Severn Trent Water Limited

Report and financial statements
for the year ended 31 March 2011

Company number 2366686

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At a glance

Severn Trent Water provides high quality water and sewerage services to over 3 2 million households and businesses in the Midlands and mid-Wales

Key strengths

- We are committed to the long term sustainable stewardship of the business, the environment, customers and the communities in which we live and work
- Our efficiencies and high standards help us keep our costs low and generate progressive, sustainable returns
- We continually work to improve our performance and deliver cost and operational efficiencies against 18 Key Performance Indicators (KPIs), each of which is aligned to our long term strategy
- Our bills for water and sewerage combined are the lowest on average in England and Wales
- We have one of the lowest reported per capita consumption rates in the UK
- We have a clear business plan and we launched our long term plans in our 25 year Strategic Direction Statement in 2007

Where we operate in the UK
Our region stretches across the heart of the UK, from the Bristol Channel to the Humber, and from mid-Wales to the East Midlands

Our physical assets include

- 46,000 km of water mains
- 126 water treatment works
- 54,000 km of sewers
- 1,026 sewage treatment works

Drinking water supplied per day
1.8bn litres

Waste water collected per day
1.4bn litres

Employees
5,128 at 31 March 2011

Turnover £m (up 0 3%)
1,389.8 2011 1,385 3 2010

Our industry

The water industry in England and Wales invests more than £3 billion a year and employs over 27,000 people There are currently 10 water and sewerage companies in England and Wales

Our sector is facing significant long term challenges The privatisation of the industry just over 20 years ago has led to improvements in services to customers, better quality drinking water and higher environmental standards It also attracted new investment Those successes, however, have also had consequences, such as high levels of debt, rising prices for customers and increased carbon emissions Our proposals for changes in our industry are helping us to play a role in shaping the debate We talk more about our position and how other bodies with a stake in our industry are responding on page 14

Our business

Severn Trent Water is a regulated business We work within five year price cycles, with the prices we charge our customers set at the beginning of each cycle by our economic regulator, Ofwat These five year cycles are known as Asset Management Plan (AMP) periods We have just reached the end of the first year of AMP5

Our performance

Every June, all water companies submit a detailed annual breakdown of their performance, known as the June Return, to Ofwat Ofwat uses this information to monitor and compare companies' performance As well as being regulated by Ofwat, our performance is monitored by

- the Drinking Water Inspectorate (DWI), which is responsible for making sure we comply with drinking water quality regulations, and
- the Environment Agency, which controls water abstraction, river pollution and flooding

We also work with the government (including the Department for Environment, Food and Rural Affairs (DEFRA) and the Welsh Assembly government) and other agencies such as the Consumer Council for Water (CCWater) and Natural England to make sure we meet the highest customer service and environmental standards, while offering our customers the lowest prices

Our vision for the future

Our 25 year Strategic Direction Statement sets out the long term direction and development of our group for the years 2010–35 (see `Our Strategy`, page 6)

Chief Executive's review

With our focus on operational excellence and continuous improvement, our goal is to keep prices low and deliver the highest customer services and environmental standards

In a challenging year, I would like to pay tribute to our people, who professionally handled both difficult operational circumstances and significant operational change Overall, we made a solid start to the new regulatory period We delivered industry leading drinking water quality and reduced the number of incidents of sewer flooding, one of the biggest causes of distress to our customers Our customers also benefited from the lowest combined average water and sewerage bills in England and Wales

In these straitened times, we've carried on helping customers who have difficulties paying their bills and as a result we have also been able to reduce bad debt

Environmental performance continues to be strong and we are reinforcing our leading position in renewable energy generation, with 22% of our power requirements being met by self-generated renewables Some of that was generated by the country's first commercial scale crops to energy plant, which we opened this year

Leakage was above target as a result of the severe winter weather However, despite significant operational challenges, we maintained our leakage at the same level as last year Unplanned interruptions to supply also increased during the year

Our business also underwent significant organisational change during the year This year we moved to our new operating centre, Severn Trent Centre in Coventry, bringing together under one roof many teams previously dispersed across seven older buildings We have transformed our technology infrastructure and implemented the second phase of SAP which will help us to run our business more effectively

With strong underlying performance and the right people, technology and AMP5 contracts in place, we are well placed to achieve our business plan and outperform our regulatory targets

Looking ahead, we continue to play a leading role in helping to shape industry thought and debate around ideas for a sustainable water industry and we are pleased at the reaction to our Changing Course report, published during the year

Throughout our operations, our goal continues to be to deliver long term sustainable growth This strategy, underpinned by a clear focus on customers, environmental performance, people and value, will continue to deliver benefits for all

Tony Wray
Chief Executive

Our strategy
Sustainable growth

Sustainable
We need to strike the right balance to maintain a healthy business We do this by

Providing high standards of service to our customers, strong environmental performance, a fair return for investors and a great place to work for our people
Running a sustainable business, balancing the needs of all our stakeholders, along with the needs of the environment in which our businesses operate

Making sure our business is efficiently financed, with a flexible and sustainable balance sheet
As well as ensuring we are securely funded we work to manage our balance sheet sensibly and keep our credit ratings stable We keep our refinancing needs under constant review to take advantage of favourable market conditions

Acting responsibly, operating safely and doing the right things
The very nature of our business makes corporate responsibility an everyday part and parcel of our business activities What we do affects the environment, local and regional communities, our people and society at large Acting responsibly, operating safely and doing the right thing also play important roles in enhancing our reputation with our stakeholders It therefore makes sense to make ethical and responsible business practices an integral part of our strategy, incorporated into our business planning and risk management

Growth
We create and release value by focusing on water and waste water We achieve this by

Growing through investment in our networks and service
We are committed to reaching the highest standards in the industry and to continually improving our performance in every area of our business, from the resilience of our networks to the energy we consume and the way we interact with our customers For that reason the improvement targets we set ourselves are ambitious, and often more challenging than our regulatory requirements

Winning in a Changing World – positioning Severn Trent Water to capitalise on opportunities in a new regulatory framework
Our industry has delivered significant benefits in the two decades since privatisation However, we believe that changes to the regulatory and policy framework are now needed in order to make the industry sustainable Our strategy of continually improving our operational and financial performance, backed by a significant programme of change, puts us in a strong position to prosper from future changes to the way we are regulated

Our vision
Our vision is to be the best water and waste water company in the UK We aim to achieve this by providing the highest standards and lowest charges and through great people We focus on four key areas – customers, environment, people and value

Customers
Our customers have the lowest, on average, bills in England and Wales But keeping customers satisfied is not just about low charges and value for money We also need to reflect their needs and priorities in our plans, communicate clearly, keep our promises and apologise if things go wrong

Environment
Our operations depend on the environment in which we operate Our activities can have a significant impact and we take our stewardship of the environment very seriously, looking for innovative ways to manage our river catchments, and minimise pollution and our carbon footprint

People
Our drive to work safer, better and faster is the cornerstone of our business transformation initiatives Making sure we have the right processes and systems in place, underpinned by a strong safety culture, is a fundamental part of our drive for operational excellence and continuous improvement

Value
The more efficiently we work, the higher our standards In turn this improves our ability to keep our costs low and generate progressive, sustainable returns

Our key focus:

Customers	Environment	People	Value
Delivering quality services at prices customers can afford	Reducing pollution and our carbon footprint	Investing in the right people with the right skills	Making our business attractive to investors

Key Strategic Intentions
Our strategy is based on eight Key Strategic Intentions (KSIs) which reflect what matters to our customers and wider stakeholder groups We measure our performance within each KSI against our 18 Key Performance Indicators (KPIs)

1. Providing a continuous supply of quality water
2. Dealing effectively with waste water
3. Responding to customers' needs
4. Minimising our carbon footprint
5. Having the lowest possible charges
6. Having the right skills to deliver
7. Maintaining investor confidence
8. Promoting an effective regulatory regime

Business review
Performance

Underlying improvements in operational performance were affected by a challenging business and economic environment, together with the coldest December in 100 years Overall progress remains strong however, with significant business change resulting in the delivery of planned efficiencies

Our aim is to deliver the highest standards and lowest prices for customers and one of the best standards of drinking water in the UK At an average of £298, Severn Trent Water customers also paid the lowest average combined water and sewerage bill in England and Wales over the last year For those customers struggling to pay, we helped to manage their payments, whilst reducing our own bad debt risk

The harsh December had a significant impact on our operations however, particularly on our leakage performance, with a sharp peak in leakages at the height of the freeze/thaw events The severe weather also meant that our capital programme got off to a slower start than we had aimed for

We are particularly pleased with progress in our work to tackle sewer flooding, one of the biggest causes of disruption and distress to our customers We also halved the number of pollution incidents in the category 1 and 2 bands, with none in the most serious, category 1 classification

Our business also underwent change during the year as we set up to deliver our ambitious AMP5 programme Our streamlined new supply chain is now in place and major improvements in technology and ways of working have been implemented, including the move to a state of the art operational centre in Coventry

Customers
Our customers' combined average water and sewerage bills are the lowest in England and Wales and the quality of the water we provide is amongst the best in the industry We also score well on the process side of dealing with our customers – we aim to deal with customer issues at first point of contact Although we solve problems efficiently, we need to improve the way we engage with our customers Our challenge is to maintain our efficiency whilst making our customers feel more valued

8.2m
We serve 8 2 million people

£298
Lowest combined average water and sewerage bill in England and Wales at £298

82p
Average customer pays just 82 pence per day

Customer experience
We are committed to providing the best customer experience possible Ofwat's Service Incentive Mechanism (SIM), a new way of measuring the customer experience, will help us keep track of our performance It measures whether our customers feel valued when we interact with them, as well as how well we respond to their telephone and written communications The 2010/11 financial year is our first full year of data We are using the information we gather to put together a Customer Experience programme that covers recruitment, training, our telephone performance and improving every single touch point customers have with Severn Trent Water

At times, and especially during the harsh winter, our customers found it difficult to contact us as we were inundated with calls from people with frozen domestic pipes This has increased complaints which we are working hard to resolve

A continuous supply of quality water
In 2010 we delivered overall mean zonal compliance with DWI drinking water quality regulatory standards However, our unplanned interruptions to supply performance over the year was not at the level we expect Three major events caused significant disruption and regrettably a number of our customers were without water for some time We have a dedicated programme in place to improve performance

Flooding and pollution
We are ahead of our target for reducing the number of properties on the sewer flooding risk register, thanks to investments in our network and our proactive monitoring, which allows us to identify and fix problems before they result in failure We have reduced the number of network failure-related repairs by 15%, resulting in less disruption to customers and reduced flooding and pollution

Managing debt
Our challenge is to reduce bad debt while helping people who genuinely want to pay, but are finding it difficult to meet their payments In 2010 we introduced a new credit management system that helps us target our efforts more efficiently Along with our relationships team, which works with social housing landlords to track tenants moving in and out of rented accommodation and stay on top of debt in this sector, we reduced bad debt to 2 3% of sales Our region is still feeling the effects of the economic change the country is currently experiencing and for this reason our outlook on debt reduction is cautious

To help people on lower incomes who want to be good payers but have fallen into debt, we are piloting the new Together Tariff, where we match payments made by customers We have contributed £4 5 million to the Severn Trent Trust Fund, helped over 4,800 customers through our WaterSure tariff and signed up 43,549 people to Water Direct

Customer written complaints per 1,000 properties
5.73 2011 4.95 2010

First time call resolution for billing
90% 2011 89% 2010

Properties at risk of low pressure per 1,000 properties
0.07 2011 0 12 2010

For more information on KPIs see page 75

Environment
Our customers should have confidence that we will take away waste water and treat it to the highest environmental standards before returning it to our region's rivers We also strive to run our operations in a sustainable way and reduce our carbon footprint

During the year we made good progress in protecting our environment and dealing with waste water, whilst continuing to lead the industry in the production of renewable energy However, severe winter weather impacted our leakage performance in what was otherwise a year of improved environmental performance

Dealing with waste water
During the past 12 months we have had a strong focus on continuous improvement which has resulted in us halving the number of serious pollution incidents from eight to four in the year, with no category 1 pollutions We have been working on improved processes for identifying, monitoring and reporting pollution and our self reporting has increased by 11% We are confident that this is helping

us to focus on the right things and whilst this has led to an overall increase from 322 to 378 reported pollution incidents, we are confident that this is due to raising our standards of working and improving understanding, such that in the longer term we will deliver better overall performance

An £8 2 million investment to resolve pollution from our sewers overflowing in rivers and streams will lead to a further significant improvement in river quality in the region

Our sewage treatment works failing consents limit was 1 69% (2010 1 80%) We are working to improve this as part of our Environmental Improvement Plan we put in place this year Our plan, developed alongside Ofwat, supports our aim of raising the standards of our watercourses to benefit local communities and those who use our rivers for recreation

One of our challenges is striking a balance between river water quality and carbon production We invest in plant to eliminate nitrates and pesticides in order to improve water quality in our rivers and comply with the Water Framework Directive (WFD) To reduce the number of new treatment works we need to build, we work in partnership with farmers and industries to encourage them to discharge less effluent and waste into watercourses through the use of Catchment Management Investigations (CMI) Severn Trent Water is currently engaged in 47 CMI's, more than any other water company We have also developed a joint initiative with the Environment Agency to balance carbon emissions and river ecology

Case study

We anticipate the transfer of private drains and sewers (PDAS) will take place in October 2011 At the moment home owners are responsible for everything up to the main sewer, including the connection After the transfer we will own around 37,000km of sewers which are currently privately owned, and be responsible for their repair and maintenance We also expect roughly 4,000 pumping stations to be transferred in stages over the following five years We believe this will benefit some customers in a number of ways such as reducing their liability and repair costs, but will lead to higher bills in general to fund the necessary continued investment Our plans for the transition are well advanced and we have been engaging with regulators and government to make sure we provide customers with an efficient service after the transfer

Protecting the biodiversity of our region

The scale and scope of our operations puts us in a unique position to protect and often enhance the biodiversity of our region, particularly its aquatic ecosystem There are over 800 Sites of Special Scientific Interest (SSSI) in our region, a number of which are nominated as sites of European importance for the conservation and protection of endangered species We own or partly manage 37 SSSIs and work in partnership with Natural England, Countryside Council for Wales, our tenants and other partners to safeguard the special interest of these sites

Case study: Improving river water quality

A £9 million project to upgrade our sewerage network and improve the water quality of the River Tame unearthed several hurdles at the feasibility study stage These included contaminated ground, buried concrete structures, the presence of great crested newts and a complex geology with a past history of deep coal mining and high groundwater levels We worked with the Environment Agency and the local authority to secure an agreement to re-use all excavated material on site, delivering a huge reduction in the project's carbon footprint Collaborating with our contractor also enabled us to introduce several innovations, such as specialist covers to the tank, and control of groundwater

Jobs resolved first time **97.5%** 2011 96.5% 2010	Net energy use – gigawatt hours (GWh) **706** 2011 714 2010
Leakage – megalitres per day (Ml/d) **497** 2011 497 2010	Pollution incidents (cat 1, 2 and 3) **378** 2011 322 2010

For more information on KPIs see page 75

Reducing leakage

We experienced the coldest December in 100 years with significant snowfall and a prolonged freeze across our region This caused severe operational difficulties but we kept customers on supply throughout the winter However, two freezes followed by two thaws caused leakage to rise to unprecedented levels We were able to maintain leakage at last year's levels of 497 megalitres per day (Ml/d) However, despite deploying additional resources we were unable to achieve our leakage target of 483 Ml/d as a direct result of the weather We have reduced leakage significantly since the winter and we have plans in place to achieve our targets in 2011/12 Our long term trend on leakage is good and we are confident of hitting our targets in future years.

Customers also have a part to play and our water conservation and efficiency programme has resulted in one of the lowest per capita water usages in the UK Severn Trent Water customers use an average of 126 litres per day, compared to a national average of 146 litres

Case study: Saving water and energy

Thanks to the efforts of our customers we continue to lead the industry in water efficiency. Nottingham couple Gary and Clare Blissett are a good example: by making a few practical changes they virtually halved their water consumption – and energy bills – in a year. As Gary explains "It's about small behavioural changes such as turning off the tap when brushing our teeth, only putting a full load into the washing machine and dishwasher and taking showers instead of baths." They also ordered free water saving devices, such as a ShowerSave device, from us. Our work with customers, energy companies and schools helps us have the lowest per capita consumption of water in the UK.

Reducing our carbon footprint

Our aim is to produce 30% of the energy we use from renewable energy sources by 2014/15 In 2010/11, we met our target of producing 22% of our energy requirements from renewables, reinforcing our leading position in the production of renewable electricity from sewage As well as reducing our carbon impact, renewable will also offer protection against rising energy prices, reducing our exposure in volatile energy markets and saving around £28m over the next five years

In addition to generating our own energy, we also set targets and monitor energy use across every area of our business Our people take every opportunity to reduce energy from turning off lights to reducing unnecessary journeys In parts of our business, we have also invested in trackers and software that routes vehicles to make job scheduling more efficient, leading to reduced mileage and an improvement in productivity

15GWh of electricity from 37,000 tonnes of converted maize sludge	**9%** increase in our production of renewable energy	**126 litres** customers used on average just 126 litres of water per day

People

Over the past 12 months we have taken significant steps to transform the way we work, from the environments our people work in to the processes and technologies we use This is a vital part of our strategy to improve our performance and operational efficiency, and the service we provide to our customers Any change on this scale is bound to be challenging but overall our people are embracing the new working arrangements, and once again showed exceptional commitment over a difficult winter period

A new way of working

In October we moved to the Severn Trent Centre in Coventry One of the most energy efficient buildings in Europe, it reflects our ethos of openness, team working, high standards and low charges We also transformed our technology infrastructure Virtual desktops allow our employees to access their PC and business systems from any desk at a large proportion of our sites It also allows us to form teams dynamically to resolve specific problems, for example, during the extreme cold weather the technology allowed our people to rapidly form work groups and share information We are now using these working arrangements as a template to modernise the rest of our sites through our ongoing workplace improvement plan

Improving our technology and business processes

Throughout the year we continued to invest strategically in new technology completing the implementation of our new SAP workforce management systems, refreshing our desktop technology, providing high bandwidth telecoms infrastructure and new data centres The adoption of new, lower running cost technology has increased reliability and performance at a lower operating cost

The new SAP workforce scheduling technology and processes are starting to make our operational teams more productive and our investment in SAP's asset management systems is contributing to improved capital programme efficiencies

Our new systems and technology are fundamentally changing the way we work and so we have invested heavily in training our people to equip them with the right skills to exploit the new technology and systems

Throughout our business, our teams are improving their performance by changing the way they work using our 'Safer Better Faster' approach to continuous improvement With more than two thirds of the organisation now upskilled in the tools and techniques, managers and their teams are equipped to improve their processes to deliver higher standards of performance to our customers in the most cost effective ways they can The approach is now being introduced into our business support areas The success of this programme is due to the involvement and engagement of our people in making the improvements for themselves – taking ownership of their performance, learning new tools and techniques, and working more collaboratively with colleagues in different functions to solve problems

Engaging our people

Although our people went through considerable changes during the year, those changes led to upskilling, simplified processes, and a better workplace and technologies Our employee engagement survey revealed that 74% of employees across the organisation remain positively engaged Positively engaged means employees are committed to the organisation and have a desire to go above and beyond the call of duty to achieve success People support the need for the improvements and changes we are making (86%) and think their colleagues give them the support they need to do their job (87%) A high percentage are also happy to go the extra mile when required (88%)

However, only 33% of employees felt that changes which affected their job had been well implemented In response to this we introduced a module on change management to our line manager development programme

We share the results of the employee engagement survey with our teams and trades union partners in order to find more productive and cooperative ways to work together in the future

A safe and healthy workforce
During the year our health and safety performance, despite remaining at upper quartile and leading the sector, did not improve This is the first time in a number of years that we have not seen a year on year improvement and we are seeking to address the underlying causes to enable the business to attain further progress in this important performance measure Importantly, we have a strong culture of people taking personal responsibility for their own health and safety, and that of others This year 95% of our workforce agreed that health and safety is taken seriously, and 87% said we give them the right support to do their job safely We have introduced better health surveillance processes as part of improving our employees' wellbeing but recognise that while we have made positive progress, we have more to do in this area

Recruitment and training
Having the right people with the right skills is more important than ever We are working to make sure we have a more diverse workforce, with a particular focus on attracting more female candidates for operational and senior roles In 2010 we continued to provide regular diversity-related training and communications to managers, employees and new joiners and worked to embed the importance of diversity within our business With the help of ACAS we have designed and are implementing diversity training events that will eventually train 500 Water Distribution employees

To develop succession plans, we identify and mentor future leaders through our talent review process which assessed 893 managers and potential leaders this year Current managers have access to our Line Manager Journey which includes a suite of training modules such as change management and coaching for performance We continue to develop the training programme package and add new modules when a need is identified

Lost time incidents per 100,000 hours worked		Employee motivation	
0.37 2011	0.36 2010	**74%** 2011	74% 2010

For more information on KPIs see page 75

Business review
Looking forward

Since privatisation our industry has experienced two decades of improvement But the world today is a very different place and if we are to meet our vision of creating a sustainable water industry, we need some changes We are playing an active role in shaping the future of the water industry in the UK

Severn Trent Water continues to address the medium and longer term challenges facing the industry and published its views in its publication 'Changing Course' A digital version of the Changing Course report is available at www stwater co uk Some of the key highlights from that document are presented below

Over the past 20 years our industry has seen improved customer standards, environmental performance and service quality, and become more efficient Water companies have also successfully funded an investment programme valued at around £85 billion However, these improvements have come at a cost

Customer bills have risen, energy use has increased by 113% and the industry as a whole is managing debts of some £33 billion On top of that the reality of climate change is already having an impact on our business To carry on in the same way would not be sustainable That is why we published our document Changing Course in 2010, setting out our position and outlining the six key changes we believe are needed to address the challenges we face

Later this year the government is due to publish its White Paper While we do not know what recommendations it will contain, we are pleased with the response to Changing Course and encouraged by the development of the debate over water trading and policy making

Climate change
Whether it is the energy we use, the water we supply to our customers, or the quality of the diverse environment under our stewardship, our business both contributes to, and is affected by, climate change On the question of water scarcity, our strategy is to reduce demand and improve the flexibility of our network before developing new sources For instance, by encouraging our customers to use water sensibly we have one of the lowest per capita consumptions of water in the UK

However valuable these measures, they are not enough on their own Water companies need to think differently in order to tackle climate change and arrive at more sustainable solutions

Water trading
Changing weather patterns are predicted to lead to hotter, drier summers and wetter winters This will mean less water being available at different times of the year Our last Water Resources Management Plan showed that, over the next 25 years, Severn Trent Water will face a shortfall of 232 million litres a day because of climate change and population growth if we do not do things differently

But this is not just a problem for Severn Trent Water, it is one for the nation as a whole One change we would like to see is more water trading Water companies could trade resources nationally using water from areas of lower cost to higher cost With the right regulatory regime we believe it would be possible to use existing networks to move water from one region to another

Intelligent funding
There is no doubt that over the next 20 years, the water industry will need to maintain significant investment in infrastructure in order to improve network resilience and reach higher environmental standards

Initiatives like water trading and more flexible outcome-based regulation will help avoid unnecessary capital investment, but the sector's continuing ability to deliver its investment programmes relies on its being able to fund them We believe that continuing to finance the programme entirely from borrowing is unsustainable, putting pressure on credit ratings and passing on risk to customers Equity participation remains as important as ever Long term sustainable returns need to reflect this reality

Competition and consolidation

Bringing about the kind of changes we believe our industry needs would require a change in the structure and regulation of the water sector The framework of incentives and output setting under the existing regime can mean that more sustainable solutions are overlooked in favour of capital intensive solutions Faced with the choice of sourcing low-cost water elsewhere or building a reservoir, companies often opt to build a reservoir This then becomes part of the regulated asset base, allowing water companies to increase pricing

We believe it would be better to encourage sustainable solutions that benefit customers and the environment A gradual move towards a market-based framework and competition within the sector would enable water companies to make best use of resources nationally rather than regionally Such a move would help maintain investors' confidence in our industry and avoid an increase in the cost of capital

Our expertise in commercial markets, together with our confidence about embracing the future and our operational, financial and strategic strength mean we are well placed to adapt to any structural or regulatory changes in our industry Indeed, we are looking forward to the opportunities the future will bring, both in the regulated and commercial spheres

Changing course – six key changes required to meet future challenges

Policy changes

- More flexible implementation of EU Directives to ensure a better trade off between costs and carbon emissions
- Developing competition through water trading, this would also optimise resources nationally rather than just regionally

Regulatory changes

- A more flexible approach to environmental consents to allow for more cost effective approaches
- An improved price setting process to provide the right incentives for sustainable financing, more sustainable solutions and increased innovation

Industry changes

- Companies must take the lead in driving innovation, both in terms of the strategic and technical solutions they pursue and in shaping the wider direction the sector takes

Changes to the institutional framework

- Government should prioritise national policy outcomes and ensure the regulatory framework is set up to deliver them

Business review
Finance

We are now some two years on from the full effect of the financial crisis and many, but not all, activities and markets have returned to what may be considered normal levels However, we are yet to see the return of a fully functioning commercial paper market and have continued to support our liquidity position by holding cash reserves from earlier bond market issuances In other areas, we are yet to see any material effect on the finances of our customer base from the package of measures the government has announced on public spending Indeed, we have improved our customer collections performance year on year The ability of domestic and commercial customers alike to support their water bills in this new environment has yet to be seen, though we remain confident that our debt recovery processes are in good shape to address any challenge that may arise

Results

Turnover in Severn Trent Water increased by 0 3% in 2010/11 to £1,389 8 million Sales prices decreased by 0 7% (including inflation) from 1 April 2010 In the first half of the year consumption was higher period on period, as a result of strong household and robust commercial consumption (due in part to re-stocking) The second half of the year showed a more normal period on period trend, leading to the 0 3% increase in turnover over the full year

Operating profit before exceptional items (underlying operating profit) decreased by £57 6 million from the previous year to £513 4 million A number of factors impacted underlying operating profit, principally increases in depreciation of £24 5 million, hired and contracted services of £6 0 million and other cost increases of £12 6 million, reductions in profit on disposal of fixed assets of £5 4 million and own work capitalised of £21 2 million, partially offset by a reduction in employment costs of £7 8 million

There was an exceptional charge to operating profit of £13 0 million (2010 £42 1 million) comprising restructuring costs This included costs relating to the implementation of SAP of £2 7 million, relocation and other costs arising from the transfer of activities to Severn Trent Centre £2 6 million and costs arising from other business change programmes of £7 7 million A £17 5 million exceptional non-operating profit (2010 £nil) was also realised from property disposals in the period

Net interest payable was £249 6 million (2010 £201 6 million) The group closed out a cross currency swap in May 2010 and received £20 5 million proceeds The swap was not recognised under UK GAAP and hence the proceeds represented a gain to the group which has been included in interest receivable and similar income Total interest payable on bank loans and overdrafts and interest payable on other loans increased by £61 9 million primarily due to a £36 3 million increase in the indexation element of index-linked bonds following increased RPI compared to 2009/10, and a £31 million increase in interest payable following the termination and redesignation of an economic hedge for a medium term note The group rolled over an interest rate swap in December 2010, and instead of paying a cash settlement of £13 4 million, re-negotiated the terms of a finance lease with the same counterparty The swap was not recognised under UK GAAP and hence this was recognised as an increase in the finance lease creditor and finance lease interest payable Net finance costs on pension obligations decreased by £8 4 million because, whilst the gross values of assets and liabilities both increased, the return on assets was higher than the discount rate on the liabilities and hence the net cost decreased

The total tax credit for the year was £37 1 million (2010 £70 5 million charge) of which current tax represented a charge of £57 4 million (2010 £49 3 million charge) and deferred tax a credit of £94 5 million (2010 £21 2 million charge) The current tax charge before adjustments in respect of prior years represents 26 1% (2010 22 5%) of the group's profits before tax Profit for the financial year was £305 4 million (2010 £256 8 million)

Capital structure

The group is funded using a mixture of equity and debt (including fixed rate, index-linked and floating rate)

	2011 £m	2010 £m
Cash and short term deposits	(10 5)	(6 8)
Bank overdrafts	-	-
Bank loans	602 7	445 6
Other loans	3,106 6	3,129 8
Obligations under finance leases	266 7	300 8
Net debt	3,965 5	3,869 4
Equity shareholder's funds	1,362 4	1,186 5
Total capital	5,327 9	5,055 9

Net debt at 31 March 2011 was £3,965 5 million (2010 £3,869 4 million) Of the net debt 63% (2010 71%) was represented by fixed interest borrowings and 68% (2010 79%) was represented by amounts payable after five years

Cash flows

Operating activities generated a net cash inflow of £827 1 million (2010 £812 9 million) Net interest paid was £172 0 million (2010 £171 4 million) Net investing activities used £461 9 million (2010 £565 8 million) which mainly included capital expenditure to meet the company's obligations under the AMP5 capital programme Dividend outflows amounted to £153 6 million (2010 £170 0 million)

Treasury management

The Severn Trent Water group's treasury affairs are managed centrally as part of the Severn Trent Plc group and in accordance with its Treasury Procedures Manual and Policy 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 Severn Trent Water Limited board ('the board') determines matters of treasury policy and its approval is required for certain treasury transactions 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 number of currency swaps and interest rate swaps to redenominate external borrowings into the currencies and interest rate coupon required for group purposes, and energy swaps to fix the future cost of expected electricity 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 Except for debt raised in foreign currency, which is fully hedged, the group's business does not involve significant exposure to foreign exchange transactions The group has £10 5 million in cash and cash equivalents The group also has an undrawn £500 million committed bank facility of which £41 7 million matures in 2012 with the balance maturing in 2013 Cash is invested in deposits with highly rated (A+) banks and liquidity funds (AAA) and the list of counterparties is regularly reviewed and reported to the board The group's policy for the management of interest rate risk requires that no less than 45% of the group's borrowings should be at fixed interest rates, or hedged through the use of interest rate swaps or forward rate agreements

The long term credit ratings of Severn Trent Water Limited are

Long term ratings	
Moody's	A3
Standard & Poor's	BBB+

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

Investment

The financial year 2010-11 was the first year of the AMP5 period (covering 2010-15) During the financial year, the group invested £424 7 million (excluding contributions received towards infrastructure assets) in fixed assets

Critical accounting policies

In the process of applying the group's accounting policies, the directors are required to make certain judgments, estimates and assumptions that they believe are reasonable based on the information available The more significant judgments and key assumptions and sources of estimation uncertainty are summarised below

Depreciation and carrying amounts of tangible fixed assets

Calculating the depreciation charge and hence the carrying value for tangible fixed assets 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) to the financial statements

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 14 to the financial statements

Tax provisions

Assessing the outcome of uncertain tax positions requires judgments 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 Assessing the extent to which the deferred tax provision should be discounted requires judgments to be made regarding the reversal of timing differences and the discount rate to be applied

Provisions for liabilities

Assessing the financial outcome of uncertain commercial and legal positions requires judgments to be made regarding the relative merits of each party's case and the extent to which any claim against the group is likely to be successful The assessments made are based on advice from the group's internal counsel and, where appropriate, independent legal advice

Directors' report

The directors present their report, together with the audited financial statements of Severn Trent Water Limited for the year ended 31 March 2011

Principal activities
The company is a wholly owned subsidiary of Severn Trent Plc

The principal activities of the company and its subsidiary undertakings (together 'the group') are the provision and the treatment of water and the removal of waste water 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 2011, 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 business review

Review of results pages 5–18
Strategy and growth pages 6–7, 14-15
Operational performance pages 8–13
Financial performance pages 16–18
KPIs page 75

Principal risks and uncertainties are detailed on page 27 of the Governance and risk assurance report

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 2011 amounted to £153 6 million (2010 £170 0 million)

Transfers to reserves are set out in note 16 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

Tony Ballance	
Bernard Bulkin*	
Richard Davey*	
Andrew Duff*	Appointed 10 May 2010
Sir John Egan*	Resigned 20 July 2010
Gordon Fryett*	
Martin Kane	
Martin Lamb*	
Michael McKeon	
Baroness Noakes*	
Andy Smith	
Tony Wray	

*non-executive director

Directors' interests
All of the directors at the year end are also directors of Severn Trent Plc In accordance with the UKLA Listing Rule 9 8 6, their interests in the share capital of Severn Trent Plc are disclosed in the Annual Report and Accounts of that company for the year ended 31 March 2011

None of the directors retain any notifiable interest in the shares of the company or any other subsidiaries as at 31 March 2011

Directors' remuneration and annual bonus scheme
Remuneration for executive directors comprises the following elements

- base salary and benefits
- annual bonus scheme and share matching plan
- long term incentive plan
- pension plan

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

As outlined in the Severn Trent Plc Annual Report and Accounts, the non-executive Chairman, Andrew Duff, and non-executive directors, do not participate in the company's incentive arrangements, i e annual bonus or share schemes

Base salaries and benefits
Base salaries are reviewed annually for each director and are determined with regard to the market median salary for similar roles in publicly quoted utility companies of a comparable size, that so far as practicable, are undertaking similar work 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 contractually includes car allowance, membership of company pension scheme or cash allowance in lieu, private medical insurance, life assurance and incapacity benefits scheme Directors may also take advantage of the Severn Trent flexible benefit scheme open to all employees

Annual bonus scheme
The directors' annual bonus scheme focuses on the achievement of specific strategic goals which are intended to drive the creation of operational efficiencies and improvements in business performance The bonus scheme operates on a balanced scorecard of measures based on the company Key Performance Indicators (KPIs), which include operational performance, leakage and customer service The scheme attributes a points score to each KPI and bonus outturn is determined by reference to the aggregate number of points awarded across all the KPIs Bonus targets were set and measured for the period 1 April 2010 to 31 March 2011

The Chief Executive and Finance Director have 10% of their bonus opportunity linked to the performance of Severn Trent Services and all directors have 10% of their bonus opportunity measured against a set of personal performance metrics

The directors' annual bonus scheme encourages improved performance, with targets established by the Severn Trent Plc Remuneration Committee to align executive directors' interests with shareholders

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

The maximum annual bonus opportunity for the executive directors was 120% of salary For the achievement of target performance, 60% of salary is awarded The table below shows the extent to which the KPI targets were achieved during 2010/11

KPI	Measure	2009/10 outturn	2010/11 outturn	Points Awarded
1	Lost time incidents per 100,000 hours worked	0 36	0 37	-
2	Employee motivation %	74%	74%	100
3	Water quality (test failure rate) ppm	131	210	-
4	Customer written complaints per 1,000 properties	4 95	5 73	100
5	First time call resolution for billing %	89%	90%	109
6	Unplanned interruptions > 6 hrs per 1,000 properties	10 09	23 85	-
7	Properties at risk of low pressure per 1,000 properties	0 12	0 07	157
8	First time job resolution %	96 5%	97 5%	59
9	Non-performance against Regulatory Obligations %	5%	4%	130
10	Capex (Gross) vs Final Determination %	6 1%	7 4%	103
11	Debtor days	32 6	33 8	100
12	Opex - £m	492 4	519 0	154
13	Pollution incidents (cat 1, 2 & 3)	322	378	-
14	Sewer flooding incidents – other causes per 1,000 properties	0 131	0 103	153
15	Sewage Treatment Works – failing consents limit %	1 80%	1 69%	23
16	Supply availability %	91 9%	94 4%	81
17	Net Energy Use – GWh	714	706	112
18	Leakage Ml/d	497	497	60
Total KPI points achieved				**1,441**

The bonus outturn in respect of Severn Trent Water performance was operated by reference to a balanced scorecard of measures, based on the KPIs The Severn Trent Plc Remuneration Committee believes that the use of the Severn Trent Water KPIs continues to be both an effective and challenging annual bonus metric and meets the needs of the business The bonus entitlement was determined by reference to the aggregate number of points awarded across all the KPIs The targets taken together 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 Ofwat

The table above shows the points awarded by the Remuneration Committee for bonus purposes under each of the 18 KPIs in relation to the 2010/2011 annual bonus scheme Four of the eighteen KPI points have been adjusted upwards This was only done after detailed consideration and in making this decision the Remuneration Committee recognised that management had done the right thing when faced with exceptional operational challenges over the winter period They also maintained overall financial performance As a consequence the bonus award was 40 0%

The actual bonus payments awarded to each director incorporate amounts in respect of personal targets and, in the case of the Chief Executive and Finance Director, Severn Trent Services' performance The bonus payments awarded are detailed below

Director	Value of bonus award £
Tony Ballance	103,646
Martin Kane	118,238
Michael McKeon	218,484
Andy Smith	133,110
Tony Wray	252,000

Half of the above bonus awards is deferred into shares to be held for three years following payment and subject to continued employment The Remuneration Committee determines whether it is appropriate to release the shares in 'good leaver' cases

Full details of executive director bonus awards for the year ended 31 March 2011 are shown in the table of directors' emoluments in the Severn Trent Plc Annual Report and Accounts

Share Matching Plan
Under the Share Matching Plan directors are eligible to receive matching share awards over those shares which have been acquired under the deferred share component of the annual bonus scheme as described above Further details of the Share Matching Plan can be found in the Severn Trent Plc Annual Report and Accounts

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

Share Incentive Plan
A company-wide Share Incentive Plan operates which includes a performance condition based on the award of points for the KPIs For the year 2010/11 awards of shares to the value of £300 will be made to all eligible employees

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 judgment 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, Severn Trent Centre, PO Box 5309, Coventry CV3 9FH) 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 the year end reflected 23 8 days purchases (2010 43 9 days)

Charitable and political donations
Donations to charitable organisations during the year amounted to £143,836 (2010 £284,294) Severn Trent Water's policy is not to make any donations for political purposes in the UK, or to donate to EU political parties or incur EU political expenditure Accordingly we have not made any political donations or incurred any political expenditure in the financial year under review

Research and development
Expenditure on research and development is set out in note 2 to the accounts on page 35 Details of the research and development activity undertaken by the company during the year are set out in the operating and financial review on pages 5 to 18

Employees
The average number of employees during the year was 5,237 (2010 5,686)

Severn Trent Water believes that a diverse and inclusive culture is a key factor in being a successful business Apart from ensuring an individual has the ability to do the job we do not discriminate in any way and make every effort to ensure that those with disabilities are able to be employed by us We ensure that training, career development and promotional opportunities are available for all our employees irrespective of their gender, race, age or disability

Regulation: 'Ring fencing'
In accordance with the requirements of Ofwat, the board confirmed that, as at 31 March 2011, 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

Conflict of interests
In 2009, the directors' report described in full the process that the board had put in place to authorise situational conflicts in accordance with the provisions of the Companies Act 2006

For any actual or potential conflicts, the following procedure has been adopted by the board to consider and, if it sees fit, to authorise situations where a director has an interest that conflicts, or may possibly conflict, with the interests of the company

- the director will notify the Chairman and Company Secretary of the actual or potential conflict,
- the Severn Trent Plc Nominations Committee will consider the notification and determine whether it needs to be proposed to a board meeting for authorisations, and
- the conflict will be considered by the board at a scheduled board meeting

Full details of the conflict will be sent to directors in advance of the meeting If there is a major conflict or it is decided that authorisation should not wait until the next scheduled meeting, the board would be asked to authorise the conflict by way of written resolution

In addition to reviewing any conflicts notified and proposing them for authorisation by the board, the Severn Trent Plc Nominations Committee monitors changes to previously notified conflicts and any conditions imposed Half yearly reports are made to the board of all directors' conflicts and directors are reminded from time to time of their obligations An annual review of conflicts is carried out and this is incorporated into the year end process of verifying directors' interests

Going concern

The company operates in an industry that is currently subject to economic regulation rather than market competition Ofwat, the economic regulator, has a statutory obligation to set price limits that it believes will enable the water companies to finance their activities As a consequence the directors believe that the company and the group are well placed to manage their business risks despite the current uncertain economic outlook The company and the group are funded for their investment and cash flow needs at least for the next year

The directors have a reasonable expectation that the company and the group have adequate resources to continue in operational existence for the foreseeable future Accordingly we continue to adopt the going concern basis in preparing the Annual Report and Accounts

Auditors

Deloitte LLP have indicated their willingness to continue as auditor and, in accordance with Section 487 of the Companies Act 2006, are deemed to be reappointed

In the case of each of the persons who are directors of the company at the date when this report was approved

- so far as each of the directors are aware, there is no relevant audit information of which the company's auditor is unaware, and
- each of the directors 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 auditor is aware of that information

Relevant audit information means information needed by the company's auditor in connection with preparing their report This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006

By order of the board

Fiona Smith
General Counsel and Company Secretary
26 May 2011

Governance and risk assurance

Severn Trent Governance
Severn Trent Plc is the ultimate holding company of Severn Trent Water Limited Since March 2007, as part of the strategy of focusing on water, the boards of directors of Severn Trent Plc and Severn Trent Water Limited have been identical

Severn Trent Plc and Severn Trent Water Limited operate as distinct legal entities The boards have regard to the Severn Trent Plc Board Governance document and the Severn Trent Water Limited Matters Reserved to the Board, and are assisted through the management of separate agendas, meetings and minutes by Company Secretariat and are advised in their meetings by the Company Secretary where appropriate

The relationships between Severn Trent Water Limited, the regulated entity, and our non-regulated businesses such as Severn Trent Services are monitored and controlled to ensure that we comply with our Ofwat obligations on arm's length transactions

During the year ended 31 March 2011, Severn Trent Plc was compliant in its application of the Combined Code on Corporate Governance issued by the Financial Reporting Council in 2008 (2008 Combined Code)

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 2008 Combined Code and are available for inspection, together with the terms of reference of the Corporate Responsibility Committee and Executive Committee, on the Severn Trent Plc website (www severntrent com) or on written request from the Company Secretary at Severn Trent Centre, PO Box 5309, Coventry CV3 9FH

Severn Trent has made solid progress in implementing the key components of its governance framework which are based on clear organisational structure and decision making, sound policies and standards, and assurance of the outcomes The board and other key stakeholders need a transparent methodology which delivers and validates the outcome of activities

The company expects roles to be performed in line with the specific annual job objectives Employees performing their roles properly, preparing and reporting outcomes on time and to the required standard is a key component in our Assurance Framework

The company continues to embed the compliance, verification and performance activities in Severn Trent These are within business areas and sometimes within discrete functions These confirm that operational activities have been performed properly

Lastly, the company maintains an independent perspective on the overall framework by obtaining confirmation that the governance structure is working properly In Severn Trent, this is obtained primarily from the Internal Audit function

In order to provide an appropriate understanding of how these responsibilities come together for Severn Trent, the company has developed a description of the key elements over which assurance is required by the board Internal Audit deliver an audit plan to confirm that key business risks are being mitigated

Severn Trent Water Limited

Operating structure

Day to day operational priorities within Severn Trent Water are led by the Chief Executive of Severn Trent Plc and his executive management team, who together comprise the Executive Committee During the year, the Executive Committee comprised the executive directors and senior executive managers responsible for key central and operational areas

The Executive Committee oversees the development and performance of the Severn Trent strategy It also has accountability for achieving business results During the year, the Executive Committee structured its meetings to focus on strategy, business management, policy and planning and operational performance

The operational structure aligns the organisation with the processes that matter to customers and drives 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 annually in accordance with the requirements of the 2008 Combined Code and the guidance set out within it The system of internal control is reviewed for effectiveness and adequacy

The internal control system can only provide reasonable and not absolute assurance against material misstatement or loss, as it is designed to manage rather than eliminate the risk of failure to achieve business objectives

The board reviews risk management and the adequacy of the system of planning and internal control through the Severn Trent Plc Audit Committee 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 Chief Executive on the significant risks faced by the group, an assessment of the effectiveness of controls over each of those risks and an action plan to improve controls where this has been assessed as necessary Any significant control weaknesses that have been identified are also reported to the Audit Committee The Internal Audit department provides objective assurance and advice on risk management and control The external auditors also report on significant control issues to this committee

The board confirms that procedures providing an ongoing process for identifying, evaluating and managing the principal risks faced by the company and its subsidiary undertakings have been in place for the year to 31 March 2011 and up to the date of the approval of the Annual Report

Key elements of the group's processes and procedures are

- clearly defined and communicated strategic and business objectives,
- an organisation structure with clear lines of accountability and responsibility,
- performance management and succession planning systems,
- regular, structured reviews of business risk by senior management and the Executive Committee, including a self assessment of control effectiveness,
- a scheme of delegated authority, approval of plans, budgets and significant investments,
- robust business planning including the identification and implementation of relevant improvement plans, and
- monthly reporting and monitoring of financial results, regulatory compliance and other operational performance indicators, and independent assurance provided by both internal and external auditors

Principal risks and uncertainties
The board considers the principal risks and uncertainties affecting the business activities of the company to be those detailed below

Strategic: Risks associated with the delivery of our strategic objectives, including our ability to influence the regulatory framework towards creating a sustainable water industry in England and Wales and our ability to continue to develop a sustainable water company

Stakeholder: Risks associated with meeting the needs and expectations of key stakeholders (regulators, customers, staff and suppliers) in order to protect and enhance our financial position, brand and reputation

Operational and asset related: Risks associated with our daily operations, including the failure of assets, processes or systems which in turn may affect our ability to serve our customers, could impact on Health & Safety or security at our sites and on our ability to meet regulatory targets

Financial: Risks associated with our financial activities including our ability to effectively manage counterparty risk, attract funding at commercially attractive rates, fund pensions promises sustainably and meet the challenging stretch targets we have set ourselves

Legal, regulatory and compliance. Risks associated with potential non compliance with the numerous and increasingly demanding obligations reflecting our operations Management of these is often dispersed throughout the organisation We pay particular attention to risks in areas subjected to changing legal and regulatory requirements Current areas of focus include

- The UK Bribery Act
- The transfer of private drains and sewers (PDAS)
- The introduction of Service Incentive Mechanism (SIM) by Ofwat

Statement of directors' responsibilities

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations Company law requires the directors to prepare financial statements for each financial year Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law) The financial statements are required by law to give a true and fair view of the state of affairs of the company and of the group and of the profit or loss of the company and group for that period In preparing these financial statements, the directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgments and estimates that are reasonable and prudent,
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements, and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006 They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities

The directors are responsible for 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

Independent auditor's report

To the members of Severn Trent Water Ltd

We have audited the financial statements of Severn Trent Water Limited for the year ended 31 March 2011 which comprise the group and parent company profit and loss account, the group and parent company balance sheets, the group cash flow statement, the group reconciliation of net cash flow to movement in net debt, the group and parent company statement of total recognised gains and losses, the group and parent company reconciliation of movements in shareholder's funds and the related notes 1 to 20 The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice)

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

Respective responsibilities of directors and auditor

As explained more fully in the Statement of Directors' Responsibilities, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error This includes an assessment of whether the accounting policies are appropriate to the group's and the parent company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the directors, and the overall presentation of the financial statements In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report

Opinion on financial statements

In our opinion the financial statements

- give a true and fair view of the state of the group's and the parent company's affairs as at 31 March 2011 and of the group's and the parent company's profit for the year then ended,
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, and
- have been prepared in accordance with the requirements of the Companies Act 2006

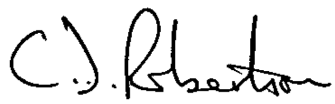
Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion

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



Christopher Robertson (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
Birmingham, United Kingdom
26 May 2011

Profit and loss accounts

Year ended 31 March 2011

	Notes	Group 2011 £m	Group 2010 £m	Company 2011 £m	Company 2010 £m
Turnover		**1,389 8**	1,385 3	**1,389 8**	1,385 3
Operatıng costs before exceptıonal ıtems	2	**(880 0)**	(818 1)	**(891 0)**	(829 0)
Exceptıonal operatıng costs	2	**(13 0)**	(42 1)	**(13 0)**	(42 1)
Total operatıng costs	2	**(893 0)**	(860 2)	**(904 0)**	(871 1)
Other ıncome		**3 6**	3 8	**3 6**	3 8
Operatıng profit before exceptıonal ıtems		**513 4**	571 0	**502 4**	560 1
Exceptıonal operatıng costs	2	**(13 0)**	(42 1)	**(13 0)**	(42 1)
Operatıng profit		**500.4**	528 9	**489 4**	518 0
Income from shares ın other group undertakıngs		**-**	-	**-**	8 6
Profit on dısposal of tangıble fixed assets	2	**17 5**	-	**17 5**	-
Net ınterest payable	4	**(249 6)**	(201 6)	**(248 6)**	(200 7)
Profit on ordinary actıvities before taxatıon		**268 3**	327 3	**258 3**	325 9
Taxatıon on profit on ordınary actıvıties - current tax	5	**(57 4)**	(49 3)	**(56 8)**	(48 2)
- deferred tax	5	**94 5**	(21 2)	**94 5**	(21 2)
Taxation	5	**37 1**	(70 5)	**37 7**	(69 4)
Profit for the financıal year	16	**305 4**	256 8	**296 0**	256 5

The results anse from contınuıng operatıons ın both the current and precedıng year

Statements of total recognısed gaıns and losses

	Group 2011 £m	Group 2010 £m	Company 2011 £m	Company 2010 £m
Profit for the financıal year	**305 4**	256 8	**296 0**	256 5
Actuanal gaın/(loss)	**37 1**	(109 8)	**37 1**	(109 8)
Tax (charge)/credıt on actuanal gaın/loss	**(9 6)**	30 8	**(9 6)**	30 8
Adjustment ın respect of tax rate change on deferred tax	**(6 2)**	-	**(6 2)**	-
Total recognised gains and losses for the financial year	**326 7**	177 8	**317 3**	177 5

Reconcılıatıons of movements ın shareholder's funds

	Notes	Group 2011 £m	Group 2010 £m	Company 2011 £m	Company 2010 £m
Profit for the financıal year		**305 4**	256 8	**296 0**	256 5
Dıvıdends	6	**(153 6)**	(170 0)	**(153 6)**	(170 0)
Retaıned profit for the financıal year		**151 8**	86 8	**142 4**	86 5
Share based payments		**2 8**	2 9	**2 8**	2 9
Net actuanal gaın/(loss)		**27 5**	(79 0)	**27.5**	(79 0)
Adjustment ın respect of tax rate change on deferred tax		**(6 2)**	-	**(6 2)**	-
Net addıtıon to shareholder's funds		**175 9**	10 7	**166 5**	10 4
Openıng shareholder's funds		**1,186 5**	1,175 8	**1,402 2**	1,391 8
Closıng shareholder's funds		**1,362 4**	1,186 5	**1,568 7**	1,402 2

Balance sheets

As at 31 March 2011

		Group		Company	
	Notes	2011 £m	2010 £m	2011 £m	2010 £m
Fixed assets					
Tangible assets	7	**6,031.9**	5,980 0	**6,029.8**	5,977 9
Investments	8	**-**	-	**235 7**	235 7
		6,031 9	5,980 0	**6,265 5**	6,213 6
Current assets					
Stocks		**6 3**	6 4	**6 3**	6 4
Debtors amounts falling due within one year	9a	**332 1**	317 0	**345 4**	319 5
Debtors amounts falling due after more than one year	9b	**5.4**	-	**43.2**	36 5
Short term deposits	12b	**4.0**	1 7	**4 0**	1 7
Cash at bank and in hand	12b	**6.5**	5 1	**6 1**	2 8
		354 3	330 2	**405 0**	366 9
Creditors amounts falling due within one year	10	**(475 4)**	(681 2)	**(552 3)**	(734 0)
Net current liabilities		**(121 1)**	(351 0)	**(147 3)**	(367 1)
Total assets less current liabilities		**5,910.8**	5,629 0	**6,118 2**	5,846 5
Creditors amounts falling due after more than one year	11	**(3,911 7)**	(3,669 1)	**(3,912 8)**	(3,670 9)
Provisions for liabilities	13	**(438 3)**	(545 4)	**(438 3)**	(545 4)
Net assets excluding pension deficit		**1,560 8**	1,414 5	**1,767 1**	1,630 2
Pension deficit	14	**(198.4)**	(228 0)	**(198 4)**	(228 0)
Net assets including pension deficit		**1,362 4**	1,186 5	**1,568 7**	1,402 2
Capital and reserves					
Called up share capital	15	**1,000 0**	1,000 0	**1,000 0**	1,000 0
Profit and loss account	16	**362 4**	186 5	**568 7**	402 2
Shareholder's funds		**1,362 4**	1,186 5	**1,568.7**	1,402 2

Signed on behalf of the board who approved the accounts on 26 May 2011

Andrew Duff
Chairman

Michael McKeon
Finance Director

Company number 2366686

Group cash flow statement

Year ended 31 March 2011

	Notes	2011 £m	2011 £m	2010 £m	2010 £m
Net cash inflow from operatıng activities	19a		**827 1**		812 9
Returns on ınvestments and servicıng of finance					
Interest receıved		**1 4**		3 0	
Interest paıd		**(162 6)**		(164 4)	
Interest element of finance lease rental payments		**(10 8)**		(10 0)	
			(172 0)		(171 4)
Taxation			**(58 3)**		(61 1)
Capıtal expenditure and financıal ınvestment					
Purchase of tangıble fixed assets		**(506 4)**		(592 1)	
Grants and contnbutıons receıved		**24 9**		19 6	
Sale of tangıble fixed assets		**19 6**		6 7	
			(461 9)		(565 8)
Equity dıvıdends paid			**(153 6)**		(170 0)
Net cash outflow before management of lıquid resources and financıng			**(18 7)**		(155 4)
Management of liquid resources			**(2 3)**		145 4
Net cash flow before financıng			**(21 0)**		(10 0)
Fınancıng					
Fınance leases repaıd		**(47 3)**		(43 2)	
Loans receıved		**528 4**		195 5	
Closed out swap		**20 5**		-	
Loans repaıd		**(477 4)**		(147 7)	
Share based payments made on LTIP awards vestıng ın the penod		**(1 9)**		(2 2)	
			22.3		2 4
Net ıncrease/(decrease) ın cash			**1 3**		(7 6)

Reconcılıatıon of net cash flow to movement ın net debt

	Notes	2011 £m	2011 £m	2010 £m	2010 £m
Net ıncrease/(decrease) ın cash as above		**1 3**		(7 6)	
Cash flow from movement ın net debt		**(3 8)**		(4 6)	
Cash flow from movement ın lıquıd resources		**2 3**		(145 4)	
Change ın net debt resultıng from cash flows			**(0 2)**		(157 6)
Rolled up ınterest on net debt			**(51 7)**		(15 2)
Termınatıon of financıal ınstruments			**(44 2)**		-
Increase in net debt			**(96 1)**		(172 8)
Openıng net debt			**(3,869 4)**		(3,696 6)
Closing net debt	19b		**(3,965 5)**		(3,869 4)

Notes to the financial statements

Year ended 31 March 2011

1 Accounting policies

a) Accounting convention

The financial statements have been prepared on the going concern basis (see Directors' report) 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 2006 (the Act) An explanation of this departure from the requirements of the Act is given in the policy on grants and contributions below

b) Consolidation and exemptions

The consolidated profit and loss account and balance sheet include the results of the company and its subsidiary undertakings as listed in note 8 Intra group sales and profits are eliminated fully on consolidation The company has taken advantage of the following exemptions

- FRS 1 'Cash Flow Statements' – a cash flow statement has not been presented
- FRS 8 'Related Party Disclosures' – related party transactions with other group undertakings have not been disclosed
- SSAP 25 'Segmental reporting' – segmental information has not been disclosed

c) Turnover

Turnover represents income receivable from regulated water activities, excluding value added tax

Income includes an estimation of the amount of mains water and waste water 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

Turnover is not recognised in respect of unoccupied properties Properties are classified as unoccupied when

- The company is informed that a customer has left a property and it is not expected to be reoccupied immediately,
- New properties are connected but are not occupied, or
- Properties are disconnected following a customer's request

Where properties are not classified as unoccupied but the identity of the customer is unknown, the properties are classified as 'The Occupier' premises Income is only recognised for such premises when

- Cash is received, or
- The identity of the occupier becomes known

Where amounts invoiced are being recovered through charges on income, turnover is recognised in accordance with the policy set out above and provisions are charged to operating costs to reflect the company's assessment of the risk of non recoverability

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 (see note 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 (see note 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

e) Leased assets

Where the company or the group obtains assets under 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

Where the company or the group obtains assets under leasing arrangements where substantially all the risks and rewards of ownership remain with the lessor, these are classified as operating leases Rental costs arising under operating leases are expensed on a straight line basis over the term 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 the Act, 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

1 Accounting policies continued

f) Grants and contributions (continued)

The effect of this departure is that the cost of fixed assets is £585 5 million lower than it would otherwise have been (2010 £566 1 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) Stock

Stock is stated at the lower of cost and net realisable value Cost includes labour, materials, transport and attributable overheads

j) Provisions

Provisions are recognised where

- There is a present obligation as a result of a past event,
- It is probable that there will be an outflow of economic benefits to settle this obligation, and
- A reliable estimate of this amount can be made

Self-insurance provisions are recognised for claims notified and for claims incurred but which have not yet been notified, based on advice from the group's independent insurance advisers

Provisions are discounted to present value using a pre-tax discount rate that reflects the risks specific to the liability where the effect is material

k) Pension costs

The group and company operate both defined benefit and defined contribution schemes

For defined benefit schemes the amounts charged to operating profit are the current and past service costs and gains and losses on settlements and curtailments They are included as part of staff costs Past service costs are recognised immediately in the profit and loss account if the benefits have vested If the benefits have not vested immediately the costs are recognised over the period until vesting occurs The interest 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 bid price and liabilities are measured on an actuarial basis using the projected unit method and discounted at a rate equivalent to the current rate of return on a high quality corporate bond of equivalent currency and term to the scheme liabilities The actuarial valuations are obtained at least triennially and are updated at each balance sheet date The resulting defined benefit asset or liability, net of the related deferred tax, is presented separately after other net assets on the face of the balance sheet

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

l) Research and development

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

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

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

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

1 Accounting policies continued

o) Derivatives and other financial instruments (continued)

Energy swaps are used to manage the risks of future fluctuations in electricity prices 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 but are recognised in the balance sheet at the difference between the swap rate and the spot rate at the balance sheet date and offset against the associated hedged borrowings

Energy swaps are not revalued to fair value

The aggregate fair values at the balance sheet date of the hedging instruments described above are disclosed in note 12 to the financial statements

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 charge 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

						Group
	2011			2010		
	Before exceptional costs	Exceptional costs	Total	Before exceptional costs	Exceptional costs	Total
	£m	£m	£m	£m	£m	£m
Wages and salaries	**156 4**	**3 9**	**160.3**	171 2	12 9	184 1
Social security costs	**13 0**	**0 4**	**13 4**	13 6	0 5	14 1
Pension costs	**24 4**	**0 6**	**25.0**	16 4	7 7	24 1
Share based payments	**4.7**	**-**	**4 7**	5 1	-	5 1
Total employee costs	**198 5**	**4 9**	**203 4**	206 3	21 1	227 4
Power	**50 5**	**-**	**50.5**	50 6	-	50 6
Raw materials and consumables	**46 2**	**0 5**	**46 7**	41 4	0 4	41 8
Rates	**61 5**	**-**	**61.5**	60 3	-	60 3
Charge for bad and doubtful debts	**31 8**	**-**	**31 8**	33 9	-	33 9
Service charges	**32 6**	**-**	**32.6**	31 2	-	31 2
Depreciation on owned assets non infrastructure	**243 4**	**-**	**243.4**	229 7	5 9	235 6
Depreciation on owned assets infrastructure	**106 7**	**-**	**106.7**	95 9	-	95 9
Depreciation of tangible fixed assets	**350 1**	**-**	**350 1**	325 6	5 9	331 5
Hired and contracted services	**119 5**	**3 4**	**122 9**	113 5	4 1	117 6
Operating lease rentals	**1 5**	**0.2**	**1 7**	2 1	5 4	7 5
Hire of plant and machinery	**6 6**	**-**	**6 6**	7 5	0 1	7 6
Research and development expenditure	**4 1**	**-**	**4.1**	5 1	-	5 1
Loss/(profit) on disposal of fixed assets	**1 1**	**-**	**1 1**	(4 3)	-	(4 3)
Other operating costs	**38 8**	**4 0**	**42 8**	29 1	5 1	34 2
	942 8	**13 0**	**955 8**	902 3	42 1	944 4
Release from deferred income	**(2 9)**	**-**	**(2 9)**	(3 1)	-	(3 1)
Own work capitalised	**(59 9)**	**-**	**(59 9)**	(81 1)	-	(81 1)
Total operating costs	**880 0**	**13 0**	**893 0**	818 1	42 1	860 2

2 Analysis of total operating costs and exceptional items continued

	Company					
	2011			2010		
	Before exceptional costs	Exceptional costs	Total	Before exceptional costs	Exceptional costs	Total
	£m	£m	£m	£m	£m	£m
Wages and salaries	156.4	3 9	160.3	171 2	12 9	184 1
Social security costs	13 0	0 4	13.4	13 6	0 5	14.1
Pension costs	24 4	0 6	25.0	16 4	7 7	24 1
Share based payments	4.7	-	4.7	5 1	-	5 1
Total employee costs	198 5	4 9	203.4	206 3	21 1	227 4
Power	50.5	-	50.5	50 6	-	50 6
Raw materials and consumables	46.2	0 5	46.7	41 4	0 4	41 8
Rates	61.5	-	61.5	60 3	-	60 3
Charge for bad and doubtful debts	31.8	-	31.8	33 9	-	33 9
Service charges	32.6	-	32.6	31 2	-	31 2
Depreciation on owned assets non infrastructure	243 4	-	243.4	229 7	5 9	235 6
Depreciation on owned assets infrastructure	106 7	-	106.7	95 9	-	95 9
Depreciation of tangible fixed assets	350 1	-	350.1	325 6	5 9	331 5
Hired and contracted services	119 5	3 4	122 9	113 5	4 1	117 6
Operating leases rentals	12 5	0 2	12.7	13 0	5 4	18 4
Hire of plant and machinery	6 6	-	6 6	7 5	0 1	7 6
Research and development expenditure	4 1	-	4.1	5 1	-	5 1
Loss/(profit) on disposal of fixed assets	1 1	-	1 1	(4 3)	-	(4 3)
Other operating costs	38 8	4 0	42.8	29 1	5 1	34 2
	953 8	13 0	966 8	913 2	42 1	955 3
Release from deferred income	(2 9)	-	(2.9)	(3 1)	-	(3 1)
Own work capitalised	(59.9)	-	(59 9)	(81 1)	-	(81 1)
Total operating costs	891 0	13 0	904 0	829 0	42 1	871 1

Auditor's remuneration

During the year the following fees were charged by the auditor

	Group		Company	
	2011	2010	2011	2010
	£m	£m	£m	£m
Fees payable to the company's auditor for the audit of the company's annual accounts	0 4	0 3	0 4	0 3
Total audit fees	0 4	0 3	0.4	0 3
Other services pursuant to legislation				
Other services	-	0 1	-	0 1
Total non-audit fees	-	0 1	-	0 1

2 Analysis of total operating costs and exceptional items continued

Exceptional items

	Group and company 2011 £m	Group and company 2010 £m
Exceptional restructuring costs and termination of operations	**(13.0)**	(42 1)
Profit on disposal of tangible fixed assets	**17 5**	-

A £13 0 million exceptional charge was incurred (2010 £42 1 million) arising from the programme to restructure and realign the business

A £17 5 million exceptional profit was realised (2010 nil) from property disposals in the period This has been classified as non-operating in accordance with FRS 3 'Reporting financial performance'

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 2011 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 $97^{17}/_{19}$p each by virtue of having received contingent awards of shares under the Severn Trent Long Term Incentive Plan (LTIP) on 14 July 2008, 7 July 2009 and 21 June 2010, deferred shares under the Severn Trent Annual Bonus Scheme (ABS) on 27 June 2008, 7 July 2009 and 28 June 2010, and contingent shares under the Share Matching Plan on 28 June 2010

The LTIP operates on a three year rolling basis The Severn Trent Employee Share ownership Trust is operated in conjunction with the LTIP and ABS 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 Severn Trent Plc's Total Shareholder Return (TSR)

During the year, the executive directors received half of their bonus for the year ended 31 March 2010 in deferred shares under the ABS and contingent matching shares (being 50% of their deferred share award) under the Share Matching Plan Performance targets apply to the Share Matching Plan award in the same manner as the LTIP

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 2011

b) Emoluments

	2011 £000	2010 £000
Aggregate emoluments (excluding pension contributions)	**3,344 8**	3,279 4
Pension contributions (defined contribution arrangements)	**239 7**	229 6
	3,584 5	3,509 0

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

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

iii) Retirement benefits are accruing to three directors (2010 three directors) under a defined benefit scheme and two directors (2010 two directors) under a defined contribution scheme

iv) Five directors (2010 nil directors) exercised share options or received LTIP awards which had vested during the year

c) Highest paid director

	2011 £000	2010 £000
Aggregate emoluments (excluding pension contributions)	**905 1**	878 1

The accrued pension at 31 March 2011 for the highest paid director was £25,002 (2010 £20,882) 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 The highest paid director's 2007 LTIP award vested during the year and he received 5,540 ordinary shares

3 Information regarding directors and employees

Employees

	Group and company	
	2011	2010
	Number	Number
Average number of employees during the year	**5,237**	5,686

4 Net interest payable

	Group		Company	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Interest receivable and similar income	**22 3**	2 8	**23 6**	4 0
Finance income on defined benefit pension schemes	**82 9**	63 4	**82 9**	63 4
Interest receivable	**105 2**	66 2	**106 5**	67 4
Interest payable and similar charges on				
Bank loans and overdrafts	**(18 4)**	(9 1)	**(18 4)**	(9 1)
Other loans	**(224 8)**	(172 2)	**(15 3)**	(14 6)
Finance leases	**(24 0)**	(10 0)	**(24 0)**	(10 0)
Amounts due to subsidiary undertaking	**-**	-	**(209 8)**	(157 9)
Interest cost on defined benefit pension schemes	**(87 6)**	(76 5)	**(87 6)**	(76 5)
Interest payable	**(354 8)**	(267 8)	**(355 1)**	(268 1)
Net interest payable	**(249 6)**	(201 6)	**(248 6)**	(200 7)

5 Taxation on profit on ordinary activities

a) Analysis of charge in the year

	Group		Company	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Current tax				
UK Corporation tax at 28%				
- Current year	**52 2**	56 4	**51 2**	55 0
- Adjustment in respect of prior years	**(13 1)**	(24 4)	**(13 1)**	(24 4)
Group relief payable at 28%				
- Current year	**17 8**	17 2	**18 2**	17 5
- Adjustment in respect of prior years	**0.5**	0 1	**0 5**	0 1
Total current tax	**57 4**	49 3	**56 8**	48 2
Deferred tax				
Origination and reversal of timing differences				
- Current year	**13 7**	(15 0)	**13 7**	(15 0)
- Adjustment in respect of prior years	**10 7**	17 4	**10 7**	17 4
- Effect of change in tax rate	**(53 8)**	-	**(53 8)**	-
- Increase in discount	**(49 3)**	(11 2)	**(49 3)**	(11 2)
Total deferred tax credit	**(78 7)**	(8 8)	**(78 7)**	(8 8)
Deferred tax included in the statement of recognised gains and losses	**(15 8)**	30 0	**(15 8)**	30 0
Deferred tax (credit)/charge included in profit and loss account	**(94 5)**	21 2	**(94 5)**	21 2
Total tax (credit)/charge	**(37 1)**	70 5	**(37 7)**	69 4

5 Taxation on profit on ordinary activities continued

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 (28%) The differences are explained below

	Group		Company	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Profit on ordinary activities before tax	**268 3**	327 3	**258 3**	325 9
Profit on ordinary activities multiplied by the standard rate of corporation tax of 28%	**75 1**	91 6	**72.3**	91 3
Effects of				
Items not taxable or not deductible for tax purposes	**(3 5)**	(1 9)	**(1.3)**	(2 6)
Capital allowances for period less than/(in excess of) depreciation	**1 4**	(17 1)	**1 4**	(17 1)
Movement in short term timing differences	**(3.0)**	1 0	**(3 0)**	1 0
Adjustment to tax charge in respect of prior periods	**(12 6)**	(24 3)	**(12 6)**	(24 4)
	57 4	49 3	**56 8**	48 2

Of the current year charge, £3 2 million (2010 £4 9 million) relates to current tax credits on exceptional items, £6 5 million credit (2010 £6 5 million credit) in respect of deferred tax

c) Tax charged directly to equity

In addition to the amount charged to the profit and loss account the following amounts have been credited directly to equity

	Group		Company	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Current tax relief on pension contributions	**-**	0 8	**-**	0 8
Deferred tax on actuarial gains and losses	**(15 8)**	30 0	**(15.8)**	30 0
Tax credited directly to equity	**(15 8)**	30 8	**(15 8)**	30 8

d) Factors affecting future tax rates

The group's current tax charge of £70 0 million (2010 £73 6 million) before adjustments to the tax charge in respect of prior periods represents 26 1% (2010 22 5%) of the group's profit before tax

The company's current tax charge of £69 4 million (2010 £72 5 million) before adjustments to the tax charge in respect of prior periods represents 26 9% (2010 22 2%) of the company's profit before tax

The 2011 deferred tax 'effect of change in tax rate' is an amount which reflects the decrease in the main corporation tax rate to 26% with effect from 1 April 2011, being the rate at which the deferred tax is expected to reverse The group and company's tax charge will continue to be affected in future years by the levels of capital expenditure, which is driven by the requirements of AMP5, and by the extent and timing of tax deductions that will be available for such expenditure The group's and company's deferred tax charge in future years is difficult to predict as it is impacted by changes to interest rates from one balance sheet date to the next

6 Dividends

	Group		Company	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Dividends paid	**153 6**	170 0	**153 6**	170 0

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 year ended 31 March 2011 amounted to £153 6 million, being 15 4p per share (2010 17p per share)

7 Tangible fixed assets

Group

	Land and buildings £m	Infrastructure assets £m	Fixed plant and equipment £m	Vehicles and mobile plant £m	Total £m
Cost					
At 1 April 2010	2,463 1	4,149 0	3,436 2	46 8	10,095 1
Additions	88 8	167 6	165 9	2 4	424 7
Grants and contributions	-	(19 4)	-	-	(19 4)
Assets sold or written off	(10 1)	(0 5)	(59 9)	(4 8)	(75 3)
At 31 March 2011	**2,541.8**	**4,296 7**	**3,542.2**	**44 4**	**10,425.1**
Depreciation					
At 1 April 2010	(759 5)	(1,583 6)	(1,749 7)	(22 3)	(4,115 1)
Charge for the year	(54 9)	(106 7)	(182 9)	(5 6)	(350 1)
Assets sold or written off	9 1	-	59 4	3 5	72 0
At 31 March 2011	**(805 3)**	**(1,690 3)**	**(1,873 2)**	**(24.4)**	**(4,393 2)**
Net book value					
At 31 March 2011	**1,736 5**	**2,606 4**	**1,669 0**	**20 0**	**6,031 9**
At 31 March 2010	1,703 6	2,565 4	1,686 5	24 5	5,980 0

Company

	Land and buildings £m	Infrastructure assets £m	Fixed plant and equipment £m	Vehicles and mobile plant £m	Total £m
Cost					
At 1 April 2010	2,463 1	4,146 7	3,436 2	46 8	10,092 8
Additions	88 8	167 6	165 9	2 4	424 7
Grants and contributions	-	(19 4)	-	-	(19 4)
Assets sold or written off	(10 1)	(0 5)	(59 9)	(4 8)	(75 3)
At 31 March 2011	**2,541 8**	**4,294 4**	**3,542 2**	**44 4**	**10,422 8**
Depreciation					
At 1 April 2010	(759 5)	(1,583 4)	(1,749 7)	(22 3)	(4,114 9)
Charge for the year	(54 9)	(106 7)	(182 9)	(5 6)	(350 1)
Assets sold or written off	9 1	-	59 4	3 5	72 0
At 31 March 2011	**(805 3)**	**(1,690 1)**	**(1,873 2)**	**(24 4)**	**(4,393 0)**
Net book value					
At 31 March 2011	**1,736 5**	**2,604 3**	**1,669 0**	**20 0**	**6,029 8**
At 31 March 2010	1,703 6	2,563 3	1,686 5	24 5	5,977 9

7 Tangible fixed assets continued

i) Included in tangible fixed assets are assets held under finance leases as follows

	Group 2011 £m	Group 2010 £m	Company 2011 £m	Company 2010 £m
Cost	**402 9**	404 3	**400 5**	401 9
Accumulated depreciation	**(179.4)**	(166 9)	**(179.1)**	(160 5)
Net book value	**223 5**	237 4	**221 4**	241 4

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

	Group 2011 £m	Group 2010 £m	Company 2011 £m	Company 2010 £m
Freehold	**1,736 2**	1,703 3	**1,736 2**	1,703 3
Short leasehold	**0 3**	0 3	**0 3**	0 3
	1,736.5	1,703 6	**1,736.5**	1,703 6

iv) Tangible fixed assets not subject to depreciation are

	Group 2011 £m	Group 2010 £m	Company 2011 £m	Company 2010 £m
Land	**30 6**	26 1	**30.6**	26 1
Assets in the course of construction	**433 8**	478 0	**433 8**	478 0
	464 4	504 1	**464 4**	504 1

8 Investments

The group had no investments The company's investments are set out below

	Company: Shares in subsidiary undertakings £m	Loans to subsidiary undertakings £m	Other investments £m	Total £m
Cost and net book value at 31 March 2011 and at 31 March 2010	**170 1**	**65.5**	**0.1**	**235.7**

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

In the opinion of the directors the fair values of the group's and company's investments are not less than the amount at which they are stated in the balance sheet

9 Debtors

a) Amounts falling due within one year

	Group		Company	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Trade debtors	**126 9**	122 3	**126 9**	122 3
Amounts owed by parent and fellow subsidiary undertakings	**5 8**	3 0	**5 8**	3 0
Other debtors	**36 2**	38 8	**38 6**	40 7
Prepayments and accrued income	**163 2**	152 9	**174.1**	153 5
	332 1	317 0	**345 4**	319 5

b) Amounts falling due after more than one year

	Group		Company	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Amounts owed by parent and fellow subsidiary undertakings	**-**	-	**37.8**	36 3
Other debtors	**-**	-	**-**	0 2
Prepayments and accrued income	**5 4**	-	**5.4**	-
	5 4	-	**43.2**	36 5
Total debtors	**337 5**	317 0	**388 6**	356 0

10 Creditors: amounts falling due within one year

	Group		Company	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Loans due to parent and fellow subsidiary undertakings	**96 5**	195 5	**96 5**	195 5
Other loans	**4 9**	1 8	**-**	-
Obligations under finance leases	**13 5**	47 2	**13 5**	47 2
Borrowings (note 12)	**114 9**	244 5	**110 0**	242 7
Trade creditors	**12 2**	8 2	**12 2**	8 2
Amounts owed to parent and fellow subsidiary undertakings	**18 2**	11 8	**116 7**	94 9
Other creditors	**8 2**	3 5	**32 5**	16 3
Taxation and social security	**4 1**	4 3	**4 1**	4 3
Corporation tax payable	**46 6**	53 2	**45 8**	51 8
Accruals and deferred income	**271 2**	355 7	**231 0**	315 8
	475 4	681 2	**552 3**	734 0

11 Creditors: amounts falling due after more than one year

	Group		Company	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Bank loans	**602.7**	445 6	**602 7**	445 6
Loans due to parent and fellow subsidiary undertakings	**-**	-	**3,006 3**	2,934 3
Other loans	**3,005 2**	2,932 5	**-**	-
Obligations under finance leases	**253.2**	253 6	**253 2**	253 6
Borrowings (note 12)	**3,861 1**	3,631 7	**3,862 2**	3,633 5
Other creditors	**13 0**	2 4	**13 0**	2 4
Deferred income	**37 6**	35 0	**37 6**	35 0
	3,911.7	3,669 1	**3,912.8**	3,670 9

12 Financial instruments

The group's policies in respect of interest rate risk management and the related use of financial instruments are set out in accounting policy note 1 o)

a) Borrowings analysed by maturity date

	Loan with other repayment terms	Finance leases	**2011**	2010
	£m	£m	**£m**	£m
Financial liabilities due within one year (note 10)	(101 4)	(13 5)	**(114 9)**	(244 5)
Between one and two years	(43 4)	(16 4)	**(59 8)**	(19 6)
Between two and five years	(1,034 3)	(84 1)	**(1,118 4)**	(538 6)
After more than five years	(2,530 2)	(152 7)	**(2,682.9)**	(3,073 5)
Total financial liabilities due after one year (note 11)	(3,607 9)	(253 2)	**(3,861 1)**	(3,631 7)
	(3,709 3)	(266 7)	**(3,976 0)**	(3,876 2)

£602 7 million (2010 £445 7 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	**2011**	2010
	%	**£m**	£m
European Investment Bank loan - 2016-20 (2010 2016-17)	0 9-4 5	**450 0**	300 0
European medium term loan notes - 2016-2067 (2010 2015-67)	1 2-6 3	**1,368 0**	1,489 5
Sterling bonds - 2018-29 (2010 2018-29)	6 1-6 3	**712 2**	1,100 7
Total capital		**2,530 2**	2,890 2

12 Financial instruments continued

b) Investments in interest earning assets

	Group 2011 £m	2010 £m
Cash at bank and in hand	**6 5**	5 1
Short term deposits	**4 0**	1 7
	10 5	6 8

Sterling deposits include £1 4 million (2010 £1 7 million) held on short term deposit with a maturity 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 account of various interest rate swaps entered into by the group

	Group			
	Fixed interest rate £m	Floating interest rate £m	Index linked rate £m	Total £m
Maturity profile				
Less than one year	13 5	101 4	-	114 9
Between one and two years	16 4	43 4	-	59 8
Between two and five years	818 3	147 4	152 7	1,118 4
Between five and twenty years	1,395 4	320 0	163 5	1,878 9
In more than twenty years	15 9	-	788 1	804 0
Total borrowings	**2,259 5**	**612 2**	**1,104 3**	**3,976.0**
Impact of interest rate swaps entered into by the group and company	237 3	(237 3)	-	-
Total borrowings after the impact of interest rate swaps	**2,496 8**	**374 9**	**1,104 3**	**3,976.0**
Short term deposits and cash at bank and in hand	-	(10 5)	-	(10 5)
Net debt as at 31 March 2011	**2,496 8**	**364 4**	**1,104 3**	**3,965 5**
Total borrowings after the impact of interest rate swaps as at 31 March 2010	2,730 6	91 4	1,054 2	3,876 2
Short term deposits and cash at bank and in hand	-	(6 8)	-	(6 8)
Net debt as at 31 March 2010	2,730 6	84 6	1,054 2	3,869 4

Fixed interest debt incurs interest at a weighted average rate of 5 9% (2010 5 8%) Interest on these borrowings is fixed for a weighted average period of 9 8 years (2010 11 5 years)

Included in the fixed interest debt above, the group has entered into an accreting interest rate swap (2010 three forward starting accreting interest rate swaps) This has a notional value of £22 3 million (2010 £40 0 million) and accretes value up to 2030 (2010 2032) The maximum notional value of this swap is £35 million (2010 £135 million) This swap is floating to fixed and bears fixed interest at 5 52% (2010 between 5 29% and 5 52%)

The group has ten (2010 ten) forward dated swaps (floating to fixed) with a total notional value of £450 million (2010 £450 million) that bear interest between 4 92% and 5 16% (2010 4 92% and 5 16%) These interest rate swaps commence in 2013 and 2014 and end in 2023 and 2024

Floating rate borrowings bear interest based on LIBOR

The principal outstanding under index linked debt is adjusted by the change in the Retail Prices Index at regular intervals Interest is charged at fixed rates on the adjusted amount

12 Financial instruments continued

d) Fair value of financial instruments

The group uses financial derivatives primarily 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 2011 interest rates on 62 8% of the group's borrowings were fixed for a weighted average period of up to 9 8 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

	2011		2010	
Financial instrument by category asset/(liability)	Book value £m	Fair value £m	Book value £m	Fair value £m
Primary financial instruments held or issued to finance business activities				
Short term deposits	**4 0**	**4 0**	1 7	1 7
Cash at bank and in hand	**6.5**	**6 5**	5 1	5 1
Short term debtors and creditors	**105.3**	**105 3**	70 2	70 2
Borrowings falling due within one year	**(114 9)**	**(112 0)**	(244 5)	(243 9)
Borrowings falling due after more than one year	**(4,001.0)**	**(4,256 9)**	(3,799 7)	(3,885 8)
Derivative financial instruments held to manage the currency and interest rate profile				
Interest rate swaps and similar instruments	**-**	**(67 2)**	-	(68 9)
Currency instruments - cross currency swaps	**139.9**	**132 2**	168 0	163 3
Energy swaps	**-**	**14 6**	-	(9 8)
Total net financial liabilities	**(3,860.2)**	**(4,173 5)**	(3,799 2)	(3,968 1)
Other long term assets				
Other fixed asset investments	**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

e) Borrowing facilities

At the balance sheet date the group had committed undrawn borrowing facilities of £41 7 million expiring in less than one year (2010 nil), £458 3 million expiring between one and two years (2010 £191 7m) and £nil (2010 £458 3 million) expiring between two and five years These facilities are held jointly with Severn Trent Plc

f) Unrecognised gains and losses

Gains or losses on derivative instruments are not recognised until the expense 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 recognise the expected future benefit or cost of interest rate and foreign currency hedges to the group and company at 31 March 2011 given prevailing economic conditions

	Group		
	Gains £m	Losses £m	Total net gains/(losses) £m
Unrecognised gains and losses on hedges 1 April 2010	30 0	(113 4)	(83 4)
Arising in previous years that were recognised in the year	(42 1)	-	(42 1)
Arising before 1 April 2010 that were not recognised in the financial year	(12 1)	(113 4)	(125 5)
Unrecognised gains and losses arising during the financial year	81 7	(15 8)	65 9
Unrecognised gains and losses at 31 March 2011	**69 6**	**(129 2)**	**(59 6)**
Expected to be recognised			
In one year or less	4 3	-	4 3
In later years	65 3	(129 2)	(63 9)

13 Provisions for liabilities

Provisions for liabilities comprise

	Group				
	Restructuring	Self insurance	Dilapidation & onerous leasehold	Deferred tax	Total
	£m	£m	£m	£m	£m
At 1 April 2010	10 5	0 7	9 7	524 5	545 4
Charged/(credited) to profit and loss account	2 0	(0 3)	(0 7)	(48 4)	(47 4)
Utilisation of provision	(9 5)	(0 2)	(0 7)	-	(10 4)
Unwind of discount	-	-	-	(49 3)	(49 3)
At 31 March 2011	**3.0**	**0 2**	**8 3**	**426 8**	**438 3**

	Company				
	Restructuring	Self insurance	Dilapidation & onerous leasehold	Deferred tax	Total
	£m	£m	£m	£m	£m
At 1 April 2010	10 5	0 7	9 7	524 5	545 4
Charged/(credited) to profit and loss account	2 0	(0 3)	(0 7)	(48 4)	(47 4)
Utilisation of provision	(9 5)	(0 2)	(0 7)	-	(10 4)
Unwind of discount	-	-	-	(49 3)	(49 3)
At 31 March 2011	**3 0**	**0 2**	**8 3**	**426 8**	**438 3**

The restructuring provision reflects costs to be incurred in respect of committed programmes Substantially all of the associated outflows are expected to occur within one year (2010 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 four years (2010 up to four 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 seven years (2010 eight years) from the balance sheet date

Deferred tax

The full deferred tax liability, calculated at a tax rate of 26% (2010 28%) is

	Group		Company	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Capital allowances	**802 6**	855 1	**802 6**	855 1
Other timing differences	**(8 1)**	(12 6)	**(8 1)**	(12 6)
Deferred tax asset relating to pension liability	**(69 7)**	(88 7)	**(69 7)**	(88 7)
Share schemes	**(1 4)**	(1 0)	**(1 4)**	(1 0)
Undiscounted provision for deferred tax	**723 4**	752 8	**723 4**	752 8
Discount	**(366 3)**	(317 0)	**(366 3)**	(317 0)
Discounted provision for deferred tax	**357 1**	435 8	**357 1**	435 8
Adjustment for deferred tax asset relating to pension liability (note 14)	**69 7**	88 7	**69.7**	88 7
Deferred tax as disclosed in provisions	**426 8**	524 5	**426 8**	524 5
Provision at start of year	**524 5**	503 3	**524 5**	503 3
Deferred tax (credit)/charge included in profit and loss account	**(94 5)**	21 2	**(94 5)**	21 2
Deferred tax credit/(charge) included in statement of recognised gains and losses	**15 8**	(30 0)	**15 8**	(30 0)
Adjustment for deferred tax relating to pension liability (note 14)				
- Included in profit and loss account (credit)/charge	**(3 2)**	-	**(3 2)**	-
- Included in statement of recognised gains and losses (credit)/charge	**(15 8)**	30 0	**(15 8)**	30 0
Provision at end of year	**426 8**	524 5	**426 8**	524 5

14 Pensions

Defined benefit schemes

The group and company participate in the Severn Trent Pension Scheme (STPS) and the Severn Trent Mirror Image Scheme (STMIS) (together 'the Schemes'), both of which are defined benefit schemes and are funded to cover future salary and pension increases The assets of the Schemes are held in a separate fund administered by trustees

As from 1 April 2004, the STPS 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

	Date of last formal actuarial valuation
Severn Trent Pension Scheme*	31 March 2007
Severn Trent Mirror Image Pension Scheme	31 March 2009

*The STPS is by far the largest of the group s UK defined benefit schemes The Severn Trent Senior Staff Pension Scheme was merged with the STPS on 31 March 2009

Following the 31 March 2007 valuation of the STPS, the employers' contribution rates were increased to 33 24%, 27 70% or 16 62% of pensionable pay until 1 July 2008 when rates were set at 22 4% STPS members' contributions continue at a rate of 6%, 5% or 3% of pensionable pay

The Schemes are closed to new entrants and hence the current service costs are expected to increase as members in the Schemes approach retirement

Contribution rates are set in consultation with the trustees for each scheme and each participating employer The triennial actuarial valuation of the STPS is currently under discussion with the trustees It is therefore not possible to determine the level of contributions that will be payable in the year ending 31 March 2012

The actuarial liabilities and market values of the assets at 31 March 2011 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

Valuation method	2011 Projected unit	2010 Projected unit
Price inflation	**3 50%**	3 60%
Salary increase	**4 00%**	4 10%
Pension increases in payment*	**3 50%**	3 60%
Pension increases in deferment*	**3 50%**	3 60%
Discount rate	**5 60%**	5 70%
Longevity at age 65 for pensioners retiring now		
- men (years)	**22 4**	20 3
- women (years)	**26 0**	23 6
Longevity at age 70 (2010 age 65) for pensioners retiring in 20 years		
- men (years)	**17.8**	21 5
- women (years)	**21 4**	24 6

* In excess of any Guaranteed Minimum Pension

14 Pensions continued

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

	Group and company	
	2011 £m	2010 £m
Amounts charged to operating costs		
Current service cost	**(21 1)**	(13 6)
Curtailment loss	**-**	(6 8)
	(21.1)	(20 4)
Amounts charged to net finance costs		
Interest cost	**(87 6)**	(76 5)
Expected return on scheme assets	**82 9**	63 4
	(4 7)	(13 1)
Total amount charged in profit and loss account	**(25 8)**	(33 5)

Actuarial gains and losses have been reported in the statement of recognised gains and losses The cumulative amount of actuarial gains and losses recognised in the statement of recognised gains and losses since the adoption of FRS 17 'Retirement benefits' is a net loss of £133 8m (2010 net loss of £216 8m) The cumulative limitation on actuarial gains recognised under FRS 17 where it is deemed that a surplus cannot be recovered in full either through reduced contributions or scheme refunds is a total of £9 1m gains not recognised (2010 £nil gains not recognised)

An element of the service cost is capitalised in line with the group's accounting policies

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

	Group and company	
	2011 £m	2010 £m
Present value of defined benefit obligations - funded schemes	**(1,570 0)**	(1,557 1)
Total fair value of assets	**1,311 0**	1,240 4
	(259 0)	(316 7)
Asset not recognised	**(9 1)**	-
Liability recognised in the balance sheet (before deferred tax)	**(268 1)**	(316 7)
Deferred tax	**69 7**	88 7
Liability recognised in the balance sheet	**(198 4)**	(228 0)

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

	Group and company	
	2011 £m	2010 £m
At 1 April	**1,557 1**	1,162 4
Current service cost	**21 1**	13 6
Curtailment loss	**-**	6 8
Interest cost	**87 6**	76 5
Contributions from scheme members	**5 6**	6 3
Actuarial (gain)/loss	**(38 5)**	353 4
Benefits paid	**(62 9)**	(61 9)
At 31 March	**1,570 0**	1,557 1

14 Pensions continued

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

	Group and company	
	2011	2010
	£m	£m
At 1 April	**1,240 4**	956 6
Expected return on scheme assets	**82.9**	63 4
Contributions	**22 9**	26 0
Special contributions	**14 4**	10 1
Contributions from scheme members	**5.6**	6 3
Actuarial gain	**7 7**	239 9
Benefits paid	**(62 9)**	(61 9)
At 31 March	**1,311 0**	1,240 4

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

	Group and Company			
	2011		2010	
	Expected return	**Fair value of assets**	Expected return	Fair value of assets
		£m		£m
Equities	**7.85%**	**711 7**	8 00%	665 2
Gilts	**4.35%**	**35 5**	4 50%	239 3
Corporate bonds	**5 60%**	**472 2**	5 70%	273 8
Property	**6 85%**	**84.8**	7 00%	54 6
Cash	**4 35%**	**6.8**	4 50%	7 5
Total fair value of assets		**1,311 0**		1,240 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 previous balance sheet date

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

The actual return on scheme assets was a gain of £90 6 million (2010 £303 3 million gain)

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

	Group and company				
	2011	2010	2009	2008	2007
	£m	£m	£m	£m	£m
Present value of defined benefit obligations	**(1,570 0)**	(1,557 1)	(1,162 4)	(1,295 5)	(1,314 1)
Fair value of scheme assets	**1,311 0**	1,240 4	956 6	1,184 0	1,208 6
Asset not recognised	**(9 1)**	-	(3 7)	-	-
Scheme deficit	**(268 1)**	(316 7)	(209 5)	(111 5)	(105 5)
Experience adjustments on scheme liabilities	**(97 6)**	17 9	(8 5)	71 7	(8 9)
Difference between actual and expected return on scheme assets	**7 7**	239 9	(291 2)	(109 8)	(10 9)

On 11 May 2011, Severn Trent Water announced it is consulting with its UK employees on proposed changes to the group's pension arrangements, which would see all existing pensions replaced by one new defined contribution scheme Under the new proposals, the defined benefit schemes would close to future accrual, whilst protecting the benefits already built up by members The existing defined contribution schemes would also be replaced by the new pension arrangements The company is also proposing to automatically enrol new employees into the new pension from 2012 and automatically enrol those employees who are not currently members of a Severn Trent Water scheme from 2013 Severn Trent Water is consulting with its employees from June for three months, with changes introduced no earlier than April 2012

14 Pensions continued

Defined contribution schemes

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

The total cost charged to operating costs of £3 9 million (2010 £3 0 million) represents contributions payable to these schemes by the group at rates specified in the rules of the schemes As at 31 March 2011 all (2010 100%) contributions due in respect of the current reporting period have been paid over to the schemes

15 Share capital

	Group		Company	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Issued and fully paid				
1,000,000,000 ordinary shares of £1 each (2010 1,000,000,000)	**1,000 0**	1,000 0	**1,000 0**	1,000 0

16 Profit and loss account

	Group	Company
	£m	£m
At 1 April 2010	186 5	402 2
Profit for the financial year	305 4	296 0
Share based payments	2 8	2 8
Actuarial gain	37 1	37 1
Tax on actuarial gain	(9 6)	(9 6)
Adjustment in respect of rate change on deferred tax	(6 2)	(6 2)
Dividends paid	(153 6)	(153 6)
At 31 March 2011	**362 4**	**568 7**

At 31 March 2011 cumulative goodwill written off against group reserves amounted to £29 2 million (2010 £29 2 million)

17 Commitments and contingent liabilities

a) Investment expenditure commitments

	Group and company	
	2011	2010
	£m	£m
Contracted for but not provided in the financial statements	**91 7**	320 9

In addition to these commitments, the group and company have longer term expenditure plans which include investments to achieve improvements in performance mandated by Ofwat and to provide for growth in demand for water and sewerage services

17 Commitments and contingent liabilities

b) Operating lease commitments

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

	2011 Land and buildings £m	2011 Other £m	2010 Land and buildings £m	2010 Other £m
Within one year	-	0 1	0 4	-
Between one year and five years	0.7	-	-	-
After five years	0.5	-	1 1	-
	1.2	**0.1**	1 5	-

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

	2011 Land and buildings £m	2011 Other £m	2010 Land and buildings £m	2010 Other £m
Within one year	-	0 1	0 4	-
Between one year and five years	0 7	-	-	-
After five years	12 7	-	12 1	-
	13 4	**0 1**	12 5	-

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 Therefore, as at 31 March 2011, the group and company had contingent liabilities of £6 5 million (2010 £5 1 million)

18 Share based payments

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 Number of share options	Employee Sharesave Scheme Weighted average exercise price	Approved Share Option Scheme Number of share options	Approved Share Option Scheme Weighted average exercise price
Outstanding at 1 April 2009	3,447,183	876p	3,125	720p
Granted during the year	926,225	806p	-	-
Forfeited during the year	(68,974)	996p	-	-
Cancelled during the year	(299,587)	977p	-	-
Exercised during the year	(565,574)	714p	-	-
Expired during the year	(19,682)	944p	-	-
Transferred to other group companies	(18,237)	948p	-	-
Outstanding at 1 April 2010	3,401,354	872p	3,125	720p
Granted during the year	341,137	1,137p	-	-
Forfeited during the year	(135,239)	896p	-	-
Cancelled during the year	(87,271)	874p	-	-
Exercised during the year	(520,711)	839p	(3,125)	720p
Expired during the year	(77,640)	1,058p	-	-
Transferred to other group companies	(5,293)	889p	-	-
Outstanding at 31 March 2011	**2,916,337**	**903p**	**-**	**720p**

18 Share based payments

The weighted average share price during the period was £12 50 (2010 £10 50)

a) 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 Severn Trent Plc board may grant those employees who have entered into an HM Revenue and Customs approved Save As You Earn contract for a period of three or five years, the right to purchase ordinary shares in Severn Trent Plc Options outstanding at 31 March were as follows

			Number of shares	
	Normal date of exercise	Option price	2011	2010
January 2003	2008 or 2010	536p	-	72,210
January 2004	2009 or 2011	592p	**44,914**	52,956
January 2005	2008, 2010 or 2012	759p	**52,960**	311,337
January 2006	2009, 2011 or 2013	823p	**196,401**	221,506
January 2007	2010, 2012 or 2014	1,172p	**86,768**	265,319
January 2008	2011 or 2013	1,221p	**197,972**	230,890
January 2009	2012 or 2014	862p	**1,167,150**	1,326,703
January 2010	2013 or 2015	806p	**829,949**	920,433
January 2011	2014 or 2016	1,137p	**340,223**	-
			2,916,337	3,401,354

ii) Share Incentive Plan (SIP)

Under the SIP the board of Severn Trent Plc may grant awards to employees of Severn Trent group companies During the year the board of Severn Trent Plc has announced that it will make awards under the SIP based on performance against the company's KPI targets Eligible employees will be entitled to shares to a maximum value of £750 It is expected that these awards will be made in August 2011 SIP shares vest with employees on the date of grant

iii) Approved share options

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

			Number of shares	
	Normal date of exercise	Option price	2011	2010
January 2002	2005-12	720p	-	3,125

b) Long Term Incentive Plan (LTIP)

Under the LTIP conditional awards are made to executive directors and senior staff Awards are subject to performance conditions and continued employment throughout the vesting period

The LTIP awards are subject to total shareholder return over three years for Severn Trent Plc measured relative to the companies ranked 51-150 by market capitalisation in the FTSE index (excluding investment trusts)

18 Share based payments continued

c) Share Matching Plan (SMP)

Under the Share Matching Plan executive directors receive matching share awards over those shares which have been acquired under the deferred share component of the annual bonus scheme Matching shares may be awarded at a maximum ratio of one matching share for every one deferred share and are subject to a three year vesting period During the year matching shares were awarded at a ratio of 0 5 to 1

Matching shares are subject to Severn Trent Plc total shareholder return over three years measured relative to the companies ranked 51-150 by market capitalisation in the FTSE Index (excluding investment trusts) This replicates the LTIP performance condition for the 2010 award

The number of shares subject to an award will increase to reflect dividends paid through the performance period on the basis of such notional dividends being reinvested at the then prevailing share price Awards will normally vest as soon as the committee determines that the performance conditions have been met provided that the participant remains in employment at the end of the performance period

During the year 23,100 matching shares with a fair value of £6 79 were made to 9 employees (2010 nil)

	Number of share options
Outstanding at 1 April 2010	–
Granted during the year	23,100
Exercised during the year	–
Outstanding at 31 March 2011	**23,100**

Details of share matching awards outstanding at 31 March 2011 were as follows

		Number of shares	
Date of grant	Normal date of vesting	2011	2010
May 2010	June 2013	**23,100**	–

d) Fair values of awards made in the year

	2011		2010	
	Number	Fair value £m	Number	Fair value £m
LTIP awards	**136,689**	**1 1**	158,608	0 9
Sharesave options	**341,137**	**1 2**	926,225	2 5
Share matching plan	**23,100**	**0 2**	-	-

The fair value of the LTIP awards was calculated using the Monte Carlo method The principal assumptions and inputs into the valuation were as follows

LTIP award year	2011	2010
Share price at grant date	**1,228p**	1,134p
Number of shares awarded	**136,689**	158,608
Number of employees	**19**	20
Vesting period (years)	**3**	3
Expected volatility	**27%**	25%
Expected life (years)	**3**	3
Expected dividend yield	**n/a**	n/a
Proportion of employees expected to cease employment before vesting	**0%**	0%
Fair value per share	**791p**	541p

18 Share based payments continued

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

Scheme year	2011		2010	
Scheme type	**3 year**	**5 year**	3 year	5 year
Share price at grant date	**1,486p**	**1,486p**	1,080p	1,080p
Number of options granted	**210,562**	**130,575**	544,829	381,396
Number of employees	**1,012**	**414**	1,480	531
Vesting period (years)	**3**	**5**	3	5
Expected volatility	**27%**	**27%**	25%	25%
Option life (years)	**3 5**	**5 5**	3 5	5 5
Expected life (years)	**3 25**	**5.25**	3 25	5 25
Risk free rate	**1 63%**	**2.24%**	1 80%	2 78%
Expected dividend yield	**4 4%**	**4 4%**	4 0%	4 0%
Proportion of employees expected to cease employment before vesting	**15 0%**	**17 0%**	15 0%	17 0%
Fair value per share	**348p**	**359p**	264p	280p

Volatility is based on historical observations as adjusted for unusual market fluctuations

The fair value of the SMP awards made during the year was calculated using the Monte Carlo method using the principal assumptions set out below

Assumptions	2011	2010
Expected volatility		
Severn Trent group	**27%**	0%
Comparator group	**46%**	0%
Correlation between Severn Trent Plc and comparator group	**33%**	0%
Proportion of employees expected to cease employment before vesting	**0%**	0%

Share price volatility is based on observations over a historical period prior to the date of grant, commensurate of the expected term of the performance period The comparator group is the companies ranked 51-150 in the FTSE Index The share price at the grant date was £11 26

Dividends paid on the shares during the vesting period are accumulated during the vesting period and released subject to the achievement of the performance condition, in the same manner as the underlying shares As a result a dividend yield assumption is not required

During the period, the group recognised total expenses of £4 7 million (2010 £5 1 million) related to equity settled share based payment transactions

19 Group cash flow statement

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

	2011 £m	2010 £m
Operating profit	**500 4**	528 9
Depreciation charge (note 7)	**350 1**	325 6
Loss/(profit) on disposal of tangible fixed assets	**1 1**	(4 3)
Exceptional depreciation of tangible fixed assets	**-**	5 9
Deferred income received	**5 4**	3 8
Deferred income credited to the profit and loss account	**(2.9)**	(3 1)
Provisions for liabilities charged to the profit and loss account	**1 0**	15 3
Utilisation of provisions for liabilities	**(10 4)**	(0 2)
Pension service and curtailment costs less contributions paid	**(16 3)**	(15 7)
Decrease in stocks	**0.4**	1 6
Increase in debtors	**(17 8)**	(35 1)
Increase/(decrease) in creditors	**11.4**	(14 9)
Share based payments charge	**4 7**	5 1
Net cash flow from operating activities	**827 1**	812 9

b) Analysis of changes in net debt

	At 1 April 2010 £m	Cash flow £m	Other non-cash changes £m	At 31 March 2011 £m
Cash at bank and in hand	5 1	1 4	-	**6 5**
Net cash	5 1	1 4	-	**6 5**
Debt due within one year (note 10)	(197 3)	95 9	-	**(101 4)**
Debt due after one year (note 11)	(3,378 1)	(147 1)	(82 7)	**(3,607.9)**
Finance leases (notes 10 and 11)	(300 8)	47 3	(13 2)	**(266 7)**
Short term deposits (note 12)	1 7	2 3	-	**4 0**
Net debt (note 12)	(3,869 4)	(0 2)	(95 9)	**(3,965 5)**

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 Investment Holdings Limited 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, Severn Trent Centre, PO Box 5309, Coventry CV3 9FH

Alternatively, the report can be viewed and downloaded from Severn Trent Plc's website at **www severntrent.com/reports2011**

Regulatory accounts

Regulatory accounts index

Water Industry Act 1991

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

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

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

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

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

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 Limited (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

Tony Wray
Chief Executive
For and on behalf of the board
26 May 2011

Report of the auditor

To the Water Services Regulation Authority

Independent auditor's report to the Water Services Regulation Authority and Directors of Severn Trent Water Limited and subsidiary undertakings ('the group')

We have audited the Regulatory Accounts of the group for the year ended 31 March 2011 on pages 59 to 73 which comprise

a) the regulatory historical cost accounting statements, comprising the regulatory historical cost profit and loss account, the regulatory historical cost statement of total recognised gains and losses, the regulatory historical cost balance sheet, and the historical cost reconciliation between statutory and regulatory accounts, and

b) the regulatory current cost accounting statements for the appointed business, comprising the current cost profit and loss account, the current cost statement of total recognised gains and losses, the current cost balance sheet, the current cost cash flow statement and the related notes to the current cost financial statements, including the statement of accounting policies

These Regulatory Accounts have been prepared in accordance with the basis of preparation and accounting policies set out in the Statement of Accounting Policies

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 a water and sewerage undertaker under the Water Industry Act 1991 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 its obligation under Condition F 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 opinions we have formed

Respective responsibilities of the WSRA, the directors and auditor

As explained more fully in the Statement of Directors' Responsibilities set out on page 28, the directors are responsible for the preparation of the Regulatory Accounts and for their fair presentation in accordance with the basis of preparation and accounting policies Our responsibility is to audit and express an opinion on the Regulatory Accounts in accordance with International Standards on Auditing (UK and Ireland), except as stated in the 'Scope of the audit of the Regulatory Accounts' below, and having regard to the guidance contained in Audit 05/03 'Reporting to Regulators of Regulated Entities' issued by the Institute of Chartered Accountants in England and Wales Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors

Scope of the audit of the Regulatory Accounts

An audit involves obtaining evidence about the amounts and disclosures in the Regulatory Accounts sufficient to give reasonable assurance that the Regulatory Accounts are free from material misstatement, whether caused by fraud or error This includes an assessment of whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the directors, and the overall presentation of the Regulatory Accounts In addition, we read all the financial and non-financial information in the regulatory accounts to identify material inconsistencies with the audited Regulatory Accounts If we become aware of any apparent misstatements or inconsistencies, we consider the implications for our report

We have not assessed whether the accounting policies are appropriate to the circumstances of the company where these are laid down by Condition F Where Condition F does not give specific guidance on the accounting policies to be followed, our audit includes an assessment of whether the accounting policies adopted in respect of the transactions and balances required to be included in the Regulatory Accounts are consistent with those used in the preparation of the statutory financial statements of the company Furthermore, 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 International Standards on Auditing (UK & Ireland)

Opinion on Regulatory Accounts

In our opinion, the Regulatory Accounts

- fairly present in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA and the accounting policies set out on page 65, the state of the company's affairs at 31 March 2011 on an historical cost and current cost basis, and its historical cost and current cost profit and its current cost cash flow for the year then ended, and
- have been properly prepared in accordance with Condition F, the Regulatory Accounting Guidelines and the accounting policies

Report of the auditor

To the Water Services Regulation Authority

Emphasis of matter - Basis of preparation

Without modifying our opinion, we draw attention to the fact that the Regulatory Accounts have been prepared in accordance with Condition F of the Appointment and the Regulatory Accounting Guidelines, the accounting policies set out in the statement of accounting policies and, in the case of the regulatory historical cost accounting statements, under the historical cost convention

The Regulatory Accounts are separate from the statutory financial statements of the company and have not been prepared under the basis of United Kingdom Generally Accepted Accounting Practice ('UK GAAP') Financial information other than that prepared on the basis of UK GAAP does not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in statutory financial statements prepared in accordance with the Companies Act 2006 Furthermore, the regulatory historical cost accounting statements on pages 59 to 60 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 The effect of this departure from Generally Accepted Accounting Practice and a reconciliation of the balance sheet drawn up on this basis to the balance sheet drawn up under the Companies Act 2006 is given on page 61

Opinion on other matters prescribed by Condition F

Under the terms of our contract, we have assumed responsibility to provide those additional opinions required by Condition F in relation to the accounting records In our opinion

- proper accounting records have been kept by the appointee as required by paragraph 3 of Condition F, and
- the Regulatory Accounts are in agreement with the accounting records and returns retained for the purpose of preparing the Regulatory Accounts

Other matters

- 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
- Our opinion on the Regulatory Accounts is separate from our opinion on the statutory financial statements of the company for the year ended 31 March 2011 on which we report, which are prepared for a different purpose Our audit report in relation to the statutory financial statements of the Company (our 'statutory audit') was made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006 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 audit report and for no other purpose In these circumstances, to the fullest extent permitted by law, we do not accept or assume responsibility for any other purpose or to any other person to whom our statutory audit report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing

Deloitte LLP

Deloitte LLP
Chartered Accountants
Birmingham UK
26 May 2011

Regulatory accounts – historical cost financial statements

Group profit and loss account year ended 31 March 2011

	2011				2010			
	Appointed business £m	Non-appointed business £m	Inter segment £m	Total £m	Appointed business £m	Non-appointed business £m	Inter segment £m	Total £m
Turnover	1,372 1	8 8	-	1,380 9	1,370 2	8 5	-	1,378 7
Operating costs	(644 3)	(11 6)	6 2	(649 7)	(622 1)	(13 3)	8 0	(627 4)
Historical cost depreciation	(240 5)	-	-	(240 5)	(232 5)	-	-	(232 5)
Other operating income	16 4	6.2	(6.2)	16.4	4 3	8 0	(8 0)	4 3
Operating profit	503 7	3.4	-	507 1	519 9	3 2	-	523 1
Other income	1 7	1.9	-	3 6	2 0	1 8	-	3 8
Net interest payable	(249 6)	-	-	(249.6)	(201 6)	-	-	(201 6)
Profit on ordinary activities before taxation	255 8	5 3	-	261 1	320 3	5 0	-	325 3
Taxation on profit on ordinary activities								
- Current tax	(55 9)	(1 5)	-	(57 4)	(47 9)	(1 4)	-	(49 3)
- Deferred tax	94.5	-	-	94 5	(21 2)	-	-	(21 2)
Taxation	38 6	(1.5)	-	37 1	(69 1)	(1 4)	-	(70 5)
Profit on ordinary activities after taxation	294 4	3 8	-	298 2	251 2	3 6	-	254 8
Dividends	(149.8)	(3 8)	-	(153 6)	(166 4)	(3 6)	-	(170 0)
Retained profit for the financial year	144 6	-	-	144 6	84 8	-	-	84 8

Statement of total recognised gains and losses year ended 31 March 2011

	2011				2010			
	Appointed business £m	Non-appointed business £m	Inter segment £m	Total £m	Appointed business £m	Non-appointed business £m	Inter segment £m	Total £m
Profit for the financial year	294.4	3 8	-	298 2	251 2	3 6	-	254 8
Actuarial gain/(loss)	37 1	-	-	37.1	(109 8)	-	-	(109 8)
Tax (charge)/credit on actuarial gain/loss	(9 6)	-	-	(9 6)	30 8	-	-	30 8
Adjustment in respect of tax rate change on deferred tax	(6.2)	-	-	(6 2)	-	-	-	-
Total recognised gains and losses for the financial year	315 7	3 8	-	319 5	172 2	3 6	-	175 8

The group results presented are for Severn Trent Water Limited and its subsidiary undertakings

Group balance sheet as at 31 March 2011

	2011				2010			
	Appointed business £m	Non-appointed business £m	Inter-segment £m	Total £m	Appointed business £m	Non-appointed business £m	Inter-segment £m	Total £m
Fixed assets								
Tangible assets	**6,024.7**	-	-	**6,024.7**	5,959 6	3 4	-	5,963 0
Current assets								
Stocks	**6.3**	-	-	**6.3**	6 4	-	-	6 4
Debtors	**337 5**	-	-	**337 5**	317 0	-	-	317 0
Short term deposits	**4 0**	-	-	**4 0**	1 7	-	-	1 7
Cash at bank and in hand	**6 5**	-	-	**6 5**	5 1	-	-	5 1
	354 3	-	-	**354 3**	330 2	-	-	330 2
Creditors. amounts falling due within one year								
Creditors	**(311 1)**	-	-	**(311 1)**	(377 2)	(3 4)	-	(380 6)
Borrowings	**(114 9)**	-	-	**(114 9)**	(244 5)	-	-	(244 5)
Corporation tax payable	**(46 6)**	-	-	**(46 6)**	(53 2)	-	-	(53 2)
Infrastructure renewal accrual	**(18 8)**	-	-	**(18 8)**	(1 8)	-	-	(1 8)
	(491.4)	-	-	**(491.4)**	(676 7)	(3 4)	-	(680 1)
Net current liabilities	**(137 1)**	-	-	**(137 1)**	(346 5)	(3 4)	-	(349 9)
Total assets less current liabilities	**5,887 6**	-	-	**5,887 6**	5,613 1	-	-	5,613 1
Creditors amounts falling due after more than one year								
Borrowings	**(3,861.1)**	-	-	**(3,861.1)**	(3,631 7)	-	-	(3,631 7)
Other creditors	**(13 0)**	-	-	**(13 0)**	(2 4)	-	-	(2 4)
	(3,874 1)	-	-	**(3,874 1)**	(3,634 1)	-	-	(3,634 1)
Provisions for liabilities								
- Deferred taxation	**(426 8)**	-	-	**(426 8)**	(524 5)	-	-	(524 5)
- Other provisions	**(11 5)**	-	-	**(11 5)**	(20 9)	-	-	(20 9)
Deferred income	**(40 4)**	-	-	**(40 4)**	(37 9)	-	-	(37 9)
Pension deficit	**(198 4)**	-	-	**(198 4)**	(228 0)	-	-	(228 0)
Net assets	**1,336 4**	-	-	**1,336 4**	1,167 7	-	-	1,167 7
Capital and reserves								
Called up share capital	**1,000 0**	-	-	**1,000 0**	1,000 0	-	-	1,000 0
Profit and loss account	**336 4**	-	-	**336 4**	167 7	-	-	167 7
Shareholder's funds	**1,336 4**	-	-	**1,336.4**	1,167 7	-	-	1,167 7

Reconciliation between statutory accounts and historical cost (HC) regulatory accounts

	2011 £m	Explanation
Profit and Loss		
Turnover as per statutory accounts	**1,389 8**	
ROC income	(8 9)	Income related to exported energy Renewable Obligation Certificates (ROC's) and ROC bonuses is deducted from operating costs for the regulatory accounts
Turnover as per regulatory accounts	**1,380 9**	
Depreciation as per statutory accounts	**(350 1)**	
Depreciation - infrastructure	106 7	Reclassified in regulatory accounts
Deferred credits written back	2 9	Reclassified in regulatory accounts
Depreciation as per regulatory HC accounts	**(240 5)**	
Operating costs per statutory accounts	**(893 0)**	
Deduct other operating loss	1 1	Reclassified in regulatory accounts
ROC income	8 9	From turnover as explained above
HC infrastructure assets	(113 9)	
Statutory infrastructure assets	106 7	
Total infrastructure assets difference	(7 2)	Adjustment to infrastructure renewals charge
Operating costs per regulatory accounts	**(890 2)**	
Operating profit as per statutory accounts	**500.4**	
Non operating income	(3 6)	Rental income is included within operating profit for statutory accounts
Profit on disposal of fixed assets	17 5	Reclassified in regulatory accounts
HC infrastructure assets	(7 2)	Adjustment to infrastructure renewals charge
Operating profit as per regulatory HC accounts	**507.1**	
Profit before tax as per statutory accounts	**268.3**	
HC infrastructure assets	(7 2)	Adjustment to infrastructure renewals charge
Profit before tax as per regulatory accounts	**261.1**	
Balance sheet		
Net assets as per statutory accounts	**1,362.4**	
Infrastructure renewals accrual	(26 0)	Adjustment to infrastructure renewals charge (prior and current years)
Net assets as per regulatory HC accounts	**1,336.4**	

Regulatory accounts – current cost financial statements

Group profit and loss account: appointed business year ended 31 March 2011

	Notes	2011 £m	2010 £m
Turnover	3a	**1,372 1**	1,370 2
Current operating cost	3d	**(922 3)**	(894 4)
Other operating income	3b	**11 9**	4 3
		461 7	480 1
Working capital adjustment	3c	**0 4**	(0 3)
Current cost operating profit		**462 1**	479 8
Other income		**1 7**	2 0
Net interest payable		**(249 6)**	(201 6)
Financing adjustment		**169.3**	130 8
Current cost profit before taxation		**383 5**	411 0
Taxation on profit on ordinary activities			
- Current tax		**(55 9)**	(47 9)
- Deferred tax		**94 5**	(21 2)
Taxation		**38 6**	(69 1)
Current cost profit attributable to shareholders after taxation		**422 1**	341 9
Dividend		**(149 8)**	(166 4)
Current cost retained profit		**272 3**	175 5

Statement of total recognised gains and losses: appointed business year ended 31 March 2011

	2011 £m	2010 £m
Profit for the financial year	**422 1**	341 9
Actuarial gain/(loss)	**37 1**	(109 8)
Tax (credit)/charge on actuarial gain/loss	**(9 6)**	30 0
Adjustment in respect of tax rate change on deferred tax	**(6 2)**	-
Total recognised gains and losses for the financial year	**443 4**	262 1

Group balance sheet: appointed business as at 31 March 2011

	Notes	2011 £m	2010 £m
Fixed assets			
Tangible assets	4	**48,724 3**	31,761 0
Third party contributions since 1989/90		**(1,921 1)**	(1,752 6)
		46,803 2	30,008 4
Working capital	5	**89 1**	(8 2)
Short term deposits		**10.5**	6 8
Infrastructure renewals accrual		**(18 8)**	(1 8)
Working capital		**46,884 0**	30,005 2
Non operating assets and liabilities			
Borrowings		**(114 9)**	(244 5)
Non trade debtors		**4.9**	6 4
Non trade creditors due within one year		**(61 3)**	(52 0)
Corporation tax payable		**(46 6)**	(53 2)
Total non operating assets and liabilities		**(217 9)**	(343 3)
Creditors amounts falling due after more than one year			
Borrowings		**(3,861.1)**	(3,631 7)
Other creditors		**(13 0)**	(2 4)
		(3,874.1)	(3,634 1)
Provision for liabilities			
Deferred taxation		**(426 8)**	(524 5)
Other provisions		**(11 5)**	(20 9)
Pension deficit		**(198 4)**	(228 0)
Net provisions		**(636 7)**	(773 4)
Total assets		**42,155 3**	25,254 4
Capital and reserves			
Called up share capital		**1,000 0**	1,000 0
Profit and loss account	6	**(31.3)**	(327 7)
Current cost reserve	7	**41,186 6**	24,582 1
		42,155 3	25,254 4

Group cash flow statement year ended 31 March 2011

	Notes	2011 Appointed business £m	2011 Non-appointed business £m	2011 Total £m	2010 Appointed business £m	2010 Non-appointed business £m	2010 Total £m
Net cash inflow from operating activities	8	821.8	5 3	827 1	807 1	5 8	812 9
Returns on investments and servicing of finance							
Interest received		1 4	-	1 4	3 0	-	3 0
Interest paid		(162 6)	-	(162 6)	(164 4)	-	(164 4)
Interest element of finance lease rental payments		(10.8)	-	(10 8)	(10 0)	-	(10 0)
Net cash inflow from returns on investing and servicing of finance		(172.0)	-	(172 0)	(171 4)	-	(171 4)
Taxation		(56.8)	(1 5)	(58 3)	(59 7)	(1 4)	(61 1)
Capital expenditure							
Purchase of tangible fixed assets		(409.5)	-	(409 5)	(486 8)	(0 8)	(487 6)
Grants and contributions received		24.9	-	24 9	19 6	-	19 6
Infrastructure renewals expenditure		(96.9)	-	(96 9)	(104 5)	-	(104 5)
Disposal of fixed assets		19.6	-	19 6	6 7	-	6 7
Net cash inflow from investing activities		(461.9)	-	(461 9)	(565 0)	(0 8)	(565 8)
Equity dividends paid		(149 8)	(3 8)	(153 6)	(166 4)	(3 6)	(170 0)
Net cash outflow before management of liquid resources and financing		(18 7)	-	(18 7)	(155 4)	-	(155 4)
Management of liquid resources		(2 3)	-	(2 3)	145 4	-	145 4
Net cash flow before financing		(21 0)	-	(21 0)	(10 0)	-	(10 0)
Financing							
Finance leases repaid		(47.3)	-	(47 3)	(43 2)	-	(43 2)
Loans advanced		528.4	-	528 4	195 5	-	195 5
Closed out swap		20.5	-	20 5	-	-	-
Loans repaid		(477.4)	-	(477 4)	(147 7)	-	(147 7)
Purchase of shares		(1 9)	-	(1 9)	(2 2)	-	(2 2)
		22.3	-	22 3	2 4	-	2 4
Net increase/(decrease) in cash		1 3	-	1 3	(7 6)	-	(7 6)

Reconciliation of net cash flow to movement in net debt

	2011 Appointed business £m	2011 Non-appointed business £m	2011 Total £m	2010 Appointed business £m	2010 Non-appointed business £m	2010 Total £m
Net increase/(decrease) in cash as above	1.3	-	1 3	(7 6)	-	(7 6)
Cash flow from movement in net debt	(3.8)	-	(3 8)	(4 6)	-	(4 6)
Cash flow from movement in liquid resources	2.3	-	2 3	(145 4)	-	(145 4)
Change in net debt resulting from cash flows	(0 2)	-	(0 2)	(157 6)	-	(157 6)
Rolled up interest on net debt	(51.7)	-	(51 7)	(15 2)	-	(15 2)
Termination of financial instruments	(44.2)	-	(44 2)	-	-	-
Increase in net debt	(96.1)	-	(96 1)	(172 8)	-	(172 8)
Opening net debt	(3,869 4)	-	(3,869 4)	(3,696 6)	-	(3,696 6)
Closing net debt	(3,965.5)	-	(3,965 5)	(3,869 4)	-	(3,869 4)

Notes to the current cost financial statements

Year ended 31 March 2011

1 Regulatory reporting

The regulatory accounts as reported on pages 59 to 73 should be read in conjunction with the operating and financial review on pages 5 to 18 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 20 and 22 of the Directors' report which sets out the link between Directors' pay and standards of performance and page 24 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 2006

b) General

The accounting policies used are the same as those adopted in the statutory historical cost financial statements on pages 33 to 35, except as set out below

c) Operating costs

Income relating to electricity generation is deducted from operating costs The difference between this treatment and that adopted in the statutory accounts is described on page 61

d) 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 2008 was undertaken during 2008/09 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 in note 1d) to the UK GAAP financial statements

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 of the Water and Sewerage Undertakers

e) 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

2 Accounting policies continued

f) 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

	2011			2010		
	Water services £m	Sewerage services £m	Total £m	Water services £m	Sewerage services £m	Total £m
Unmeasured - household	339.8	350 5	690 3	328 9	375 2	704 1
Unmeasured - non-household	4.0	8 7	12 7	3 0	7 0	10 0
Unmeasured	343 8	359 2	703.0	331 9	382 2	714 1
Measured - household	159 4	147 6	307 0	142 4	148 6	291 0
Measured - non-household	128 7	148 3	277 0	124 3	156 4	280 7
Measured	288 1	295 9	584 0	266 7	305 0	571 7
Trade effluent	-	11.0	11 0	-	11 1	11 1
Larger user tariffs and special agreements	28 7	32 0	60 7	25 4	33 5	58 9
Revenue grants	-	0 4	0 4	-	0 6	0 6
Rechargeable works	0.9	-	0 9	1 1	-	1 1
Bulk supplies/inter-company	4 7	-	4 7	4 7	-	4 7
Other	4 0	-	4 0	4 0	-	4 0
Third parties	9 6	-	9 6	9 8	-	9 8
Other sources	1 1	2 3	3 4	1 3	2 7	4 0
Total turnover	671 3	700 8	1,372 1	635 1	735 1	1,370 2

b) Other operating income

	2011			2010		
	Water services £m	Sewerage services £m	Total £m	Water services £m	Sewerage services £m	Total £m
Current cost profit on disposal of tangible fixed assets	5 7	6 2	11 9	2 2	2 1	4 3

c) Working capital adjustment

	2011			2010		
	Water services £m	Sewerage services £m	Total £m	Water services £m	Sewerage services £m	Total £m
Working capital adjustment	0 2	0 2	0 4	(0 1)	(0 2)	(0 3)

3 Analysis of current cost turnover and operating costs continued

d) Analysis of operating costs and tangible fixed assets

2011	Water services: Resources and treatment £m	Water services: Distribution £m	Water services: Water supply subtotal £m	Sewerage services: Sewerage £m	Sewerage services: Sewerage treatment £m	Sewerage services: Sludge treatment and disposal £m	Sewerage services: Sewerage service total £m
Direct costs							
Employment costs	12 2	22 5	34 7	12 1	17 8	7 5	37 4
Power	11 1	20 0	31 1	4 0	9 5	(5 8)	7 7
Hired and contracted services	5 3	25 7	31 0	9 6	8 8	14 6	33 0
Associated companies	1 3	0 1	1 4	-	0 2	-	0 2
Materials and consumables	10 3	6 4	16 7	2 0	10 4	8 7	21 1
Service charges	12 4	-	12 4	3 6	6 0	0 1	9 7
Bulk supply imports	10 1	-	10 1	-	-	-	-
Other direct costs	0 6	3 6	4 2	1 0	0 2	0 2	1 4
Total direct costs	**63.3**	**78.3**	**141 6**	**32 3**	**52 9**	**25 3**	**110.5**
General and support expenditure	19 4	30 5	49 9	13 8	16 9	19 2	49 9
Functional expenditure	**82.7**	**108 8**	**191 5**	**46 1**	**69 8**	**44 5**	**160.4**
Business activities							
Customer services			21 0				23 7
Scientific services			7 0				5 0
Other business activities			3 4				3 4
			222 9				**192 5**
Local authority rates			38 1				20 5
Doubtful debts			15 5				16 3
Exceptional items			5 2				7 8
			281 7				**237 1**
Services for third parties			9 7				1 8
Total operating expenditure			**291 4**				**238 9**
Capital maintenance							
Infrastructure renewals charge	1 0	76 5	77 5	36 4	-	-	36 4
Current cost depreciation	58 7	52 4	111 1	33 6	94 7	41 5	169 8
Amortisation of deferred income			(1 3)				(1 6)
			187 3				**204 6**
Services for third parties depreciation			0 1				-
Total capital maintenance			**187 4**				**204 6**
Total operating costs			**478 8**				**443 5**
Analysis of tangible fixed assets							
Service activities	2,853 2	11,943 4	14,796 6	31,371 0	1,732 8	252 6	33,356 4
Business activities	-	-	186 9	68 5	102 0	16 7	187 2
Service totals			**14,983 5**				**33,543.6**
Services for third parties			197 2				-
Total tangible fixed assets			**15,180 7**				**33,543 6**

Included within customer service costs is £3 5 million (2010 £3 5 million) payable to the Severn Trent 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

3 Analysis of current cost turnover and operating costs continued

d) Analysis of operating costs and tangible fixed assets continued

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 costs 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

	Water services			Sewerage services			
2010	Resources and treatment £m	Distribution £m	Water supply subtotal £m	Sewerage £m	Sewerage treatment £m	Sludge treatment and disposal £m	Sewerage service total £m
Direct costs							
Employment costs	5 9	18 5	24 4	9 1	10 4	4 9	24 4
Power	11 5	18 9	30 4	5 8	10 4	(4 6)	11 6
Hired and contracted services	4 3	17 9	22 2	6 7	4 5	15 6	26 8
Associated companies	1 1	0 1	1 2	-	-	-	-
Materials and consumables	8 3	3 9	12 2	1 0	3 9	8 0	12 9
Service charges	11 9	-	11 9	2 8	5 7	-	8 5
Bulk supply imports	10 2	-	10 2	-	-	-	-
Other direct costs	0 4	3 2	3 6	1 5	0 4	0 2	2 1
Total direct costs	**53 6**	**62 5**	**116 1**	**26 9**	**35 3**	**24 1**	**86 3**
General and support expenditure	28 3	27 6	55 9	17 5	33 4	13 1	64 0
Functional expenditure	**81 9**	**90 1**	**172 0**	**44 4**	**68 7**	**37 2**	**150 3**
Business activities							
Customer services			20 3				23 0
Scientific services			6 8				5 9
Other business activities			3 3				3 3
			202 4				**182 5**
Local authority rates			39 3				18 1
Doubtful debts			15 7				18 2
Exceptional items			18 7				17 5
			276 1				**236 3**
Services for third parties			10 8				1 0
Total operating expenditure			**286 9**				**237 3**
Capital maintenance							
Infrastructure renewals charge	1 6	60 1	61 7	36 2	-	-	36 2
Current cost depreciation	51 8	51 3	103 1	36 6	103 4	32 2	172 2
Amortisation of deferred income			(1 4)				(1 7)
			163 4				**206 7**
Services for third parties depreciation			0 1				-
Total capital maintenance			**163 5**				**206 7**
Total operating costs			**450 4**				**444 0**
Analysis of tangible fixed assets							
Service activities	1,798 4	7,779 8	9,578 2	19,497 0	1,769 0	368 6	21,634 6
Business activities	-	-	180 9	66 1	94 4	19 7	180 2
Service totals			**9,759 1**				**21,814 8**
Services for third parties			187 1				-
Total tangible fixed assets			**9,946 2**				**21,814 8**

3 Analysis of current cost turnover and operating costs continued

e) Reactive and planned maintenance

Expenditure on reactive and planned maintenance included in operating costs for 2011 in respect of infrastructure assets amounted to £52 9 million on water services (2010 £26 1 million) and £10 2 million for sewerage services (2010 £11 8 million)

Expenditure on reactive and planned maintenance included in operating costs for 2011 in respect of non-infrastructure assets amounted to £15 7 million on water services (2010 £10 7 million) and £24 9 million for sewerage services (2010 £30 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	Infrastructure assets £m	Other assets £m	Total £m
Gross replacement cost					
At 1 April 2010	2,568 0	150 8	8,603 3	418 4	11,740 5
RPI and other adjustments	641 2	10 1	4,956 7	(13 6)	5,594 4
Additions	68 0	4 1	34 8	13 1	120 0
Disposals and amounts written off	(5 3)	(1 9)	-	(21 6)	(28 8)
At 31 March 2011	**3,271 9**	**163 1**	**13,594 8**	**396 3**	**17,426 1**
Depreciation					
At 1 April 2010	1,473 4	43 8	-	277 1	1,794 3
RPI and other adjustments	390 8	(5 5)	-	(18 0)	367 3
Charge for the year	83 3	2 1	-	25 7	111 1
Disposals and amounts written off	(5 4)	(0 9)	-	(21 0)	(27 3)
At 31 March 2011	**1,942 1**	**39 5**	**-**	**263 8**	**2,245 4**
Net book value					
At 31 March 2011	**1,329 8**	**123 6**	**13,594 8**	**132 5**	**15,180 7**
At 1 April 2010	1,094 6	107 0	8,603 3	141 3	9,946 2

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

b) Sewerage services tangible fixed assets analysed by asset type

	Specialised operational assets £m	Non-specialised operational assets £m	Infrastructure assets £m	Other assets £m	Total £m
Gross replacement cost					
At 1 April 2010	4,953 9	169 5	19,102 7	385 5	24,611 6
RPI and other adjustments	(319 9)	(4 2)	11,830 8	(14 0)	11,492 7
Additions	142 7	5 0	89 4	24 2	261 3
Disposals and amounts written off	(43 9)	(3 1)	(0 5)	(21 7)	(69 2)
At 31 March 2011	**4,732 8**	**167 2**	**31,022 4**	**374 0**	**36,296 4**
Depreciation					
At 1 April 2010	2,506 9	42 0	-	247 9	2,796 8
RPI and other adjustments	(126 1)	(5 5)	-	(19 0)	(150 6)
Charge for the year	140 7	2 1	-	27 0	169 8
Disposals and amounts written off	(41 3)	(0 9)	-	(21 0)	(63 2)
At 31 March 2011	**2,480 2**	**37 7**	**-**	**234 9**	**2,752 8**
Net book value					
At 31 March 2011	**2,252 6**	**129 5**	**31,022 4**	**139 1**	**33,543 6**
At 1 April 2010	2,447 0	127 5	19,102 7	137 6	21,814 8

c) Total tangible fixed assets analysed by asset type

	Specialised operational assets £m	Non-specialised operational assets £m	Infrastructure assets £m	Other assets £m	Total £m
Gross replacement cost					
At 1 April 2010	7,521 9	320 3	27,706 0	803 9	36,352 1
RPI and other adjustments	321 3	5 9	16,787 5	(27 6)	17,087 1
Additions	210 7	9 1	124 2	37 3	381 3
Disposals and amounts written off	(49 2)	(5 0)	(0 5)	(43 3)	(98 0)
At 31 March 2011	**8,004.7**	**330 3**	**44,617 2**	**770 3**	**53,722 5**
Depreciation					
At 1 April 2010	3,980 3	85 8	-	525 0	4,591 1
RPI and other adjustments	264 7	(11 0)	-	(37 0)	216 7
Charge for the year	224 0	4 2	-	52 7	280 9
Disposals and amounts written off	(46 7)	(1 8)	-	(42 0)	(90 5)
At 31 March 2011	**4,422 3**	**77 2**	**-**	**498 7**	**4,998 2**
Net book value					
At 31 March 2011	**3,582 4**	**253.1**	**44,617 2**	**271 6**	**48,724 3**
At 1 April 2010	3,541 6	234 5	27,706 0	278 9	31,761 0

5 Working capital

	2011 £m	2010 £m
Stocks	**6 3**	6 4
Trade debtors		
Measured household	**36 0**	33 1
Unmeasured household	**64 5**	55 8
Measured non-household	**24 4**	30 2
Unmeasured non-household	**0 9**	1 0
Other	**2 0**	3 1
Measured income accrual	**139 9**	134 5
Prepayments and other debtors	**64.9**	52 9
Trade creditors	**(12 2)**	(8 2)
Deferred income - customer advance receipts	**(124 7)**	(120 0)
Capital creditors and accruals	**(42 9)**	(124 7)
Accruals and other creditors	**(70 0)**	(72 3)
Working capital	**89 1**	(8 2)

6 Reserves – profit and loss account

	2011 £m	2010 £m
At 1 April	**(327 7)**	(427 1)
Retained current cost profit for the year	**272 3**	175 5
Share based payments	**2 8**	2 9
FRS 17 actuarial gain/(loss)	**37 1**	(109 8)
Tax (credit)/charge on actuarial gain/loss	**(15 8)**	30 8
At 31 March	**(31 3)**	(327 7)

7 Reserves – current cost reserve

	2011 £m	2010 £m
At 1 April	**24,582 1**	23,473 0
AMP adjustment	**14,432 1**	-
RPI adjustments		
Fixed assets	**2,438 3**	1,313 7
Working capital	**(0 4)**	0 3
Financing	**(169 3)**	(130 8)
Grants and third party contributions	**(96 2)**	(74 1)
At 31 March	**41,186 6**	24,582 1

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

	2011 £m	2010 £m
Current cost operating profit	**462 1**	479 8
Working capital adjustment	**(0 4)**	0 3
Working capital changes	**(15 5)**	(39 0)
Other income	**1 7**	2 0
Current cost depreciation after amortisation of deferred income	**278 1**	272 3
Current cost profit on disposal of tangible assets	**(11 9)**	(4 3)
Infrastructure renewals charge	**113 9**	97 9
Other non-cash profit and loss items	**(6 2)**	(1 9)
Net cash inflow from operating activities	**821 8**	807 1

9 Analysis of net debt

Interest rate risk profile

	Fixed interest rate £m	Floating interest rate £m	Index-linked rate £m	Total £m
Maturity profile				
Less than one year	13 5	101 4	-	114 9
Between one and two years	16 4	43 4	-	59 8
Between two and five years	818 3	147 4	152 7	1,118 4
Between five and twenty years	1,395 4	320 0	163 5	1,878 9
In more than twenty years	15 9	-	788 1	804 0
Total borrowings	**2,259 5**	**612 2**	**1,104 3**	**3,976 0**
Impact of interest rate swaps entered into by the group and company	237 3	(237 3)	-	-
Total borrowings after the impact of interest rate swaps	**2,496 8**	**374 9**	**1,104 3**	**3,976 0**
Short term deposits and cash at bank and in hand	-	(10 5)	-	(10 5)
Net Debt as at 31 March 2011	**2,496 8**	**364.4**	**1,104 3**	**3,965 5**
Total borrowings after the impact of interest rate swaps as at 31 March 2010	-	(6 8)	-	(6 8)
Short term deposits and cash at bank and in hand	2,730 6	84 6	1,054 2	3,869 4
Net Debt as at 31 March 2010	2,730 6	84 6	1,054 2	3,869 4

Fixed interest debt incurs interest at a weighted average rate of 5 9% (2010 5 8%) Interest on these borrowings is fixed for a weighted average period of 9 8 years (2010 11 5 years)

10 Reconciliation of HCA operating profit to CCA operating profit

	2011 £m	2010 £m
HCA operating profit per regulatory accounts	**507 1**	523 1
Less non appointed activities	**(3 4)**	(3 2)
Sub total HCA accounts	**503 7**	519 9
Less difference in profit on disposals	**(4 5)**	-
Add back working capital adjustment	**0.4**	(0 3)
Add HCA depreciation including infrastructure renewals charge	**357 3**	333 5
Less CCA depreciation	**(280.9)**	(275 4)
Less infrastructure renewals charge	**(113.9)**	(97 9)
CCA operating profit	**462 1**	479 8

As in previous years the principal reconciling item between the historical cost profit and the current cost profit is the difference in depreciation charges

11 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 Values (RCV)

The projected outturn for the company's RCV from the December 2009 determination is as follows

At 31 March	2011 £m	2012 £m	2013 £m	2014 £m	2015 £m
Per determination (at 2007/08 prices)	6,114	6,141	6,177	6,236	6,279
Actual/estimated outturn (at average prices)	6,638	6,977	7,233	7,545	7,841

Regulatory capital values at 2010/11 prices

	2011 £m
Opening regulatory capital value for the year	**6,275**
Indexation	**311**
Opening regulatory capital value at average 2010/11 prices	**6,586**
Capital expenditure	**416**
Infrastructure renewals expenditure	**135**
Grants and contributions	**(22)**
Depreciation	**(308)**
Infrastructure renewals charge	**(125)**
Outperformance of regulatory assumptions	**(44)**
Closing regulatory capital value	**6,638**
Average regulatory capital value	**6,612**

The RCVs in this table are based on those published by Ofwat in its letter RD04/10, inflated to 2010/11 prices The value of the RCV is protected against inflation by increasing the value each year by RPI The opening RCV for the year has decreased by £72m compared to the prior year closing RCV following Ofwat's reassessment in the December 2009 determination

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 benefits 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

Supplementary regulatory accounting disclosures – unaudited

Year ended 31 March 2011

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 and repaid by the appointee during the year from associated companies were

		Principal amounts £m	Repayment dates	Interest rates %
Severn Trent Reservoirs Limited	Borrowed	0 7	October 2011	3 Months LIBID
Severn Trent Plc	Borrowed	357 2	April 2010 to March 2011	LIBOR + 0 19%
Severn Trent Plc	Repaid	456 2	April 2010 to March 2011	LIBOR + 0 19%

b) Dividends

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 factors changes The ordinary dividend declared and paid by the company in 2010/11 amounted to £153 6 million (2010 £170 million), being 15 4p per share (2010 17 0p per share)

c) Transfer of assets/liabilities

During the year, the appointee made disposals to associated businesses of freehold land and property with a total current cost net book value of £5 5 million Transfer prices were approved by Ofwat prior to the transactions taking place

d) Supply of services

Services supplied by the appointee to associated companies

Nature of transactions	Company	Terms	£m
Rental and office accommodation	Various	Market rent	0 0
Service charges in respect of payroll, legal, transport and other	Various	Cost	0 6
Water, tankering, reception, treatment and disposal of waste	Various	Market rent	0 5
			1 1

Services supplied to the appointee by associated companies

Nature of transactions	Company	Competitive letting £m	Other market testing £m	No market £m	**Total turnover £m**
Asset management	Cognica Ltd	0 1	-	-	**0 1**
Insurance services	Derwent Insurance Ltd	-	5 4	-	**5 4**
Analytical services	Severn Trent Laboratories Ltd	4 8	-	-	**4 8**
Meter installation and maintenance	Severn Trent Metering Services Ltd	7 4	-	-	**7 4**
Supply of materials and other engineering services	Severn Trent Services Ltd	0 8	-	1 0	**1 8**
Supply of Electricity	Severn Trent Green Power	-	0 4	-	**0 4**
Pass through costs	Severn Trent Plc	-	-	1 1	**1 1**
		13 1	5 8	2 1	**21 0**

Of the £21 0 million, £6 0 million was spent on investment expenditure

e) Omission rights

None

f) Waivers

None

g) Guarantees

None

Supplementary annual report disclosures – unaudited

Year ended 31 March 2011

Delivering against our Key Performance Indicators (KPIs)

Basis	KPI	2009/10 Performance	2010/11 Performance	2010/11 Quartile	At a glance
MAT	Lost time incidents per 100,000 hrs worked [1]	0 36	**0 37**	**Upper**	**—**
QR	Employee motivation % [2]	74%	**74%**	**Lower**	**▼**
MAT	Water quality (test failure rate) ppm	131	**210**	**Upper**	**—**
MAT	Customer written complaints per 1,000 properties [3,4]	4 95	**5.73**	**Upper**	**—**
MAT	First time call resolution for billing % [5]	89%	**90%**	**Median**	**—**
MAT	Unplanned interruptions > 6 hrs per 1,000 properties [3]	10 09	**23 85**	**Lower**	**—**
NPR	Properties at risk of low pressure per 1,000 properties [3]	0 12	**0 07**	**Upper**	**▲**
MAT	First time job resolution % [5]	96 5%	**97 5%**	**Upper**	**—**
QR	Non-performance against Regulatory Obligations % [5]	5%	**4%**	**Upper**	**—**
AMP	Capex (Gross) vs Final Determination % [6,14]	6 1%	**7 4%**	**N/A**	**N/A**
ACT	Debtor days [7]	32 6	**33 8**	**Median**	**—**
ACT	Opex - £m [6,7]	492 4	**519 0**	**N/A**	**N/A**
MAT	Pollution incidents (cat 1, 2, & 3) [8,9]	322	**378**	**Median**	**—**
MAT	Sewer flooding incidents – other causes per 1,000 properties [13]	0 131	**0 103**	**Upper**	**—**
ACT	Sewage Treatment Works – failing consents limit % [9,10]	1 80%	**1 69%**	**Lower**	**—**
ACT	Supply availability [11]	91 9%	**94 4%**	**Lower**	**—**
MAT	Net Energy Use – GWh [5,12]	714	**706**	**Upper**	**—**
MLE	Leakage Ml/d [3,6]	497	**497**	**N/A**	**N/A**

Key

▲ Improved quartile
— Maintained quartile
▼ Declined quartile

Notes

Benchmarks updated in September

MAT = Moving Annual Total
QR = Quarterly Review
NPR = Number of Properties on Register
AMP = Asset Management Plan[5] to date
PPS = Percentage of Population Served
MLE = Maximum Likelihood Estimate
ACT = Year end Actual

1 Actual performance across all employees and agency staff
2 Performance based on annual survey of all employees (09/10 based on sample of 10% of STW 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 10 June 2011
4 Performance excludes properties billed by other water companies
5 Actual performance based wholly or partially on internal data
6 As this is the first year of AMP5, benchmark data is unavailable until September 2011
7 Actual performance based on audited UK GAAP financial statements for the year ended 31 March 2011
8 Metrics of this KPI changed from pollution incidents per 1,000 properties to number of pollution incidents Prior year performance has been restated accordingly
9 Measure for calendar year to 31 December 2010
10 Metrics of this KPI changed to align with Environment Agency approach Prior year performance has been restated accordingly
11 Metrics of this KPI changed from security of supply to supply availability Prior year performance has been restated accordingly The KPI measures how much of our designed capacity is available taking into account known restrictions and works outages There were no supply failures resulting from works restrictions during the year
12 Metrics of this KPI changed from kWh/Ml to GWh Prior year performance has been restated accordingly
13 Excludes minor escape of sewage
14 Percentage outperformance against the Final Determination