2007

Independent Auditors' report to the Water Services Regulation Authority ('WSRA') and Severn Trent Water Limited and subsidiary undertakings ('the Group')

We have audited the Regulatory Accounts of the Group which incorporates East Worcester Water Plc and its other subsidiary undertakings for the year ended 31 March 2007 set out on pages 48 to 61 which comprise

- * The regulatory historical cost accounting statements for the group, comprising the regulatory historical cost profit and loss account and the regulatory historical 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 12 to the current cost financial statements including the statement on 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 WSRA 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 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 WSRA those matters that we have agreed to state to them in our report, in order (a) to assist the Company to meet their obligations under the Company's Instrument of Appointment to procure such a report and (b) to facilitate the carrying out by the WSRA 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 WSRA, for our audit work, for this report, or for the opinion 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 1.04, 2.03, 3.06, 4.03 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 Group. 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 specially address an accounting issue, they then 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 WSRA. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the WSRA's purposes. Accordingly we make no such assessment.

The Directors' responsibilities for preparing the Regulatory Accounts in accordance with the Regulatory Accounting Guidelines are set in the statement of director's responsibilities for regulatory information on page 45.

Our responsibility is to audit the Regulatory Accounts in accordance with the International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board, except as stated in the "Basis of audit 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, assets and liabilities of the Appointee and the Appointed Business in accordance with the Company's Instrument of Appointment and Regulatory Accounting Guideline 2.03 (Guideline for classification of expenditure), Regulatory Accounting Guideline 3.06 (Guideline for the contents of regulatory accounts) and Regulatory Accounting Guideline 4.03 (Guideline for the analysis of operating costs and assets) and whether the regulatory current cost accounting statements on pages 50 to 61 have been properly prepared in accordance with Regulatory Accounting Guidelines 1.04 (Guideline for accounting for current costs and regulatory capital values), Regulatory Accounting Guideline 3.06 and Regulatory Accounting Guideline 4.03. 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 Appointees' accounting records and has been properly prepared in accordance with the requirements of Condition F and as appropriate, Regulatory Accounting Guideline 1.04, Regulatory Accounting Guideline 2.03, Regulatory Accounting Guideline 3.06 and Regulatory Accounting Guideline 4.03.

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 performance review, the notes on regulatory information and the additional information required by the Regulatory licence.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the 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 WSRA, 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's 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's members those matters we are required to state to them in a statutory auditors' report and for no other purpose.

In those circumstances, to the fullest 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 48 to 49 have been drawn up in accordance with Regulatory Accounting Guideline 3.06 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. This represents a 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 11.

Audit opinion

In our opinion the Regulatory Accounts of the Company for the year ended 31 March 2007 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 water and sewerage undertaker under the Water Industry Act 1991, the Regulatory Accounting Guidelines issued by the WSRA and the accounting policies set out in note 2 to the Regulatory accounts the state of the Company's affairs at 31 March 2007 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 Appointees 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 Guidelines 1.04, Regulatory Accounting Guidelines 2.03, Regulatory Accounting Guideline 3.06 and Regulatory Accounting Guideline 4.03 issued by the WSRA,
- c) the regulatory historical cost accounting statements on pages 48 to 49 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 3.06 and Regulatory Accounting Guideline 4.03 issued by the WSRA,
- d) The regulatory current cost accounting statements on pages 50 to 61 have been properly prepared in accordance with Regulatory Accounting Guideline 1.04, Regulatory Accounting Guideline 3.06 and Regulatory Accounting Guideline 4.03 issued by the WSRA.

Deloitte & Touche LLP

Chartered Accountants and Registered Auditors
London
5 June 2007

Deloitte & Touche LLP

The maintenance and integrity of the 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, 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.

Regulatory accounts – historical cost financial statements

Group profit and loss account year ended 31 March 2007

	Appointed business 2007 £m	Non appointed business 2007 £m	Inter segment 2007 £m	2007 £m	Appointed business 2006 £m	Non- appointed business 2006 £m	Inter segment 2006 £m	2006 £m
Turnover	1,195 7	12 3	(1 1)	1,206 9	1,127 5	11 5	(1 3)	1,137 7
Operating costs	(577 9)	(10 5)	1 1	(587 3)	(534 1)	(10 6)	1 3	(543 4)
Historical cost depreciation	(216 0)	-	-	(216 0)	(194 9)	-	-	(194 9)
Other operating income	36 2	-	-	36 2	2 5	-	-	2 5
Operating profit	438 0	1 8	-	439 8	401 0	0 9	-	401 9
Other income	1 5	2.1	-	3 6	3 3	0 2	-	3 5
Net interest payable	(143 7)	-	-	(143 7)	(129 4)	-	-	(129 4)
Profit on ordinary activities before taxation	295 8	3 9	-	299 7	274 9	1 1	-	276 0
Taxation on profit on ordinary activities								
Current tax	(71 6)	-	-	(71 6)	(57 8)	-	-	(57 8)
Deferred tax	39 3	-	-	39 3	(39 7)	-	-	(39 7)
Taxation	(32 3)	-	-	(32 3)	(97 5)	-	-	(97 5)
Profit on ordinary activities after taxation	263 5	3 9	-	267 4	177 4	1 1	-	178 5
Dividend	(651 9)	(3 9)	-	(655 8)	(152 8)	(1 9)	-	(154 7)
Retained (loss)/profit for the financial year	(388 4)	-	-	(388 4)	24 6	(0 8)	-	23 8

Statement of total recognised gains and losses year ended 31 March 2007

	Appointed business 2007 £m	Non appointed business 2007 £m	Inter segment 2007 £m	2007 £m	Appointed business 2006 £m	Non- appointed business 2006 £m	Inter segment 2006 £m	2006 £m
Profit for the financial year	263 5	3 9	-	267 4	177 4	1 1	-	178 5
FRS 17 actuarial (loss)/gain	(19 8)	-	-	(19 8)	26 0	-	-	26 0
Deferred tax on actuarial (loss)/gain	5 9	-	-	5 9	(7 8)	-	-	(7 8)
Total recognised gains and losses for the financial year	249 6	3 9	-	253 5	195 6	1 1	-	196 7

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 2007

	Notes	Appointed business 2007 £m	Non- appointed business 2007 £m	Inter segment 2007 £m	2007 £m	Appointed business 2006 £m	Non appointed business 2006 £m	Inter segment 2006 £m	2006 £m
Fixed assets									
Tangible assets	11	5,216 7	-	-	5,216 7	5,075 6	-	-	5,075 6
Investments		0 1	-	-	0 1	0 1	-	-	0 1
		5,216 8	-	-	5,216 8	5,075 7	-	-	5,075 7
Current assets									
Stocks		6 0	-	-	6 0	6 1	-	-	6 1
Debtors	11	274 2	-	-	274 2	207 7	1 5	(1 1)	208 1
Short-term deposits		1 9	-	-	1 9	2 1	-	-	2 1
Infrastructure renewals prepayment		3 4	-	-	3 4	7 7	-	-	7 7
		285 5	-	-	285 5	223 6	1 5	(1 1)	224 0
Creditors									
amounts falling due within one year									
Overdrafts		(611 7)	-	-	(611 7)	(390 3)	-	-	(390 3)
Creditors		(396 3)	-	-	(396 3)	(317 5)	(1 5)	1 1	(317 9)
Borrowings		(134 9)	-	-	(134 9)	(92 4)	-	-	(92 4)
Corporation tax payable		(44 1)	-	-	(44 1)	(54 4)	-	-	(54 4)
		(1,187 0)	-	-	(1,187 0)	(854 6)	(1 5)	1 1	(855 0)
Net current liabilities		(901 5)	-	-	(901 5)	(631 0)	-	-	(631 0)
Total assets less current liabilities		4,315 3	-	-	4,315 3	4,444 7	-	-	4,444 7
Creditors									
amounts falling due after more than one year									
Borrowings		(2,375 2)	-	-	(2,375 2)	(2,004 2)	-	-	(2,004 2)
Other creditors		(3 0)	-	-	(3 0)	(3 3)	-	-	(3 3)
		(2,378 2)	-	-	(2,378 2)	(2,007 5)	-	-	(2,007 5)
Provision for liabilities and charges									
- Deferred taxation		(484 4)	-	-	(484 4)	(543 9)	-	-	(543 9)
- Other provisions		(4 6)	-	-	(4 6)	(6 6)	-	-	(6 6)
Deferred income		(41 7)	-	-	(41 7)	(44 4)	-	-	(44 4)
Pension deficit		(73 8)	-	-	(73 8)	(107 2)	-	-	(107 2)
Net assets		1,332 6	-	-	1,332 6	1,735 1	-	-	1,735 1
Capital and reserves									
Called up share capital		1,000 0	-	-	1,000 0	1,000 0	-	-	1,000 0
Profit and loss account		332 6	-	-	332 6	735 1	-	-	735 1
Shareholder's funds		1,332 6	-	-	1,332 6	1,735 1	-	-	1,735 1

Regulatory accounts – current cost financial statements

Group profit and loss account appointed business year ended 31 March 2007

	Notes	2007 £m	2006 £m
Turnover	3a	1,195 7	1,127 5
Current cost operating costs	3d	(837 6)	(773 7)
Other operating income	3b	34 1	3 1
		392 2	356 9
Working capital adjustment	3c	3 4	1 6
Current cost operating profit		395 6	358 5
Other income		1 5	3 3
Net interest payable		(143 7)	(129 4)
Financing adjustment		116 2	74 7
Current cost profit before taxation		369 6	307 1
Taxation on profit on ordinary activities			
Current tax		(71 6)	(57 8)
Deferred tax		39 3	(39 7)
Taxation		(32 3)	(97 5)
Current cost profit attributable to shareholder after taxation		337 3	209 6
Dividend		(651 9)	(152 8)
Current cost profit retained		(314 6)	56 8

Statement of total recognised gains and losses appointed business year ended 31 March 2007

	2007 £m	2006 £m
Current cost profit for the financial year	337 3	209 6
FRS 17 actuarial (loss)/gain	(19 8)	26 0
Deferred tax on actuarial (loss)/gain	5 9	(7 8)
Total recognised gains and losses for the financial year	323 4	227 8

Group balance sheet appointed business as at 31 March 2007

	Notes	2007 £m	2006 £m
Fixed assets			
Tangible assets	4c	28,651 5	27,194 9
Third party contributions since 1989-90		(1,388 3)	(1,267 8)
		27,263 2	25,927 1
Working capital		11 8	(69 8)
Short-term deposits		1 9	2 1
Overdrafts		(611 7)	(390 3)
Infrastructure renewals prepayment		3 4	7 7
Net operating assets		26,668 6	25,476 8
Non operating assets and liabilities			
Borrowings		(134 9)	(92 4)
Non-trade debtors		0 1	1 5
Non-trade creditors due within one year		(128 0)	(35 5)
Investments		0 1	0 1
Corporation tax payable		(44 1)	(54 4)
Total non operating assets and liabilities		(306 8)	(180 7)
Creditors amounts falling due after more than one year			
Borrowings		(2,375 2)	(2,004 2)
Other creditors		(3 0)	(3 3)
		(2,378 2)	(2,007 5)
Provision for liabilities and charges			
- Deferred taxation		(484 4)	(543 9)
- Other provisions		(4 6)	(6 6)
Pension deficit		(73 8)	(107 2)
Net provisions		(562 8)	(657 7)
Total assets		23,420 8	22,630 9
Capital and reserves			
Called up share capital		1,000 0	1,000 0
Profit and loss account	6	(236 1)	92 6
Current cost reserve	7	22,656 9	21,538 3
		23,420 8	22,630 9

Regulatory accounts – current cost financial statements continued

Group cash flow statement year ended 31 March 2007

Notes	Appointed business		Non-appointed business		Total 2007 £m	Appointed business		Non-appointed business		Total 2006 £m
	2007 £m	2007 £m	2007 £m	2007 £m		2006 £m	2006 £m	2006 £m	2006 £m	
Net cash inflow from operating activities	8	640 4		3 9	644.3		642 1		1 9	644 0
Returns on investments and servicing of finance										
Interest received		1 3	-	1 3		0 4	-	-	0 4	
Interest paid		(118 5)	-	(118 5)		(104 0)	-	-	(104 0)	
Interest element of finance lease rental payments		(20 1)	-	(20 1)		(41 6)	-	-	(41 6)	
Net cashflow from returns on investment and servicing of finance		(137 3)	-	(137 3)		(145 2)	-	-	(145 2)	
Taxation		(68 6)	-	(68 6)		(58 3)	-	-	(58 3)	
Capital expenditure										
Purchase of tangible fixed assets		(381.3)	-	(381 3)		(343 8)	-	-	(343 8)	
Grants and contributions received		34 5	-	34 5		32 2	-	-	32 2	
Infrastructure renewals expenditure		(98 1)	-	(98 1)		(94 5)	-	-	(94 5)	
Disposal of fixed assets		41 2	-	41 2		6 2	-	-	6 2	
Sale of other fixed asset investments		-	-	-		0 1	-	-	0 1	
Net cashflow from investing activities		(403 7)	-	(403 7)		(399 8)	-	-	(399 8)	
Equity dividends paid		(651 9)		(3 9)	(655 8)	(152 8)		(1 9)	(154 7)	
Net cash outflow before management of liquid resources and financing		(621 1)	-	(621 1)		(114 0)	-	-	(114 0)	
Management of liquid resources		0 2	-	0 2		0 2	-	-	0 2	
Net cashflow before financing		(620 9)	-	(620 9)		(113 8)	-	-	(113 8)	
Financing										
Receipt from sale and leaseback transaction		-	-	-		170 2	-	-	170 2	
Finance leases repaid		(33 7)	-	(33 7)		(159 2)	-	-	(159 2)	
Loans advanced		490 2	-	490 2		31 9	-	-	31 9	
Loans repaid		(57 0)	-	(57 0)		(159 3)	-	-	(159 3)	
		399 5	-	399 5		(116 4)	-	-	(116 4)	
Net decrease in cash		(221 4)	-	(221 4)		(230 2)	-	-	(230 2)	

Reconciliation of net cash flow to movement in net debt

	Appointed business		Non-appointed business		Total 2007 £m	Appointed business		Non-appointed business		Total 2006 £m
	2007 £m	2007 £m	2007 £m	2007 £m		2006 £m	2006 £m	2006 £m	2006 £m	
Net decrease in cash as above	(221 4)		-	(221 4)		(230 2)		-	(230 2)	
Cash flow from movement in net debt and financing	(399 5)		-	(399 5)		116 4		-	116 4	
Cash flow from movement in liquid resources	(0 2)		-	(0 2)		(0 2)		-	(0 2)	
Change in net debt resulting from cash flows	(621 1)		-	(621 1)		(114 0)		-	(114 0)	
Rolled up interest on debt	(14 0)		-	(14 0)		(3 0)		-	(3 0)	
Rolled up interest on finance leases	-		-	-		18 9		-	18 9	
Increase in net debt	(635 1)		-	(635 1)		(98 1)		-	(98 1)	
Opening net debt	(2,484 8)		-	(2,484 8)		(2,386 7)		-	(2,386 7)	
Closing net debt	(3,119 9)		-	(3,119 9)		(2,484 8)		-	(2,484 8)	

Notes to the current cost financial statements year ended 31 March 2007

1 Regulatory reporting

The regulatory accounts as reported on pages 48 to 61 should be read in conjunction with the Operating and Financial review on pages 1 to 14 for further understanding of the performance of the business

It should also be noted that the company has reassessed its forecast for infrastructure renewal expenditure and thus the infrastructure renewals charge has been increased to reflect this

In particular attention is drawn to pages 15 to 18 of the Directors report which sets out the link between director's pay and standards of performance and page 18 of the Directors Report in respect of the Statement of Disclosure of Information to auditors

2 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 term 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 23 to 44, 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 a 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

Regulatory accounts – current cost financial statements continued

Notes to the current cost financial statements year ended 31 March 2007 continued

2 Accounting policies continued

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 assets and liabilities in the balance sheet apart from those included in working capital and excluding fixed assets, deferred taxation provision, index linked debt and dividends payable

3 Analysis of current cost turnover and operating costs

a) Turnover

	Water services £m	Sewerage services £m	2007 Total £m	Water services £m	Sewerage services £m	2006 Total £m
Unmeasured – household	306 6	331 6	638 2	300 3	313 3	613 6
Unmeasured – non household	2 5	4 4	6 9	2 9	12 1	15 0
Unmeasured	309 1	336 0	645 1	303 2	325 4	628 6
Measured – household	105 0	112 7	217 7	92 3	96 7	189 0
Measured – non household	110 5	137 3	247 8	102 5	122 0	224 5
Measured	215 5	250 0	465 5	194 8	218 7	413 5
Trade effluent	-	16 0	16 0	-	8 6	8 6
Large user tariffs and special agreements	24 0	28 4	52 4	23 8	31 8	55 6
Revenue grants	-	0 3	0 3	-	0 2	0 2
Non potable large user tariffs and special agreements	-	-	-	-	-	-
Rechargeable works	1 6	0 3	1 9	1 9	0 6	2 5
Bulk supplies/inter company	3 9	-	3 9	3 6	0 4	4 0
Other	4 1	0 5	4 6	6 3	1 6	7 9
Third parties	9 6	0 8	10 4	11 8	2 6	14 4
Other sources	2 2	3 8	6 0	2 4	4 2	6 6
Total turnover	560 4	635 3	1,195 7	536 0	591 5	1,127 5

b) Other operating income

Current cost profit on disposal of tangible fixed assets	4 8	29 3	34 1	1 7	1 2	2 9
Other operating income	-	-	-	0 1	0 1	0 2
Total	4 8	29 3	34 1	1 8	1 3	3 1

c) Working capital adjustment

	1 1	2 3	3 4	(0 1)	1 7	1 6
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3 Analysis of current cost turnover and operating costs continued

d) Analysis of operating costs and tangible fixed assets

	2007 Business analysis											Total £m
	Resources and treatment £m	Water services Distri- bution £m	Water services sub total £m	Sewerage £m	Sewage treatment £m	Sludge treatment and disposal £m	Sewerage treatment /disposal sub total £m	Sewerage services sub total £m	Customer services £m	Scientific services £m	Cost of regulation £m	
Direct costs												
Employment costs	61	164	225	75	116	68	184	259				
Power	139	213	352	34	149	03	152	186				
Agencies	-	-	-	-	-	-	-	-				
Hired and contracted	13	144	157	96	36	121	157	253				
Associated companies	09	01	10	29	04	19	23	52				
Materials and consumables	60	29	89	11	31	62	93	104				
Service charges	98	01	99	32	59	-	59	91				
Bulk supply imports	81	-	81	-	-	-	-	-				
Other direct costs	12	25	37	15	01	03	04	19				
Total direct costs	473	577	1050	292	396	276	672	964	324	115	46	2499
General and support	240	223	463	216	369	132	501	717	79	30	10	1299
Functional expenditure	713	800	1513	508	765	408	1173	1681	403	145	56	3798
Business activities recharge			286					318	(403)	(145)	(56)	-
Rates			360					197				557
Doubtful debts			104					119				223
Exceptional items			11					19				30
			2274					2334				4608
Services for third parties			123					24				147
Total operating expenditure			2397					2358				4755
Capital costs												
Infrastructure renewals charge	15	685	700	323	-	-	-	323				1023
Current cost depreciation	520	495	1015	249	931	426	1357	1606				2621
Amortisation of deferred income			(13)					(15)				(28)
Business activity capital costs			01					-				01
			1703					1914				3617
Services for third parties depreciation			04					-				04
Total capital maintenance			1707					1914				3621
Total operating costs			4104					4272				8376
Analysis of tangible fixed assets												
Service activities	1,625.9	7,035.2	8,661.1	17,667.2	1,562.9	331.2	1,894.1	19,561.3				28,222.4
Business activities			130.1	23.0			102.0	125.0				255.1
Service totals			8,791.2	17,690.2			1,996.1	19,686.3				28,477.5
Services for third parties			174.0					-				174.0
Total			8,965.2					19,686.3				28,651.5

Included within customer service costs are payments amounting to £3.5 million (2006 £3.5 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 4.03 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 allocated directly to the service to which they relate. Any remaining general and support costs which cannot be directly allocated to a service are then allocated over the service activity costs on a pro-rata basis, based on the value of direct cost and overhead costs already directly allocated. Business activity costs are analysed firstly on a direct basis, then together with the general and support costs allocated, are apportioned again over the service activity using relevant activity drivers where possible.

Regulatory accounts – current cost financial statements continued

Notes to the current cost financial statements year ended 31 March 2007 continued

3 Analysis of current cost turnover and operating costs continued

d) Analysis of operating costs and tangible fixed assets

	Resources and treatment £m	Water services		Sewerage £m	Sewage treatment £m	Sludge treatment and disposal £m	Sewerage services		Customer services £m	Scientific services £m	2006 Business analysis	
		Distribu- tion £m	Water services sub total £m				Sewerage treatment sub total £m	Sewerage services sub total £m			Cost of regulation £m	Total £m
Direct costs												
Employment costs	65	174	239	72	119	68	187	259				
Power	74	120	194	31	78	11	89	120				
Agencies	-	-	-	-	-	-	-	-				
Hired and contracted	16	125	141	73	26	86	112	185				
Associated companies	15	01	16	27	03	19	22	49				
Materials and consumables	48	29	77	11	31	58	89	100				
Service charges	95	-	95	30	62	-	62	92				
Bulk supply imports	83	-	83	-	-	-	-	-				
Other direct costs	06	32	38	12	04	01	05	17				
Total direct costs	402	481	883	256	323	243	566	822	330	125	32	2192
General and support	255	204	459	167	377	127	504	671	112	43	10	1295
Functional expenditure	657	685	1342	423	700	370	1070	1493	442	168	42	3487
Business activity recharge			304					348	(442)	(168)	(42)	-
Rates			358					199				557
Doubtful debts			122					136				258
Exceptional items			04					03				07
			2130					2179				4309
Services for third parties			97					23				120
Total operating expenditure			2227					2202				4429
Capital costs												
Infrastructure renewals charge	15	596	611	301	-	-	-	301				912
Current cost depreciation	544	472	1016	232	866	307	1173	1405				2421
Amortisation of deferred income			(14)					(16)				(30)
Business activity capital costs			-					-				-
			1613					1690				3303
Services for third parties depreciation			05					-				05
Total capital maintenance			1618					1690				3308
Total operating costs			3845					3892				7737
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

e) Reactive and planned maintenance

Expenditure on reactive and planned maintenance included in operating costs for 2007 in respect of infrastructure assets amounted to £23.8 million on water services (2006 £20.8 million) and £20.4 million for sewerage services (2006 £16.6 million)

Expenditure on reactive and planned maintenance included in operating costs for 2007 in respect of non-infrastructure assets amounted to £9.9 million on water services (2006 £9.7 million) and £29.2 million for sewerage services (2006 £28.7 million)

4 Analysis of tangible fixed assets by asset type within service

a) Water services tangible fixed assets analysed by asset type

	Specialised operational assets £m	Non specialised operational assets £m	Infra structure assets £m	Other assets £m	Total £m
Gross replacement cost					
At 1 April 2006	2,006 4	109 3	7,431 0	300 4	9,847 1
RPI and other adjustments	95 4	5 0	358 0	13 7	472 1
Additions	75 7	3 0	52 4	24 4	155 5
Disposals and amounts written off	(13 2)	(4 8)	–	(17 5)	(35 5)
At 31 March 2007	2,164 3	112 5	7,841 4	321 0	10,439 2
Depreciation					
At 1 April 2006	1,107 1	34 4	–	196 6	1,338 1
RPI and other adjustments	54 8	1 6	–	9 6	66 0
Charge for year	68 9	2 0	–	31 1	102 0
Disposals and amounts written off	(12 9)	(2 5)	–	(16 7)	(32 1)
At 31 March 2007	1,217 9	35 5	–	220 6	1,474 0
Net book value					
At 31 March 2007	946 4	77 0	7,841 4	100 4	8,965 2
At 1 April 2006	899 3	74 9	7,431 0	103 8	8,509 0

b) Sewerage services tangible fixed assets analysed by asset type

Gross replacement cost					
At 1 April 2006	3,834 3	126 0	16,557 9	276 6	20,794 8
RPI and other adjustments	181 2	6 0	797 6	13 4	998 2
Additions	170 0	3 0	73 5	25 0	271 5
Disposals and amounts written off	(47 1)	(5 2)	–	(17 1)	(69 4)
At 31 March 2007	4,138 4	129 8	17,429 0	297 9	21,995 1
Depreciation					
At 1 April 2006	1,912 8	32 7	–	163 4	2,108 9
RPI and other adjustments	94 7	1 6	–	8 7	105 0
Charge for year	126 2	2 0	–	32 4	160 6
Disposals and amounts written off	(47 0)	(2 4)	–	(16 3)	(65 7)
At 31 March 2007	2,086 7	33 9	–	188 2	2,308 8
Net book value					
At 31 March 2007	2,051 7	95 9	17,429 0	109 7	19,686 3
At 1 April 2006	1,921 5	93 3	16,557 9	113 2	18,685 9

Regulatory accounts – current cost financial statements continued

Notes to the current cost financial statements year ended 31 March 2007 continued

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

c) Total tangible fixed assets analysed by asset type

	Specialised operational assets £m	Non specialised operational assets £m	Infra structure assets £m	Other assets £m	Total £m
Gross replacement cost					
At 1 April 2006	5,840.7	235.3	23,988.9	577.0	30,641.9
RPI and other adjustments	276.6	11.0	1,155.6	27.1	1,470.3
Additions	245.7	6.0	125.9	49.4	427.0
Disposals and amounts written off	(60.3)	(10.0)	–	(34.6)	(104.9)
At 31 March 2007	6,302.7	242.3	25,270.4	618.9	32,434.3
Depreciation					
At 1 April 2006	3,019.9	67.1	–	360.0	3,447.0
RPI and other adjustments	149.5	3.2	–	18.3	171.0
Charge for year	195.1	4.0	–	63.5	262.6
Disposals and amounts written off	(59.9)	(4.9)	–	(33.0)	(97.8)
At 31 March 2007	3,304.6	69.4	–	408.8	3,782.8
Net book value					
At 31 March 2007	2,998.1	172.9	25,270.4	210.1	28,651.5
At 1 April 2006	2,820.8	168.2	23,988.9	217.0	27,194.9

5 Working capital

	2007 £m	2006 £m
Stocks	6.0	6.1
Trade debtors		
Measured household	31.7	23.2
Unmeasured household	49.5	42.9
Measured non-household	35.3	27.0
Unmeasured non-household	0.2	1.2
Other	7.2	4.7
Measured income accrual	108.7	93.4
Prepayments and other debtors	41.5	13.7
Trade creditors	(10.1)	(10.4)
Deferred income – customer advance receipts	(96.5)	(85.1)
Capital creditors and accruals	(85.1)	(67.0)
Accruals and other creditors	(76.6)	(119.5)
	11.8	(69.8)

6 Reserves – profit and loss account

	£m
At 1 April 2006	92.6
Retained current cost loss for the year	(314.6)
Share based payments	(0.2)
FRS 17 actuarial loss	(19.8)
Deferred tax on actuarial loss	5.9
At 31 March 2007	(236.1)

7 Reserves – current cost reserve

	2007 £m	2006 £m
At 1 April	21,538 3	21,023 8
AMP adjustment	-	-
RPI adjustments		
Fixed assets	1,299 3	618 7
Working capital	(3 4)	(1 6)
Financing	(116 2)	(74 7)
Grants and third party contributions	(61 1)	(27 9)
At 31 March	22,656 9	21,538 3

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

	2007 £m	2006 £m
Current cost operating profit	395 6	358 5
Working capital adjustment	(3 4)	(1 6)
Working capital changes	(99 8)	(5 8)
Other income	1 5	3 3
Current cost depreciation after amortisation of deferred income	259 8	239 6
Current cost profit on disposal of tangible fixed assets	(34 1)	(3 1)
Infrastructure renewals charge	102 3	91 2
Movement in provisions including pensions	18 5	(40 0)
Net cash inflow from operating activities	640 4	642 1

**9 Analysis of net debt
Interest rate risk profile**

	Fixed rate £m	Floating rate £m	Index linked £m	Total £m
Maturity profile				
Less than one year	75 0	60 2	-	135 2
Between one and two years	-	119 8	-	119 8
Between two and five years	100 0	143 2	-	243 2
Between five and twenty years	293 6	662 9	164 7	1,121 2
In more than twenty years	414 5	55 9	420 3	890 7
Total borrowings	883 1	1,042 0	585 0	2,510 1
Cash				611 7
Short term deposits				(1 9)
Net debt as at 31 March 2007				3,119 9

10 Reconciliation of HCA operating profit to CCA operating profit

	2007 £m	2006 £m
HCA operating profit per regulatory accounts	439 8	401 9
Less non appointed activities	(1 8)	(0 9)
Add back inter segment	-	-
Sub total HCA accounts	438 0	401 0
Less difference in profit on disposals	(2 0)	0 6
Add back working capital adjustment	3 4	1 6
Add HCA depreciation including infrastructure renewals charge	321 1	289 1
Less CCA depreciation	(262 6)	(242 6)
Less infrastructure renewals charge	(102 3)	(91 2)
CCA Operating profit	395 6	358 5

As in previous years the principal reconciling item between the Historical Cost profit and the Current Cost profit is the difference in depreciation charges

Regulatory accounts – current cost financial statements continued

Notes to the current cost financial statements year ended 31 March 2007 continued

11 Reconciliation of historic balance sheet per statutory accounts to historic 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 FRS 15 'Tangible fixed assets'. However, for the purposes of the Regulatory Accounts, Ofwat has requested that FRS 15 is not applied for infrastructure renewals accounting, thereby providing a consistent basis with prior years. A reconciliation to the balance sheet shown in the statutory accounts is set out below.

Fixed assets

	2007 £m	2006 £m
Infrastructure assets – cost		
As per regulatory accounts	7,218 3	6,922 3
Adjustment to opening balance	1,158 1	1,065 0
Disposal in year	(1 4)	(1 4)
Infrastructure renewals expenditure capitalised in year	98 0	94 5
Cost as per statutory accounts	8,473 0	8,080 4
Infrastructure assets – depreciation		
As per regulatory accounts	2,001 6	1,846 7
Adjustment to opening balance	1,150 4	1,060 6
Disposal in year	(1 4)	(1 4)
Depreciation charge in year	102 3	91 2
Depreciation as per statutory accounts	3,252 9	2,997 1
Infrastructure assets – net		
As per regulatory accounts	5,216 7	5,075 6
Infrastructure	11 3	7 7
Net book values as per statutory accounts	5,228 0	5,083 3
Debtors		
As per regulatory accounts	274 2	207 7
Non appointed business debtors	–	0 4
Total debtors as per statutory accounts	274 2	208 1

Deferred income – grants and contributions

In the statutory accounts deferred income relating to grants and contributions of £41.7 million is classified as follows:

- Creditors due within one year £2.8 million
- Creditors due after more than one year £38.9 million

12 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:

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 (at average prices)	5,209	5,546	5,889	6,136	6,412
Regulatory capital values at 2006/07 prices					2007 £m
Opening regulatory capital value for the year					5,209
Indexation					194
Opening regulatory capital value at average 2006/07 prices					5,403
Capital expenditure					498
Infrastructure renewals expenditure					88
Grants and contributions					(39)
Depreciation					(268)
Infrastructure renewals charge					(88)
Outperformance of regulatory assumptions					(48)
Closing regulatory capital value					5,546
Average regulatory capital value					5,474

The RCVs in this table are based on those published by Ofwat in its letter RD08/06, inflated to 2006/07 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 2006/2007 outturn prices

	2007 £m	(restated) 2006 £m	(restated) 2005 £m	(restated) 2004 £m	(restated) 2003 £m
Profit and loss account					
Turnover	1,195 7	1,200 0	1,087 5	1,066 5	1,042 4
Current cost operating costs	(837 6)	(823 4)	(797 6)	(751 3)	(739 8)
Other operating income	34 1	33	90	21 2	6 3
	392 2	379 9	298 9	336 4	308 9
Working capital adjustment	3 4	1 7	2 2	2 4	3 6
Current cost operating profit	395 6	381 6	301 1	338 8	312 5
Other income	1 5	3 5	3 0	2 9	3 3
Net interest payable	(143 7)	(137 7)	(142 7)	(139 7)	(137 0)
Financing adjustment	116 2	79 5	101 1	79 3	76 4
Current cost profit before taxation	369 6	326 9	262 5	281 3	255 2
Taxation	(71 6)	(61 5)	11 7	(24 4)	(10 1)
Deferred tax	39 3	(42 3)	(42 3)	(45 5)	(63 9)
Current cost profit attributable to shareholders	337 3	223 1	231 9	211 4	181 2
Dividend	(651 9)	(162 6)	(161 4)	(178 3)	(163 4)
Current cost (loss)/profit retained	(314 6)	60 5	70 5	33 1	17 8
	2007 £m	2006 £m	2005 £m	2004 £m	2003 £m
Balance Sheet					
Fixed assets					
Tangible assets	28,651 5	29,179 1	29,291 9	28,962 1	28,928 7
Third party contributions since 1989/90	(1,388 3)	(1,360 3)	(1,308 0)	(1,240 4)	(1,182 0)
	27,263 2	27,818 8	27,983 9	27,721 7	27,746 7
Working capital	11 8	(74 9)	(76 6)	(71 6)	(95 3)
Short-term deposits	1 9	2 3	-	-	-
Overdrafts	(611 7)	(418 8)	-	-	-
Infrastructure renewals prepayment	3 4	83	-	-	-
Cash and investments	-	-	2 9	0 8	0 8
Net operating assets	26,668 6	27,335 7	27,910 2	27,650 9	27,652 2
Non operating assets and liabilities					
Borrowings	(134 9)	(99 1)	-	-	-
Non-trade debtors	0 1	1 6	11 0	11 6	7 1
Non-trade creditors due within one year	(128 0)	(38 1)	(408 2)	(414 5)	(471 9)
Investments	0 1	0 1	-	-	-
Corporation tax payable	(44 1)	(58 4)	-	-	-
Total non operating assets and liabilities	(306 8)	(193 9)	(397 2)	(402 9)	(464 8)
Creditors amounts falling due after more than one year					
Borrowings	(2,375 2)	(2,150 4)	-	-	-
Other creditors	(3 0)	(3 5)	-	-	-
Creditors due after one year	-	-	(2,353 0)	(2,320 5)	(2,185 1)
	(2,378 2)	(2,153 9)	(2,353 0)	(2,320 5)	(2,185 1)
Provision for liabilities and charges					
- Deferred taxation	(484 4)	(583 6)	(571 6)	(546 4)	(516 0)
- Other provisions	(4 6)	(7 1)	(12 7)	(0 3)	(0 8)
Pension deficit	(73 8)	(115 0)	(170 1)	-	-
Net provisions	(562 8)	(705 7)	(754 4)	(546 7)	(516 8)
Net assets employed	23,420 8	24,282 2	24,405 6	24,380 8	24,485 5
Capital and reserves					
Called up share capital	1,000 0	1,073 0	1,107 3	1,136 2	1,171 3
Profit and loss account	(236 1)	99 4	19 5	130 1	116 7
Current cost reserve	22,656 9	23,109 8	23,278 8	23,114 5	23,197 5
	23,420 8	24,282 2	24,405 6	24,380 8	24,485 5

The profit and loss account and balance sheet for the year ended 31 March 2006 has been restated to reflect the revision to the disclosure requirements arising from the amendments to Regulatory Accounting Guidelines 1 04 and 3 06

The profit and loss accounts and balance sheets for the years ended 31 March 2005, 31 March 2004 and 31 March 2003 have not been restated to reflect the revision to disclosure requirements arising from the revision to Regulatory Accounting Guidelines 1 04 and 3 06

Supplementary Regulatory Accounting Disclosures – unaudited

Year ended 31 March 2007

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 amounts £m	Repayment dates	Interest rates between %
Severn Trent Water Utilities Finance Plc	Borrowed	index linked	300.0	2016 -2057	1.399 -1.626 plus RPI
	Borrowed		40.2	2012 -2025	6 months LIBOR plus 23 -30bp

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

Severn Trent Water Utilities Finance Plc	Repaid	7.0
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b) Dividends paid

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. The ordinary dividend declared and paid by the company in 2006/07 amounted to £79.8 million, being 7.98 pence per share (2006: 15.47 pence per share) and a special dividend of 57.6 pence per share.

In March 2007 an ordinary dividend of £63.1 million, being 6.31 pence per share was proposed and paid in April 2007.

c) Transfer of assets/liabilities

During the course of the year the Appointee did not acquire any assets/liabilities from any associated business.

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	2.0
Water, tankering, reception, treatment and disposal of waste	Various	Market rates	0.6
			3.4

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 (1)	Competitive letting/no market	3.4	390.8
Asset management	Cognica Ltd	Competitive letting/no market	0.1	1.1
Provision of customer care facilities	Complete Credit Management Ltd	Other market testing	1.6	3.6
Insurance services	Derwent Insurance Ltd	Other market testing	3.8	8.9
Analytical services	Severn Trent Laboratories Ltd	Other market testing	7.2	32.5
Supply of materials	Severn Trent Metering Services Ltd	Competitive letting/no market	16.8	27.7
Management fee	Severn Trent Plc	No market	5.9	-
Meter installation and provision of other engineering services	Severn Trent Services Ltd	Competitive letting/no market	2.0	14.0
			40.8	

Of the £40.8 million (2006: £57.0 million), £17.9 million (2006: £21.7 million) was spent on investment expenditure.

Note 1: To date when ceased to be an associated company.

e) Omission of rights

None

f) Waivers

None


g) Guarantees

None



Unaudited financial and operating statistics

Information on Severn Trent Water's financial, customer service, operational and quality performance will be available on its website from 16 July 2007



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