

**SOUTHERN WATER SERVICES LIMITED**

**DIRECTORS' REPORT  
AND ACCOUNTS FOR THE YEAR ENDED  
31 MARCH 2003**

Registered No. 2366670

4/8/03  
280.



**SOUTHERN WATER SERVICES LIMITED**

**Directors' Report and Accounts for the year  
ended 31 March 2003**

<b>Contents</b>	<b>Page</b>
Report of the Directors	1
Profit and Loss Account	5
Balance Sheet	6
Notes to the Accounts	7
Report of the Auditors	27

## **REPORT OF THE DIRECTORS**

The directors present their report and the audited Accounts for the year ended 31 March 2003.

## **RESULTS AND DIVIDEND**

The profit after taxation for the financial year amounted to £63.6 million (2002: £93.0 million). The directors recommend a final dividend of £nil per ordinary share (2002: £nil) which together with an interim dividend totalling £1,214 per ordinary share (2002: £nil) gives a total dividend of £1,214 per ordinary share for the year (2002: £nil). The retained loss for the year of £4.4 million (2002: Profit £93.0 million) has been transferred to reserves.

## **PRINCIPAL ACTIVITIES AND REVIEW OF THE BUSINESS**

The principal activities of the company are the provision of water supply and wastewater services in the south-east of England.

Turnover in 2002/03 increased by 1.8% to £436.5m (2001/02 £428.9m) resulting from an increase in charges and new growth. Operating costs, before exceptional items, increased by 17% in 2002/03 to £255.9m (2001/02 £217.7m) representing the effects of inflation together with increases in depreciation and bad debts and costs arising from newly commissioned schemes and new regulatory obligations offset by operating efficiencies.

The company is undertaking a major refinancing project which, it is anticipated, will be completed during the financial year 2003/2004.

## **RESEARCH AND DEVELOPMENT**

The improvement of existing services and processes, together with the identification and development of new technology and solutions, are key aspects of the company's strategy to enhance the quality of service to customers and improve methods of working. Research and development expenditure for the year amounted to £1.8 million (2002: £2.0 million).

## SOUTHERN WATER SERVICES LIMITED

### **DIRECTORS AND THEIR INTERESTS**

The directors who held office at 31 March 2003 were as follows:

Anthony Nelson (Chairman - appointed 23 April 2002, resigned 7 May 2003)  
Martin Baggs  
Prof Christopher Chapman  
Barrie Delacour  
Stuart Derwent  
Anthony Fegan  
John Harris  
Eric Hutchinson (Resigned 30 May 2003)  
David Stainthorpe

None of the directors who held office at the end of the financial year had any disclosable interests in the shares of the company.

### **POST BALANCE SHEET EVENTS**

On 7 May 2003, the ultimate parent undertaking, First Aqua Holdings Limited, sold its entire interest in the ordinary shares of Southern Water Services (Finance) Limited (formerly First Aqua (JV Co) Limited) (an intermediate parent company) to Southern Water Capital Limited.

From 7 May 2003, the directors regard Southern Water Capital Limited as the ultimate holding company. Southern Water Capital Limited is majority owned by Royal Bank of Scotland plc.

On 7 May 2003 Bob Thian was appointed as Non-Executive Chairman and Rory Cullinan, Cyril Roger-Lacan, Jean Claude Banon and François Darley were appointed as Non-Executive Directors.

### **DIRECTORS' RESPONSIBILITIES**

Company law requires the directors to prepare accounts for each financial period which give a true and fair view of the state of affairs of the company as at the end of the financial period and of the profit or loss of the company for that period. In preparing those accounts, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the accounts.
- prepare the accounts on a going concern basis unless it is inappropriate to presume that the group will continue in business.

## **DIRECTORS' RESPONSIBILITIES (continued)**

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the accounts comply with the Companies Act 1985. The directors are responsible for the maintenance and integrity of the website. Uncertainty regarding legal requirements is compounded as information published on the internet is accessible in many countries with different legal requirements relating to the preparation and dissemination of financial statements. 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.

## **EMPLOYEES**

The company has developed its communications processes with its employees to ensure greater understanding of and involvement in the business. This has been achieved through the "Waterline" staff magazine, produced to complement "Southern Water News", and by staff briefings.

The Southern Water Learning business is now firmly established with programmes for school leavers and the long-term unemployed to work alongside and learn from our employees. The Open Learning facilities at all the main company locations reinforce the commitment of the company to providing learning opportunities.

The company continues to work actively with the trade unions and meets with them at senior management level on a regular basis. Key issues for consideration include business reorganisations, consultation on employment policy and discussion of key health and safety issues. As a result of recent changes in the business structure, the company is currently carrying out a review of the consultation arrangements. The objective of this review will be to ensure that all areas of the new organisation are adequately represented for consultation purposes.

### ***Equal opportunity***

Southern Water Services Limited policy is to promote equality of opportunity in recruitment, employment continuity, training and career development. The policy is designed to ensure that equal opportunity in these areas extends as far as practicable to people with disabilities. The company is a member of the Employer's Forum on Disability, which supports the efforts to meet the needs of the disabled for employment and access to the company and its buildings.

## SOUTHERN WATER SERVICES LIMITED

### **EMPLOYEES (continued)**

#### ***Health and safety***

Every employee receives a copy of the corporate policy statement on health and safety. There are regular meetings of employee representatives and managers to consider all aspects of health and safety, and there is a health and safety management review group which ensures that there is an adequate system for meeting the company's responsibilities for health and safety to its staff, customers and members of the public.

Southern Water Services Limited has its own internal occupational health service, including the provision of physiotherapy. These services are being developed to meet the needs of the business and our employees at work.

### **CREDITOR PAYMENT POLICY AND PRACTICE**

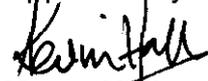
The company's current policy and practice concerning the payment of its trade creditors is to follow the Better Payment Practice Code to which it is a signatory. Copies of the Code may be obtained from the Department of Trade and Industry or from the website [www.payontime.co.uk](http://www.payontime.co.uk).

The company's policy and practice is to settle terms of payment when agreeing the terms of the transaction, to include the terms in contracts and to pay in accordance with its contractual and legal obligations. The company's creditor days at 31 March 2003 were 52 days (2002: 56 days).

### **AUDITORS**

Following the conversion of our auditors PricewaterhouseCoopers to a Limited Liability Partnership (LLP) from 1 January 2003, PricewaterhouseCoopers resigned on 6 March 2003 and the directors appointed its successor, PricewaterhouseCoopers LLP, as auditors. A resolution to reappoint PricewaterhouseCoopers LLP as auditors to the company will be proposed at the annual general meeting.

Approved by the Board of Directors and signed on behalf of the Board.



**Kevin Hall**

Secretary

15 July 2003

SOUTHERN WATER SERVICES LIMITED

**PROFIT AND LOSS ACCOUNT**

For the year ended 31 March 2003

	Notes	2003 £m	2002 £m
<b>Turnover</b>	1,2,3	<b>436.5</b>	428.9
Cost of sales	3	<b>(230.7)</b>	(195.9)
<b>Gross profit</b>		<u><b>205.8</b></u>	<u>233.0</u>
Administrative expenses – Normal	3	<b>(26.7)</b>	(23.4)
– Exceptional	4	-	(9.6)
Total administrative expenses		<u><b>(26.7)</b></u>	<u>(33.0)</u>
Other operating income	3	<b>1.5</b>	1.6
<b>Operating profit and profit on ordinary activities before interest and taxation</b>	5	<u><b>180.6</b></u>	<u>201.6</u>
Profit on disposal of fixed assets		<b>8.8</b>	1.6
Net interest and similar charges – Normal	7	<b>(76.3)</b>	(71.9)
– Exceptional	4,7	<b>(14.0)</b>	-
Total net interest and similar charges		<u><b>(90.3)</b></u>	<u>(71.9)</u>
<b>Profit on ordinary activities before taxation</b>	5	<u><b>99.1</b></u>	<u>131.3</u>
Tax on profit on ordinary activities	8	<b>(35.5)</b>	(38.3)
<b>Profit on ordinary activities after taxation</b>	19	<u><b>63.6</b></u>	<u>93.0</u>
Dividends	9,19	<b>(68.0)</b>	-
<b>Retained (loss)/profit for the financial year</b>	19	<u><u><b>(4.4)</b></u></u>	<u><u>93.0</u></u>

The above results relate entirely to continuing operations. There were no recognised (losses)/profits other than the retained (losses)/profits for the periods presented. The company has no recognised gains and losses other than those included in the loss above and therefore no separate statement of total recognised gains and losses has been presented.

The Notes on pages 7 to 26 form part of these Accounts.

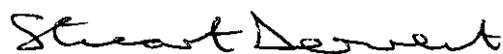
SOUTHERN WATER SERVICES LIMITED

**BALANCE SHEET**

As at 31 March 2003

	Notes	2003 £m	2002 £m
<b>Fixed assets</b>			
Tangible assets	10	2,631.9	2,504.8
Investments	11	-	-
		2,631.9	2,504.8
<b>Current assets</b>			
Stocks	12	1.8	4.1
Debtors: amounts falling due within one year	13	97.8	111.8
		99.6	115.9
<b>Creditors: amounts falling due within one year</b>	14	(1,516.5)	(939.5)
<b>Net current liabilities</b>		(1,416.9)	(823.6)
<b>Total assets less current liabilities</b>		1,215.0	1,681.2
<b>Creditors: amounts falling due after more than one year</b>	15	-	(482.1)
<b>Provision for liabilities and charges</b>	16	(372.2)	(355.2)
<b>Grants and contributions</b>	17	(40.7)	(37.4)
<b>Net assets</b>		802.1	806.5
<b>Capital and reserves</b>			
Called up share capital	18	0.1	0.1
Share premium	19	46.3	46.3
Profit and loss account	19	755.7	760.1
<b>Total equity shareholder's funds</b>		802.1	806.5

The Accounts on pages 5 to 26 were approved by the Board on 15 July 2003 and signed on its behalf by:



**Stuart Derwent**  
Managing Director

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2003

**1 Accounting policies**

**Basis of accounting**

The Accounts have been prepared under the historical cost convention and in accordance with applicable accounting standards and, subject to the treatment of infrastructure grants and contributions described below, with the requirements of the Companies Act 1985.

**Basis of preparation**

The Accounts contain information about Southern Water Services Limited as an individual company and do not contain consolidated financial information as the parent of subsidiary companies. The company is exempt under section 228 of the Companies Act 1985 from the requirement to prepare consolidated accounts as it and its subsidiary undertaking are included by full consolidation in the *consolidated Accounts of an intermediate holding company, Southern Water Services Group Limited (formerly First Aqua Limited)*.

The 2002 comparative for turnover has been restated from £429.9m to £428.9m to reflect the reclassification of £1m of income arising from aerial masts into other operating income. This is to ensure consistency with current year classifications.

**Statement of cash flows**

The company has taken an exemption, as allowed by Financial Reporting Standard 1, not to publish a cash flow statement as an intermediate parent company, Southern Water Services Group Limited (formerly First Aqua Limited), publishes full statutory consolidated Accounts.

**Turnover**

Turnover represents the income receivable (excluding value added tax) in the ordinary course of the business for goods and services provided and, in respect of unbilled charges, includes an accrual for measured and unmeasured income.

Measured income arises from customers who have meters fitted at their premises. Therefore amounts billed are based on actual water consumption. Unmeasured income bills are based on the rateable value of properties.

The income accrual is an estimation of the amount of main water and wastewater charges unbilled at the year end. The accrual is estimated using a defined methodology based upon weighted average tariffs and historical billing and consumption information.

**Bad Debts**

The bad debt provision is calculated based on applying expected recovery rates to an aged debt profile.

## SOUTHERN WATER SERVICES LIMITED

### NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2003

#### 1 Accounting policies (continued)

##### Research and development

Expenditure on research and development is charged to the profit and loss account as it is incurred.

##### Tangible fixed assets

- i) Infrastructure assets (being mains and sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls) comprise a network of systems.

Expenditure on infrastructure assets relating to increases in capacity or enhancement of the network and on maintaining the operating capability of the network in accordance with defined standards of service, is treated as an addition to fixed assets and is stated at cost after deducting grants and contributions. Staff costs represent those costs directly related to the construction of a specific infrastructure asset and are capitalised as part of infrastructure assets on the basis of the amount of time spent by individuals on capital projects.

The depreciation charge for infrastructure assets is the estimated level of annualised expenditure required to maintain the operating capability of the network and is based on the asset management plan determined by the water industry regulator as part of the price regulation process. The asset management plan is developed from historical experience combined with a rolling programme of reviews of the condition of the infrastructure assets.

- ii) Other assets (including overground assets, plant and equipment) are stated at cost less accumulated depreciation. Other assets are depreciated on the straight-line method over their estimated operating lives which are principally as follows:

	Years
Buildings	10 - 60
Operational structures	15 - 80
Fixed plant	10 - 40
Vehicles, computers and mobile plant	3 - 10

Operational structures are assets used for wastewater and water treatment purposes. These include water tanks and similar assets.

- iii) Freehold land is not depreciated.

Assets in the course of construction are not depreciated until they are commissioned. Commissioning is deemed to occur when a new works is officially taken over from the contractor following completion of performance and take-over tests.

**NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2003**

**1 Accounting policies (continued)**

**Grants and contributions**

Capital grants and customer contributions in respect of additions to non-infrastructure fixed assets are treated as deferred income and released to the profit and loss account over the estimated operational lives of the related assets in accordance with the provisions of the Companies Act.

Grants and Capital contributions received relating to infrastructure assets have been deducted from the cost of fixed assets as permitted by Statement of Standard Accounting Practice (SSAP) 4. This is not in accordance with Schedule 4 of the Companies Act 1985 which requires fixed assets to be stated at their purchase price or production cost. The Act does not permit the deduction of contributions, hence these would have been accounted for as deferred income.

*This departure from the requirements of the Act is, in the opinion of the directors, necessary for the Accounts to give a true and fair view because infrastructure assets do not have determinable finite lives. Accordingly related capital contributions would not be recognised in the profit and loss account. The effect of this treatment on tangible fixed assets is disclosed in note 10.*

Revenue grants and contributions are credited to the profit and loss account in the year to which they relate.

**Leased assets**

Fixed assets leased to the company under finance leases are capitalised and depreciated in line with the company's depreciation policy. The interest element of finance lease repayments is charged to the profit and loss account in proportion to the balance of the capital repayments outstanding.

Rentals payable under operating leases are charged to profit and loss account as incurred.

**Stocks**

Stocks are valued at the lower of cost and net realisable value.

**Taxation**

Deferred taxation is provided on all timing differences that have originated but not reversed by the balance sheet date, calculated at the rate at which it is expected the tax will arise in accordance with FRS 19 "Deferred Tax". Deferred taxation balances are not discounted.

**NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2003**

**1 Accounting policies (continued)**

**Pensions**

Southern Water Limited (formerly Southern Water plc) operates pension schemes which cover the majority of the employees of Southern Water Services Limited. A valuation of the defined benefits pension schemes is normally conducted by an independent actuary every three years. In accordance with Statement of Standard Accounting Practice (SSAP) 24, the regular cost of providing pensions and related benefits and any variations from regular cost arising from the actuarial valuations are charged to the profit and loss account over the expected remaining service lives of current employees following consultations with the actuary. Any difference between the charge to the profit and loss account and the actual contributions paid to the pension schemes is included as an asset or liability in the balance sheet.

**Provisions**

A provision is recognised when there is a present obligation, whether legal or constructive, as a result of a past event for which it is probable that a transfer of economic benefits will be required to settle the obligation and a reliable estimate can be made of the obligation.

**2 Segmental Analysis**

The directors believe that the whole of Southern Water Service Limited's activities constitute a single class of business. The company's turnover is generated wholly from within the UK.

**3 Classification of turnover and revenue costs**

Turnover represents the income receivable for providing water supply and wastewater services and is generated wholly in the United Kingdom.

Cost of sales reflects the direct costs of providing water supply and wastewater services. Administrative expenses comprise the indirect costs of the business. Other operating income refers to rents receivable.

**4 Exceptional Items**

During the year ended 31 March 2002, net exceptional costs of £9.6m were incurred, which comprised legal and professional fees arising from the proposed refinancing of the Southern Water group in March 2002.

During the year ended 31 March 2003, a net exceptional finance cost of £14.0m was incurred with respect to the early redemption of the £100m bonds issued by Southern Water Services Finance plc and charged to Southern Water Services Limited.

SOUTHERN WATER SERVICES LIMITED

**NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2003**

**5 Profit on ordinary activities before taxation**

Profit on ordinary activities before taxation is stated after charging/(crediting):	2003 £m	2002 £m
Staff costs (note 6a)	45.5	43.8
Depreciation on		
- owned assets	92.9	75.1
- assets held under finance leases	0.4	0.4
	<u>93.3</u>	<u>75.5</u>
Rentals under operating leases	4.9	5.3
Research and development expenditure	1.8	2.0
Release of grants and contributions (note 17)	(1.9)	(1.6)
Auditors' remuneration for audit work	0.1	0.1
Auditors' remuneration for non-audit services to the company	0.1	0.1

**6 Employee information**

	2003 £m	2002 £m
<b>(a) Employee costs (including directors' emoluments):</b>		
Wages and salaries	50.4	49.4
Social security costs	3.6	3.6
Pension costs	8.0	4.7
	<u>62.0</u>	<u>57.7</u>
Total employee costs		
Less: charged as capital expenditure	(16.5)	(13.9)
	<u>45.5</u>	<u>43.8</u>
Charged to the profit and loss account		

Employee costs that are charged as capital expenditure are those directly related to the construction or acquisition of assets.

	2003 No.	2002 No.
<b>(b) Average number of persons employed</b>		
Operations	1,289	1,399
Project Delivery	115	119
Customer Services	294	271
Corporate Centre	317	244
	<u>2,015</u>	<u>2,033</u>

SOUTHERN WATER SERVICES LIMITED

**NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2003**

**7 Net interest and similar charges**

	<b>2003</b>	<b>2002</b>
	<b>£m</b>	<b>£m</b>
Interest payable on bank loans and overdraft	(1.2)	(2.2)
Interest payable on other loans	(75.1)	(69.9)
Exceptional cost arising due to early redemption of £100m bond by subsidiary (note 4)	(14.0)	-
Total interest payable	<b>(90.3)</b>	<b>(72.1)</b>
Interest receivable	-	0.2
Net interest charge	<b>(90.3)</b>	<b>(71.9)</b>

For the years ended 31 March 2002 and 31 March 2003, the company paid interest of £69.9m and £75.1m respectively to Group companies.

**8 Tax on profit on ordinary activities**

	<b>2003</b>	<b>2002</b>
	<b>£m</b>	<b>£m</b>
<b>Current tax:</b>		
UK corporation tax on profits of the year at 30% (2002:30%)	<b>18.5</b>	20.2
Adjustment in respect of prior years	-	(2.3)
	<b>18.5</b>	<b>17.9</b>
<b>Deferred tax:</b>		
Origination and reversal of timing differences	<b>11.9</b>	20.4
Adjustment in respect of prior years	<b>5.1</b>	-
Total deferred tax	<b>17.0</b>	<b>20.4</b>
Total tax on profit on ordinary activities	<b>35.5</b>	<b>38.3</b>

SOUTHERN WATER SERVICES LIMITED

**NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2003**

**8 Tax on profit on ordinary activities (cont)**

The rate of current tax charge on profit on ordinary activities varied from the standard rate of corporation tax due to the following factors:

	<b>2003</b>	<b>2002</b>
	<b>£</b>	<b>£</b>
<b>Profit on ordinary activities before tax</b>	<b>99.1</b>	<b>131.3</b>
<b>Current tax:</b>		
UK corporation tax rate at 30% (2002: 30%) on profit for the period	<b>29.7</b>	39.4
Adjustments in respect of prior years	-	(2.3)
Other differences	<b>(0.6)</b>	-
Permanent differences	<b>1.3</b>	1.2
<b>Tax charge on ordinary activities</b>	<b>30.4</b>	<b>38.3</b>
Effect of deferred tax	<b>(11.9)</b>	<b>(20.4)</b>
<b>Current tax charge for period</b>	<b>18.5</b>	<b>17.9</b>

**9 Dividends per ordinary share**

	<b>2003</b>	<b>2002</b>	<b>2003</b>	<b>2002</b>
	<b>£ per</b>	<b>£ per</b>	<b>£m</b>	<b>£m</b>
	<b>ordinary</b>	<b>ordinary</b>		
	<b>share</b>	<b>share</b>		
Interim dividend –23 July 2002	<b>482.14</b>	-	<b>27.0</b>	-
Interim dividend –23 Oct 2002	<b>364.29</b>	-	<b>20.4</b>	-
Interim dividend –23 Jan 2003	<b>367.86</b>	-	<b>20.6</b>	-
<b>Total interim dividend</b>	<b>1,214.29</b>	-	<b>68.0</b>	-
Final dividend	-	-	-	-
<b>Total Dividend</b>	<b>1,214.29</b>	-	<b>68.0</b>	-

SOUTHERN WATER SERVICES LIMITED

**NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2003**

**10 Fixed assets and capital commitments**

(a) **Tangible assets**

	Freehold land & buildings	Plant & Machinery	Vehicles & Equipment	Infra- structure assets	Assets in the course of const- ruction	Other	Total
	£m	£m	£m	£m	£m	£m	£m
<b>Cost:</b>							
At 1 April 2002	689.7	710.5	0.7	1,086.9	497.2	256.3	3,241.3
Additions	46.2	83.6	-	71.3	-	29.9	231.0
Transfers	81.2	45.8	-	55.7	(186.6)	3.9	-
Grants & contributions	-	-	-	(10.6)	-	-	(10.6)
Disposals	(0.3)	(0.5)	-	(0.7)	-	(9.8)	(11.3)
<b>At 31 March 2003</b>	<b>816.8</b>	<b>839.4</b>	<b>0.7</b>	<b>1,202.6</b>	<b>310.6</b>	<b>280.3</b>	<b>3,450.4</b>
<b>Depreciation:</b>							
At 1 April 2002	168.8	198.1	0.7	229.4	-	139.5	736.5
Charge for the year	17.8	30.8	-	23.7	-	21.0	93.3
Disposals	(0.3)	(0.5)	-	(0.7)	-	(9.8)	(11.3)
<b>At 31 March 2003</b>	<b>186.3</b>	<b>228.4</b>	<b>0.7</b>	<b>252.4</b>	<b>-</b>	<b>150.7</b>	<b>818.5</b>
<b>Net book value:</b>							
<b>At 31 March 2003</b>	<b>630.5</b>	<b>611.0</b>	<b>-</b>	<b>950.2</b>	<b>310.6</b>	<b>129.6</b>	<b>2,631.9</b>
At 31 March 2002	520.9	512.4	-	857.5	497.2	116.8	2,504.8

Of the additions to infrastructure assets, the amount spent on infrastructure renewals during the years ended 31 March 2002 and 31 March 2003 was £32.9m and £41.0m, respectively. Of the grants and contributions set against infrastructure assets during the years ended 31 March 2002 and 31 March 2003 £6.5m and £8.9m respectively, relates to infrastructure renewals.

For the years ended 31 March 2002 and 31 March 2003, the net book value of infrastructure assets is stated after deducting grants and contributions since privatisation of £115.1m and £125.7m, respectively.

Freehold land is stated at a cost of £39.5m and £40.8m at 31 March 2002 and 31 March 2003, respectively, and is not depreciated.

Other assets relate primarily to computer equipment and meter reading devices.

SOUTHERN WATER SERVICES LIMITED

**NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2003**

**10 Fixed assets and capital commitments (continued)**

Assets held under finance leases are capitalised and included in plant and machinery.

	2003 £m	2002 £m
Cost	11.7	11.7
Aggregate depreciation	<u>(7.1)</u>	<u>(6.7)</u>
Net book amount	<u>4.6</u>	<u>5.0</u>

**(b) Capital commitments**

	2003 £m	2002 £m
In respect of contracts placed	<u>151.3</u>	<u>179.2</u>

**11 Fixed asset investments**

Southern Water Services Limited holds 49,999 of the 50,000 issued shares of Southern Water Services Finance plc, a company incorporated in the UK on 13 March 1998. The principal activity of the company is to raise debt finance. The investment is stated at cost of £49,999 (2002: £49,999).

**12 Stocks**

	2003 £m	2002 £m
Raw materials	1.2	1.1
Work in progress	0.6	3.0
	<u>1.8</u>	<u>4.1</u>

**13 Debtors: amounts falling due within one year**

	2003 £m	2002 £m
Trade debtors	56.2	60.8
Unbilled income	34.8	32.5
Amounts owed by group undertakings	-	14.2
Prepayments	0.1	0.1
Other debtors	6.7	4.2
	<u>97.8</u>	<u>111.8</u>

SOUTHERN WATER SERVICES LIMITED

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2003

**14 Creditors: amounts falling due within one year**

	2003 £m	2002 £m
Bank overdraft	46.7	54.5
Trade creditors	21.6	20.2
Loans from group undertakings (see below)	1,210.6	666.0
Capital creditors and capital accruals	116.4	89.0
Amounts owed to group undertakings	52.6	54.4
Corporation tax	7.3	7.4
Other taxation and social security	1.4	1.2
Other accruals and deferred revenue	59.9	46.8
	<b>1,516.5</b>	<b>939.5</b>

Amounts owed to group undertakings include £8.9m in respect of payments due for group relief, together with £30.1m from cash sweeping arrangements, £5.5m of inter company creditors and £8.1m relating to interest on loans.

The loans from the parent company and group undertakings are unsecured and repayable on demand with varying interest rates between 5-7%. An analysis is shown below:

	2003 £m	2002 £m
Loan from parent company	495.6	190.2
Loan from intermediate holding company	715.0	-
Loan from Scottish Power plc	-	475.8
	<b>1,210.6</b>	<b>666.0</b>

SOUTHERN WATER SERVICES LIMITED

**NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2003**

**15 Creditors: amounts falling due after more than one year**

	<b>2003</b>	2002
	<b>£m</b>	£m
Loans and other borrowings:		
Loans from parent company	-	382.5
Loans from subsidiary undertakings	-	99.6
	-	482.1
	-	482.1
	<b>2003</b>	2002
	<b>£m</b>	£m
<b>Repayments fall due as follows:</b>		
Between one to two years	-	285.5
Between two and five years	-	51.8
After five years not by instalments	-	129.7
After five years by instalments	-	15.1
	-	482.1
	-	482.1

All group debt falling due after more than one year has been repaid following the sale of the company by Scottish Power plc.

SOUTHERN WATER SERVICES LIMITED

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2003

**16 Provision for liabilities and charges**

	2003 £m	2002 £m
<b>(a) Environmental obligations</b>	<u>3.1</u>	<u>3.1</u>
<b>(b) Deferred taxation</b>		
Accelerated capital allowances	378.0	355.6
Other timing differences	<u>(8.9)</u>	<u>(3.5)</u>
<b>Deferred taxation</b>	<b>369.1</b>	<b>352.1</b>
<b>Total</b>	<u><u>372.2</u></u>	<u><u>355.2</u></u>

The environmental provision relates to costs for the decommissioning of abandoned sites. No reimbursement is expected. As the period over which the provision will be utilised cannot be determined the provision is not discounted.

	2003 £m	2002 £m
<b>Movement in deferred tax provision:</b>		
Deferred tax provided at 1 April	352.1	331.7
Deferred tax charge in Profit and Loss Account	17.0	20.4
<b>Deferred tax provided at 31 March</b>	<u><u>369.1</u></u>	<u><u>352.1</u></u>

**17 Grants and contributions**

	£m
At 1 April 2002	37.4
Receivable in year	5.2
Released to profit and loss account	(1.9)
<b>At 31 March 2003</b>	<u><u>40.7</u></u>

Grants and Contributions relate to non-infrastructure assets.

SOUTHERN WATER SERVICES LIMITED

**NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2003**

**18 Share capital**

	2003 £m	2002 £m
Authorised 46,050,000 ordinary shares of £1 each	<u>46.1</u>	<u>46.1</u>
Allotted, called up and fully paid 56,000 ordinary shares of £1 each	<u>0.1</u>	<u>0.1</u>

**19 Reconciliation of movement in shareholder's funds**

	Called up share capital £m	Share premium £m	Profit and loss account £m	Total £m
At 1 April 2001	0.1	46.3	667.1	713.5
Profit retained	-	-	93.0	93.0
Dividends paid	-	-	-	-
<b>At 31 March 2002</b>	<u>0.1</u>	<u>46.3</u>	<u>760.1</u>	<u>806.5</u>
At 1 April 2002	0.1	46.3	760.1	806.5
Profit before Dividends paid	-	-	63.6	63.6
Dividends paid	-	-	(68.0)	(68.0)
<b>At 31 March 2003</b>	<u>0.1</u>	<u>46.3</u>	<u>755.7</u>	<u>802.1</u>

**20 Pensions**

The Company accounted for pension costs during the year under SSAP 24, but has also made the detailed disclosures required in the second year of the transitional arrangements under FRS 17. These disclosures show a net FRS 17 deficit (after deferred tax) of £99.5 million. The deficit has arisen mainly as a result of turbulence in the stock market and low interest rates.

**Pension schemes operated**

The Company principally operates three schemes:

1. Southern Water Pension Scheme (SWPS), a funded defined benefit scheme which has been closed to new members since 31 December 1998. This scheme has eight trustee directors.

**NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2003**

**20 Pensions (continued)**

2. Southern Water Executive Pension Scheme (SWEPS), which is a funded defined benefit scheme. This scheme has five trustee directors.

Both of the above schemes are operated by Southern Water Limited (formerly Southern Water plc). The power of appointment is vested in Southern Water Limited (formerly Southern Water plc) an intermediate holding company.

The assets of the schemes are held separately from those of the company. State Street Bank and Trust Company acts as custodian for the main defined benefit scheme (SWPS) and asset management is delegated to external fund managers.

3. Scottish Power plc pension scheme, which is also a defined benefit scheme. This is actually administered by Scottish Power plc, however, the Company makes contributions on behalf of certain of its employees.

Members of all three schemes receive an annual statement of their accrued benefits.

**Regular pension costs under SSAP 24**

1. Pension costs for the SWPS and SWEPS during the year were £7.1m (2002 - £4.0m). The pension cost for the year was greater than the actual contribution paid of £4.1m resulting in an accrual in the balance sheet at 31 March 2003 of £3.0m (2002 - nil). The increased cost is in relation to the fund deficits.
2. Pension costs for the Scottish Power plc scheme were £0.9m (2002 - £0.7m). The actual contributions for the year were also £0.9m, resulting in no accruals or prepayments being held on the balance sheet (2002 - nil).

**FRS 17 - disclosures**

In November 2000 the Accounting Standards Board (ASB) issued FRS 17 'Retirement Benefits', replacing SSAP 24 'Accounting for Pension Costs'. In July 2002 the ASB published for comment an Exposure Draft which would, if implemented, allow an extension to the transitional arrangements of FRS 17. The probability of implementation is uncertain and partly dependent upon proposals from the International Accounting Standards Board (IASB). The Company will take advice to ensure that it continues to adopt best practice in respect of accounting for retirement benefits. The Company is in the second year of the transitional arrangements under FRS 17 and the required disclosures are made below.

## NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2003

## 20 Pensions (continued)

## FRS 17 - assumptions, asset, liability and reserves disclosures

Full actuarial valuations of the two principal defined benefit schemes in the UK were carried out at 1 April 2001 and updated to 31 March 2003 by a qualified independent actuary. The following disclosures are combined for the SWPS and SWEPS. The major assumptions used by the actuary are set out in the table below.

	2003 % pa	2002 % pa
Price inflation	2.5	2.8
Rate of increase in salaries (plus an age-related promotional scale)	4.0	4.3
Rate of increase of pensions in payment	2.5	2.8
Rate of increase for deferred pensions	2.5	2.8
Discount rate	5.6	6.0
Expected return on assets – SWPS	7.5	7.3
Expected return on assets – SWEPS	5.6	6.0

The assets and liabilities in the schemes and the expected rates of return at the 31 March 2003 and 31 March 2002 were:

	Rate of return 2003 %	Rate of return 2002 %	Value at 2003 £m	Value at 2002 £m
Equities	8.7%	8.0%	156.4	210.3
Bonds	4.7%	5.3%	78.6	84.2
Cash	4.0%	3.8%	1.9	5.1
Total market value of Plan assets			<b>236.9</b>	299.6
Total value of Plan liabilities			<b>(379.1)</b>	(338.6)
Accrued deficit in the Plan			<b>(142.2)</b>	(39.0)
Related deferred tax liability			42.7	11.7
Net pension liability			<b>(99.5)</b>	(27.3)

If FRS 17 had been adopted and therefore the pension liabilities as discussed above were to be recognised, the company's net assets and profit and loss account after taking account of the effect of both pension schemes would have been as follows:

## NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2003

## 20 Pensions (continued)

Shareholder's funds	2003	2002
	£ m	£ m
As reported (note 19)	802.1	806.5
SSAP 24 accrual in relation to SWPS and SWEPS, net of related deferred tax	2.1	-
FRS 17 net pension liability as above	(99.5)	(27.3)
As adjusted for FRS 17	<u>704.7</u>	<u>779.2</u>
Profit and loss account	2003	2002
	£ m	£ m
As reported (note 19)	755.7	760.1
SSAP 24 accrual as above	2.1	-
FRS 17 net pension liability as above	(99.5)	(27.3)
As adjusted for FRS 17	<u>658.3</u>	<u>732.8</u>

## FRS 17 – profit and loss account disclosures

The following amounts would have been recognised in the profit and loss account for the year to 31 March 2003 under the requirements of FRS17.

## Analysis of amounts charged to operating profit:

	2003
	£ m
Employer's current service cost	6.4
Employer's past service costs	2.0
Total charged to operating profit	<u>8.4</u>

## Analysis of the amount charged to other finance income:

	2003
	£ m
Interest on pension scheme liabilities	20.3
Expected return on pension scheme assets	(21.4)
Net credit to other finance income	<u>(1.1)</u>
<b>Total P&amp;L charge before deduction for tax</b>	<u><b>7.3</b></u>

SOUTHERN WATER SERVICES LIMITED

**NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2003**

**20 Pensions (continued)**

**Analysis of the amounts recognised in STRGL:**

	2003 £ m
Actuarial loss on scheme assets	(77.6)
Experience loss arising on scheme liabilities	(3.0)
Loss on change of assumptions (financial and demographic)	(19.4)
Total loss recognised in STRGL before	(100.0)
Adjustment for tax	(100.0)

**Analysis of the movement in the schemes' deficits during the year**

	2003 £ m
Deficit in the plan at 1 April 2002	(39.0)
Employers' contributions	4.1
Employers' current service cost	(6.4)
Employers past service cost	(2.0)
Other finance income	1.1
Actuarial loss	(100.0)
Deficit in the plan at end of year	(142.2)

**Details of experience gains and losses for the year to 31 March 2003 are as follows:**

	2003
<b>a. Actuarial loss on plan assets</b>	
Amount (£m)	77.6
Percentage of the scheme assets	32.8%
<b>b. Experience loss on plan liabilities</b>	
Amount (£m)	3.0
Percentage of the present value of the scheme liabilities	0.8%
<b>c. Total actuarial loss recognised in STRGL</b>	
Amount (£m)	100.0
Percentage of the present value of the scheme liabilities	26.4%

## NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2003

## 20 Pensions (continued)

## Future profile of the pension schemes

The SWPS closed to new members with effect from 31 December 1998. This will result in the age profile of the active membership rising over time and hence, under the method required to calculate FRS 17 liabilities, the future cost in relation to this Scheme will reduce in the long-term.

## Other pension arrangements

As previously discussed, there is also a third scheme operated by Scottish Power plc which is also a defined benefit scheme. Details are given below. Southern Water continues to operate a defined benefit scheme with Scottish Power plc. However, the contributions paid by the company are accounted for FRS17 purposes as if the scheme were a defined contribution scheme, as the company is unable to identify its share of the underlying assets and liabilities in the scheme. The cost of contributions to this scheme during the year amounted to £911k (2002: £668k).

## 21 Contingent liabilities

	2003 £m	2002 £m
Contractors' claims	<u>22.5</u>	<u>15.7</u>

Contractors' claims consist of the contractors' estimate of the cost of undertaking works for Southern Water. The claim is reviewed by Southern Water, who assess where the liability for the costs rests and the amount that will actually be settled. This amount is included within capital creditors and a further sum is identified as a contingent liability, representing a proportion of the difference between the contractors claim and Southern Water's valuation.

## 22 Financial commitments

	2003 £m	2002 £m
As 31 March 2003, the company had annual commitments under non-cancellable operating lease agreements in respect of vehicles for which the payment extends over a number of years as follows:		
Expiring within one year	1.6	0.9
Expiring between two and five years	2.0	1.9
Expiring after five years	-	0.1
	<u>3.6</u>	<u>2.9</u>

Operating leases are charged to the Profit and Loss Account over the lease term.

SOUTHERN WATER SERVICES LIMITED

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2003

**23 Directors' emoluments**

	2003 £000	2002 £000
Aggregate emoluments (including benefits in kind)	<u>922</u>	<u>611</u>

Retirement benefits are accruing to five directors under a Southern Water defined benefit scheme.

Details of emoluments and benefits for the highest paid director:

	2003 £000	2002 £000
<i>Aggregate highest paid director's emoluments and benefits</i>	<u>234</u>	<u>147</u>
Defined benefit scheme: Accrued annual pension at 31 March	<u>90</u>	<u>71</u>

**24 Related party transactions**

The company has taken an exemption, as allowed by Financial Reporting Standard 8, not to disclose related party transactions with other group companies as an intermediate parent company, Southern Water Services Group Limited (formerly First Aqua Limited) publishes full statutory consolidated Accounts.

Prior to 24 April 2002, the ultimate parent undertaking was Scottish Power plc which publishes full statutory consolidated Accounts.

**25 Ultimate holding company**

The immediate parent undertaking is Southern Water Services Holdings Limited.

Up to 24 April 2002, the ultimate parent undertaking and controlling party was Scottish Power plc.

At 31 March 2003, the ultimate parent undertaking and controlling party was First Aqua Holdings Limited. First Aqua Holdings Limited is incorporated in the Cayman Islands and does not publish financial statements.

An intermediate holding company is Southern Water Services Group Limited (formerly First Aqua Limited), which prepares consolidated accounts. Copies of Southern Water Services Group Limited's (formerly First Aqua Limited) consolidated Accounts may be obtained from the Company Secretary at 200 Aldersgate Street, London, EC1A 4JJ.

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2003

**26 Post Balance Sheet event**

On 7 May 2003, the ultimate parent undertaking, First Aqua Holdings Limited, sold its entire interest in the ordinary shares of Southern Water Services (Finance) Limited (formerly First Aqua (JV Co) Limited) (an intermediate parent company) to Southern Water Capital Limited.

From 7 May 2003, the directors regard Southern Water Capital Limited as the ultimate holding company. Southern Water Capital Limited is majority owned by Royal Bank of Scotland plc.

On 7 May 2003 Bob Thian was appointed as Non-Executive Chairman and Rory Cullinan, Cyril Roger-Lacan, Jean Claude Banon and François Darley were appointed as Non-Executive Directors.

On 23 April 2003 dividends of £15m were paid to Southern Water Services Group Holdings Limited.

## SOUTHERN WATER SERVICES LIMITED

### **INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF SOUTHERN WATER SERVICES LIMITED**

We have audited the Accounts which comprise the profit and loss account, the balance sheet, and the related notes which have been prepared under the historical cost convention and the accounting policies set out in the accounting policy note.

#### **Respective responsibilities of directors and auditors**

The directors' responsibilities for preparing the directors' report and the Accounts in accordance with applicable United Kingdom law and accounting standards are set out in the statement of directors' responsibilities.

Our responsibility is to audit the Accounts in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board. This report, including the opinion, has been prepared for and only for the company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or *into whose hands it may come save where expressly agreed by our prior consent in writing.*

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

We read the other information contained in the directors' report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Accounts. The other information comprises only the directors' report.

#### **Basis of audit opinion**

We conducted our audit in accordance with auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Accounts. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the Accounts, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

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

SOUTHERN WATER SERVICES LIMITED

**Opinion**

In our opinion the Accounts give a true and fair view of the state of the company's affairs at 31 March 2003 and of its loss for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

*PricewaterhouseCoopers LLP*

PricewaterhouseCoopers LLP

Chartered Accountants and Registered Auditors  
London,  
17 July 2003