

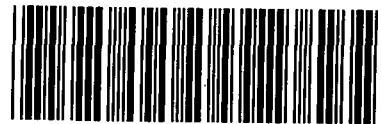
Registered no: 2366623 (England & Wales)

Thames Water Limited

Directors' report and financial statements

For the year ended 31 March 2014

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Thames Water Limited

Strategic report, Directors' report and financial statements for the year ended 31 March 2014

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Thames Water Limited

Directors and advisors

Directors

Sir Peter Mason KBE - Chairman
E Beckley
D Buffery (appointed 13 December 2013)
C R Deacon
R Blomfield-Smith
Dr P Dyer
S R Eaves
C Heathcote (appointed 21 June 2013)
N Horler (appointed 14 April 2014)
D J Shah OBE
L Webb
D Xu

Registered auditor

KPMG LLP
Chartered Accountants and Registered Auditors
15 Canada Square
London
E14 5GL

Company Secretary and registered office

J E Hanson
Clearwater Court
Vastern Road
Reading
Berkshire
RG1 8DB

Thames Water Limited

Strategic report

The directors present their strategic report of Thames Water Limited ("the Company") for the year ended 31 March 2014.

Business review

The Company's principal activity is that of an intermediate holding company in the Kemble Water Holdings Limited group of companies ("the Group").

The Company's business review disclosures are integrated with those of the Group and so they are not disclosed separately. Accordingly, the business review and disclosures of the Group, which include those of the Company, are discussed in the Group's annual report which does not form part of this report.

The Group's annual report is available from the address shown in note 18 on page 24.

Results and performance

The Company made a profit before tax for the year of £196.7m (2013: £150.2m). The directors have reviewed the recoverability of investments (equity & loan) and determined that no additional provisions (2013: £55.9m) were required to appropriately reflect the recoverable values. These were charged to the profit and loss account in 2013.

Principal risks and uncertainties

From the perspective of the Company, the principal risks and uncertainties are integrated with the principal risks of the Group and are not managed separately. The principal risks of the Group are disclosed in the financial statements of the ultimate controlling parent Kemble Water Holdings (KWH) Group Limited. Accordingly, the principal risks and uncertainties of the group, which include those of the Company, are discussed in the Group's Annual Report which does not form part of this report. The Group's annual report is available from the address shown in note 18 on page 24.

Future outlook

The Company is expected to continue to act as an intermediate holding company within the Group.

By the order of the Board:



J Hanson
Company Secretary

Clearwater Court
Vastern Road
Reading
Berkshire
RG1 8DB

5 June 2014

Thames Water Limited

Directors' report

The directors present their report and the audited financial statements of Thames Water Limited ("the Company") for the year ended 31 March 2014.

The registered number of the Company is 2366623.

Future outlook

The future outlook of the Company is discussed in the strategic report.

Dividends

The directors paid dividends of £190.0m during the year (2013: £152.0m). This was made up of two dividends. The first interim dividend of £84.4m (23.72p per 0.23p ordinary share); (2013: £122.0m, 34.29p per 0.23p ordinary share) was paid in September 2013. The second interim dividend of £105.6m (29.68p per 0.23p ordinary share); (2013: £30.0m, 8.43p per 0.23p ordinary share) was paid in March 2014. There were no further dividends in 2014 (2013: none).

During the year forfeited dividends amounting to £1.5m that have not been claimed by former shareholders were returned to the Company, as detailed in note 13. The monies associated with these forfeited dividends will be retained to spend over the next five years on measures to provide redress to our customers affected by flooding in previous years.

Financial risk management

The Company has access to the Group Executive Team and receives regular reports from all areas of the business to enable prompt identification of financial and other risks so that appropriate actions can be taken.

The Company's operations expose it to a variety of financial risks that include the effects of changes in debt market prices, liquidity risk, interest rate risk and exchange rate risk.

The Company's treasury operations are managed centrally by a small specialist team, which operates with the delegated authority of, and under policies approved by, the Board of Directors.

The operation of the treasury function is governed by specific policies and procedures that set out specific guidelines for the management of interest rate risk and foreign exchange risk and the use of financial instruments. Treasury policy and procedures are incorporated within the financial control procedures of the Company.

Directors

The directors who held office during the year ended 31 March 2014 and to the date of signing were:

Sir Peter Mason KBE - Chairman
E Beckley
R Blomfield-Smith
D Buffery (appointed 13 December 2013)
C R Deacon
Dr P Dyer
S R Eaves
C Heathcote (appointed 21 June 2013)
N Horler (appointed 14 April 2014)
G I W Parsons (resigned 21 June 2013)
K Roseke (resigned 24 May 2013)
D J Shah OBE
L Webb
D Xu

During the year under review, none of the directors had significant contracts with the Company or any other body corporate other than their contracts of service, except as disclosed in note 17 to the accounts.

Thames Water Limited

Directors' report (continued)

The following directors have formally appointed alternate directors to represent them when they are unavailable:

Director

E Beckley
R Blomfield-Smith
C R Deacon
Dr P Dyer
S R Eaves
C Heathcote (appointed 21 June 2013)
N Horler (appointed 14 April 2014)
D J Shah OBE

L Webb
D Xu

Alternate Director

G Parsons
P Noble
R Evenden (resigned 16 August 2013)
R Greenleaf (appointed 31 July 2013)
M C Hill
G Parsons (appointed 21 June 2013)

C van Heijningen (resigned 1 April 2014)
K Roseke (appointed 22 April 2014)
C Pham
F Sheng

Political donations

No political donations were made by the Company during the year (2013: £nil).

Disclosure of information to the auditor

The directors who held office at the date of approval of this directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditor is unaware; and each director has taken all the steps that they ought to have taken as director to make themselves aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

Directors' indemnities

The Company has made qualifying third party indemnity provisions for the benefit of its directors (which extend to the performance of any duties as director of any associated company) and these remain in force at the date of this report.

Auditor

Our external auditor informed the directors that for administrative reasons and to instigate the orderly wind down of business, they wished to formally change the entity which conducts the Thames Water Limited audit from KPMG Audit Plc to KPMG LLP.

KPMG Audit Plc resigned as auditor on 30 October 2013 pursuant to section 516 of the Companies Act 2006. At the Extraordinary General Meeting held on 30 October 2013, KPMG LLP was appointed as auditor of the company under section 485 of the Companies Act.

Approved by the Board of Directors on 5 June 2014 and signed on its behalf by



J Hanson
Company Secretary

Clearwater Court
Vastern Road
Reading
Berkshire
RG1 8DB

Thames Water Limited

Statement of directors' responsibilities in respect of the Strategic report, the Directors' report and the financial statements

The directors are responsible for preparing the Strategic Report, the Directors' 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 they have elected to prepare the financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice).

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company 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 a going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and 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 have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

Independent auditor's report to the members of Thames Water Limited

We have audited the financial statements of Thames Water Limited for the year ended 31 March 2014 set out on pages 8 to 24. The financial reporting framework that has been applied in their preparation is applicable law and UK Accounting Standards (UK 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 Directors' Responsibilities Statement set out on page 5, 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

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 March 2014 and of its profit for the year then ended;
- have been properly prepared in accordance with UK Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion the information given in the Strategic report and Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Independent auditor's report to the members of Thames Water Limited (continued)

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, or returns adequate for our audit have not been received from branches not visited by us; or
- the 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.

W. Meredith

**William Meredith (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor**

Chartered Accountants
KPMG LLP
15 Canada Square
London
United Kingdom
E14 5GL

5 June 2014

Thames Water Limited

Profit and loss account for the year ended 31 March 2014

	Note	Year ended 31 March 2014 £m	Year ended 31 March 2013 £m
Operating costs	2,3	(2.9)	(2.9)
Operating loss		(2.9)	(2.9)
Fixed asset investment provision	8	-	(49.1)
Interest receivable and similar income	4	199.5	202.2
Other finance income	5	0.1	-
Profit on ordinary activities before taxation		196.7	150.2
Taxation on profit on ordinary activities	6	(41.4)	(48.8)
Profit for the financial year		155.3	101.4

All amounts above relate to continuing operations.

There is no difference between the profit on ordinary activities before taxation for the years stated above and their historical cost equivalents.

The notes from pages 10 to 24 form part of these financial statements.

Statement of total recognised gains and losses for the year ended 31 March 2014

	Note	Year ended 31 March 2014 £m	Year ended 31 March 2013 £m
Profit for the year		155.3	101.4
Actuarial (loss)/gain on pension scheme	16	(1.0)	0.2
Deferred tax relating to actuarial loss/gain		0.4	(0.1)
Total recognised gains and losses relating to the financial year		154.7	101.5

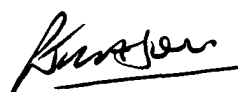
Thames Water Limited

Balance sheet as at 31 March 2014

	Note	As at 31 March 2014 £m	As at 31 March 2013 £m
Fixed assets			
Investments	8	15.7	15.9
Current assets			
Debtors			
- due within one year	9	183.3	1,764.5
- due after one year	9	2,122.4	2,155.1
		2,305.7	3,919.6
Investments		13.7	3.5
		2,319.4	3,923.1
Creditors: amounts falling due within one year	10	(382.9)	(1,953.2)
Net current assets		1,936.5	1,969.9
Total assets less current liabilities		1,952.2	1,985.8
Provisions for liabilities	11	(0.6)	(0.7)
Net assets excluding pension asset		1,951.6	1,985.1
Net pension asset	16	4.4	4.7
Net assets including pension asset		1,956.0	1,989.8
Capital and reserves			
Called up share capital	12	81.8	81.8
Share premium account	13	104.5	104.5
Capital redemption reserve	13	320.8	320.8
Profit and loss account	13	1,448.9	1,482.7
Shareholder's funds	14	1,956.0	1,989.8

The notes on pages 10 to 24 form part of these financial statements.

The financial statements on pages 8 to 24 were approved by the Board of Directors on 5 June 2014 and signed on its behalf by:



Sir Peter Mason KBE
Chairman

Registered no: 2366623 (England & Wales)

Thames Water Limited

Notes to the financial statements

1 Principal accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the financial statements.

Basis of preparation

The financial statements have been prepared on a going concern basis and in accordance with applicable accounting standards and under historical accounting rules.

The Company is exempt by virtue of s400 of the Companies Act 2006 from the requirement to prepare Group financial statements. Therefore these financial statements present information about the Company as an individual undertaking and not about its Group.

Going concern

The financial statements have been prepared on the going concern basis. This is based upon a review of the Group's budget, business plan and investment programme, together with the cash and committed borrowing facilities available.

Summary of significant accounting policies

The principal accounting policies adopted in the preparation of the financial statements, which have been applied consistently are set out below.

(a) Investments

Investments held as fixed assets are stated at cost less provisions for impairment in value. Impairment reviews are performed by the directors when there has been an indication of potential impairment. An impairment loss is recognised whenever the carrying amount exceeds the recoverable amount. Impairment losses are recognised in the profit and loss account.

(b) Related party disclosures

As the Company is a wholly owned subsidiary of Kemble Water Holdings Limited, the Company has taken advantage of the exemption contained in FRS8 and has therefore not disclosed transactions or balances with other wholly owned subsidiaries which form part of the Group (or investees of the Group qualifying as related parties). The consolidated financial statements of Kemble Water Holdings Limited can be obtained from the address in note 18.

(c) Cash flow

Under FRS1 the Company is exempt from the requirement to prepare a cash flow statement on the grounds that a parent undertaking includes the Company in its own published consolidated financial statements, which include a cash flow statement.

(d) Dividends

Dividends unpaid at the balance sheet date are only recognised as a liability at that date to the extent that they are appropriately authorised and are no longer at the discretion of the Company. Unpaid dividends that do not meet these criteria are disclosed in the notes to the financial statements.

Dividend income is recognised when there is a legal right to receive.

Thames Water Limited

Notes to the financial statements (continued)

(e) Taxation

The tax expense in the period represents the sum of current tax and deferred tax.

Current taxation

Current tax, including UK corporation tax and foreign tax, is based on the taxable profit for the period and is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantially enacted at the balance sheet date.

Taxable profit differs from the net profit as reported in the profit and loss account because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible.

Consideration receivable or payable in respect of losses surrendered or claimed by way of group relief is dealt with in the profit and loss account.

Deferred taxation

Deferred tax is recognised without discounting, in respect of all timing differences between the treatment of certain items for taxation and accounting purposes which have arisen but not reversed by the balance sheet date, except as otherwise required by FRS 19.

A net deferred tax asset is regarded as recoverable and therefore recognised only when, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits against which to recover carried forward tax losses and from which the future reversal of underlying timing differences can be deducted.

Deferred taxation is measured at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted by the balance sheet date.

Deferred tax is charged or credited in the profit and loss account except when it relates to items charged or credited to equity, in which case the deferred tax is also dealt with via the statement of total recognised gains and losses.

(f) Foreign currencies

Transactions in foreign currencies are recorded using the rate of exchange ruling at the date of transaction. Monetary assets and liabilities denominated in foreign currencies are translated using the contracted rate or the rate of exchange ruling at the balance sheet date and the gains or losses on translation are included in the profit and loss account.

(g) Provisions

Provisions are recognised without discounting when the Company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated.

Thames Water Limited

Notes to the financial statements (continued)

1 Principal accounting policies (continued)

(h) Cash

Cash comprises cash at bank and in hand, deposits, and other short-term highly liquid investments which are readily convertible on initial investment into known amounts of cash at any time without penalty or if a maturity or period of notice of not more than 24 hours or one working day has been agreed.

(i) Financial risk management

The financial risk management of the company is discussed in the Director's Report on page 3.

(j) Interest receivable

Interest receivable is recognised in the profit and loss account on an accruals basis.

(k) Interest Payable

Interest payable is recognised in the profit and loss account on an accruals basis.

(l) Pension and other post-retirement benefits

The Company operates one pension scheme only, being a defined benefit scheme providing retirement benefits to a previous director and their spouse based on final salary. The scheme is an unfunded arrangement but is secured against assets held by the Company. There are no benefits currently being accrued with the scheme and no contributions are currently being paid by the Company.

A full actuarial valuation of the scheme is carried out each year. Defined benefit assets are measured at fair value while liabilities are measured at present value (which approximates to fair value).

The difference between the assets and liabilities of the scheme are recognised as a surplus (to the extent that the surplus is recoverable) or obligation in the balance sheet.

The difference between the expected return on scheme assets and interest on scheme liabilities is included within other finance income/expense in the profit and loss account on page 8.

Actuarial gains and losses are recognised outside the profit and loss account in retained earnings and presented in the statement of total recognised gains and losses on page 8.

2 Operating loss

Included in operating loss is the auditor's remuneration in respect of the following:

	Year ended 31 March 2014 £m	Year ended 31 March 2013 £m
Audit fees in relation to subsidiaries and fellow subsidiaries	0.1	0.1

No other fees were payable to the auditor in either year.

Thames Water Limited

Notes to the financial statements (continued)

3 Information regarding directors

Directors' emoluments

	Year ended 31 March 2014 £m	Year ended 31 March 2013 £m
Aggregate emoluments	0.5	0.6

Other than as noted above and included in note 17, no other amounts were payable to any of these directors. No remuneration was payable in respect of any alternate directors whose period of service can be found in the Directors' report on page 4.

At 31 March 2014, no retirement benefits are accruing to directors (2013: £nil) under a defined benefit pension scheme.

Highest paid director

	2014 £m	2013 £m
Aggregate emoluments	0.1	0.1

The highest paid director's emoluments are paid by Thames Water Utilities Limited and 30% of the total remuneration is recharged to the Company on a monthly basis for services provided by the director to the Kemble Water Holdings Group.

4 Interest receivable and similar income

	Year ended 31 March 2014 £m	Year ended 31 March 2013 £m
Receivable from Group undertakings	199.5	202.2
	199.5	202.2

Interest receivable from Group undertakings represents interest receivable on the intercompany loans described in note 9.

5 Other finance income

	Year ended 31 March 2014 £m	Year ended 31 March 2013 £m
Expected return on pension scheme assets	0.4	0.3
Interest on pension scheme liabilities	(0.3)	(0.3)
	0.1	-

Thames Water Limited

Notes to the financial statements (continued)

6 Taxation on profit on ordinary activities

Analysis of charge in the year

	Year ended 31 March 2014 £m	Year ended 31 March 2013 £m
Current tax		
Amounts payable in respect of group relief	45.1	48.2
Adjustments in respect of previous periods	(3.7)	(0.2)
Total current tax	41.4	48.0
Deferred tax		
Adjustments in respect of previous periods	-	0.8
Total deferred tax	-	0.8
Tax charge on profit on ordinary activities	41.4	48.8

The tax assessed for the year is lower (2013: higher) than the standard rate of corporation tax in the UK of 23% (2013: 24%). The differences are explained below:

	Year ended 31 March 2014 £m	Year ended 31 March 2013 £m
Profit on ordinary activities before taxation	196.7	150.2
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 23% (2013: 24%)	45.2	36.1
Effects of:		
(Income not taxable) / expenses not deductible	(0.1)	12.1
Adjustments in respect of previous periods	(3.7)	(0.2)
Current tax charge for the year	41.4	48.0

Reconciliation of movements in deferred tax:	2014 £m	2013 £m
At the beginning of the year	-	0.8
Charge to the profit and loss for the year in respect of other timing differences	-	(0.8)
At the end of the year	-	-

Thames Water Limited

Notes to the financial statements (continued)

6 Taxation on profit on ordinary activities (continued)

There is an unrecognised deferred tax asset in respect of capital losses where the Company does not anticipate taxable profits in the immediate future. The amount of deferred tax asset unrecognised at 20% and 21% is:

	As at 31 March 2014 £m	As at 31 March 2013 £m
Deferred tax asset not recognised in respect of capital losses	6.0	6.9

Factors affecting the future tax charge

Reductions in the UK corporation tax rate from 26% to 24% (effective from 1 April 2012) and to 23% (effective 1 April 2013) were substantively enacted on 26 March 2012 and 3 July 2012 respectively.

Further reductions to 21% (effective from 1 April 2014) and 20% (effective from 1 April 2015) were substantively enacted on 2 July 2013. This will reduce the company's future current tax charge accordingly. As the Company has no deferred tax asset or liability, there is no effect on these financial statements. The unrecognised deferred tax asset at 31 March 2014 has been calculated based on the rates of 20% and 21% substantively enacted at the balance sheet date.

7 Dividends

	Year ended 31 March 2014 £m	Year ended 31 March 2013 £m
Equity – Ordinary		
First Interim dividend paid: 23.72p (2013: 34.29p) per £0.23p ordinary share	84.4	122.0
Second Interim dividend paid: 29.68p (2013: 8.43p) per £0.23p ordinary share	105.6	30.0
Total	190.0	152.0

Thames Water Limited

Notes to the financial statements (continued)

8 Fixed asset investments

The Company's fixed asset investments can be analysed as follows:

	Shares in Group undertakings £m	Loans to Group undertakings £m	Total £m
Cost:			
As at 1 April 2013	50.1	377.6	427.7
Disposals	(0.2)	-	(0.2)
As at 31 March 2014	49.9	377.6	427.5
Provisions:			
As at 1 April 2013 & 31 March 2014	(34.2)	(377.6)	(411.8)
Net Book Value:			
As at 31 March 2014	15.7	-	15.7
As at 1 April 2013	15.9	-	15.9

On 1 January 2014 the Company disposed of its holding in Thames Water Commercial Services Limited, which had a book value of £0.2m, to Thames Water Commercial Venture Finance Limited for proceeds of £0.2m.

The directors have reviewed the recoverability of investments (equity & loan) and determined that no additional provisions (2013: £55.9m) were required to appropriately reflect the recoverable values. These were charged to the profit and loss account in 2013.

Thames Water Limited

Notes to the financial statements (continued)

8 Fixed asset investments (continued)

	Year end	% owner- ship	Country of incorporation	Description of shares held	Nature of business
Interests in group undertakings:					
Direct:					
Thames Water Utilities Holdings Limited	31 March	100	England & Wales	Ordinary £1	Holding Company
Kennet Properties Limited	31 March	100	England & Wales	Ordinary £1	Property
Thames Water Investments Limited	31 March	100	England & Wales	Ordinary £1	Property
Indirect (through Thames Water Utilities Holdings Limited):					
Thames Water Utilities Limited	31 March	100	England & Wales	Ordinary £1	Regulated Water Operations
Thames Water Utilities Finance Limited	31 March	100	England & Wales	Ordinary £1	Finance Company
Thames Water Utilities Cayman Finance Limited	31 March	100	Cayman Islands*	Ordinary \$1	Finance Company
Indirect (through Thames Water Investments Limited):					
Trans4m Limited	31 March	25	England & Wales	Ordinary £1	Contract management for stations and civil assets

* Thames Water Utilities Cayman Finance Limited is resident in the UK for tax purposes.

Advantage is taken of S410 of the Companies Act 2006 therefore information is given only with respect to such undertakings whose financial position principally affects the figures of the Company. A full list of subsidiary undertakings will be filed at Companies House with the Company's annual return.

Thames Water Limited

Notes to the financial statements (continued)

9 Debtors

Amounts falling due within one year:

	As at 31 March 2014 £m	As at 31 March 2013 £m
Amounts owed by Group undertakings	183.1	1,764.3
Other debtors	0.2	0.2
	183.3	1,764.5

	As at 31 March 2014 £m	As at 31 March 2013 £m
Amounts owed by Group undertakings		
Inter-company loans due within one year	136.3	136.3
Other amounts due within one year	46.8	1,628.0
	183.1	1,764.3

Amounts owed by Group undertakings are unsecured, repayable on demand and interest free except the following loans:

- £136.3m owed by Kemble Water Finance Limited (2013: £136.3m owed by Kemble Water Liberty Limited) on which interest is based on London Interbank Offered Rate ("LIBOR") + 0.50%. During the year the amounts owed by Kemble Water Liberty Limited were assigned to Kemble Water Finance Limited as part of the restructure of the Kemble Water Holdings Limited Group.

On 28 March 2014 the Kemble Water Holdings Group completed transactions to simplify the corporate structure of the Group resulting in the assignment of all amounts that were due to Thames Water Limited from Kemble Water Holdings Ltd, Kemble Water Eurobond Plc, Kemble Water Liberty Ltd, Kemble Water Structure Ltd, Kemble Water Investments Ltd, Kemble Water Ltd and Thames Water Holdings Ltd.

Amounts falling due after more than one year:

	As at 31 March 2014 £m	As at 31 March 2013 £m
Amounts owed by Group undertakings – loans	1,980.1	1,980.1
Amounts owed by Group undertakings – other amounts	142.3	175.0
	2,122.4	2,155.1

Amounts owed by Group undertakings are unsecured and interest free except the following loan:

The loan of £1,980.1m (2013: £1,980.1m) above, owed by Thames Water Utilities Holdings Limited, being the unpaid deferred consideration on the purchase of Thames Water Utilities Limited, on which interest is payable at 10%. Repayment is at the discretion of the Company but must be repaid by 2056. Interest repayment on this loan is determined by agreement between both parties. No repayment date has been set for interest incurred.

Thames Water Limited

Notes to the financial statements (continued)

10 Creditors: amounts falling due within one year

	As at 31 March 2014 £m	As at 31 March 2013 £m
Bank overdraft	18.9	13.4
Amounts owed to Group undertakings	336.2	1,870.7
Group relief	25.0	62.7
Corporation Tax	2.3	5.9
Accruals and deferred income	0.5	0.5
	382.9	1,953.2

The Company's bank accounts, along with a number of other Group bank accounts form part of a cross-company guarantee arrangement with the bank. Should the net position be overdrawn, then this is unsecured.

Amounts owed to Group undertakings:

	As at 31 March 2014 £m	As at 31 March 2013 £m
Inter-company loans	34.1	34.1
Other amounts	302.1	1,836.6
	336.2	1,870.7

The above loans are all non-interest bearing loans.

The balance in other amounts as at 31 March 2014 of £302.1m consists of intercompany balances owed to a variety of group entities.

As part of the corporate restructure described in note 9, £998.9m of other amounts due to Kemble Water Limited were settled.

11 Provisions for liabilities

	As at 31 March 2014 £m	As at 31 March 2013 £m
At the beginning of the year	0.7	4.9
Release of provision	-	(4.2)
Utilisation of provision	(0.1)	-
At the end of year	0.6	0.7

Trans4m

The Company holds a 25% interest in Trans4m Limited ("Trans4m"), the company that was contracted by Metronet to deliver £1.86 billion of station upgrade and civil engineering works. As a result of significant projected cost overruns and insufficient liquidity, a Public Private Partnership Administrator was appointed to Metronet in 2007. The Company continues to maintain its ownership in Trans4m, however the company is no longer trading, and the Company has no further obligations to provide debt or equity to Trans4m. The above provision represents an estimation of the remaining expenses relating to Trans4m that the Company is to incur.

Thames Water Limited

Notes to the financial statements (continued)

12 Called up share capital

	As at 31 March 2014 £m	As at 31 March 2013 £m
Allotted, called up and fully paid:		
355,770,743 ordinary shares of 23p each (2013: 355,770,743)	81.8	81.8

13 Share premium and reserves

Current Year	Share premium £m	Capital redemption account £m	Profit and loss account £m	Total £m
As at 1 April 2013	104.5	320.8	1,482.7	1,908.0
Profit for the year	-	-	155.3	155.3
Dividends paid	-	-	(190.0)	(190.0)
Forfeited dividends	-	-	1.5	1.5
Actuarial loss on pension scheme	-	-	(1.0)	(1.0)
Movement in deferred tax relating to pension scheme	-	-	0.4	0.4
As at 31 March 2014	104.5	320.8	1,448.9	1,874.2

Forfeited dividends:

In December 2013 the Company received £1.5m from the former registrar of the company, Computershare Investor SVS Plc ("Computershare"). These relate to the Company's legacy of when the Company was a Public Limited Company (PLC) with a listing on the London Stock Exchange. The money being held by Computershare related to dividends which the Company had declared and paid, but that had not been claimed by the relevant shareholders. As the statutory time limit for claiming these dividends, 12 years, has now passed the money has been returned to the Company. The Company has accounted for the money as a reversal of the dividends paid, increasing its profit and loss account by £1.5m.

Prior Year	Share premium £m	Capital redemption account £m	Profit and loss account £m	Total £m
As at 1 April 2012	104.5	320.8	1,533.2	1,958.5
Profit for 2013	-	-	101.4	101.4
Dividends paid	-	-	(152.0)	(152.0)
Actuarial gain on pension scheme	-	-	0.2	0.2
Movement in deferred tax relating to pension scheme	-	-	(0.1)	(0.1)
As at 31 March 2013	104.5	320.8	1,482.7	1,908.0

Thames Water Limited

Notes to the financial statements (continued)

14 Reconciliation of movements in shareholder's funds

	2014 £m	2013 £m
Shareholder's funds as at 1 April 2013	1,989.8	2,040.3
Profit for the year	155.3	101.4
Dividends paid	(190.0)	(152.0)
Forfeited dividends	1.5	-
Actuarial (loss)/gain in pension scheme	(1.0)	0.2
Movement in deferred tax relating to pension scheme	0.4	(0.1)
Closing shareholder's funds as at 31 March 2014	1,956.0	1,989.8

15 Guarantees

At 31 March 2014, the Company has guaranteed the overdrafts and loans of certain subsidiaries with a net overdraft facility of £5.0m (2013: £5.0m) available across the company and the relevant subsidiaries. At the year end the Company had an overdraft of £18.9m (2013: £13.4m) which is netted off against the positive cash balances of the other relevant subsidiaries of £34.6m (2013: £23.5m).

In addition, there are a number of parent company guarantees in respect of subsidiary company contractual obligations as well as legacy non Thames Water Limited group companies that have been entered into in the normal course of business. No unprovided loss is expected to arise under these arrangements.

16 Pension schemes

Defined benefit pension scheme

The Company operates one pension scheme only, being a defined benefit scheme providing retirement benefits to a previous director and their spouse based on final salary.

The scheme is an unfunded arrangement but is secured against assets held by the Company. The latest full valuation was carried out at 31 March 2013 by independent actuaries, Mercer Limited (Mercer) (independent and professionally qualified consulting actuaries) using revised assumptions that are consistent with the requirements of FRS 17 and shown in this note to the accounts.

Reconciliation of funded status to balance sheet

	As at 31 March 2014 £m	As at 31 March 2013 £m
Fair value of scheme assets	12.4	13.2
Present value of scheme liabilities	(6.9)	(7.1)
Surplus in scheme	5.5	6.1
Asset recognised on the balance sheet	5.5	6.1
Deferred tax liability	(1.1)	(1.4)
Net pension asset	4.4	4.7

Thames Water Limited

Notes to the financial statements (continued)

16 Pension schemes (continued)

Movement in the present value of scheme liabilities

	As at 31 March 2014 £m	As at 31 March 2013 £m
Opening present value of scheme liabilities	7.1	6.3
Interest cost	0.3	0.3
Actuarial (gains)/losses on scheme liabilities	(0.2)	0.8
Net benefit paid out	(0.3)	(0.3)
Closing present value of scheme liabilities	6.9	7.1

Movement in fair value of scheme assets

	As at 31 March 2014 £m	As at 31 March 2013 £m
Opening fair value of scheme assets	13.2	11.9
Expected return on scheme assets	0.4	0.3
Actuarial (losses)/gains on scheme assets	(1.2)	1.0
Company contributions	0.3	0.3
Net benefits paid out	(0.3)	(0.3)
Closing fair value of scheme assets	12.4	13.2

Expense recognised in the profit and loss account:

	Year ended 31 March 2014 £m	Year ended 31 March 2013 £m
Interest cost	0.3	0.3
Expected return on scheme assets	(0.4)	(0.3)
	(0.1)	-

Analysis of amount recognised in the Statement of total recognised gains and losses:

	Year ended 31 March 2014 £m	Year ended 31 March 2013 £m
Actual return less expected return on pension scheme assets	(1.2)	1.0
Actuarial losses/(gains) on scheme liabilities	0.2	(0.8)
Actuarial gain recognised in the Statement of total recognised gains and losses	(1.0)	0.2
Cumulative amount of gains recognised in the Statement of total recognised gains and losses	1.6	2.6

Thames Water Limited

Notes to the financial statements (continued)

Fair value of scheme assets and return on these assets:

The fair value of the assets held by the pension scheme, the long-term expected rate of return on each class of assets and the average expected long-term rate of return obtained by weighting the individual rates in accordance with the anticipated balance in the schemes' investment portfolio are shown in the following table:

	2014		2013		2012	
	Long-term expected rate of return	Value £m	Long-term expected rate of return	Value £m	Long-term expected rate of return	Value £m
Index-linked Gilts	3.25%	10.9	2.90%	11.8	2.86%	10.8
Other assets	3.50%	1.5	3.15%	1.4	3.11%	1.1
Average expected long-term rate of return/total fair value of assets	3.28%	12.4	2.92%	13.2	2.88%	11.9

The Company employs a building block approach in determining the long-term rate of return on pension plan assets. Historical markets are studied and assets with higher volatility are assumed to generate higher returns consistent with widely accepted capital market principles. The assumed long-term rate of return on each asset class is set out within this note. The overall expected rate of return on assets is then derived by aggregating the expected return for each asset class over the actual asset allocation for the schemes.

The main financial assumptions used for FRS 17 purposes are as follows:

	2014	2013	2012
Price inflation	3.45%	3.5%	3.1%
Pension increases	3.5%	3.1%	3.1%
Discount rate for scheme liabilities	4.6%	4.3%	4.7%

In valuing the liabilities of the pension scheme mortality assumptions have been made based on the data regarding the schemes only member and their spouse and therefore have not been disclosed.

Thames Water Limited

Notes to the financial statements (continued)

History of fair value of assets, present value of liabilities, surplus in scheme and experience gains and losses:

	Year ended 31 March 2014 £m	Year ended 31 March 2013 £m	Year ended 31 March 2012 £m
Fair value of scheme assets	12.4	13.2	11.9
Present value of scheme liabilities	(6.9)	(7.1)	(6.3)
Surplus in scheme	5.5	6.1	5.6

Experience adjustments:

	Year ended 31 March 2014 £m	Year ended 31 March 2013 £m	Year ended 31 March 2012 £m
Experience gains/(losses) on scheme assets:			
Amounts	1.2	(1.0)	(1.3)
Percentage of scheme assets	9.7%	7.6%	10.9%
Experience gains on scheme liabilities:			
Amounts	-	0.1	0.1
Percentage of present value scheme liabilities	-	1.4%	1.6%
Total amount recognised in the Statement of Total Recognised Gains and Losses:			
Amounts	1.2	(0.2)	(0.8)
Percentage of present value of scheme liabilities	9.7%	2.8%	12.7%

17 Related parties

During the year, an indirect subsidiary of the Company made a payment of £45,000 (2013: £60,000) to C R Deacon, a director, for consultancy services.

18 Immediate and ultimate parent company and controlling party

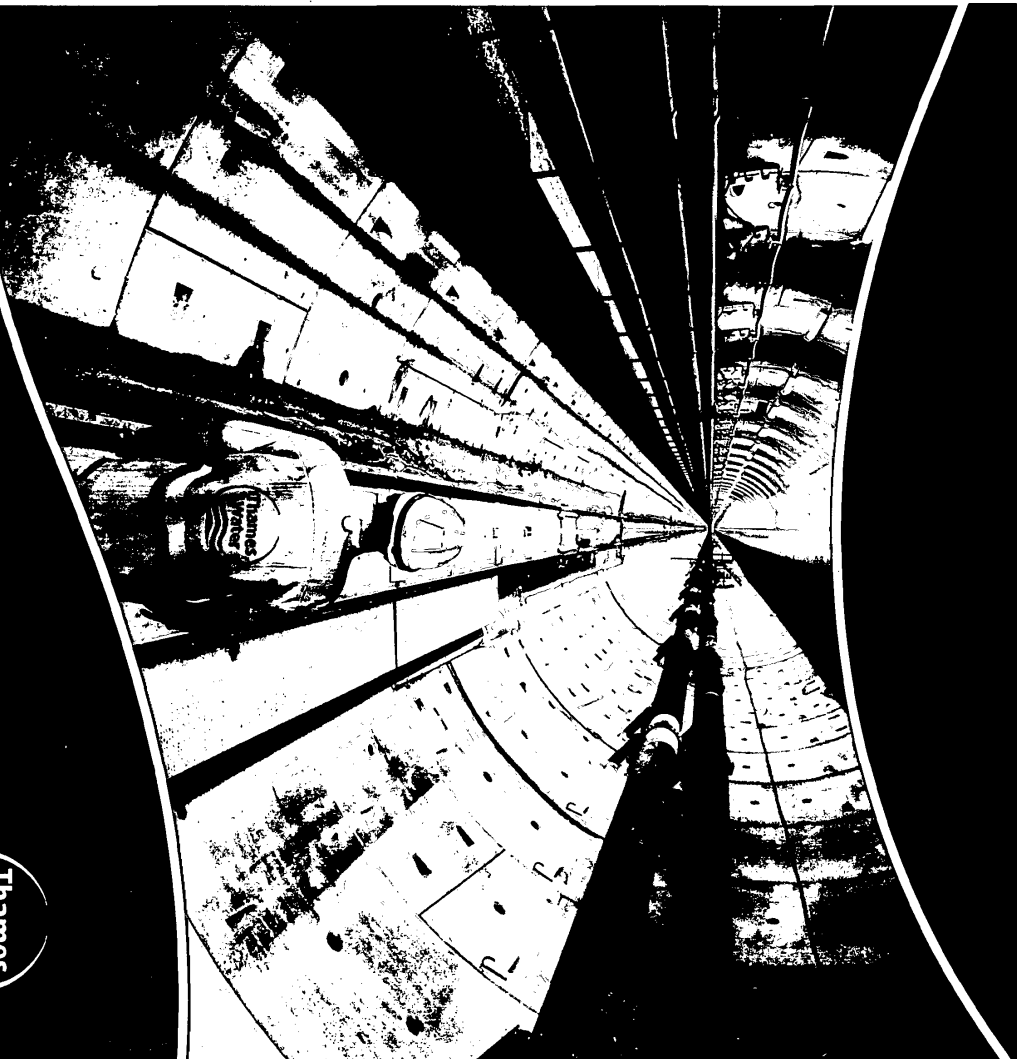
On 28 March 2014 the former immediate parent company of Thames Water Limited, Thames Water Holdings Limited sold Thames Water Limited to Kemble Water Finance Limited, a subsidiary of Kemble Water Holdings Group Limited. Therefore at 31 March 2014, the immediate parent company of Thames Water Limited is Kemble Water Finance Limited which owns 100% of the share capital.

Kemble Water Finance Limited, a company incorporated in the United Kingdom, is the smallest group to consolidate these financial statements.

The directors consider the ultimate parent company and controlling party to be Kemble Water Holdings Limited, a company incorporated in the United Kingdom and largest group to consolidate these financial statements. Copies of the accounts of all of the above companies may be obtained from The Company Secretary's Office, Thames Water Group, Clearwater Court, Vastern Road, Reading, Berkshire, RG1 8DB.

Investing in our future

Thames Water Utilities Limited
Annual report and financial statements 2013/14



We provide the **essential service**
at the heart of **daily life, health**
and **enjoyment**.



We have **15 million customers**



27% of the population
of England and Wales

We built the UK's
first desalination
plant to make
us **more resilient**
against drought



We operate

2,650



pumping stations

We operate



major
reservoirs

Each day we treat

4.4 billion



litres of sewage

We operate

350

sewage
works

We **generate** enough
electricity from sewage
to run a city the size of



We operate



water treatment works

We built the UK's
first industrial-scale
sewage recycling
plant to turn wastewater
into water for irrigation
and toilet flushing



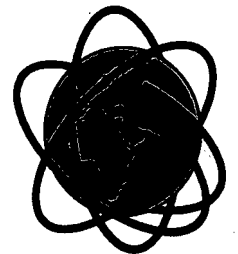
Each day we
provide nearly
2.6 billion litres of
top-quality
drinking water

2.6



By 2020 we will
generate 33%
of our **power**
renewably

We have **87,000 miles**
of water mains and sewers –
enough to wrap around the
world more than **3 times!**



2013/14 Highlights

Operational

- Our drinking water is among the **best in the industry** with a water quality compliance score of 99.99%
- **Reducing leakage** - we beat our regulatory leakage target for the eighth year in succession
- Providing a **reliable wastewater treatment service** – we once again met our regulatory targets for sewage treatment work and sludge disposal compliance
- Opened **Europe's first phosphorous recovery plant** in Slough

Customer & Environmental

- Commitment to **delivering a value for money service** – average bills remain among the lowest in the industry
- Excellent work in customer service has seen **written complaints fall by almost a third** from last year
- Delivering **sustained improvements in customer satisfaction** – improving by 12.3% our performance as measured by Ofwat's Service Incentive Mechanism (SIM)
- **Introduced a social tariff** for most vulnerable customers a year ahead of schedule to provide a further 50% discount on bills for qualifying customers
- We have committed to the **contribution of an additional £10m to our Customer Assistance Fund** to share the benefits from a resolution of historic tax issues with HMRC
- Generated 12.7% of our **own renewable power** in the year
- **Protecting water resources** – started the roll-out of our progressive metering programme
- We won the **"Carbon Reduction Initiative of the Year"** at the Water Industry Achievement Awards 2014

People

- Providing a **safer place to work** – injuries amongst our workforce are at their lowest ever rate
- We won the **"Health & Safety Initiative of the Year"** at the Water Industry Achievement Awards 2014
- Employed a total of **45 apprentices** and will be increasing to 75 on apprenticeship programmes in 2014/15
- Our employees completed **16,000 learning and development days** in the year

Investment

- The **Government have specified the Thames Tideway Tunnel** project to be delivered by a separately regulated entity with contingent support from Her Majesty's Government
- Continuing to **enhance the network** through long term efficient investment – more than £1.1bn invested this year on improvements to pipes, sewers and other facilities
- **Significant progress on capital projects** including completing the tunneling phase of the Lee Tunnel, London's deepest tunnel, on budget and to schedule
- Further commitment from shareholders to **reinvest capital efficiencies** taking the total agreed this year to over £150m

Financial

- Total **dividends paid** by Thames Water Utilities Limited of £208.5m (2012/13: £231.4m)
- Continued **growth in Regulatory Capital Value** ("RCV") of 6.2% to £11,569.5m
- Interest cover of 1.8 (2012/13: 1.7) and gearing of 77.6% (2012/13: 77.4%)
- Pre-tax profit increased to £259.3m (2012/13: £144.9m)



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Chairman's Welcome



"In a highly challenging year of unusual weather conditions, continuing economic uncertainty and regulatory change, Thames Water has delivered a strong performance for our customers, employees and shareholders."

Review of the year ended 31 March 2014

Employee safety and wellbeing is the highest priority of the Board and we are focused to achieve the highly challenging target of zero safety incidents. During the year we introduced a number of initiatives, further reinforcing our zero compromise mentality as well as improved health and safety training for our employees. I am pleased that these measures have already borne fruit and work related injuries are now at their lowest ever level.

This year has been dominated by weather conditions that affected many people. Following the driest summer since 2006, parts of our region saw more than double the average rainfall between December 2013 and February 2014, contributing to the wettest winter since records began. These weather conditions have had a significant impact on many of our customers and we remain committed to assisting those affected. This includes working closely with a number of stakeholders including Local Authorities and the Environment Agency to identify and implement a series of local solutions and longer term improvements.

Despite the operational challenges caused by these weather conditions, we have not compromised on providing a safe and reliable water and wastewater service to our customers. Further opportunities to improve and develop our service remain a high priority of the Board.

We have delivered a strong financial performance, performing better than we initially expected despite the impact of the weather conditions. Total revenues have grown by 8.5% to £1,943.7 million largely driven by increased prices. The higher costs caused by the weather, have been largely offset by the positive impact of savings achieved from our business improvement plan and a reduced charge for bad and doubtful debts.

However, our performance at the operating profit level during this five year regulatory period is approximately £200m lower than expected due to the rising cost of bad debt and costs incurred in acquiring 25,000 miles of private sewers. For these reasons we felt compelled to submit an application to Ofwat to recover such costs. We were unable to convince Ofwat that we should recover these additional unfunded costs and we have accepted their ruling. We recognise for many of our customers the cost of living is rising and the affordability of household bills is an immediate cause for concern. We are very aware of our responsibilities and will continue to structure our business to deliver the best value service to our customers.

We have been subject to significant media attention and scrutiny focusing on our financial structure, levels of infrastructure investment and taxes. We are committed to being straightforward and transparent in all aspects of our operations and so we have published a separate document – 'Our Finances Explained' to describe how we structure our finances to fund our activities.

We have continued to improve the customer service we provide as measured by Ofwat's Service Incentive Mechanism score. We acknowledge that further progress in this area is a necessity and the Board is focused on supporting the Executive Team in their delivery of a programme of activity, detailed in our recently submitted Business Plan, as we approach the next five-year regulatory period.

Investing in our future

At Thames Water we are aware of the economic, environmental and social benefits that we are able to bring to the region, and where we can we make a positive difference. Investment by water companies has a particularly significant role to play in contributing to the local economy including job creation and improving the quality of life of our customers. We directly employ over 4,500 people in the region and in the year we have taken on a total of 10 new apprentices as part of our work based learning initiatives. We have now launched our 2014 Apprentice Campaign, with the aim of recruiting a further 30 apprentices.

During 2013/14 we have directly invested more than £1.1bn in additions and improvements to our capital assets. This includes a major expansion of London's sewage networks through the Thames Tideway Programme and we have also made good progress on the Lee Tunnel, London's deepest tunnel. These projects represent the largest investments in infrastructure since the water industry was privatised and are urgently needed to tackle major discharges of untreated sewage into the River Thames.

Effective governance

The Board supports the increased calls, including those from Ofwat, for enhanced transparency and improvements in corporate governance. We have committed to address these concerns and we will continue to work with our shareholders to obtain their approval to implement a revised governance framework by the start of April 2015.

During the year we have introduced various changes to enhance our governance, including the appointment of Michael Pavia as the Board's Senior Independent Non-Executive Director, my appointment as an Independent Chairman and the establishment of a new Committee to nominate my successors as Chairman in due course.

Future outlook

Our industry is about to undergo the greatest level of change that it has witnessed since it was privatised in 1989, with increased competition from 2017 amongst several upcoming challenges faced by all companies in the industry. We recognise the importance of changing with the times and have embarked on a programme of transformational restructuring and reorganisation to ensure efficient delivery of our business plans to 2020 and beyond.

I do not expect the coming year to provide any less of a test for the Company. However, notwithstanding the current issues we face, I remain confident about the future success of our business and that we will continue to effectively deliver our quality service to the stringent standards our customers expect. In taking forward these plans, we will not lose sight of our essential purpose of delivering safe, reliable and cost effective services, along with fair returns for shareholders, while continuing to protect the natural environment on which our business depends.



Sir Peter Mason
Chairman

Strategic Report

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Introduction by the Chief Executive Officer



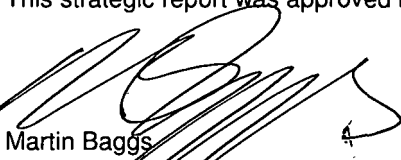
“Thames Water has delivered a strong performance in the year and the transformation process on which we are currently embarking will ensure that we continue to deliver essential services to our customers in a rapidly changing environment.”

I am pleased to present, on behalf of the board, Thames Water’s Strategic Report for the year ended 31 March 2014. Under the new reporting regime this is the first year in which we have presented this within our Annual Report and Financial Statements. We have structured this report into several distinct sections which incorporate: our vision, strategy and business model, my review of the year, an assessment of our performance as measured by our key performance indicators, a report presented by our Chief Financial Officer detailing our financial results for the year and the principal risks we face as an organisation including the controls and mitigating strategies we have implemented.

2014/15 is going to be a key year for Thames Water as we close AMP 5 and prepare for the next regulatory period, 2015-2020 (AMP 6). We submitted our business plan for AMP 6 to Ofwat in December 2013 and we have received feedback from Ofwat on this plan. These plans focused on water resources in the Thames region and the impact of a growing population, calls to keep bills as low as possible, improving service and preparing for changes to the regulatory environment. 2015-2020 will see significant changes in our market place with increased external competition for business customers from 2017. We are working on a revised plan which will take account of Ofwat’s comments and further customer research. This revised plan will be submitted to Ofwat in summer 2014.

Against this background of greater uncertainty and change I am pleased to present within this report our new business operating model which will redesign the way which we deliver our service to customers and operate as a business. We have developed this model based on extensive involvement and discussions with our customers and employees. This new model will provide us with the flexibility to deal with the challenges that we will be facing and to ensure alignment between our business plans, the needs of our customers and the way we conduct our business.

This strategic report was approved by the Board of Directors on 10 June 2014 and signed on its behalf by:



Martin Baggs
Chief Executive Officer

Our vision and strategy

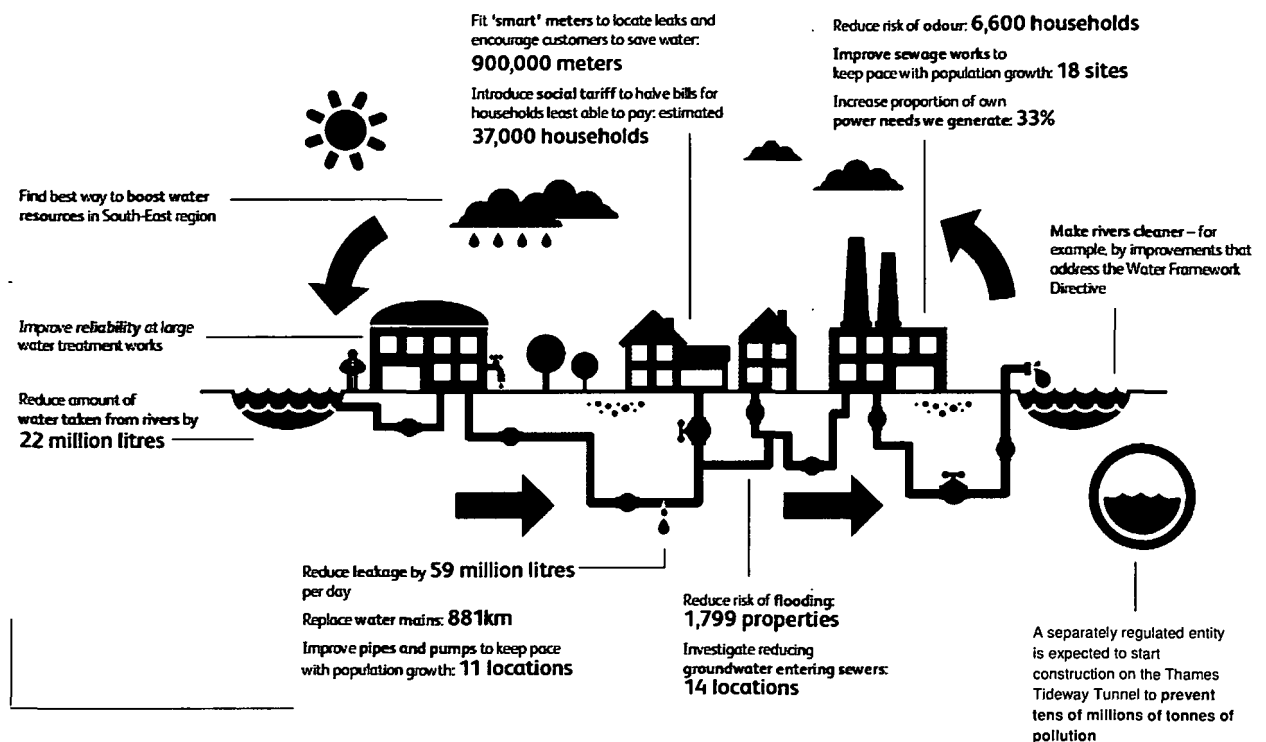
We provide 15 million people in London and the Thames Valley, more than any other UK water company, with an essential service. Clean, trustworthy, reliable drinking water and sanitation, 24 hours a day, 365 days a year is often taken for granted. It shouldn't be, but if it is that's a sign we are doing a good job.

We expect that our role will always be to provide our customers with clean, safe drinking water and to recycle their wastewater safely to the environment. In doing so we will deliver standards of service that meet customer expectations and are affordable, we will comply with all the applicable regulations and we will regard the health, safety and well-being of our staff, contractors and the general public as an absolute priority.

Our five year plan at a glance

It is important that we understand the views of the wide range of people we serve before deciding our plans for the future. In July 2013 we began a public consultation in conjunction with our draft business plan and water resources management plan. Additionally, to help with the development of our plans, we have shared our proposals with our independent Customer Challenge Group.

This summary sets out the main elements of the five year plan we submitted to Ofwat on 2 December 2013.



Our long term strategy, vision and business model looks to address the challenges we will face in the years to 2040 and has been drafted in response to the feedback we have received.

Our vision and values

If customers had a choice they would choose Thames Water

Our vision sets out the kind of Company we aspire to be and what we would like to achieve, with acknowledgement that our stakeholders, including our customers, are central to everything that we do. We aim to provide the best-in-class water and sewerage service, which is profitable and sustainable and act in the long term interests of both our customers and the wider community. This is supported by our five core values that express what we stand for, underpin our vision and are an integral part to working at Thames Water.

- **Supportive** – At Thames Water, we want people to feel safe and secure, able to express their views and able to come up with new and fresh ideas.
- **Challenging** – We want people at Thames Water to search constantly for continuous improvement in the way we work. This means looking at alternative views and pushing the boundaries, questioning each other and ourselves constructively, in whatever part of the business we work.
- **Committed** – We throw ourselves fully into everything that we do, we care about achieving the right outcome and we have the courage to do the right thing. Passion comes through in everything we do, from our first impressions, our attitude, through to the quality of work we produce every day.
- **Reliable** – Being reliable means putting in the effort to get the job done. These people are dependable, trustworthy and consistently deliver for the business and customers. Their positive behaviour rubs off on others.
- **Purposeful** – Purposeful people don't give up easily when the going gets tough. They are persistent, look for ways to overcome barriers, think through problems and refuse to let negativity get in the way, wherever they are in the business.

We are reviewing our vision and values to reflect the challenges we will face in the future. This work is being developed by our own staff and will be made public during 2014/15. This approach will enable us to remain flexible and have the ability to respond to changes in the economic and regulatory environment.

Our business strategy

Alongside the development of our new vision and values we have commenced a series of business mapping sessions that will define our business unit and Company business strategies and embed our AMP6 regulatory submissions into the way we will run our business in the future. These will be completed over the next six months.

We welcome the opening of competition in the sector, which we will help facilitate and develop, and will provide greater choice for customers through the provision of a wider range of services. To help enable this, we will seek out opportunities to work with other industries to lead a strategic approach for the delivery of a better overall experience for our customers.

We will further this approach to working collaboratively with our stakeholders, regulators and other authorities to develop new holistic and sustainable approaches to protect the environment and provide greater benefits to customers. As well as putting customers at the centre of our business we will always strive to deliver continuous improvement for today, whilst providing the flexibility and agility to meet the demands of tomorrow.

We will be incorporating the following functional strategies into the company and business unit strategies to ensure our business has a single defined common purpose.

Our customer service strategy

We provide the most basic and the most essential of all services. Our customers expect to be able to trust us to do that with the utmost reliability. They also expect us to make things easy for them and to show that we care about them.

Our strategy is to provide a top class service for our customers, while ensuring that bills are affordable.

The majority of our customers only need to make contact with us to pay their bills, to tell us they are moving or to update their account details. We will save time, cost and confusion by making sure our bills are easy to understand, accurate and easier to pay with simple and secure online account management and an increased range of available contact options for our customers. When customers do need to contact us, for instance, to report a problem with their water supply, we will place greater priority on getting things right first time and communicating effectively at every stage. To help improve satisfaction and reduce complaints, we will continue to invest in staff training and new technology.

Affordability will always be as high a priority for us as it is for our customers. We have introduced a means-tested social tariff from April 2014 and continue with other ways to help our most disadvantaged customers. We will provide access to frequent consumption data so that customers can choose to manage their usage and their bill through 'smart' metering technology and we have begun the roll-out of this metering programme. We will also provide water efficiency advice to help customers reduce consumption and to manage their bills.

The costs of non-payment of bills are ultimately borne by the customers who do pay. This is an inequitable situation which we will endeavour to mitigate and reduce as much as possible. We will use technology to help us segment customers and capture information about their payment behaviour and their respective abilities to pay, so that we can target the right type of collection activity.

Our water resources strategy

We have a statutory duty to provide reliable supplies of safe drinking water to all our customers. We have to do this with as little impact as possible on the environment, meeting the needs of a growing population, adapting to a changing climate and keeping bills affordable.

Our strategy is to manage demand to the greatest extent possible, including:

- making further reductions in leakage;
- moving progressively to becoming a fully metered company; and
- actively promoting the wise use of water by our customers.

Since, on current projections, this will be insufficient to bridge the gap between supply and demand in the longer term, we will also develop new water resource options that provide overall best value for customers and the environment in the longer term.

Our water treatment strategy

We produce some of the best-quality tap water in the UK, but in operating our treatment works we face significant challenges from population growth and climate change.

Our strategy is to improve gradually both the capacity and the reliability of our major works. We will target investment where the potential effect of equipment failure on customer service is most significant. We have carried out a site-by-site analysis of our existing major works and in the next five years we will focus on improvements to some of our key London water treatment works, to ensure they continue to provide a reliable, safe supply.

Our water distribution strategy

Our water distribution network is the system of pipes, pumps and other infrastructure that delivers treated water to our customers. It includes mains, storage reservoirs, tunnels, aqueducts and pumping stations. A high rate of burst mains, coupled with the need to reduce leakage, means our total expenditure in this area is significant. In addition, about 25 per cent of the written complaints we receive concern issues related to water distribution. Supply failures and the impact of repair work also lead to high volumes of calls from customers.

Our strategy is to make use of the latest technology to monitor and manage the performance of our system and reduce losses of water. Improving our knowledge of the system, with information from many more 'smart' meters, both in buildings and in the network, is key. It will give us a single model to help us identify where replacing mains will best improve our service and reduce long-term costs, easing pressure on bills.

Our wastewater collection strategy

We collect and treat wastewater from 15 million people and recycle it safely to the environment. Our wastewater network includes sewers, pumping stations and other equipment used to capture and transport sewage. The number of calls we receive about failures related to our sewerage service is in line with the industry average. However, the consequences can often be very unpleasant for customers and can involve public health issues, as in the case of sewer flooding. Feedback from customers has told us they see preventing sewer flooding in properties as a priority and that the quality of rivers is a major concern.

Our strategy is to take a fully integrated and active approach to running our wastewater system, from sewers through to treatment works. A major part of this will involve cost-effective measures to reduce the input of rainfall to our sewers. In most areas, our sewers operate as a combined system, with rainwater and foul sewage carried in the same network. High volumes of rainfall can therefore fill the system to capacity, causing untreated sewage to overflow, potentially leading to flooded properties and polluted watercourses. It also increases wear and tear on our equipment, putting pressure on pumps and treatment works and increasing energy costs.

The Thames Tideway Tunnel will be the biggest single wastewater project in the UK since Sir Joseph Bazalgette built London's combined sewage and drainage system in the 1860s. The tunnel is required to deal with the now overloaded combined sewer network in London. The Government has specified the Thames Tideway Tunnel project. Under the provisions of the Flood and Water Management Act 2010, specification means that the project is to be delivered by a separately regulated Infrastructure Provider. We will work towards getting the best deal for customers and the project and the final phase of procurement of the equity has commenced.

Our wastewater treatment strategy

Our 350 sewage works are currently almost 100-per-cent compliant with the treatment standards set by the Environment Agency. Treated sewage effluent often forms a major proportion of the volume in the watercourses to which we discharge it, so our activities play a significant role in safeguarding the ecology of the rivers in our region.

Our strategy is to give priority to ensuring our works continue to meet whatever standards are set, through careful assessment of the risk of failure and focusing investment accordingly. This will include improved monitoring and real-time control of our treatment operations and an increased focus on pre-emptive maintenance work on equipment which, if it failed, could cause significant problems such as river pollution.

This approach will also help us make better informed decisions on where best to invest to reduce the risk of operational problems. This will reduce overall costs in the long term, which in turn will help reduce pressure on customers' bills.

Our sludge treatment and disposal strategy

Around 99% of sewage is water, which we treat and recycle safely to local rivers and streams. The process leaves a solid residue, known as sewage sludge. We have generated renewable energy from some of our sewage sludge, either by digestion or incineration, for decades. Our strategy is to increasingly adopt treatment processes that will maximise the generation of renewable energy and minimise the volume of sludge produced.

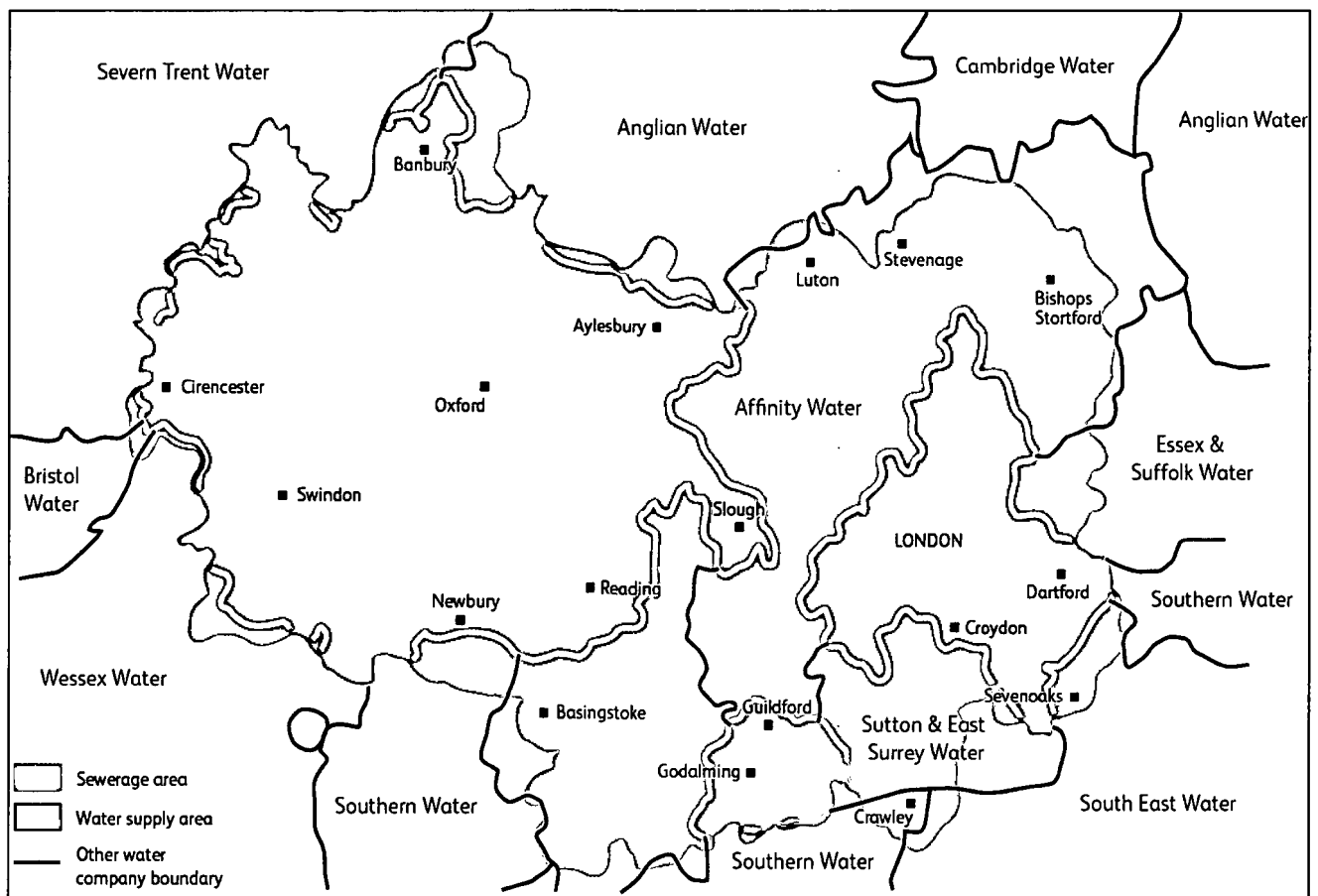
We will continue to comply with the Safe Sludge Matrix, a voluntary agreement between water companies and retailers. This defines what treatment is required before sludge can be applied to certain crops.

We aim to ensure safe and sustainable recycling, to give confidence to farmers and food producers, but also to reduce our reliance on farm land by using other forms of treatment and energy generation.

Our business model

We are the UK's largest water and sewerage company serving the equivalent of 27% of the population of England & Wales covering an area of 5,000 square miles across London and the Thames Valley. Amongst our activities we treat and supply 2.6 billion litres of water per day and transport and treat 4.4 billion litres of sewerage per day. To deliver this we operate 102 water treatment works, 350 sewage treatment works and maintain 87,000 miles of network water mains and sewers.

We are therefore a large and highly complex organisation, but added to this complexity a number of other water supply companies also have a duty to provide water services in this area though we are the only organisation to provide sewerage services. The map below shows the areas which we cover:



This complexity requires us to structure our business model such that we can effectively manage our day-to-day operations, being the provision of a quality and reliable service to our customers, whilst being flexible enough to mitigate and control the risks and uncertainties we face on a daily basis.

Our current business model, which was operating throughout this financial year, is functionally focused and centrally structured. This can be summarised as follows:

- Asset investment – responsible for major capital projects and asset stewardship;
- Operations – which incorporates our waste process plants, clean water process plants, water distribution network, water abstraction and waste collection network;
- Customer service – this includes billing, cash collection and call centre management;
- Commercial – responsible for innovation, property searches and related activities; and
- Thames Tideway Tunnel – promoting the development of the project which we expect will be delivered by a separately regulated entity.

The above businesses are supported by central support services, including financial control, human resources, external affairs and strategy & regulation.

This model has served us well. However we recognise that if we want to give customers the level of service that they expect and to achieve our company outcomes, we need to make a step change in our future operational performance going forward.

Changes in the sector demand that our operating model comprises more business and customer focused entities. We are keen to ensure we have the most appropriate operating model to deliver our future business activities and in line with this, we undertook a strategy mapping exercise alongside the submission of our regulatory plan to Ofwat.

We have concluded that the business should be reorganised over time from our current centralised structure into four separate business units, each with its own managing director and executive team able to focus on its own specific issues, supported by a central corporate services unit thus creating alignment between our business plan commitments and our customers. This will put the business in a strong position to respond to the ground breaking changes that we will see in the sector over the next five years. We will be undertaking detailed business operating modelling early in 2014/15 following on from our vision and values and business strategy activities.

This new operating model will lead, in the longer term, to better targeted accountabilities for each area, better decision making and the ability of each business unit to adopt an appropriate structure and culture to deliver its business plan as effectively as possible. This will also enable the wholesale elements to interact with the retail activities in the same way as any other third party retailer.

The devolution of centralised decision making has already begun and we will see the pace of change accelerate during 2014/15. Although we have made the decision to operate the business in this way we recognise that such a fundamental change to a company of our size is not one to be entered into lightly or hurriedly. We will be developing a detailed implementation plan, and we are committed to restructuring the company in the most appropriate manner to deliver our long term strategy and operating model as efficiently and effectively as possible.

The business units that we will create in 2014/15 are shown below.



Retail Household: Provides customer facing activities such as billing and revenue collection.



Retail Non-household: Responsible for all aspects of retail service delivery to all business customers.



Wholesale Water Services: Responsible for all aspects of water abstraction, treatment and distribution.



Wholesale Wastewater Services: Responsible for all aspects of wastewater collection and treatment to environmental standards.



Central Services: Responsible for shared services across the wider organisation such as financial control, human resources, external affairs and strategy & regulation.

Chief Executive Officer's Review of the Year

Customer service

Our work in the area of Customer Service continues to be a key area of focus and, although we have seen improvement in the year, there remains much to be done. A key measure of customer service, Service Incentive Mechanism ("SIM"), has indicated that 2013/14 saw our best performance yet with respect to customer services; a 12.3% improvement in 2013/14. Our level of written complaints is now at the lowest level we have ever reported in a single year with 21,915 written complaints in 2013/14 on an approximate base of 4.3 million calls and 0.6 million written enquiries from customers. However, we acknowledge that our score remains below industry averages. Therefore, this is an area of continued focus for the Board.

We have also continued to monitor CSAT (Customer Satisfaction) scores daily based on our own surveys, and have seen improving trends. CSAT is the measure used by Ofwat to determine how satisfied our customers are with the service we provide. Using our internal CSAT monitor, 191,515 surveys have been completed across revenue, water and waste services during 2013/14, with the key results provided below compared to prior year.

As can be seen, all areas have shown improvement over 2012/13 in their internal CSAT scores, but there is much to do – we need to improve further by consistently fixing urgent customer problems, keeping our promises and keeping our customers fully informed about service disruptions. Reaching our customer services goals is a key underpin of management performance metrics in 2014/15.

Area of Internal Survey	2012/13 CSAT	2013/14 CSAT	Change
Revenue	4.21	4.47	+0.26
Waste contractor	4.09	4.42	+0.33
Waste field	2.81	3.57	+0.76
Water field	3.31	3.67	+0.36
Overall CSAT Score	3.61	4.03	+0.42

Compliance

There are three key aspects of compliance for our business – Health and Safety, Regulatory and Corporate Governance – which are discussed in further detail below.

Health and Safety

The health and safety of our employees remains a key priority and during the year ended 31 March 2014 we continued our strong focus on this area, with a number of teams operating for considerable periods of time without lost time incidents. This is real evidence that the continued focus on health and safety, not just by our employees, but by our contractors and suppliers, is making a difference to the way we operate as an organisation.

I am deeply saddened to report that there have been two separate road traffic collisions involving suppliers of the contractors working on our behalf which have resulted in fatalities. On 17 March 2014 a supplier's lorry removing spoil was travelling away from the Maida Vale project site when it was involved in a collision with a

pedestrian and on 13 November 2013 a supplier's lorry removing spoil from the Abbey Mills site was involved in a collision with a cyclist at the Bow Roundabout.

The executive team and I feel enormous sorrow for the bereaved. Commercial fleet standards have been an area of focus for the business and our supply chain this past year, which has resulted in the publishing of a formal set of standards which exceed the minimum legal requirements for large vehicle safety equipment. On investigation both vehicles involved in the incidents were found to be compliant with the safety standards of Thames Water and the Fleet Operator Recognition Scheme. We believe investigations by the police are continuing into the cause of these tragic incidents.

During 2013/14 we further enhanced the profile of Health and Safety within Thames Water, leading to an 18% decrease in the number injuries across the organisation compared to last year. This occurred through the introduction of a range of new initiatives:

- At the beginning of the year we introduced the "Thames Water Zero Compromise Card" aimed at empowering all employees and contractors to stop and challenge any unsafe act or condition.
- We introduced Executive Incident Reviews, where every lost time injury to one of our employees, our contractors' employees or a member of the public is reviewed by a member of our senior management. This also includes a review of any significant incident which occurs but does not necessarily lead to injury. This approach has enabled better discussions to be held at the conclusion of any incident investigation providing senior management with confidence that local management actions taken are appropriate and shared across the organisation.
- During the year we launched our online "Lost time counter". This gives around the clock updates on the number of man hours worked since the last workplace injury that resulted in one of our employees or contractors having to take time off work. The counter is visible both on our internal portal and the external health and safety hub and enables immediate enterprise wide learning at an individual level along with providing clear messaging to all on how to avoid similar incidents.
- During the year we have also been running a series of zero compromise and service avoidance stand down days across our contractors and network teams reaching over 3,000 people. This has resulted in the number of service strikes (where another utility provider's infrastructure is affected) reducing by 25% from the previous year.
- This year we have increased the volume of health and safety training within the organisation by approximately 50%. In particular we have introduced the NEBOSH (National Examination Board in Occupational Safety and Health) General Certificate in Occupational Health and Safety as a qualification for our managers, a first for the water industry and we have already seen the first 150 managers now complete the course.
- At the end of September 2013 the UK water industry took part in the first ever Water Wellbeing Week. This was a whole week dedicated to increasing health awareness and encouraging healthy lifestyles. Thames Water introduced the concept and led the communications for the week, developing the literature and multiple activities to get staff and contractors engaged. An estimated total of 200,000 people were involved in the event across the UK.

- Our "Driving Safely" programme was launched during the year with the aim of improving driver awareness and reducing injuries from vehicle incidents. The programme includes compliance through a permit system and vehicle checks, together with online training.
- In the year we introduced a series of formal health and safety risk based audits. The objective of these audits is to provide assurance that the company is compliant with its legal obligations and is demonstrating strong governance and best practice control in relation to a number of selected risk topics. Audits included: mobile plant & traffic management, oil & chemical storage, electricity management and fire management.
- Finally over the next few months, mini-health checks will be available to all company employees.

Regulatory

As noted in our interim financial statements for the period ended 30 September 2013, we submitted an application to Ofwat to adjust customer bills in August 2013. This was to enable us to catch up on revenue that was not factored into prices for 2010 to 2015 when they were last set by Ofwat in 2009. At that point in time certain cost items were impossible to quantify including Thames Tideway Tunnel, land purchases, customer bad debt, acquiring 25,000 miles of additional sewers following a 2011 change in the law and a rise in Environment Agency abstraction charges. If such items had been factored into prices in 2009, our average household bill would have been nearly £6 a year higher across the current five-year period. On 9 November 2013 Ofwat formally rejected our application in their Final Determination, which we have accepted.

On 25 October 2013, we received a letter from Ofwat proposing the imposition of a financial penalty for an alleged contravention in AMP4 (2005 – 2010), specifically in relation to the number of properties reported as having been removed from the register of properties at risk of sewer flooding in our 2010 June Return.

On 5 June 2014, Ofwat published an Enforcement Order relating to an alleged breach of Condition J of our Instrument of Appointment. Ofwat has concluded that the Company misreported the number of properties alleviated from flooding in 2009/10 though has recognised that any misreporting was unintentional and did not continue post March 2010. In response, we have volunteered to spend a total of £8.5m over the next five years on measures which provide redress to our customers and the community. We have therefore made a financial provision of £8.5m (reduced from the total of £14.1m recognised in our interim financial statements). In addition, Ofwat has proposed to make a downward adjustment to the Company's RCV of £79m (plus associated finance costs received between 2010/11 and 2014/15).

On 2 December 2013 we submitted to the regulator our plans for the five years to 2020. This is part of Ofwat's review of pricing for those five years which will take place in 2014 ("PR14"). Our plans have been put together over the last three years, during which time we have consulted widely with thousands of our customers to ensure our plan reflects what customers want at an affordable price. We believe that our plan builds on the delivery of AMP 5 (2010 - 2015), investing to improve further Thames Water's networks and other assets and, most importantly, further improving our service to customers. Ofwat is due to make its "final determination" on our business plan in autumn 2014. While we were not selected by Ofwat for "enhanced status", we received positive feedback from the regulator on our business plan and will submit a revised plan on 27 June 2014.

Corporate Governance

The Directors and the ultimate shareholders are committed to high standards of corporate governance and therefore this area is kept under continual review and scrutiny to ensure it is fit for purpose and transparent.

During the year ended 31 March 2014, we introduced various amendments to enhance our governance as detailed further in the Corporate Governance report on page 60. On 31 January 2014, Ofwat published its principles on Board leadership, transparency and governance for regulated companies. We have provided our draft principles to Ofwat and we will work closely with our shareholders to implement a series of revisions to our governance structure by April 2015.

As mentioned in my introduction to this report, in common with other companies, we are preparing this Annual Report and Accounts under the new reporting regime (introduced by the updated UK Corporate Governance Code and changes to the Companies Act 2006), which required amongst other items, this new Strategic Report, and updated Remuneration and Audit Committee Reports for the year ended 31 March 2014.

Asset Investment

From an asset investment perspective, we have made significant progress on several key projects.

In the past year we have made excellent progress with regard to the Thames Tideway Tunnel project through our participation in public hearings for the planning application, launching the construction procurement and agreeing the preferred structure for delivery of the tunnel with key stakeholders. Also, Her Majesty's Government ("HMG") has specified the project, under the provisions of the Flood and Water Management Act 2010. Specification means that the project is to be delivered by a separately regulated Infrastructure Provider. We have received the consent of secured creditors, those providing debt to fund our activities, to make necessary changes to our loan documents to accommodate the preferred delivery structure. This major new sewer is vital to capture tens of millions of tonnes of untreated sewage that currently overflows into the tidal River Thames from London's Victorian sewers after as little as 2mm of rain. The new tunnel will tackle the overflows, leading to a cleaner, healthier river for people and wildlife. Systems commissioning should commence in 2023 when construction is due to be completed.

Construction of the tunnelling work on the Lee Tunnel is now complete. When the tunnel is fully completed in 2015 it will prevent more than 16 million tonnes of sewage mixed with rainwater overflowing into the River Lee each year by capturing and transferring it to our Beckton sewage works. This tunnel is the deepest in London, at a depth of up to 77 metres and 7.2 metres in diameter, and has been delivered on time and on budget. The Thames Tideway Tunnel will subsequently link into the completed Lee Tunnel as part of our overall London Tideway Improvements programme.

The upgrade of the sewage treatment works at Mogden was completed in May 2013. This £140 million upgrade boosted the treatment capacity of the UK's third largest sewage works by 50% and will significantly reduce the storm overflows into the River Thames, as well as improving the quality of treated effluent returned to the river.

These investments show our continued commitment to improving operational efficiency. The excellent progress that we have made on these projects has not compromised our overall plan which includes continuing to deliver safely our record £1bn-a-year programme of improvements to our pipes, sewers and other facilities. In the year ended 31 March 2014, we invested in excess of £1.1bn.

We strive to find new ways to deliver our service and we are constantly innovating which has complemented our asset investment programme during the year. We have invested £3.9 million (2012/13: £3.9m) in research and development activities to ensure we continue to deliver a high quality service to our customers, and our activities in the year include the following:

- Blockage alarms have been installed at 100 residential properties. These alarms are installed on individual properties and trigger a warning with our customers if their sewer is blocked; and
- We have continued to roll out Thermal Hydrolysis Process (“THP”) across six of our major sewage treatment sites. THP involves heating sludge up and effectively ‘cooking it’ before it is digested. The resultant digestion then releases more gas than with untreated sludge. The resultant gas is burnt to generate renewable electricity. The more electricity we can generate this way the less we have to buy from the grid, again reducing operating costs and our environmental impact. This investment will help us achieve our target to self-generate renewably over 33% of our annual electricity requirements by 2020.

Operations

Our long term priority is to provide a water and wastewater service that complies with all necessary standards and is available when our customers require it. Throughout 2013/14 we have continued to invest in our network and infrastructure and instigated innovative solutions to ensure reliable delivery of our core operations.

Our drinking water achieved a quality compliance score of 99.99% which is our best ever performance and ranks us amongst the best in the industry. Our performance follows a number of improvements in recent years such as refining our sampling process and replacing ageing mains. We also have an ongoing programme of upgrades to parts of our water treatment process, including refurbishing slow sand filters, which has enhanced supplies.

In February 2014 we began a long-term project to progressively meter all properties, starting in Bexley. Installing more meters will be vital in ensuring we have sufficient supplies to meet demand in the future. The new ‘smart’ meters, which can be read remotely, will also locate leaks on our pipes and those belonging to our customers. Additionally we have proactively managed leakage across our water network during the year by increasing the number of repair gangs and their productivity. As a result, the number of outstanding leakage repair jobs has reduced, such that we achieved our regulatory leakage reduction target for the eighth consecutive year.

Within our waste network, we have taken actions to address the number of customer properties which have been flooded (other than by overflows from sewers) such that our monthly performance now tracks very close to Ofwat’s serviceability levels. Significant progress continues to be made through our recovery plan and the extreme wet weather in the winter of 2013/14 has put additional strain on our assets and network. We are aiming to return the waste network to stable serviceability by March 2015.

To ensure we can continue to meet our customers’ needs in the future we have carried out work on two major sewage works along the River Thames which has increased capacity by 41% at our Beckton works and 62% at our Crossness works.

In conjunction with our drive to improve customer service, our extensive business improvement plan has progressed well in the year. This two-year programme has already yielded benefits of £62.7 million for the year ended 31 March 2014 and should yield benefits of around £83 million per year on an ongoing basis.

Despite this improvement, our earnings before interest, taxation, depreciation and amortisation (EBITDA) for the five year period ending 31 March 2015 is forecast to be around £200 million below our original expectations based on the final determination set following the 2009 price review ("PR09").

Commercial

The commercial division focuses on servicing our business customers within the region, and our activities in the year have concentrated on front-end systems and water efficiency services. Total sales in the year were £29.6 million (2012/13: £16.6m).

Within the commercial division we also operate a property searches business, which provides information about our assets for conveyancing purposes and to property developers, and we offer other water related services through third parties. In 2013/14 these activities generated sales of £19.3 million (2012/13: £15.9m).

Financial results

Revenue for the year ended 31 March 2014 rose 8.5% to £1,943.7 million, driven primarily by annual bill increases. Increased network costs and inflationary pressure partially offset by the delivery of cost savings initiatives resulted in operating costs of £1,300.4 million (2013: £1,249.2m) for the year. Consequently operating profit has increased by 19.3% to £655.1 million (2013: £549.3m). Further details on the financial results are provided on pages 38 to 41 of the report of the Chief Financial Officer.

People

We have engaged with our people across the business, raising awareness and understanding of the role they have to play in providing a great customer experience. There has been a key focus on further enhancing our customer experience training for our people that interact with our customers on a daily basis. Additionally we have increased engagement through Executive site and office visits, including roadshows occurring twice a year and individual site visits.

We are committed to increase the number of apprentices employed within the business; we currently employ 45 and plan to take on another 30 during 2014/15.







Many of our employees have been recognised by external organisations in reflection of the results they have achieved and key highlights of this include:

- In February 2014 our treasury team won the Association of Corporate Treasurers' team of the year trophy – the first time a water company has won the award.
- In December 2013 the Lee Tunnel team won the Fleming Awards, presented annually by the British Geological Association, for excellence in geotechnical design and construction. The award was presented for the construction, design and monitoring of one of five shafts being constructed along the route
- Our Health and Safety team won Initiative of the Year at the Water Industry Achievement Awards in April 2014 for the Water Wellbeing Week initiative. This week was attended by 200,000 people and promoted health education for all, along with lifestyle assessments and resilience training.
- Our fleet team was awarded the "Van Excellence" accreditation by the Fleet Transport Association.
- We were shortlisted for the best Human Resources team and best recruitment strategy in the HR Excellence Awards. Our HR director Janet Burr was also shortlisted for HR Director of the Year in the awards, due to be announced in July 2014.

Our performance for 2013/14

We are committed to conducting our business with integrity and transparency to ensure that the decisions we make today are right for the long term. To ensure that our plans, vision and strategies for the future are closely aligned with the ongoing needs and requirements of our customers and other stakeholders we have designed a range of measurable 'outcomes' against which we assess our performance.




These represent the fundamental services and benefits we aim to provide for our customers and the environment in the long term and have been designed to work alongside and support our overall long term strategy and plans as detailed on pages 8 to 11.

-  **Caring for our customers** – We are committed to delivering the basics excellently and aim to demonstrate to our customers that they can trust us, we are easy to do business with and that we care.
-  **Caring for our people** – We aim to recruit and retain the best people and help them reach their true potential. We want all our employees and contractors to be safe and healthy.
-  **Providing a safe and reliable water service** – We aim to provide a safe and reliable water service that is available when our customers require it.
-  **Providing a safe and reliable wastewater service** – We aim to provide a safe and reliable wastewater service that is available when our customers require it.
-  **Limiting our environmental impact** – What we do impacts on the environment in many ways. We aim to limit this impact to achieve a socially responsible and sustainable business for future generations.
-  **Providing value for money and investment** – We aim to provide the level of service our customers require, in the most economic and efficient manner, to ensure their bills are no more than necessary.
























We monitor our performance very carefully against these outcomes, which is done through the use of a number of Key Performance Indicators ("KPIs"). These demonstrate how well we are operating as a business and are grouped together into the above categories. All of our KPIs are monitored by the Board of Directors and senior management on a frequent basis and are used to help us to make effective decisions which affect the business both now and into the future.

Key performance indicator summary

The summary dashboard shown below gives an overview of some of the most important KPIs we use to measure our performance, grouped together by the outcomes we aim to achieve. We assign each indicator a red, amber or green rating to show how we've performed in the year against a benchmark set either by Ofwat or by our own criteria where we have identified other important measures. We define these ratings as follows:

-  **Green** Performance at or above our benchmark
-  **Amber** Performance slightly below our benchmark
-  **Red** Performance significantly below our benchmark

In this table KPIs identified with an * represent those KPIs we are required to report on to Ofwat. Detailed analysis of the metrics relating to 'Providing value for money and investment' have been incorporated into the analysis performed by the Chief Financial Officer within his report on pages 36 to 38.

Caring for our customers, our community and our people	Providing a safe and reliable water service	Providing a safe and reliable wastewater service	Limiting our environmental impact	Providing value for money and investment
 Service Incentive Mechanism*	 Drinking water quality	 Sewer flooding*	 Greenhouse gas emissions*	 Average bill.
 Health and safety	 Supply interruptions*	 Discharge compliance*	 Pollution incidents* (all)	 Post tax return*
	 Security of supply index* (annual average)	 Sludge disposal*	 Pollution incidents* (serious)	 Credit rating
	 Security of supply index* (peak demand)	 Asset performance* (above ground)	 Leakage*	 Gearing
	 Asset performance* (above ground)	 Asset performance* (below ground)	 Condition of SSSIs	 Interest cover*
	 Asset performance* (below ground)			

Service Incentive Mechanism: We have graded our Service Incentive Mechanism statistic as 'green' as our score in the current year of 70.67 is greater than the threshold of 50 as set by Ofwat. Although we have seen a 12.3% improvement in this metric we are well below the industry average and we recognise we need to continue to make significant improvements.

Discharge Compliance: For the 2013 calendar year we have reported two different sewage treatment works discharge compliance scores. This is because on 30 April 2014, the Environment Agency ("EA") issued a revised set of compliance scores, which saw our reported compliance for 2013 reduce from 99.14% to 95.71%. The EA has recommended that we report both figures in our KPI dashboard. The difference is due to a change in the reporting methodology. The regulations relating to the Urban Wastewater Treatment Directive define a minimum number of samples which should be taken each year. On the occasions when we could not take a sample from a sewage works because no treated effluent was being discharged, we did not reschedule these samples. The EA previously considered this an acceptable practice, but has recently told us that it has changed its position and that the revised approach should be applied retrospectively to our compliance figure for 2013. There is no suggestion that the approach we took to sampling caused any damage to the environment.

Caring for our customers



Providing a good and reliable level of service is essential to our business. We have 15 million customers and we aim to demonstrate to all that we can deliver the basics excellently, that they can trust us, we are easy to do business with and that we care.

Improving our customer service



Service Incentive Mechanism: 70.67 (2012/13: 62.90)

We measure customer satisfaction using a two part Service Incentive Mechanism (SIM). The first part allocates a penalty point for each unnecessary contact and complaint made by customers. This includes every occasion on which a caller cannot get through on our telephone lines as well as any abandoned calls. The second part gauges customer satisfaction by independently surveying a sample of those people who have contacted us. The maximum score is 100, and we have graded ourselves as 'green' status as our score is greater than or equal to 50, in line with Ofwat methodology.

Customer service continues to be a key area of focus for us given that our score remains well below the industry average. Our work throughout the year has been rewarded with a 12.3% improvement in our performance against this metric and as such 2013/14 is our best year yet.

Our written complaints are at the lowest level we have ever reported in a single year at 21,915 (2012/13: 32,232) from a total of 4.3 million phone calls and 0.6 million written enquires in 2013/14. This is a reduction of approximately a third on last year, despite the increased volume of calls during the wet winter period. The number of calls to our call centres abandoned by the customer has reduced to 3%, the lowest level we have reported since 2003.

We have also improved our response to complaints, resolving nearly 90% of cases when the customer first wrote to us. We have also made significant progress in reducing unnecessary customer contacts, improving our performance by over 25% from last year.

For those instances where we do get it wrong, we have set out our minimum standards of customer service and the compensation payments we will make if we fail to meet them under our Customer Guarantee Scheme. Details of this are available on our website.

Throughout the year, we continued to provide free extra help to customers who require assistance because of disability or other personal circumstances. Over 58,000 customers were registered for our Extra Care Services in 2013/14 which is over 1,600 more than during the previous year.

We continue to provide financial help for customers who are struggling to pay their bills. This includes donations of £2.1 million to our Customer Assistance Fund which provides help for 3,426 customers and £254K to the Thames Water Trust Fund, who have directly assisted 152 customers and provide assistance to organisations offering debt advice to local residents.

We continue to monitor our customer satisfaction ("CSAT") scores daily based on our own surveys, and have seen improving trends. Using our internal CSAT monitor, 191,515 surveys have been completed across revenue, water and waste services during 2013/14, with the key results shown overleaf compared to prior year.

Area of Internal Survey	2012/13 CSAT	2013/14 CSAT	Change
Revenue	4.21	4.47	+0.26
Waste contractor	4.09	4.42	+0.33
Waste field	2.81	3.57	+0.76
Water field	3.31	3.67	+0.36
Overall CSAT Score	3.61	4.03	+0.42

As can be seen, all areas have shown improvement over 2013 in their internal CSAT scores, but amongst these improvements we acknowledge that there is much more still to do given that our score remains below the industry average. We need to improve further by consistently fixing urgent customer problems, keeping our promises and keeping our customers fully informed about service disruptions. Reaching our customer services goals is a key underpin of management's performance metrics in 2014/15.

Listening to our stakeholders and being a good neighbour

We aim to contribute positively to the community, to be a good neighbour and to act on the views of our stakeholders. We listen to our stakeholders in the community and where possible we will act on their views.

In May 2013 we began an eight week public consultation to seek views on our business plan for the period 2015-2020 including hosting 'roadshow' stands and community events. We spoke to more than 5,000 people during these events and additionally we have held regular meetings with our Customer Challenge Group. This is an independent body whose members come from a range of stakeholder groups and their role is to ensure customers views have been properly considered within our proposals. We have used this feedback to inform our plans into the future, including the business plan which we submitted to Ofwat in December 2013.

We recognise our responsibility, where possible, to give access to the land we own and over 100 of our sites have some form of public access. More than 1,500 people also took advantage of open days at Thames Water sites which are not normally open to visitors, including trips to see our work on the Lee Tunnel. Our educational activities have reached a total of more than 15,000 young people including our community speaker programme and the Network Challenge where we invite students to set up their own water supply network.

Our employees can each take two days leave for volunteering activities. In 2013/14, the number of volunteering opportunities taken up by staff rose from 1,074 to 1,092. The Company has made charitable donations in the year totaling £533K which has been paid to the following charitable organisations:

- £259K to Ten for Ten projects, of which £5K went to educational and recreational projects, and £254K to the Thames Water Trust Fund for income deprived families.
- £118K to the Charities Aid Foundation.
- £61K to the Company's principal charity, WaterAid.
- £60K to Thames21, a range of charities which assist in cleaning rivers and streams in the Thames Valley.
- £35K of other donations.

Our employees also raised £120K either by taking part in fundraising or through our payroll giving scheme. We are pleased to support our colleagues and matched this to a total of £45K which is included in the above figures. We continue to raise funds for WaterAid, where 2013/14 is the third year in our four year bid to raise £2m, half of which will go to support four villages in Bangladesh. Together with our customers, staff and contractors we have so far reached around three-quarters of this total and remain on track to hit our target.

Caring for our people



We aim to recruit and retain the best people; supporting them in their work and helping them make the most of their abilities. It is also vital that we keep them safe and healthy, as well as the many contractors we employ.

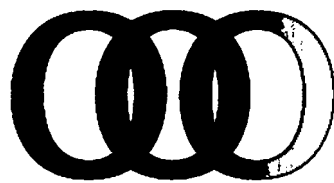
Health, safety and wellbeing



Health & Safety: 0.25 reportable injuries per 1,000 employees (2012/13: 0.25)

Health and safety remains the top business priority for all our staff and the thousands of contractors who work with us and we are all focused on achieving our highly challenging target of zero incidents.

The Board adopts a no compromise mentality to health and safety in all aspects of the Company's operations and is committed to learning from and improving our processes whenever an incident occurs. This is our core message and is central to our vision for all staff, contractors and site visitors which is:



**Zero incidents
Zero harm
Zero compromise**

Keeping you healthy and safe, every day at work

Alongside the implementation of our vision we have further empowered our employees to challenge any unsafe act or condition without fear of reprisal. Additionally we have enhanced the profile of Health and Safety within the organisation through increasing the volume of health and safety training we provide by approximately 50%. In particular we have introduced the NEBOSH (National Examination Board in Occupational Safety and Health) General Certificate in Occupational Health and Safety as a qualification for our managers, a first for the water industry and we have already seen the first 150 managers now complete the course.

All lost time injuries to one of our employees, our contractors' employees or a member of the public is reviewed by a member of our senior management. This also includes a review of any significant incident which occurs but does not necessarily lead to injury. This approach has enabled more productive discussions to be held at the conclusion of any incident investigation providing senior management with confidence that local management actions taken are appropriate and shared across the organisation.

Additionally in the year we have introduced a series of formal health and safety risk based audits. The objective of these audits is to provide assurance that the Company is compliant with its legal obligations and is demonstrating strong governance and best practice control in relation to a number of selected risk topics. Audits conducted in the 2013/14 financial year have included: mobile plant and traffic management, oil & chemical storage, electricity management and fire management.

The implementation of our vision, alongside the associated extensive training and communication programme, has resulted in noticeable improvements in health and safety during the year. Major injuries have fallen by 36% and lost time injuries have decreased by 19% from the previous year to 106. In total all injuries have fallen by 18%. Raising the profile of occupational health along with a range of initiatives has resulted in a 20% reduction in the number of days off work following an injury.

Our key performance indicator, based on the rate of reportable incidents under RIDDOR (Reporting of Injuries, Diseases and Dangerous Occurrences Regulations), has remained the same as in the year before at 0.25 injuries per 1,000 employees. Despite the other improvements in health and safety that we have achieved; as we have not achieved our target of more than a 10% improvement on our performance against this metric from the prior year we have awarded this an 'amber' rating in acknowledgement that we have further to progress in order to achieve our vision.

These metrics constitute real evidence that the continued focus on health and safety, not just by our employees, but by our contractors and suppliers, is making a difference to the way we operate as an organisation.

Developing our staff

We aim to attract a high calibre and diverse workforce and we work to make sure our people have the right skills and opportunities. We aim to ensure our reward and recognition schemes are industry leading.

During 2013/14, our people completed more than 16,000 formal learning and development days across all disciplines, including operations, health and safety, and customer service. Our commitment to developing our own talent is shown by the success of our Apprenticeship Programme which has been running for many years. We currently employ 45 apprentices and plan to take on a further 30 in 2014/15. We also have 18 employees on our Graduate Programme, which seeks to nurture future people managers and leaders, and plan to employ a further 27 later this year.

The success of our programme can be defined through the external achievements of our employees, and particular successes awarded in the year have been detailed within the report of the CEO on page 20.

Diversity

At Thames Water our aim is to attract highly talented individuals who are innovative and can contribute to furthering Company performance. We seek to hire a cultural mix of people who can offer different but complementary attitudes, values, talents and knowledge. We understand the importance of appreciating the unique skills, experiences, background and differences that each individual possesses and that by recognising and celebrating these differences creates a better atmosphere in which everybody feels valued, talents are fully developed and organisational goals are met.

To support this we aim to provide rewarding careers and a supportive working environment that provides an opportunity for all to utilise their talents and which creates a working community that promotes inclusion and encourages individuality. These aspects are central to the growth and success of our Company.

Illustrating this diverse workforce 116 (26.4%) of our senior management team are female and across our total workforce 1,373 (29.3%) of all employees are female.

We are clear that we do not tolerate discrimination under any circumstances and that opportunities should be available to all. We have policies and procedures in place to ensure this is maintained throughout the Company, and this ethos is supported by our corporate values.

Disability

Aligned with the Company's stance on diversity the Company is fully committed to ensuring that existing or potential future employees with disabilities are not treated less favourably than any other such person without a disability and that they are fully integrated into the work environment. Disabilities are not only restricted to disabilities that can be seen, but include physical, mental and sensory impairments, such as those affecting sight or hearing.

The Company is committed to fulfilling its obligations in accordance with the Disability Discrimination Act 1995 and has policies and procedures in place that aim to ensure both job applicants and employees with disabilities have equality of opportunity, are treated fairly and have a safe and practical workplace, free from discrimination, bullying, harassment or victimisation.

We give full and fair consideration to applications for employment made by disabled people. Through disability and attendance management policies, support and training is provided for employees who become disabled during the course of their employment so that they continue to work in a position appropriate to their experience and abilities.

Human Rights

The Company acknowledges the UN Guiding Principles on Business and Human Rights and has policies and procedures in place which ensures we are compliant with these requirements and that this is enforced throughout the Company.

Our Code of Conduct publically expresses our approach to business activities and how we work providing a clear ethical and legal framework for our employees, customers and stakeholders and clearly sets out the minimum behaviours we expect. This Code covers a wide range of human rights issues including discrimination, working conditions and equal opportunities.

Our contractors are required to abide by the provisions of this Code when they are operating on our behalf. We also require all suppliers and contractors to undergo health and safety assessments which are conducted independently by the Achilles UVDB organisation using their utilities verification and assessment scheme.

Ethical Behaviour

Thames Water seeks to promote a culture of honesty and integrity in all its dealings and it will not tolerate acts of fraud, dishonesty, bribery, corruption or theft of assets or data from the business. We are committed to the highest standards of honesty and integrity in all aspects of our operations. Our Code of Conduct helps us to meet this commitment by clearly setting out the behaviours we expect of our employees, and we have separate Honest and Ethical Behaviour policies and procedures in place. We have a confidential 24 hour whistleblowing helpline available to all employees, where individuals can ask questions or raise concerns.

Providing a safe and reliable water service



We aim to provide a safe and reliable water service that is available when our customers require it. This means supplying our customers with water that exceeds all health and safety requirements, whilst making sure that water reaches our customers' taps all day, every day.

Safe and clean drinking water



Drinking Water Quality: 99.99% compliant (2012/13: 99.97%)

We provide 2,600 million litres of high-quality drinking water to our customers every day, sourcing untreated water from rivers and boreholes, treating it at one of our 102 water treatment works and distributing it to our customers through our network of water mains.

Our drinking water quality remains amongst the best in the world. In 2013/14 we took approximately 420,000 samples from throughout our supply network and carried out 458,000 tests to ensure our water met stringent UK and European standards. For 2013/14 we achieved a compliance score of 99.99%, our highest ever, and as such we are ranked amongst the highest in the industry and have graded this metric 'green'.

The number of customer contacts related to drinking water quality remained at a very low level, falling from 0.69 per thousand people in 2012/13 to 0.65 in 2013/14. We have continued with our programme of lead pipe replacement and last year replaced almost 10,400 pipes to keep us on target for meeting the tightening lead standards in drinking water.

However we acknowledge the need for improvement against the Drinking Water Inspectorate's 'Reservoir Integrity Index' which monitors the quality of samples taken from underground storage reservoirs. In 2013/14, 99.93% of samples passed the relevant tests. Although this is consistent with previous years it is not as good as we would like it to be, and we have a range of measures in place to improve our score.

Providing a reliable supply of water



Security of Supply Index (average): 100 (2012/13: 100)



Security of Supply Index (peak): 99 (2012/13: 100)

We use the Security of Supply Index (SOSI) to measure the reliability of our water supplies in the long term. This compares the level of available water against demand and thus represents a measure of our ability to meet that demand. The SOSI is assessed over a full year (annual average) and over a peak week which occurs in the summer (peak period) to measure our demand in hot dry weather. The maximum score that we can achieve is 100.


Average usage per head is approximately 156 litres per person per day, which is around 10 litres above the national average. During the year the demand for water peaked for two weeks in July which represented the highest level of demand in our region since 1995. This, combined with higher than anticipated leakage levels in the Guildford area, resulted in our index score for the peak demand dropping to 99, which is below our target,

however as we are on course to meet our target in the next year we have graded this as 'amber' in accordance with Ofwat methodology. We achieved the maximum level of 100 on the basis of the annual average, which is the maximum value and as such we have graded this metric as 'green'.

Population growth and climate change are likely to increase the future demand for water and we are proactively implementing solutions which will enable us to keep pace with the rapidly increasing demand. Our new 'smart' meters, which can be read remotely, will also help locate leaks on our pipes and those belonging to customers, allowing for expedient repairs and less water wastage. We began a long term project in February 2014 to progressively meter all properties, starting in Bexley. Installing more meters will be vital in ensuring we have sufficient supplies to meet demand in the future

Our water efficiency programme aims to help domestic customers and businesses reduce their water usage. We have exceeded our annual target for the past four years. During 2013/14, our activities resulted in a saving of 5.23 million litres per day, compared to the target figure of 4.42 million litres per day. As such and based on our performance in the year, we should never have to apply severe water restrictions.

We will be continuing our investment in this area with the intention of returning our peak performance score to 100; however, during prolonged periods of very dry conditions, and as a last resort, we may still be required to introduce a hosepipe ban.

 **Water Supply Interruptions: 0.20 hours (2012/13: 0.22 hours)**

We measure the reliability of our supplies by calculating the average amount of time for which each property we supply was without water. On average each property was without supply for 12 minutes, although the majority of customers experienced no interruptions. We have awarded this metric as 'Green' status as this is below the historic average value, in line with Ofwat methodology.

However, there was a significant rise in the number of properties without water for more than 12 hours. During the year more than 6,000 properties were affected, of which over 4,000 were a result of nine events caused by burst mains and power supply issues. We will continue to focus on improving our response to burst mains and are reviewing our power resilience capability.

Looking after our assets

 **Asset Performance (above ground): Stable (2012/13: Stable)**

 **Asset Performance (below ground): Stable (2012/13: Stable)**

The ongoing performance of our water mains, pumping stations and treatment works (serviceability) is measured by analysing trends in performance against a range of measures. This analysis shows that the performance of our assets remained stable last year, and 'green' status has been awarded in line with Ofwat methodology.

Providing a safe and reliable wastewater service



We aim to provide a safe and reliable wastewater service that is available when our customers require it. This means disposing of wastewater in a way that exceeds all health and environmental standards, and without inconvenience to our customers, every day.

Collecting and transporting wastewater safely



Sewer Flooding: 471 incidents (2012/13: 549)

We remove and safely treat 4,400 million litres of wastewater for 15 million customers every day. This includes collecting and transferring wastewater through our network of sewer mains and pumping stations, treating it at one of our 350 sewage treatment works and safely disposing of treated sludge.

Like many other parts of the UK, our region saw the wettest winter on record, which proved very challenging. Our sewer network was overwhelmed by flood water from rivers, rain water and groundwater, causing it to overflow in some places. The sewer flooding KPI measures incidents of internal flooding at properties which have repeatedly flooded. In 2013/14 there were 471 repeat incidents, which is a reduction of 78 from the previous year. Despite the reduction, we recognise that this is an unacceptable service failure for our customers and we still have much to do. 'Amber' status is given as the number is within the range around the 2008-2010 historic average, defined as 416-547 incidents, in line with Ofwat methodology.

The wet winter caused a significant increase in cases of external flooding. However, the number of flooding incidents caused by blockages fell by a third from the previous year. We also improved our average response time to calls about flooding. Additionally we have brought forward a scheme to reduce sewer flooding in the Counters Creek catchment in west London, and will now be spending an additional £26 million before April 2015 to reduce the risk of flooding in this area.

Treating wastewater and returning it safely to the environment



Sewage Treatment Works Discharge Compliance: 99.14% and 95.71% (2012/13: 99.13%)

As discharges from our sewage treatment works often make up a major proportion of flows in rivers, it is really important that we get our treatment processes right to maintain the health of the river. The Environment Agency is responsible for setting quality standards at each of our 350 sewage treatment works. The discharge compliance KPI measures our compliance with these quality standards.

For the 2013 calendar year, we have reported two different sewage treatment works discharge compliance scores. This is because on 30 April 2014, the Environment Agency ("EA") issued a revised set of compliance scores, which saw our reported compliance for 2013 reduce from 99.14% to 95.71%. The EA has recommended that we report both figures in our KPI dashboard.

The difference is due to a change in the reporting methodology. The regulations relating to the Urban Wastewater Treatment Directive define a minimum number of samples which should be taken each year. On the occasions when we could not take a sample from a sewage works because no treated effluent was being discharged, we did not reschedule these samples. The Environment Agency previously considered this an acceptable practice, but has recently told us that it has changed its position and that the revised approach

should be treated retrospectively to our compliance figure for 2013. There is no suggestion that the approach we took to sampling caused any damage to the environment.

In a letter to us dated 9 June 2014, the EA said that *"we recognise that this was a mistake due to a misunderstanding of how to deal with 'no flow' samples ... Unfortunately, we did not pick this up early enough to advise the Company to make up the shortfall. Such 'no flow' samples had been accepted in the past. We note that these failures did not result in any environmental impact."*

To ensure we can meet our standards and our customers' needs in future, we have carried out work on five major sewage works along the tidal River Thames. This has increased capacity by 41% at our Beckton works and by 62% at our Crossness works, to meet future demands and quality standards. Additionally we have increased the treatment capacity at eight other works in areas where population is growing and improved the quality of effluent at 14 other works, including three which are due for delivery in 2015.

Limiting odour

We aim to minimise the odours that can occasionally arise at our sewage treatment works and cause an issue for residents living nearby. During 2013/14 we completed work to reduce the risk of odour at our Slough site, and have ongoing work at Beckton in east London, and Long Reach in Dartford, both of which we are due to finish in 2015.

Disposing of sludge

 **Satisfactory Sludge Disposal: 100% (2012/13: 100%)**

Sewage sludge is the main by-product of the wastewater treatment process. This KPI measures the percentage of sludge we dispose of safely. The production, treatment and recycling, reuse or disposal of sewage sludge is controlled by comprehensive legislation, with which we maintained 100% compliance in 2013/14 and so we have graded this metric as 'green'.

Looking after our assets

 **Asset Performance (above ground): Stable (2012/13: Stable)**

 **Asset Performance (below ground): Marginal (2012/13: Marginal)**

The performance of our wastewater assets, sewers, pumping stations and treatment works is measured against a number of key indicators. These include the number of blockages and collapses on our network, and the number of pollution incidents and compliance with discharge consents at sewage works.

The performance of our sewage treatment works has continued to be excellent, and we have therefore assessed the performance of these assets to be 'stable' and graded this metric as 'green'.

We have assessed performance of our below-ground wastewater assets, however, to be 'marginal' and graded this as 'amber' in line with Ofwat methodology. This grading has been driven by a marginal performance assessment of the pollution and sewer flooding other causes indicator. This was due to a number of factors,

such as slower response times to problems with our sewers, the continuing impact of our adoption of privately-owned sewers, and the severe winter weather.

We are continuing to implement our recovery and action plans and forecast that our performance will return to 'stable' over the next year. As part of this action plan, we have undertaken nearly 125 miles of additional sewer cleaning, worked with our contractors to reduce response times, installed a large number of additional monitors to our network to detect when problems are likely to occur, extended our 'Bin it don't block it' education programme to 80,000 customers and sent fat munching bacteria sachets to 10,000 customers.

Reducing sewage overflows in London

Major work is progressing to upgrade London's sewer system and tackle the growing problem of overflows to the tidal River Thames. Construction is well under way on the Lee Tunnel, which will help prevent more than 16 million tonnes of sewage entering the River Lee each year. The second of these two new sewers is the proposed Thames Tideway Tunnel, which will address discharges of sewage into the Thames and is expected to be delivered by a separately regulated entity. It will be 15 miles long, and will be one of the longest and deepest tunnels under London. Both sewers will transfer wastewater to our biggest treatment works, at Beckton in east London. The third part of the solution is the improvements to our five major sewage treatment works in London, all of which discharge into the Thames.

Protecting the environment



What we do impacts on the environment in many ways. We aim to limit this impact as a socially responsible and sustainable business. Understanding and addressing the causes of climate change and adapting to its consequences are key elements of our business planning

Managing our emissions



Greenhouse Gas Emissions: 739,157 tCO₂e (2012/13: 770,322 tCO₂e)

We calculate our greenhouse emissions using the UK Water Industry Research Carbon Accounting Workbook ("CAW"). The CAW is the industry standard which is updated annually to reflect changes to emission factors and carbon reporting guidance from Defra.

Operational Greenhouse Gas Emissions ("GHG") within the regulated business are calculated annually for use in company performance reporting reflecting the six major greenhouse gases and the Defra Environmental Reporting Guidelines. The emissions reported are associated with the operational emissions of the regulated business and include:

- Scope 1 (Direct emissions)
- Scope 2 (Indirect energy use emissions)
- Scope 3 (Emissions from outsourced services and business travel)
- Carbon intensity ratios per mega-litre day (MLd) of service delivered

Emissions from the greenhouse gases are standardised to global warming potential represented as carbon dioxide equivalents ("CO₂e"), and are independently audited by CH2MHill.

Our total GHG emissions have fallen from 770,322 tCO₂e in 2012/13 to 739,157 tCO₂e which represents a decrease of 4.0%. Additionally the annual quantity of emissions arising from the purchase of electricity consumed plus transmission and distribution has decreased from 534,763 tCO₂e to 500,940 tCO₂e, a decrease of 6.3%. We have graded this as 'green' status as we are in line to meet our projected target for 2015 within the tolerances specified within Ofwat's methodology.

The overall decrease in our GHG emissions was predominately due to a change in Government accounting practices. Defra has changed the method for converting energy use into carbon emissions from a five year rolling average approach to conversion factors based on a single average factor for a particular year. The level of GHG emissions arising from our normal business operations can be expressed as follows:

	2013/14	2012/13	% Change
Operational GHG emissions per MI of treated water	270.9 kgCO ₂ e/MI	298.2 kgCO ₂ e/MI	-9.2%
Operational GHG emissions per MI of sewage treated	272.5 kgCO ₂ e/MI	266.1 kgCO ₂ e/MI	+2.4%

Our energy consumption increased in 2013/14 due to the exceptional winter rainfall and rising wastewater quality requirements which meant we had to pump significantly more wastewater through our sewers than during a typical winter. The impact of the additional energy demand was partially offset by our energy efficiency activity.

In 2013/14 we generated 156 GWh of renewable electricity at our operational sites, the same as 2012/13. This was achieved despite a range of challenging factors, including operational problems and the very high winter rainfall, which diluted sewage, reducing the amount of biogas we could produce and use to generate renewable energy. We used 153 GWh of this energy ourselves and exported the remainder to the National Grid. A total of 12.7% of our electricity requirements were covered by self-generated renewable electricity.

On 1 April 2014 we won Carbon Reduction Initiative of the Year at the national Water Industry Achievement Awards for an innovative scheme at Lower Basildon sewage treatment works. We used specially planted reed beds to filter wastewater, removing the need to import additional power to the site. We remain accredited to the Carbon Trust Standard, which recognises our efforts to reduce carbon emissions.

Preventing pollution incidents



Pollution Incidents (all sewerage): 89.6 incidents per 10,000km sewer (2012/13: 68.49)



Pollution Incidents (serious sewerage): 3.22 incidents per 10,000km sewer (2012/13: 2.34)

The Environment Agency categorises pollution incidents on a scale from one (most serious) to four (no significant environmental impact). They maintain the official database of all reported pollution incidents and confirm numbers for each calendar year. For the calendar year ended 31 December 2013, the total number of Category One and Two pollution incidents was 22, an increase of six from the previous year. The number of Category Three pollution incidents increased by 28% to 590 incidents. 'Amber' status has given where the number is within a defined range, around the historic water industry average for 2008-2010. For the current financial year this was:

- For all sewerage incidents: 50-130 incidents
- For serious sewerage incidents: 1.5-4.0

The increase was partly due to the heavy rainfall at both the start and end of the year, which in some areas breached the capacity of sewers and flooded pumping stations. We continue to work hard to prevent pollution taking place and to improve our response when it does. Every Category One and Two pollution incident is thoroughly investigated and is subject to a thorough review with our Chief Executive Officer and Operations Director. Our aim is to understand the cause, whether the incident was predictable (and therefore preventable) and whether our response could have been improved. We share the lessons learnt from these reviews with other operational teams, to prevent similar incidents occurring in a different location.

During the calendar year ended 31 December 2013, our average response time reduced and we focused on priority activities. By the end of the year, we were attending 79% of incidents within an hour, a significant increase from 48% in April 2013 despite the exceptionally heavy winter rainfall.

Leakage

 **Leakage: 644 million litres per day (2012/13: 646)**

Fixing leaks remains a major priority, in line with the concerns of many customers and stakeholders. We have graded this as 'green' as we have achieved our annual target set by Ofwat (673 Ml/d) for the eighth year running, with leakage in 2013/14 two million litres per day lower than the previous year.

Making environmental and wildlife improvements

 **Condition of Sites of Special Scientific Interest (SSSI): 99% (2012/13: 99%)**

Much of the land we own is within important wildlife areas including Sites of Special Scientific Interest (SSSIs). There are 32 parcels of land, spread across 12 sites, for which Natural England considers us to be an 'influential land manager'. We aim to have a positive impact on these locations and benefit the wildlife that flourishes there. We have again met the target set by Natural England for the positive management of SSSIs, with more than 99 per cent of those for which we are responsible classified as 'favourable' or 'unfavourable recovering'. We award this metric as 'green' where the percentage of sites in the top two categories exceeds 95%.

Recycling waste

In 2013/14 we recycled, or sent to a recycling facility, 99.8 per cent of the waste produced from our capital projects, including spoil from road works. Increasing landfill taxes and a declining number of landfill sites encourage an increased focus on recycling. Waste is now recognised as a valuable commodity as most can be recycled to generate income.

Chief Financial Officer's Report



“At a time when household budgets are tight it is more important than ever that we find cost effective ways to continue our delivery of a value for money service.”

Key financial highlights

At Thames Water we aim to deliver for our customers a safe, reliable and value for money service. However we must also ensure that we are able to provide adequate returns to our investors as they provide the capital that we require to fund continued investment in developing and maintaining the infrastructure network.

We do recognise that this is a difficult time for many of our customers who may be struggling with their overall cost of living. We continually aim to provide our essential services in the most economic and efficient way possible to ensure that bills are no higher than necessary. Our average annual bill (which represents the average combined water and wastewater

bill for our household customers) in 2013/14 was £358. This is an increase from 2012/13 of 6.25% and was primarily driven by increases in the retail prices index coupled with real price increases.

However, despite this increase, our bills remained the second lowest of all the major water and sewerage providers in England and Wales and we continue to invest around £1bn per annum developing and maintaining our infrastructure, more than any other water and sewage company. We will continue to structure our finances and operations to ensure that we keep our bills as low as possible.

For this financial year we have delivered a strong financial performance in excess of our initial expectations. This performance was achieved whilst managing costs relating to the impact of weather conditions on our operations and a continued level of bad debt expense above the allowance set by PR09. A summary of our key financial performance indicators have been included within the table below:

	2013/14	2012/13
Post-tax return on capital	4.88%	4.31%
Credit rating*	Baa1	Baa1
Regulatory capital value	£11,569.5m	£10,896.6m
Gearing	77.6%	77.4%
Interest cover	1.8	1.7

*Representing the consolidated Corporate Family Rating assigned by Moody's

Post-tax return on capital

The post-tax return on capital is a regulatory measure of the level of post-tax regulatory operating profit the Company makes on its asset base. We operate our business to allow for a reasonable return on the money provided by our investors to fund continued investment in our infrastructure. The post-tax return on capital was 4.88% for the year and compares to our performance of 5.42% cumulatively for the current asset management

period ("AMP") to date. Overall this was greater than the regulator's assumption of 5.0% that was set at the commencement of the AMP and the improved performance we have achieved from the prior year demonstrates the effectiveness of our ongoing cost management programme in driving business efficiencies and cost reductions.

Credit rating

The Company has maintained its investment grade credit rating of Baa1 for the year ended 31 March 2014. We obtain credit rating assessments each year from both Moody's and Standard & Poor's which also serve as an external assessment of our performance and prospects.

A Corporate Family Rating ("CFR") is assigned by Moody's and reflects the consolidated rating of the different classes of outstanding debt obligations issued by the financing subsidiaries of the Company. Our licence requires us to maintain this with an investment grade rating at least Baa3 from Moody's or BBB- from Standard & Poor's ("S&P"), as this ensures the Company can access the debt funding that we need to ensure delivery of the investment programme in an efficient and cost effective manner.

Subsequent to the financial year end, on 16 April 2014, we publically announced the commencement of a process to obtain consent from our Class A secured creditors for changes to the whole business securitisation agreement. This was approved in May and the amendment will enable us to utilise the preferred method, a separately regulated infrastructure provider, for the delivery of the Thames Tideway Tunnel.

The development of the tunnel project through a separately regulated infrastructure provider will ring-fence the Company from the main construction risk and is credit positive. However, subsequent to our announcement, Moody's have placed the Company on negative outlook. This reflects the Company's exposure to residual reputational and financial risks associated with the Thames Tideway Tunnel that other companies within the sector do not face, rather than the underlying financial performance or prospects of the Company. Moody's has also provided revised guidance to maintain an interest cover ratio of 1.4, which is higher than other companies in the industry, whilst maintaining an adjusted net debt to RCV ratio of 82.0% or lower. We expect to submit a business plan at the end of June 2014 that is consistent with maintaining Moody's credit rating of Baa1.

Regulatory capital value

The regulatory capital value ("RCV") has been developed by Ofwat for regulatory purposes. This is a measure of the regulatory net book value of our assets expressed in current cost terms and is published by Ofwat on their website. This is a key measure of focus as it is used by Ofwat in determining the prices that the Company is able to charge. The increase of this measure is driven by the impact of inflation as measured by RPI, which is used to index up the value of reported assets, and the excess of our capital expenditure over grants received and depreciation charged.

Gearing and interest cover

Our investments are funded by a combination of equity from our shareholders and from borrowings under long term secured financing arrangements including bank loans and bonds. Our gearing of 77.6% (2013: 77.4%) is measured by comparing the sum of our net debt of £8,910.1m and debt issuance cost not yet amortised of £62.1m against our RCV of £11,569.5m.

As part of the whole business securitisation agreement with our secured creditors we are required to keep these within certain financial limits. Under these covenant conditions we are required to maintain a gearing

level below 85.0% and an interest cover ratio of at least 1.1. Our dividend payment policy requires that we maintain these ratios with minimum headroom on our gearing ratio of 2%.

Our financial performance for the year ended 31 March 2014 ensures that we have met the conditions defined within our covenants within the headroom required by our dividend payment policy.

Financial performance

The key measures of our financial performance are detailed below, all of which are used by the Board of Directors in assessing the performance of the Company. The directors consider the Company to have one class of business which is conducted solely within the United Kingdom; as such we have elected to present the following analysis of the performance of the Company as a whole.

	2013/14 £m	2012/13 £m
Turnover	1,943.7	1,791.9
Operating costs	1,300.4	1,249.2
Net interest payable	408.4	405.3
Profit on ordinary activities before taxation	259.3	144.9
Net debt	8,910.1	8,372.7
Cash flow from operating activities	1,158.5	1,057.0
Capital expenditure	1,156.5	1,008.2
Dividends paid	208.5	231.4

Turnover

Total turnover for the year has increased by 8.5% to £1,943.7 million, which has been largely driven by a combination of annual bill increases and higher water consumption impacting both domestic and commercial volumes. This increase in consumption was primarily due to an increase in demand caused by dry summer weather during 2013.

Operating costs

Effective cost control is a significant aspect of managing our business responsibly. In 2013/14 we launched our Business Improvement Plan, which identified those areas where we can either reduce costs or where we can perform aspects of our operations more efficiently. These plans have resulted in efficiencies and other cost savings of £62.7 million in 2013/14 however; we expect recurring cost savings to reach approximately £83 million per annum from 2015 onwards. These savings are wide ranging throughout the business and are represented by reduced employment, materials and consultancy costs and power generated from renewable sources.

Despite the cost savings achieved through the Business Improvement Plan, our operating costs have increased by £51.2 million when compared to 2013. This was primarily due to the increased costs that we incurred from higher than anticipated levels of activity in the Company's water and waste water networks. Following the drop in the serviceability in our waste network in 2013 we have increased spending in this area with the goal of returning to stable serviceability by March 2015. Operating costs also reflect the S203 AMP4 sewer flooding settlement of £8.5 million.

We continue to spend considerable sums of money on leakage prevention and reduction in our water networks. The wet winter weather of 2013/14 has had a significant impact on our networks and we have incurred approximately £21 million of costs, in excess of normal levels, to ensure we maintain services to customers during these difficult conditions.

Bad debt costs remain at a high level as customers continue to struggle in the current tough economic climate. In line with our expectations our bad debt provision expense was £60.0 million for the year ended 31 March 2014. The charge in 2012/13 of £93.7 million reflected an additional charge to bring the bad debt provision into line with the lower levels of cash collections during the recession reflecting the severity of the recession on our customers' ability to pay. The Executive and our Customer Service Management Team have implemented measures to manage the level of bad debt which has seen the proportion of our bad debt as a percentage of regulated revenue decrease from 5.3% in the previous year to 3.1%. This remains a significant issue within the wider industry and is a key focus of the Company where we ultimately aim to reduce this measure to the 2.5% average we achieved during the previous AMP4 regulatory period.

Net interest payable

Net interest payable comprises the interest we pay on our borrowings offset by the interest we received on our intercompany loans and financial instruments. The overall increase in net interest payable from the prior period was primarily caused by lower levels receivable from group undertakings. New borrowing was incurred to fund the Company's investment programme, repay debt maturing in the year and maintain a high level of liquidity.

Net Debt

Net debt is a measure of the total outstanding short and long term borrowings net of cash and liquid resources. The increase in this measure has been primarily driven through additional borrowings made in the period which we incurred in order to fund our capital expenditure programme. This year we have spent more in funding fixed asset additions, including improvements and maintenance to the general infrastructure, than the cash inflow generated by our normal operating activities. As such these loans form an important part of the Company's financial risk management policy and the proceeds of which have been used to fund our investment in infrastructure.

Cash flow

Cash flow from operating activities has increased to £1,158.5 million (2013 £1,057.0m). This has been primarily driven by improvements in the profitability of the business' underlying operations reflecting the positive savings that we have achieved through the Business Improvement Plan and improvement in revenues generated.

Capital expenditure

Capital expenditure in the year was £1,156.5 million as the Company continues its £1 billion a year capital programme, the largest of any water company in the UK's history. Expenditure on key projects and our significant achievements in the year include:

Project	2013/14 £m
Thames Tideway Tunnel	£200.8
Lee Tunnel	£130.9
Beckton & Crossness Upgrade	£128.0
Oxford Sewage Treatment	£21.0

In the past year we have made excellent progress on the Thames Tideway Tunnel project. Following the submission of application for Development Consent Order (DCO) in February 2013, the Planning Inspectorate conducted hearings from September 2013 to March 2014 with the final submission on 12 March 2014. We expect the final report to be issued in the autumn of 2014. Main works procurement has progressed with tenders released for the East, West and Central regions. During the year, the project acquired freehold land at Whiffen Wharf and the long leasehold of Camelford House. We have begun work to establish a new independent company which will deliver the project and which will be sold on to external investors. A management team has been established to manage this transition with key appointments of Sir Neville Simms, former Chief Executive of Tarmac and former Chairman of Carillion, as Chairman in November 2013 and Andrew Mitchell, joining from the Crossrail Project where he was Programme Director and member of the Board, as CEO in May 2014.

The tunneling of the 7.2m diameter, 6.9km length Lee Tunnel was completed in January 2014. This was a key milestone in the project from both a progress and risk viewpoint. The project remains on track for completion in December 2015.

The construction phase of the Beckton and Crossness Thermal Hydrolysis Plants were completed on both sites during the year and pre-commissioning checks and tests have started. Process commissioning (treating sludge through the new process) will commence during 2014 with power generation expected later in the summer. The wind turbines, which form part of the planning requirements, were both also constructed and commissioned during the year and are generating up to 2.5MW of renewable power each.

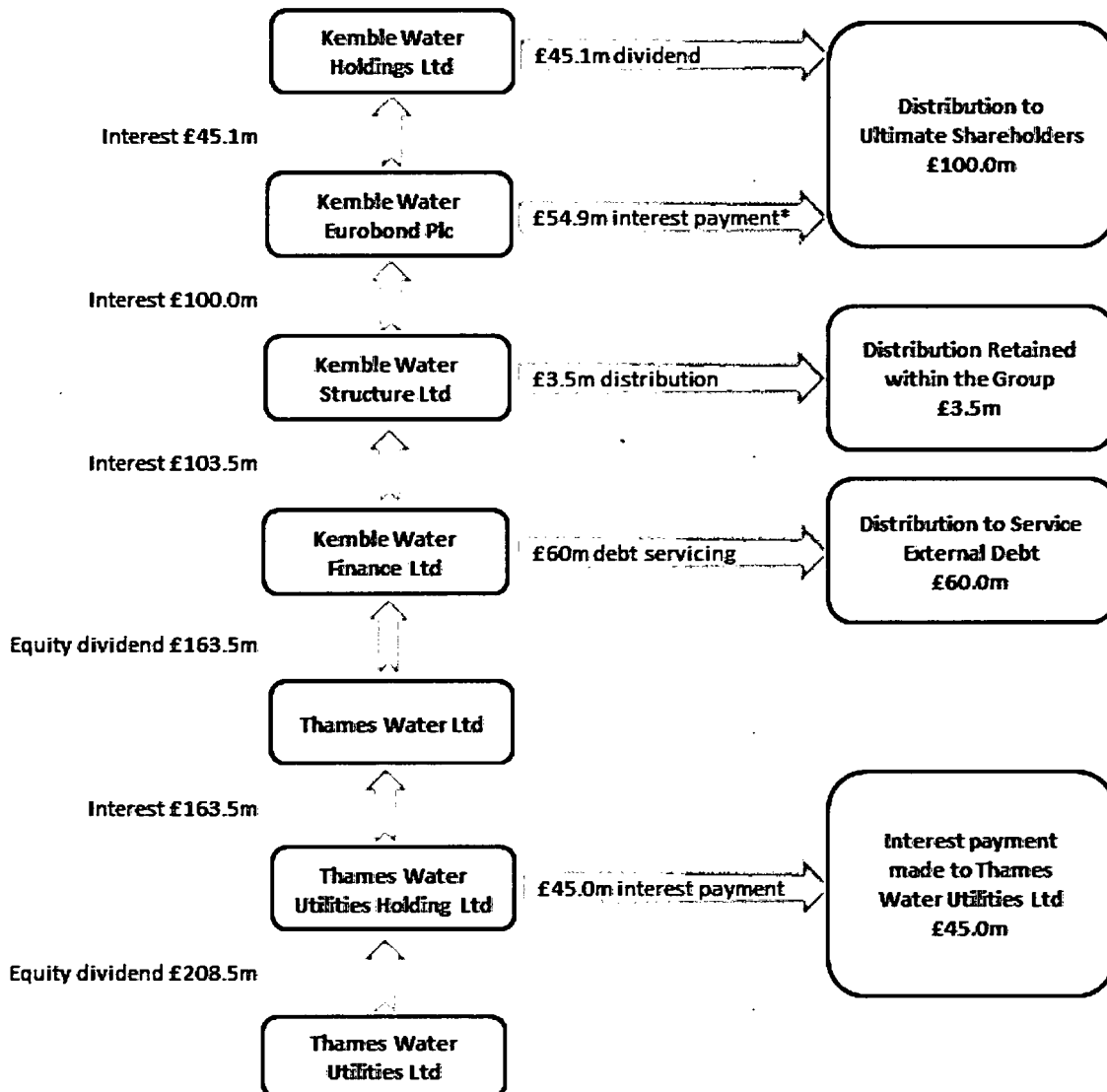
The purpose of the Oxford Sewage Treatment project was to achieve an increased 18,104 tonnes dry solid per year of sludge treatment capacity. The project was awarded in March 2012 and major construction was completed in March 2014. The innovative use of Bucher process within this project has also been used for final sludge de-watering. The project is now in its commissioning and optimisation phase, with planned total completion by October 2014.

The upgrade of the sewage treatment works at Mogden was completed in May 2013. This £140 million upgrade boosted the treatment capacity of the UK's third largest sewage works by 50%, and will significantly reduce the storm overflows into the River Thames, as well as improving the quality of treated effluent returned to the river.

Dividends paid

During the year we paid £208.5 million (2013: £231.4m). These dividends were used to fund obligations within our holding companies, and ultimately dividends and interest to our external shareholders totalling £100.0 million (2013: £92.0 million). The organisation chart below shows the structure of the Group including the holding companies and the way in which dividends payments from the Company in the year were utilised within the wider Group.

This diagram incorporates the results of a corporate restructuring programme we implemented in the year. This removed several non-trading holding companies in order to simplify the Group's structure and improve transparency.



*Included within the payment to Kemble Water Eurobond Plc is £17.5 million relating to interest payments falling due in the year to March 2013 but paid in September 2013.

Financing and financial risk management

Our treasury affairs are managed internally with the ultimate aim of managing our financial risks. The Company's operations expose it to a variety of financial risks.

Funding and treasury policy

The Company's debt is comprised of bank loans and intercompany loans from subsidiary undertakings that issue secured bonds. The Company's policy is to maintain a broad portfolio of debt (diversified by source and maturity in order to protect profits against risks arising from adverse movements in interest rates) and maintain liquidity. The management of interest rate risk, inflation risk and foreign exchange risk includes entering into derivative financial instruments. All funding and financing needs are managed by the Treasury function.

We use financial derivatives, including cross currency swaps, interest rate swaps and forward currency contracts solely to manage risks associated with our normal business activities. The Treasury function is managed as a cost centre, not a profit centre. No material open or speculative positions are taken and the operation of the treasury function is governed by specific policies and procedures that set out specific guidelines for the management of liquidity, credit and market risks associated with the financing activities of the Company.

Treasury policy and procedures are incorporated within the financial control procedures of the Company. The key objectives of the funding strategy are to retain our investment grade credit rating, provide liquidity for our ongoing obligations and keep customer bills low. The Board reviews the Company's exposure to these risks and actively oversees the treasury activities, reviewing treasury policy and approving the treasury strategy and funding plan on an annual basis.

Market risk

Market risk is the risk that changes in market variables, such as inflation, foreign currency rates and interest rates, will affect the Company's income or the value of its holdings of financial instruments.

Debt issued by the Company includes RPI linked loans and these instruments are exposed to movements in the RPI. As a regulated water company, The Company's revenues are linked to RPI. Therefore the Company's index linked borrowings form a partial economic hedge as the assets and liabilities partially offset. The Company also uses derivatives to manage inflation risk on non-index linked borrowings.

The Company has currency exposures resulting from one debt instrument, a ¥20bn bond maturing in 2038. The Company uses currency swaps to hedge the foreign currency exposure of this bond. All hedges are undertaken for commercial reasons with the objective of minimising the impact of exchange rate fluctuations on net assets and profits. The Company has no material unhedged monetary assets and liabilities denominated in a currency different from the local currency of the Company.

Interest rate risk arises on interest-bearing financial instruments. Floating rate borrowings are exposed to a risk of change in interest cash flows due to changes in interest rates. The Company uses interest rate swaps which economically hedge future cash flows, thereby protecting future cash flows against interest rate movements.

Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's loan with its immediate

parent entity Thames Water Utilities Holdings Limited and cash flows receivable from counterparties to the derivative financial instruments.

Under the terms of the whole business securitisation agreement, counterparties to the Company's short term investments have to meet minimum short and long term credit rating criteria, and derivative counterparties have to meet minimum short term criteria assigned by both Moody's and Standard & Poor's ("S&P"). In respect of the derivative counterparties there is also a mechanism for the counterparty to post collateral when amounts due to the Company under outstanding derivative contracts exceed a contractually agreed threshold amount or the counterparty fails to meet the necessary credit rating criteria.

At 31 March 2014 the Company held £nil (2013: £1.3m) of collateral cash, and amounts of £7.5 million (2013: £nil) were due to the Company, representing amounts owed from counterparties to the Company's derivative contracts that have failed to meet minimum short term credit rating criteria assigned by Moody's. The amount outstanding was subsequently received in May 2014.

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company manages long-term liquidity by maintaining continuity of funding through access to different market and debt instruments, raising funds in the capital markets and ensuring that diverse debt maturity profiles are maintained. The Company also maintains a level of committed liquidity facilities.

Taxation

As shown within our financial statements we have not paid substantial amounts of corporation tax in recent years, principally due to the capital allowances we have legitimately received to incentivise our infrastructure investments. As we are investing in excess of £1 billion a year from 2010 to 2015, more than any water firm in the UK's history, we are able to defer tax payments to future years.

The water industry has recently reached agreement with HMRC on the availability of capital allowances on certain assets at water and waste water treatment works. This is responsible for the recognition of a credit in respect of tax for prior years and this benefit has enabled the Company to commit a further sum of £10 million to our Customer Assistance Fund, doubling the funds available to help our customers over the next four years.

Our financial statements recognise the benefit of the reduction in deferred tax liabilities resulting from the cut in corporation tax rates from the current rate of 23% to 20% with effect from 1 April 2015, which increased profits for the year by £132.2 million. This represents a reduction in the level of tax payable in future years and hence does not constitute a refund from HMRC in the current year. This benefit will eventually flow through to customers in the form of lower bills.

Debt finances the substantial majority of our investment programme and like any other UK company borrowing money to finance its activities we receive tax relief on the interest payments on this debt.

Like all taxes, corporation tax payments are among the costs Ofwat takes into account when setting price limits. Had we not taken advantage of the tax relief available to us, these tax payments would otherwise have been reflected within customers' bills. The current tax charge of £11.2 million on profits in the current year is calculated after allowing for the benefit of deductions for finance costs and capital allowances. Any taxable profits in the current year have been offset by tax losses claimed from other companies in the Kemble group. All intercompany interest paid is due to group companies that are tax resident in the UK. These include

Thames Water Utilities Cayman Finance Limited (TWUCF) which was incorporated in the Cayman Islands, but is UK tax resident and whose profits are subject to tax in the UK.

Thames Water continues to contribute our fair share of around £150 million annually in other taxes, including central and local government business rates, PAYE and national insurance.

Adoption of new accounting standards

The financial reporting council (FRC) has issued a new set of accounting standards under the UK Generally Accepted Accounting Practice ("UK GAAP") accounting standards for UK companies, bringing UKGAAP into closer alignment with International Financial Reporting Standards ("IFRS"). We will be required to adopt these new standards in the preparation of our financial statements for the year ending 31 March 2016.

Preparation has commenced to identify the set of standards that the Company will use and the resultant recognition, measurement and presentational adjustments that will be made to the financial statements.

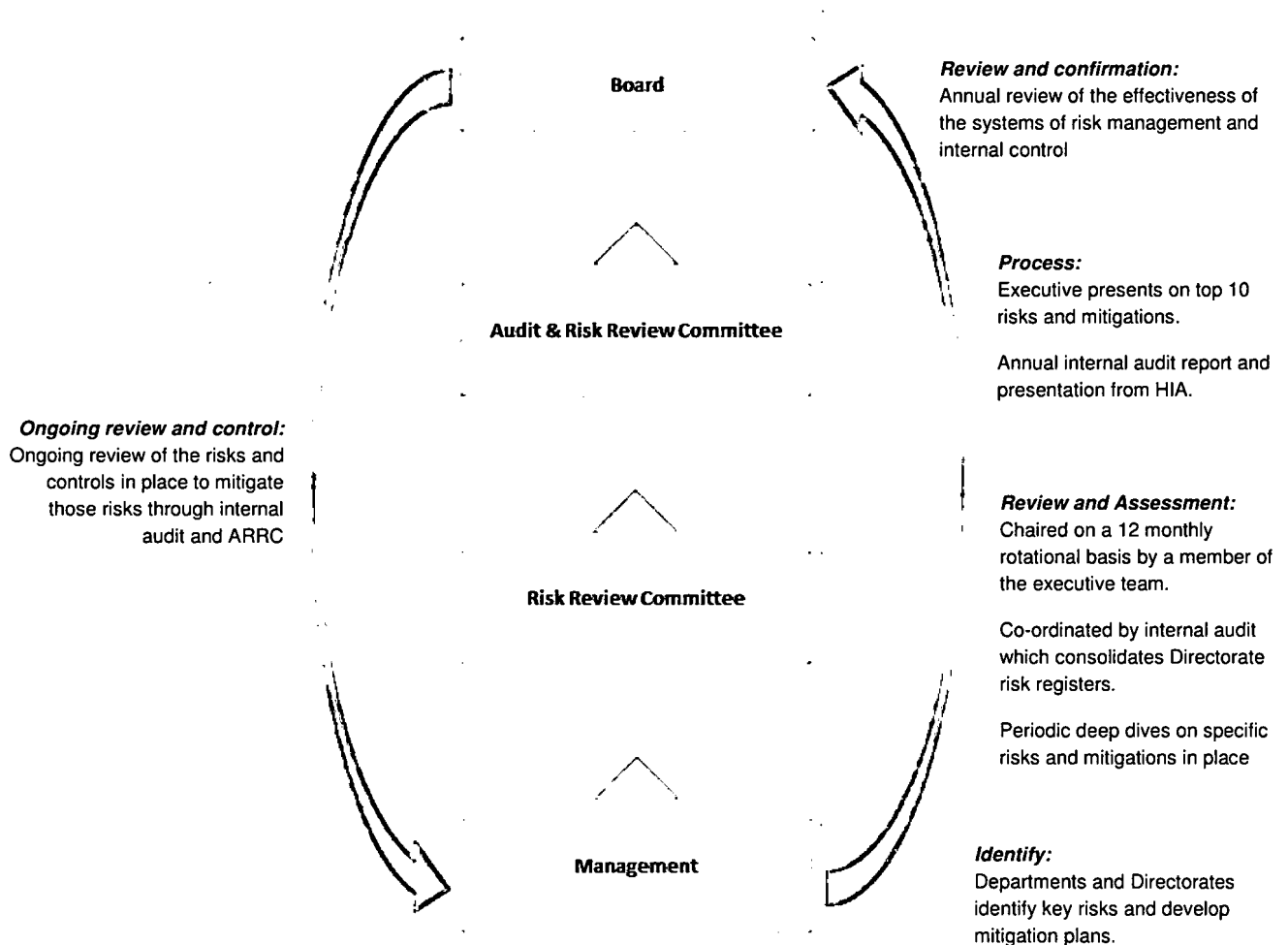
Principal Risks and Uncertainties

Managing the risks that could prevent the achievement of the Company's objectives is a core element of our day to day business activities. This is undertaken using a practical and flexible framework which provides a consistent and sustained approach to risk evaluation.

Risk management framework

The Audit and Risk Review Committee ("ARRC") is responsible for assisting the Board in discharging its responsibilities for considering the effectiveness of the risk management framework and internal controls. The risk management framework is designed to manage, rather than eliminate, the risk of failure to achieve business objectives and is coordinated by the Head of Internal Audit and Assurance ("HIA").

Our risk management approach looks at risks arising in all parts of the business using both a bottom up and top down approach.



Assessment of key risks

All material risks and their associated controls are challenged by the Risk Review Committee and the Audit & Risk Review Committee as well as Internal Audit. We outline below the principal risks specific to our business and how we manage and mitigate them:

Safety

Description & Impact	Mitigation	Change
<p>At Thames we have a zero compromise approach to health, safety and wellbeing.</p> <p>A failure in safety could result in injury or loss of life which would have tragic implications for individuals and their families and communities.</p>	<p>There is a clearly defined strategy, safety protocols and standards that are set, monitored and reported to the Board and the Health and Safety Committee on a monthly basis. A number of initiatives have been put in place in 2013/14.</p>	<p>During 2013/14 there has been an improvement in the safety environment supported by the introduction of a number of new initiatives. These include the CEO zero compromise card and the Executive Incident reviews.</p>

Delivery of our capital projects

Description & Impact	Mitigation	Change
<p>Our core business requires significant capital expenditure, particularly in relation to new and replacement plant and equipment for water and wastewater networks and treatment facilities.</p> <p>A failure at one of the Company's major assets could significantly impact the safety of its workforce and the public, as well as interrupting supply to customers and breaching environmental and regulatory targets.</p> <p>Delivery of our capital investment programmes could be affected by a number of factors including adverse legacy effects of earlier capital investments (such as increased maintenance, repair, reinstatement or renewal costs) or cost and programme overruns which may put pressure on our budgets or our ability to meet our regulatory and legal obligations.</p>	<p>Capital investment programmes are regularly monitored to identify the risk of time, cost and quality variances from plans and budgets and to identify, where possible, any appropriate opportunities for outperformance and any necessary corrective actions.</p> <p>Senior management are incentivised, as part of their performance reviews, on time, cost and quality of delivery of our capital investment programme.</p>	<p>This remains a significant risk for us as we have the largest capital programme within the industry, at approximately £1bn per annum. We remain focused on the regulatory targets that apply to all of our water treatment, distribution, sewerage and sewage treatment assets. Measures are in place in relation to water quality, continuous supplies, sewer flooding, sewer collapses and pollution events.</p>

Delivery of the Thames Tideway Tunnel

Description & Impact	Mitigation	Change
<p>As an innovative solution to the challenge of reducing sewage discharges into the Thames, the design and construction of the Thames Tideway Tunnel present a number of major technical and logistical challenges.</p> <p>A key challenge is to manage the impact of the project (which is intended to be undertaken by a stand-alone Infrastructure Provider ("IP")) on the Company's credit rating, as detailed on page 37.</p> <p>Failure to successfully deliver the IP model could lead to continued adverse discharges into the Thames with associated environmental and reputational impacts. In addition, there could be an adverse impact on the Company's credit rating.</p>	<p>The key mitigation and the preferred solution for key stakeholders is the establishment of a separately regulated entity to deliver the Thames Tideway Tunnel. This model requires third party investment and will enable exceptional construction risks, which require contingent support from HMG, to be ring fenced.</p> <p>The Company has worked with the Government on the development of an approved resilience plan, identifying alternative solutions that could be adopted should the preferred model fail or be delayed.</p>	<p>The procurement of the IP and third party equity is commencing. Market interest is good but the process may take over 12 months so risk remains.</p>

Operational service

Description & Impact	Mitigation	Change
<p>The Company controls and operates water and wastewater networks and maintains the associated assets with the objective of providing a continuous service.</p> <p>Physical, environmental, technological or human factors, either within or outside the Company's control, could result in impacts ranging from a decline in performance to interruptions and environmental impact. Ofwat could make financial adjustments at the next price review if corrective actions do not restore service to the required reference levels for each of their serviceability measures and could go on to force additional operating or capital expenditure if performance were to continue to decline.</p>	<p>Operational processes combined with the capital investment programme are targeted to maintain stable serviceability of our water and wastewater assets and to minimise the risk of significant operational events occurring.</p> <p>The various indicators of performance are closely and routinely monitored by management. There are also governance and inspection regimes for key infrastructure assets such as aqueducts, dams, reservoirs and treatment works.</p> <p>Where adverse trends in performance or asset integrity develop, corrective action is identified and taken.</p>	<p>This has increased as a risk to the Company due to the two prolonged periods of adverse weather in the year which has challenged serviceability levels.</p> <p>Pollution reference levels do not take into account extreme weather, increasing pressure on stabilisation levels in 2014/15.</p>

Customer service

Description & Impact	Mitigation	Change
<p>Failure to deliver good customer service can be caused by failures in supply and quality requirements and also the effectiveness of communication and response. The Service Incentive Mechanism (SIM), introduced by Ofwat for the 2010-15 period, compares companies' performance in terms of the number of 'unwanted' contacts received from customers and how well a company then deals with those contacts.</p> <p>Depending on the Company's relative performance under SIM it could receive a revenue penalty (up to 1 per cent of turnover in 2010-15) or reward (up to 0.5 per cent of turnover in 2010-15) when price limits are next reset through the Price Determination in December 2014.</p>	<p>We have improved our SIM score as detailed in our KPIs. We have an overall customer experience programme covering a range of initiatives to improve customer service, responding to our customers' requirements and focusing on people, processes and systems. The Company's focus is on ensuring right first time service delivery to our customers, thus avoiding the need for 'unwanted' contacts and reducing associated operating costs. Where 'unwanted' contacts do arise, there is a clear focus on identifying the root causes to improve the overall customer experience and the SIM score.</p>	<p>The Company's initiatives to deliver reduced 'unwanted' contacts have led to an improvement in the overall SIM score. However, the trend has been affected adversely by the recent wet weather event. An appropriate penalty will be reflected in our draft business plan to be submitted in June 2014.</p>

Loss of customer data

Description & Impact	Mitigation	Change
<p>We need to treat our customer data securely and only use it for the purposes intended.</p> <p>Loss of customer data could lead to potential regulatory and financial impacts as well as more importantly damaging our customer's trust in the Company.</p>	<p>We are continuing to undertake an extensive awareness programme with our employees and supply chain as well as investing in improving our IT and physical security controls. All employees and key contractors are undergoing mandatory data security training.</p>	<p>Customer feedback is clear that protection of data is very important. Several incidents in 2013/14 indicate that our processes are working however they also underline the need to reinforce our security protocols to all our staff and contractors.</p>

Impact of regulatory changes

Description & Impact	Mitigation	Change
<p>There is a high level of regulatory uncertainty which will impact on future strategy execution by the Company. All UK water and sewerage companies must justify the operating costs and capital investment needed to deliver service to customers in the five-year period from April 2015. In addition, the draft Water Bill (2012) will enable the creation of a new market for retail water and sewerage services to non-domestic customers in England in 2017.</p> <p>Failure to demonstrate the Company's case to Ofwat's satisfaction may mean that we are unable to invest in asset improvements or provide services that the Company believes will benefit its customers in the long term or to finance its business plans. Anti-competitive behaviour could lead to a financial fine and also divert management resource to defend any investigation or allegations.</p>	<p>Compliance with competition law and applicable regulation will remain a key focus. We are restructuring our business as set out in our December PR14 submission to better respond to these challenges as well as enabling us to deliver efficient and effective customer service improvements.</p> <p>We remain in active dialogue with Ofwat around our PR14 submission as well as participating with the industry in helping to respond to the challenge for increased competition.</p>	<p>The risk remains significant although both the market and the Company are changing. We are committed to our proposed changes to our business model and believe this will support efficient and effective delivery of what our customers and other stakeholders want through the next AMP period and beyond.</p>

Inflation

Description & Impact	Mitigation	Change
<p>In return for their capital investment in assets, regulated water companies earn a return on their Regulatory Capital Value (RCV), which is adjusted by the Retail Price Index (RPI). In times of low inflation or deflation, the return on this investment will decrease relative to the cost of funding, reducing cash flow and shareholder value.</p> <p>Falling inflation or deflation could lead to pressure on covenants due to reduced headroom between our RCV and the financing structures in place especially for instruments which are not linked to RPI.</p>	<p>In order to reduce the impact of low inflation or deflation, around half of the Company's debt is indexed to RPI, either directly in the underlying debt instrument, or by use of RPI swaps.</p> <p>In 2013/14 there has been a significant focus on cost reductions such that savings of approximately £60m were identified and secured.</p>	<p>The risk profile has increased due to falling inflation which could lead to reduced headroom when comparing our revenue to the level of debt which needs to be financed.</p>

Levels of bad debt

Description & Impact	Mitigation	Change
<p>Our area covers London and the Thames Valley where the proportion of persons in rented accommodation is higher than other parts of the UK. This leads to, amongst other things, an increased risk of bad debt. The law prohibits the disconnection of a water supply from certain premises including domestic dwellings as a method of enforcing payment.</p> <p>Failure to adequately manage cash collection processes will lead to a detrimental impact on working capital and will reduce the overall efficiency and effectiveness of the Company leading to potentially higher customer bills.</p>	<p>Bad debt risk is managed in-house by the customer collections department whose approach includes the adoption of best practice collection techniques and segmentation of customers based on their credit risk profile.</p> <p>We are implementing, in 2014/15, a new Debt Management System to further enhance management information and reporting.</p>	<p>No significant change in the risk profile in the year for the Company and the Cost of Living debate remains a key issue for both residential and commercial customers.</p>

Credit downgrade risk

Description & Impact	Mitigation	Change
<p>As a regulated utility, the Company expects to be able to access financing, but an increase in the cost of funds may put pressure on key financial covenants. In addition the Company is closely associated with the Thames Tideway Tunnel which presents exceptional project risks.</p> <p>This could lead to increased borrowing costs to be serviced which could impact on the Company's ability to invest in improving services for our customers as well as impacting on shareholder returns which could impact on future investment.</p>	<p>The Company is focused on supporting free cash flow at a level commensurate with the current credit rating. Our Funding Strategy is resilient and approved by the Board annually. We are maintaining dialogue with Rating Agencies to gauge market sentiment to emerging PR14 plans. We are keeping this under review when considering the final PR14 submission and forecast financial ratios and dividend policy.</p> <p>The Thames Tideway Tunnel project is expected to be delivered by a separately regulated entity which should ring-fence the associated risks.</p>	<p>The risk has increased in significance in the current period given the continuing economic backdrop and the uncertainty in the PR14 submission and returns. Credit rating agencies have noted that whilst the preferred delivery structure for the Thames Tideway Tunnel is credit positive for the Company the project introduces an element of increased risk to our overall credit profile.</p>

Impact of change of key risks

Since the 2013 Annual Report, the Board believes that there has been no material change within the relative prioritisation of the principal risks as set out above with the exception of the following risks where the Board believes the relative risk has been reduced:

Climate Change

Description	Change
As the Company continues to supply an increasing population, the effects of climate change could adversely affect its ability to maintain its Security of Supply Index (SoSI) requirements.	The Company has been working on measures to reduce demand including Progressive Metering, mounting widespread awareness campaigns and providing free water saving devices, as well as making provision for new sources of potable water and improving the integrity of its network. We also hit our leakage reduction target for the eighth year in succession.

Employee pension scheme funding

Description	Change
The Company operates two major defined benefit pension schemes. Although both are closed to new entrants, the Company remains liable for the historic rights earned by past and present employees, and both schemes are currently in deficit on a Gilts valuation basis.	Following the results of a preliminary actuarial valuation and agreed actions arising from this valuation, pension costs (subject to trustee consent) should remain at a similar level until 2016/17. In addition the Company's balance sheet is strong in terms of funding and cash reserves.

Corporate Governance

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Chairman's Introduction



Dear Shareholders,

I am pleased to present Thames Water's Corporate Governance report on behalf of the Board. We are committed to maintaining high standards of corporate governance and the report which follows is intended to give shareholders, customers and other stakeholders an understanding of the Group's corporate governance arrangements during the year ended 31 March 2014.

Thames Water delivers an essential service to millions of customers every day. We recognise that we play a key role in the region we serve and strive to be a good neighbour to all whom our operations and activities affect.

The Company and its shareholders are committed to continuously improving our service and to ensuring that Thames Water is a sustainable business, providing for the long term needs of our customers and other stakeholders.

We understand the importance of high standards of corporate governance and see good governance as going hand in hand with the performance of our functions. Thames Water adopts as much of existing best practice as is appropriate, and subject to shareholder consent we will, by April 2015, comply with the UK Corporate Governance Code, or where this is not appropriate, Ofwat's principles.

There have been several reviews and consultations on corporate governance during the year, including Ofwat's publication *Board leadership, transparency and governance – principles*. We responded positively to these developments and, subject to the continuing support of our shareholders, intend to adopt a new governance framework at the start of the next regulatory period, AMP6. In the meantime, and recognising the complementary standards expected by Ofwat's guidelines and the Code, we have published a set of Corporate Governance Key Principles.

We have started to implement various amendments to enhance our governance during the period, including the appointment of Michael Pavia as the Board's Senior Independent Non-Executive Director (SID) and the establishment of a new ad hoc Committee to nominate my successors as Chairman.

A handwritten signature in black ink, which appears to read "Peter Mason". The signature is written in a cursive style and is underlined.

Sir Peter Mason
Chairman

The Directors and Executive Team

Independent Chairman

Sir Peter Mason KBE, Chairman (67)

Sir Peter became Chairman of Thames Water Utilities Limited in December 2006, and brings extensive experience in engineering, construction and complex capital investment businesses. He retired as CEO of AMEC plc in September 2006, and previously was Chairman and CEO of Balfour Beatty Limited. Sir Peter was the senior non-executive director of BAE Systems plc until May 2013, and until October 2008 was a Board member of the 2012 Olympic Delivery Authority. He is currently a non-executive member of the Board of Spie S.A., and senior independent director of Subsea 7 S.A.

Sir Peter was made a Knight Commander of the British Empire (KBE) in 2002 for services to international trade.

Executive Directors

Martin Baggs, Chief Executive Officer (49)

Martin became CEO of Thames Water Utilities Limited in March 2010 having been a non-executive Director since 2006.

Prior to taking up the role of CEO of Thames Water, he was an Executive Director with the Macquarie Infrastructure Funds with responsibility for the portfolio of utility investments across Europe. Martin has a long career in the water industry with previous roles including Managing Director at South East Water and Operations Director at Southern Water.

Martin is a Chartered Civil Engineer, a Fellow of the Institution of Civil Engineers and a member of the Worshipful Company of Water Conservators.

Stuart Siddall, Chief Financial Officer (61)

Stuart joined Thames Water Utilities Limited in September 2011, having previously held the position of Chief Executive of the Association of Corporate Treasurers. Stuart joined Price Waterhouse in Johannesburg after qualifying as a Chartered Accountant. Returning to the UK, he held several senior financial roles and was among the first students to qualify with the Association of Corporate Treasurers. Stuart has gained extensive experience in the construction, engineering and utilities sectors, including serving as finance director for Amec plc, Balfour Beatty Limited and Manweb plc. He is the second executive member of the Thames Water Board, alongside Chief Executive Officer Martin Baggs.

Non-Executive Directors

Edward Beckley (38)

Edward became a non-executive director of Thames Water Utilities Limited in January 2009, having served as an alternate since March 2008. He is head of the Macquarie Infrastructure and Real Assets business in Europe and the Middle East.

Rosamund Blomfield-Smith (65)

Rosamund became a non-executive director of Thames Water Utilities Limited in November 2012. She spent almost 30 years in the City, first as a project financier and subsequently as a corporate financier with a variety of investment banks, including Schrodgers and Rothschilds. She is currently a director of the Wales Audit Office and has recently retired as the chairman of Moat Homes Limited and from the Board at British Empire Securities, a FTSE 250 investment trust.

Dan Buffery (34)

Dan became a non-executive director of Thames Water Utilities Limited in December 2013. He is a Portfolio Manager in the Private Markets Group of OPTrust. The Private Markets Group has been involved in private equity and infrastructure investments since 2005.

Christopher Deacon (66)

Christopher became a non-executive director of Thames Water Utilities Limited in December 2006. He brings extensive experience as a banker and advisor in major infrastructure and project finance. Presently, he is an adviser to OFGEM on the offshore wind transmission programme and a member of the Investment Committee for the Dutch Infrastructure Fund. He is a non-executive director of various other companies and a Trustee of the Franco British Council.

Dr. Peter Dyer (72)

Peter Dyer was appointed a non-executive director of Thames Water Utilities Limited in July 2013 (but prior to this has been a non-executive director of other group companies since 2006). He was a director of Macquarie European Infrastructure Plc and has extensive experience in both infrastructure and engineering projects. As a director of Trafalgar House Corporate Development Limited, he was responsible for the development of its UK-based road projects, including the Birmingham Northern Relief Road and the A1-M1 shadow toll road. Before joining Trafalgar House Corporate Development Ltd, he worked for Imperial Chemical Industries plc.

Simon Eaves (46)

Simon became a non-executive director of Thames Water Utilities Limited in January 2012. He is a Regional Head in the Infrastructure division of the Abu Dhabi Investment Authority (ADIA) and has over 20 years' experience in the utilities sector around the world, having previously worked for a number of multinational companies, including Sumitomo Mitsui Banking Corporation, PricewaterhouseCoopers, International Power and the GCC Energy Fund. He has been responsible for completing several investments in the utilities sector and has actively managed those investments as a director on the companies' boards and management committees.

Chris Heathcote (51)

Chris became a non-executive director of Thames Water Utilities Limited in June 2013. He is a director in the Macquarie Infrastructure and Real Assets division of Macquarie Group Limited with responsibility for Macquarie's utilities assets and its German metering business, Techem. Chris joined Macquarie in April 2013 from Lloyds Banking Group, where he was Global Head of Project Finance responsible for Project Finance activities in Infrastructure, Utilities, Renewable and Conventional Energy. He was previously a founding partner of Hyder's infrastructure Investment fund and has also worked in the City involved in the financing of a number of utilities including Southern Water and Kelda. Chris has been involved in a number of landmark deals in the

UK and overseas, including Wembley Stadium, London Underground, M25, the Melbourne Citylink and Gatwick Airport.

Nick Horler (55)

Nick Horler was appointed as a non-executive director of Thames Water Utilities Limited in April 2014. Nick is a portfolio non-executive director. He has been a member of the Board of the Royal Mail since 2010 and a member of the Board of the Go-Ahead Group since 2011. He has been Chair of Alderney Renewable Energy Ltd since 2013 and Chair of Meter Provida Ltd since 2014. He recently stepped down as the Chair of the Advisory Board of KPMG's Energy and Natural Resources practice which he held from 2011-2014.

Nick spent his Executive career in the energy industry. He worked for Phillips Petroleum for 12 years in a variety of roles in the UK and USA. He spent 11 years with E.On including 8 years on the Board of E.On UK, first as Managing Director of PowerGen Energy Trading Ltd and then as Managing Director of E.On Retail. He spent 2 and a half years as the CEO of Scottish Power from 2008 to 2010.

Dipesh J Shah OBE (61)

Dipesh became a non-executive director of Thames Water Utilities Limited in October 2007. He is a non-executive director on the Boards of Canaccord Genuity Group Inc., JKC Oil & Gas Plc (where he is Chairman of the Remuneration Committee), The Crown Estate, EU Fund for Energy, Climate Change and Infrastructure (the Marguerite Fund) where he is Chairman of the Investment Committee, Trustee of the British Youth Opera, Governor of Merchant Taylors' School, and Chairman of ANHD International Advisory Services Ltd. He was the chief executive of the UK Atomic Energy Authority and of various large businesses in the BP Group, and a non-executive director of Babcock International Group plc and Lloyd's of London. He was chairman of Viridian Group plc, HgCapital Renewable Power Partners LLP and a European trade association. He was also a member of the Government's Renewable Energy Advisory Committee from 1994 to 2002.

Lincoln Webb (43)

Lincoln became a non-executive director of Thames Water Utilities Limited in November 2011. He is the Vice President of Private Placements for British Columbia Investment Management Corporation (bcIMC). The Private Placements group has been involved in private equity and infrastructure investments since 1995.

Dapeng Xu (42)

Dapeng became a non-executive director of Thames Water Utilities Limited in October 2012. He is a director in the Special Investment Department of CIC (China Investment Corporation). Prior to joining CIC he worked on asset valuation and transaction structuring for several utility companies in the U.S. and Canada.

Independent Non-Executive Directors

Dame Deirdre Hutton CBE (65)

Dame Deirdre was appointed as an independent non-executive director of Thames Water Utilities Limited in July 2010. She is Chair of the Civil Aviation Authority, Pro-Chancellor of Cranfield University and a non-executive director of Castle Trust. She was a non-executive member of HM Treasury Board, was previously Chair of both the National Consumer Council and Food Standards Agency, and was formally Vice President of the Trading Standards Institute. Dame Deirdre has also held a number of positions on a variety of bodies dealing with food issues.

Michael Pavia (67)

Michael became a non-executive director of Thames Water Utilities Limited in December 2006 and was appointed as Senior Independent Non-Executive Director in June 2013. Michael is a member of the Institute of Chartered Accountants in England and Wales (ICAEW) and he brings extensive experience in management of regulated businesses. He was previously Group Finance director of SEEBOARD group and Chief Financial Officer of the London Electricity Group (EDF Energy Group). He is currently a non-executive director of Salamander Energy plc, Telecom Plus PLC and Wales & West Utilities Ltd and chairman of their audit committees. He is also non-executive chairman and a founder shareholder of PetroGranada Ltd, an oil exploration company and Hon. Treasurer of the charity Elizabeth Finn Care.

Ed Richards (48)

Ed Richards was appointed as an independent non-executive director of Thames Water Utilities Limited in July 2010. He has been the Chief Executive of Ofcom since October 2006, having previously been the Chief Operating Officer. He was previously a senior policy advisor to the Prime Minister for media, telecoms, the internet and government and Controller of Corporate Strategy at the BBC. He has also worked in consulting at London Economics Ltd, as an advisor to Gordon Brown MP and began his career as a researcher with Diverse Production Ltd where he worked on programmes for Channel 4. He is also a Vice Chairman of the Body of European Regulators for Electronic Communications (BEREC), a director of Donmar Warehouse and a Governor of the London School of Economics.

Executive Team

Thames Water's Executive Team is responsible for the day-to-day running of the business. Our Executive Team consists of the Chief Executive Officer (CEO) and Chief Financial Officer (CFO) and nine functional directors:

Richard Aylard CVO, External Affairs and Sustainability Director

Richard joined Thames Water in 2002 as Corporate Responsibility Director. He leads the Company's engagement with external stakeholders, including Government, the Environment Agency and the Consumer Council for Water, and is the principal spokesperson with the media and other audiences.

As Sustainability Director, Richard is the Executive Team member with responsibility for environmental and social issues.

Janet Burr, Human Resources Director

Janet was appointed Human Resources Director in November 2010, having previously served as Interim Human Resources Director from June 2010. Janet is the Executive Team member with responsibility for all employee issues. The HR function contributes to the overall business strategy, particularly through the Company's People Strategy, which underpins the vision, mission and values required to achieve the business goals of profitable growth and operational delivery.

Ian Cain, Managing Director, Customer Service

Ian joined Thames Water in November 2013, having previously held the position of Managing Director at Centrica's Credit Energy business.

Ian enjoyed a successful career with Centrica where he played a key role in establishing British Gas as the UK's leading energy supplier. As Managing Director for its Credit Energy business, Ian was instrumental in the transformation of service to some 13 million residential customers, delivering programmes which radically reduced complaints, while improving customer satisfaction and retention.

Piers Clark, Commercial Director

Piers was appointed Commercial Director in May 2011, having previously served as Interim Asset Management Director from March 2010.

Prior to joining Thames Water, Piers was Managing Director of Mouchel Regulated Industries, part of Mouchel plc. Prior to joining Mouchel, Piers spent nine years at Atkins plc, holding positions as Head of Research & Development, Director for New Ventures and, finally, Managing Director for Atkins Water (2001 to 2005).

Piers started his career in the water sector in 1991 at North West Water, now United Utilities plc.

Bob Collington OBE, Operations Director

Bob was appointed as Operations Director in September 2012, having previously served as Asset Management Director. He is responsible for more than 2,300 employees who operate and maintain our water and wastewater treatment plants and networks.

He first joined Thames Water in October 1989 as a Quality Assurance Officer. Since then he has had a number of senior roles throughout the water industry including five years in the USA at Elizabethtown Water Company and American Water where he served on the Board of the Long Island Water Company.

In October 2006, Bob was appointed as Wastewater Services Director. This included responsibility for the management of all wastewater operations and assets and delivery of the wastewater asset investment programme.

Nick Fincham, Strategy & Regulation Director

Nick was appointed Strategy and Regulation Director in April 2011, having previously served as Head of Regulation from June 2010. Before joining Thames Water, Nick spent six years as Director of Economic Regulation and Competition Policy at the Civil Aviation Authority. Prior to that, he held senior positions at a number of economic regulators (OFFER, Ofgas, Ofgem and Postcomm).

Michael Gerrard, Managing Director, Thames Tideway Tunnel

Michael was appointed Managing Director for the Thames Tideway Tunnel project in May 2011. Michael has worked for most of his 30 year career on the development, finance and delivery of major capital projects and programmes, both within the public and private sectors. Before joining Thames Water, he had also been a member of Defra's Waste Infrastructure Delivery Programme (WIDP) Executive and the Welsh Assembly Government's waste investment programme board.

Lawrence Gosden, Asset Director

Lawrence was appointed Asset Director in May 2013, having previously been Capital Delivery Director since October 2011. He joined Thames Water in October 2007 and has previously held senior positions in Southern Water and South East Water. He is responsible for Thames Water's £5bn capital programme in the five years to 2015, including the Lee Tunnel, Thames Tideway sewage treatment works improvements and the four joint ventures responsible for the majority of our remaining programme.

Kevan Mossman, Transformation Director

Kevan joined Thames Water as Transformation Director in April 2014. For the last 14 years Kevan has run his own business specialising in M&A, transformation and change delivery for major clients in the UK, USA, Asia and Australasia. Major clients include Alcatel Lucent, Vodafone, Orange, Network Rail, British Energy, Littlewoods, Scottish Power, Macquarie Bank and in the water sector Anglian Water, Southern Water and Severn Trent.

Prior to 1999 Kevan was Operations Director and latterly Transformation Director at Southern Water.

Corporate Governance Report

Compliance with the UK Corporate Governance Code

The UK Corporate Governance Code 2012 applies to accounting periods beginning on or after 1 October 2012. Additionally the UK Corporate Governance Code 2010 applies under Listing Rules 9.8.6. These are collectively referred to throughout this report as the "Codes". The Board has reviewed its operations and governance framework and confirms that throughout the year ended 31 March 2014, and as at the date of this report, the Company has complied with the provisions set out within the Codes, except as detailed below. The proposed changes which, subject to shareholder approval, will be implemented by April 2015 are also stated:

Provision	Explanation	Proposed Governance Changes for 2015
<i>Provision B.1.2 requires that at least half the Board, excluding the Chairman, should comprise non-executive directors determined to be independent.</i>	The Company is privately owned and currently directors representing the shareholders are the largest single group on the Board.	Independent directors (including the Chairman) will represent the largest single group on the Board in line with Ofwat principles.
<i>Provision B.2.1 requires that there should be a Nomination Committee comprising a majority of independent nonexecutive directors.</i>	The Company currently has a Compensation & HR Committee which broadly incorporates the activities and scope of a Nomination Committee.	The Board will establish a distinct, separate Nominations Committee with an independent chair and a majority of independent directors.
<i>Provision B.2.2 relates to the evaluation by the nominations committee of the capabilities required for appointments to the Board.</i>	Non-executive directors are currently nominated and appointed by the shareholders. The selection of the independent non-executive directors is considered by the Compensation & HR Committee with any recommendations being made to the Board.	Nominations to the Board will be made through a newly established Nominations Committee which will ensure that the Board has the appropriate balance of skills, experience, independence and knowledge of the Company.
<i>Provision B.2.3 provides for non-executive directors to be appointed for specified terms subject to re-election.</i>	Non-executive directors are currently nominated and appointed by the shareholders for unspecified periods. The appointment of the independent non-executive directors is reviewed every three years.	The nomination process will be modified including the introduction of specific terms of appointment and a re-election process.
<i>Provision B.2.4 requires the inclusion in the Annual Report of a description of the Board's policy on diversity along with any measurable objectives.</i>	As a private limited company a specific diversity policy does not currently exist but the Board will review this requirement as part of the enhancements being made to corporate governance.	The Board will consider the inclusion of a specific Board diversity policy as part of its corporate governance enhancements for 2015.

Provision	Explanation	Proposed Governance Changes for 2015
<i>Provision B.3.1 relates to the appointment of the Chairman including the preparation of a job specification by the Nomination Committee and expected time commitment.</i>	The appointment of the Chairman is currently a matter for the Board requiring 75% approval. A new ad hoc Committee (comprising a majority of independent non-executive directors) was created in October 2013 to nominate any successors to the current Chairman.	The nomination of any future chairman will be made by the Independent Chairman Nomination Committee.
<i>Provision B.4.1 requires that all new Directors undertake a tailored induction on joining the Board.</i>	An induction is offered to all new Directors in joining the Board, however certain Directors may not attend an induction as they may have already adequately familiarised themselves with the operations and performance of the Company by other means (e.g. shareholder Directors appointed following an investment in the Company may have received presentations from senior management on the Company as part of their due diligence).	The attendance at an induction course will become mandatory from 2015.
<i>Provision B.6.1 requires that the annual Board evaluation includes an evaluation of individual Director's performance.</i>	Whilst an externally facilitated Board evaluation is conducted every 3 years, as required by the Code, the individual performance of the Directors is not currently assessed.	The evaluation of Directors individual performance will be included in future externally facilitated reviews.
<i>Provisions B.6.3 and A.4.2 requires that an evaluation of the Chairman's performance is undertaken by the non-executive directors.</i>	The performance of the Chairman is not evaluated by the non-executive directors. Until October 2013, the Chairman was not considered by the Board as independent and as such it was not considered appropriate to review his individual performance.	Led by the senior independent director, the non-executive directors will undertake an evaluation of the Chairman's performance.
<i>Main Principle B.7 requires that all directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance.</i>	See explanation for Provision B.2.3	Directors will be appointed for specific terms and subject to re-election by shareholders.
<i>Provision C.3.1 requires that the Audit and Risk Review Committee ("ARRC") is made up of at least three independent NEDs.</i>	The current composition of the committee is one independent non-executive director and two non-executive directors in accordance with the Shareholders' Agreement.	The composition of the ARRC will be amended to comprise at least three independent directors.
<i>Provision D.2.1 requires that the Company establish a remuneration committee comprising at least three independent directors.</i>	The existing composition of the Compensation & HR Committee is two independent directors and two non-executive directors. Its Chairman was not considered independent on appointment.	The Board will establish a distinct, separate Remuneration Committee with an independent chair and a majority of independent directors (at least three).

Leadership

Role of the Board

The Board of Thames Water believes that a clearly defined framework of roles, responsibilities and delegated authorities is in place to support the Board's primary responsibility to promote the long term success of the Company for the benefit of its customers, employees, shareholders and other stakeholders. The Board seeks to achieve this through setting the Company's overall strategic objectives, providing appropriate resources to meet these objectives and reviewing executive management's performance. The Board considers that it sets the standards and values expected of management and staff, for example, the Board has raised the profile of health & safety matters by making the Health & Safety Report the first item to be considered at every Board meeting.

The Company has adopted a framework of delegated authorisations in its Schedule of Delegated Authority (SoDA). The SoDA defines levels of authorisation required for specified transactions and also sets out approval limits for operating and capital expenditure. The SoDA also contains matters specifically reserved to the Board for approval. These include approval of annual budgets, financial plans, financial statements, business strategies and material transactions, such as major acquisitions, divestments, funding and investment proposals. The SoDA authorises the CEO and CFO to approve certain transactions up to specified limits, beyond which the approval of the Board needs to be obtained. Below the CEO and CFO, there are appropriate delegations of authority and approval sub-limits at senior management level, to facilitate operational efficiency.

The Board also meets on the afternoon preceding formal Board meetings to receive more detailed presentations and updates on various subjects. Topics discussed through the year have included: Transformation (including vision and values), corporate governance, PR14 Business Plan, Bad Debts, Capital Programme AMP6 Procurement, Corporate Sustainability Themes, Customer Service and Strategic Systems.

The Board holds separate meetings, on a regular basis, without the Executive Directors being present, to discuss any issues or concerns. In addition, the Chairman meets with the Independent Non-Executive Directors only at least once a year. There are also a number of informal opportunities for the Directors to meet and discuss specific areas of the business with individual members of the Executive Team and also invited industry related external guests.

Directors' attendance at Board and Committee meetings during the year is summarised in the table below:

	Board	Audit & Risk Review	Regulatory	Health, Safety & Environment	Compensation & HR	Thames Tideway Tunnel	Customer Service
Total meetings held	12	4	7	4	5	10	3
Attendance by Directors in office for the whole period							
Sir P Mason	11	-	1	-	5 ^c	10 ^c	-
M Baggs	12	4	7	4	5	10	3
E Beckley	8	-	5	-	3	1	-
R Blomfield-Smith	12	4	1	-	-	6	-
C Deacon	12	1	6	-	5	6	-
S Eaves	10	-	-	-	-	-	-
Dame D Hutton	11	-	1	4	-	-	3 ^c
M Pavia	12	4 ^c	5	-	5	8	-
E Richards	11	-	6	-	-	-	3
D J Shah	10	-	4	0*	-	5	-
S Siddall	12	4	5	-	3	8	1
L Webb	6	-	-	-	-	-	-
D Xu	8	-	-	-	-	-	-
Attendance by Directors appointed during the period							
D Buffery (13/12/13)	3	-	-	-	-	-	-
Dr P Dyer (31/07/13)	7	-	-	-	-	-	-
C Heathcote (21/06/13)	11	3	5 ^c	4 ^c	4	9	3
N Horler (14/04/2014)	-	-	-	-	-	-	-
Attendance by Directors resigned during the period							
G Parsons (21/06/13)	1	1	2	1	1	2	-
D Rees (24/05/13)	6	-	4	-	-	3	2
K Roseke (24/05/13)	2	-	-	-	-	-	-



Denotes membership of a Committee

* D J Shah was incapacitated due to an accident and did not attend these meetings
c Denotes chair of the relevant Committee

The Articles of Association provide for directors to appoint alternate directors to represent them when they are unable to attend meetings. The following directors have appointed alternates (dates are shown only for appointments/resignations during the period):

Director			Alternate Director		
Name	Appointment	Resignation	Name	Appointment	Resignation
E Beckley			G Parsons		
R Blomfield-Smith			P Noble		
D Buffery	13/12/2013		D Rees	22/04/2014	
C Deacon			R Evenden		16/08/2013
Dr P Dyer	31/07/2013		R Greenleaf	31/07/2013	
S Eaves			M Hill		
C Heathcote	21/06/2013		G Parsons	21/06/2013	
G Parsons		21/06/2013	E Beckley		21/06/2013
K Roseke		24/05/2013	D Rees		24/05/2013
D J Shah			C Van Heijningen		01/04/2014
			K Roseke	01/04/2014	
L Webb			C Pham		
D Xu			F Sheng		

Attendance by the Directors' Alternates at the Board and Committee meetings during the year can be summarised in the following table:

	Board	Audit & Risk Review	Regulatory	Health, Safety & Environment	Compensation & HR	Thames Tideway Tunnel	Customer Service
Attendance by Alternate Directors							
R Greenleaf	2	-	-	-	-	-	-
C Van Heijningen	2	-	1	-	-	-	-
C Pham	3	-	-	-	-	-	-
F Sheng	4	-	-	-	-	-	-

Division of responsibilities

The roles of the Chairman and executive management, led by the Chief Executive Officer, are separate and clearly defined. This division of responsibility has been approved by the Board.

The Chairman – is responsible for leading the Board, ensuring its effectiveness, setting the agenda and ensuring effective dialogue with the Company's shareholders. In addition, he is responsible for ensuring that the Board receives accurate, timely and clear information and that constructive relations exist between executive and non-executive directors. The Chairman is also responsible for leading the effectiveness review of the Board.

The Chairman is considered by the Board to be independent but in terms of provision B.1.1 of the Code was not considered independent on appointment as he was appointed by the shareholders of Kemble Water Holdings Limited.

The Chief Executive Officer – is responsible for the leadership and operational management of the Company within the strategy and business plan agreed by the Board. He is supported by the Chief Financial Officer and nine functional directors (together, the “Executive Team”). None of the functional directors are members of the Board. (Biographies for the Executive Team can be found on pages 57 to 59).

Non-executive directors

The Board includes the Chairman and fourteen other Non-Executive Directors, three of whom are independent. The Board considers that the independent non-executive directors are independent in character and judgement and is satisfied that there are not any relationships or circumstances which are likely to affect, or could appear to affect, the director's independence. Eleven Non-Executive Directors are nominated and appointed by the shareholders of Kemble Water Holdings Limited and are therefore cannot be classified as independent non-executive directors.

Michael Pavia was appointed as the Senior Independent Director with effect from 6 June 2013 and is available to Directors and shareholders to answer any queries that cannot be addressed by the Chairman or other Executive Directors. He is also available to chair the Board and Committee meetings should the Chairman or Committee Chairman be unable to attend.

Effectiveness

Composition of the Board

The Board is chaired by Sir Peter Mason and at the year-end there were two Executive Directors (Chief Executive Officer and Chief Financial Officer), eleven Non-Executive Directors and three Independent Non-Executive Directors. The Board considers that the Independent Non-Executive Directors all meet the independence criteria set out in provision B.1.1 of the Code.

The Board does not comply with provision B.1.2 since less than half of the Board is independent, however, the Board considers that, collectively, the current Directors have the appropriate balance of skills, experience and knowledge of the Company to ensure that they are able to discharge their duties and responsibilities effectively.

The Articles of Association of the Company allow the Board to authorise conflicts, or potential conflicts, of interest. Directors are expected to advise the Company Secretary of any actual or potential conflicts as soon as they arise, so that they can be considered by the Board at the next available opportunity. It is the Board's view that this procedure operated effectively during the year under review.

The Company is actively engaged with its shareholders to address the composition of the Board in order to comply with Ofwat corporate governance principles by April 2015.

Appointments to the Board

The appointments and resignations during and subsequent to the financial year are set out in the following table:

Director	Appointment	Resignation
D Buffery	13/12/2013	
Dr P Dyer	31/07/2013	
C J Heathcote	21/06/2013	
Sir P Mason (Reappointed)	01/04/2014	
N Horler	14/04/2014	
G I W Parsons		21/06/2013
D Rees		24/05/2013
K Roseke		24/05/2013

During the financial year 2014/15, the Board proposes to appoint at least one additional independent Non-Executive Director. The role specification was produced by the Chairman, who led the recruitment process on behalf of the Board assisted by the Compensation & HR Committee and an external search agency, Egon Zehnder.

The Board and shareholders are currently in consultation on the creation of a Nomination Committee that will be made up of a majority of Independent non-executive directors and will be responsible for the formal and transparent nomination of all new directors to the Board.

The Independent Non-Executive Directors are appointed for three year terms. The appointments of Dame Deirdre Hutton, Michael Pavia and Ed Richards will be reviewed in 2014/15. The Investor appointed Non-Executive directors are all appointed for non-time specific periods in accordance with the Shareholders' Agreement.

The Board includes two women (from a total of seventeen Directors) representing 11.8% of the total. Janet Burr is currently the only woman on the Executive team from a total of eleven members.

The process to nominate and appoint any new Chairman has been revised during the year and an *ad hoc* committee established, the *Independent Chairman Nomination Committee*, made up of a majority of Independent Non-Executive Directors.

The letters of appointment of the Non-Executive Directors, detailing the terms and conditions of appointment and the expected time commitment, are available on request from the Company Secretary. As a matter of good governance all Directors are required to disclose their other significant commitments to the Board. Neither the CEO nor the CFO acts for any FTSE100 company in the capacity of a Non-Executive Director or Chairman.

Development

There is an induction programme for newly appointed Directors, designed to develop Directors' knowledge and understanding of the Company's operations and culture and includes meetings with the CEO and CFO along with other members of the Executive Team and Company Secretary. The programme provides an overview of the financial and operational performance of the Company, the regulatory framework along with commercial and customer service perspectives. The most recent induction was held in May 2014 and was attended by N Horler.

In certain circumstances, new Directors will not attend an induction as they may have already adequately familiarised themselves with the operations and performance of the Company by other means (e.g. shareholder Directors appointed following an investment in the Company may have received presentations from senior management on the Company as part of their due diligence). The attendance at an induction course will become mandatory from 2015.

Ongoing training is provided for Directors during the year by way of site visits, presentations and circulated updates. During 2013/14, guidance was provided to the Board on topics including:

- Submission of our business plan for the next regulatory period (PR14);
- Procurement results relating to the next asset management period (AMP6);
- Submission of our Interim Determination of K (IDoK);
- Corporate sustainability;
- Succession planning; and
- Development of strategic themes for customer service.

Training is available on an ongoing basis to meet any individual needs as appropriate.

Information and Support

The Board and shareholders are kept informed through the circulation of regular updates and information from the CEO, CFO and Executive Team including a monthly Management Report which includes financial, regulatory and operational performance indicators and commentary.

Directors have access to independent professional advice at the Company's expense and to the advice and services of the Company Secretary who is responsible to the Board for advice on corporate governance matters and for ensuring that the Company and the Board operate within applicable legislation, rules and regulations. The appointment and removal of the Company Secretary is a matter requiring approval of the Board.

Board Evaluation

In line with the Code, the 2014 annual Board effectiveness review was conducted by Egon Zehnder (the last externally facilitated review was conducted by Egon Zehnder in 2011 with the intervening reviews being carried out by the Company Secretariat). Egon Zehnder also assisted the Board and Compensation & HR Committee in the search for an additional independent non-executive director.

A questionnaire was circulated to all Directors seeking their evaluation of a number of matters, including Board dynamics and relationships, efficiency of the decision making process, the work of the Board committees, people, succession planning and remuneration. This was followed up in separate interviews with each of the Directors to take their detailed feedback on any emerging themes. Egon Zehnder then presented the principal conclusions to the Board at the April 2014 meeting. The review concluded that the Board was operating effectively, noted the impact of the proposed changes to the composition of the Board and Committees going forward and made certain recommendations. Led by the Chairman, these recommendations will now be addressed.

Re-Election

As a privately owned company, non-Executive Directors are appointed in accordance with the Shareholders' Agreement/Articles of Association and are therefore not subject to re-election.

Accountability

Financial & Business Reporting

The Board is mindful of its responsibility to present a balanced and clear assessment of the Company's position and prospects through the production of an annual report and financial statements, and the Board is satisfied that it has met this obligation. This assessment is primarily provided in the Directors' Report on page 100. The Statement of directors' responsibilities in respect of the Company's financial statements is set out on page 102.

Executive Committees

Thames Water has six standing committees each of which is described in more detail below and are a valuable part of the Company's corporate governance structure. The workload of the committees includes the scheduled meetings during the year in addition to any ad hoc meetings and communication frequently requiring considerable amounts of time.

Additionally, there are project specific committees that have also been created such as the AMP6 Capital Works Committee and Network Services Committee.

Each of the committees has terms of reference which have been approved by the Board. The Chairmen of each of the committees provide regular updates to the Board on the work of respective committees. Minutes of the committee meetings are available to all Directors.

a) Audit and Risk Review Committee

The Audit and Risk Review Committee has prepared a separate report and is presented on pages 93 to 99.

b) Health, Safety & Environment Committee (HS&E)

The Company is committed to the highest standards of health, safety and environmental compliance in the performance of its activities. The Board has delegated to the Committee responsibility to regularly review, develop and oversee consistent policy, standards and procedures for managing health and safety and environmental risks to the Company's business. The Committee thoroughly reviews, and provides appropriate challenge on, all significant health, safety and environmental incidents.

During the year the Committee met four times (with one meeting being held at Coppermills Water Treatment Works and included an inspection of the operational site). Attendance by Committee members is set out in the Attendance Table on page 63. In addition to reviewing the regular performance reports, the Committee has also considered other items during the year including:

- *Road Traffic Fatalities*
Tragically there have been two road traffic collisions involving suppliers of contractors working on our behalf which have resulted in fatalities. The HS&E Committee has reviewed the detail of each road traffic collision incident and the actions taken by the business. As a part of the review we confirmed that, as required by Thames Water, all vehicles within our supply chain complied with our commercial vehicle standards. We believe investigations by the police are continuing into the cause of these tragic incidents.
- *Enterprise Risk Management*
The Committee commented on the enterprise risk management (ERM) process which provides a framework to effectively identify, assess and manage risk. To avoid the risks simply being viewed as

'static' we have made the risks more visible and escalate both 'static' and 'dynamic' risks to the Executive and Board each month. All risks are discussed and reviewed at every HS&E committee meeting along with monitoring of the risk and statutory inspections register which provides confidence the business is meeting its obligations.

- *Safe Driving*
Following consideration by the Committee a 'Driver Behaviour Point' system (DBP) was introduced during 2013/14. The DBP system has been designed to encourage positive driver behaviour and demonstrates Thames Water's commitment to road safety. This initiative has seen a cultural shift in driving behaviour and has seen a marked reduction in vehicle incidents and is considered a success.
- *Walthamstow Wetlands Transformation Project*
The Committee received a briefing on the Walthamstow Wetlands project, which is a partnership project led by Thames Water and the London Borough of Waltham Forest to transform the reservoirs in Walthamstow, adjacent to Coppermills works, into a major urban nature reserve. The site is of international importance for birds (designated as a site of special scientific interest and a special protection area) and offers the potential to showcase one of the most important urban wetlands site in the country, whilst providing access to nature to over 300,000 residents that live within a three mile radius.

Thames Water has pledged £1.5 million towards the overall delivery cost of the project, with other funding secured from the Environment Agency, Greater London Authority, Growth Area Fund and the Outer London Fund.

- *Water Wellbeing Week*
During the first week of October 2013 the UK water industry took part in Water Wellbeing Week. This was a whole week dedicated to increasing health awareness and encouraging healthy lifestyles. Thames Water introduced the new initiative and led the communications for the week, developing the literature and multiple activities to get staff and contractors engaged. An estimated total of 200,000 people were involved in the event across the UK.
- *Stress and Personal Resilience Initiatives*
With an escalation in work related referrals to stress, anxiety and depression there has been an increase in 'presenteeism' (stress recognised and managed whilst in work) as opposed to all cases being referred due to 'absenteeism' (stress managed post absence).

The "building personal resilience" workshop is based on recognition that 'stress free' is neither achievable nor desirable. It identifies ways in which individuals can help themselves to cope with increased pressure and change by ensuring that they maintain a healthy work life balance. The programme is delivered by the specialist Occupational Health advisors within the H&S team at locations throughout the geographical area. A pilot programme was launched during Water wellbeing week where 15 minute taster sessions were available as part of the roadshow.

- *Health & Safety Conference 2014*
Each year Thames Water holds its H&S conference inviting senior directors from our contractor organisations, along with senior management from Thames Water and the chair of the HS&E Committee,

to come together to understand our collective performance of the previous year and strategy for the coming year. The conference also presents an opportunity to focus and discuss areas of development and interest across the organisation. This year's theme was catastrophic risk management.

c) Regulatory Committee

As a regulated utility, the Board has created the Regulatory Committee to provide oversight and guidance in respect of significant regulatory issues affecting the Company. The Committee assists the Board in reviewing any matters of significance affecting the regulation of the Company.

During the year the Committee met seven times with the main areas of focus for the committee being the submission of the Business Plan in support of the Price Review 2014 (PR14) and the submission to Ofwat of an application for a one-off bill increase ("IDoK") relating to the period 2010 to 2015 in August 2013.

Other business considered by the committee included:

- *Upstream Wholesale Services Reporting to Ofwat*
In February 2013 Ofwat released definitions for upstream services and the new guidance required each water company to publish its upstream services expenditure with accompanying commentary on its website. The guidance required appointed wholesale costs to be allocated across 15 service categories.

Ofwat requires that the Upstream Services table be accompanied by a methodology statement. The Committee approved both a table and a methodology statement as an appendix to the Company's 2012/13 Regulatory accounts and were made available on the website.
- *Response to the Ofwat's informal consultation on corporate governance*
In September 2013, Ofwat published a paper setting out expectations and principles for all companies in the areas of Board leadership, transparency and governance. This included Ofwat's expectations around the composition of the Board: independent non-executive directors to be the single largest group on the Board, fewer investor representatives than independents, and fewer executives than independent non-executive directors. Ofwat expects companies to put in place a code showing how the principles are applied, with full compliance by 1 April 2015. Thames Water has submitted its Key Principles to Ofwat and subject to obtaining the shareholder consent required, is confident of compliance by April 2015.
- *2014-15 Charges*
The Committee reviewed the proposed pricing structure based on price setting parameters, impact on bills and approval process for setting 2014/15 water and wastewater charges
- *Business Plan Assurance*
Prior to our submission to Ofwat in December 2013, following consideration of three potential outcome scenarios, a recommendation was given to the Board along with an assurance that the Company had complied with the principles and guidelines. The assurance statement and Principal Statement was submitted to Ofwat on 23 December 2013.
- *Response to Ofwat's consultation on Service Incentive Mechanism*
In October 2013, Ofwat published a consultation regarding potential changes in AMP6 to the Service Incentive Mechanism ("SIM").

The Committee considered a response that was supportive of the continued use of SIM in AMP6 but requested clarification around how it will work in practice. Whilst SIM remains largely fit for purpose both the qualitative and quantitative components can be improved; and there may be scope for moving to a measure based on company-specific targets, rather than comparative performance measured against the industry.

- *Open Water Market Blueprint Consultation*

On 2 January 2014, Open Water consulted on a Market Blueprint for retail competition arrangements in water and sewerage services. The new arrangements are proposed to be implemented for April 2017. The Open Water programme is focused on delivering the market architecture/design, the market codes and any central systems needed to implement the retail and upstream market arrangements. The Market Blueprint is the first formal opportunity for the Company to comment on the proposed arrangements and also provides an indication of the requirements Thames Water will be expected to comply with by 2017.

Following consideration and comment on the draft response by the Committee, the Company submitted a response which was supportive of the Open Water programme and retail market competition and broadly agreed with the core elements of the proposed Market Blueprint whilst highlighting potential areas of concern especially around certain governance aspects.

- *Regulatory Investigations*

The Committee received regular updates on regulatory investigations (such as by Ofwat regarding the Company's AMP4 sewer flooding capital schemes) and provided guidance to the Executive Team and recommendations to the Board on the Company's responses to such investigations.

- *Defra's consultation on the licence modification process*

The Committee considered Defra's review of processes for modifying the licences of water companies. The Company submitted a response which concluded that reforms to the current system should not be made without a clear case for change founded on experience in the water sector and that there was no case for changing the current system to modifying licences.

In the response, we emphasised the importance of having a process that provides stability in the regulatory regime and certainty to investors, and a process with clear recourse to appeal decisions based on the merits of the economic and technical arguments. These are all features of the current system.

d) *Customer Service Committee*

The Committee was established to focus on Customer Service, Customer Engagement and Communications. The core activities of the Committee are to review and advise on areas of Performance, Strategy and Customer Consultation and Engagement. The Committee met three times, and in addition to the regular customer service key measures, considered other business including:

- *Customer Service – Strategic IT Systems*

The Committee challenged management on the strategic investment in three critical IT systems for Customer Service: (i) Telephony and Contact Centre Platform (IPCC) – the current technology does not provide the level of customer experience required; (ii) Debt Management system – required to improve our cash collection rates and also improve our debtor segmentation. (iii) Replacement Billing System (CRB) –

the current system does not support the retail strategy or allow customers to interact with Thames Water in the way they wish to as CRB does not allow online account management.

- *Alternative Dispute Resolution Scheme*
Thames Water has been actively involved in developing the alternative dispute resolution (“ADR”) scheme working closely with Ofwat, the Consumer Council for Water (“CCW”) and other companies in the industry. The scheme, which will be voluntary, provides customers whose complaint has reached a deadlock position the opportunity for an independent review of their complaint by an appointed third party such as an Ombudsman. This is an additional stage in the complaints procedure and as such the current role of CCW will be broadly unchanged. The service will be funded by water companies and decisions made by the appointed independent body will be binding on companies. It is expected that the new service will be introduced in early 2015.
- *Improving the Customer Journey to deliver Customer Satisfaction*
A project to map the customer ‘journey’ was initiated during 2013. A customer journey describes the series of interactions customers have with a company via all available contact options such as telephone, web, face to face and service or marketing communications. A journey concerns itself with what customers do and how they feel about these interactions and looks at the end to end lifecycle from initial awareness, through to advocacy.

The project is mapping all customer journeys so that they can provide a baseline for customer satisfaction improvement.

- *Social Tariff Proposal Update*
The introduction of a social tariff from April 2014, to be called ‘WaterSure Plus’, was considered by the Committee. Designed to work closely alongside the existing WaterSure tariff it will be available to all Thames Water customers, water and wastewater and measured and unmeasured, irrespective of who raises the bill with no cap on bills.

WaterSure Plus will be funded through a cross-subsidy applied to the bills of all household customers. Qualifying households must contain someone in receipt of one of the same means-tested benefits that are specified in the quality criteria for the existing WaterSure tariff and customer’s annual water charges must exceed 3% of the household’s total income, after deduction of tax and national insurance. Successful applicants will receive a 50% discount on their annual water and/or wastewater charges, as appropriate.

e) Compensation & HR Committee

The Compensation & HR Committee has prepared a separate report and is presented on pages 74 to 92.

f) Thames Tideway Tunnel Committee

The Committee was created in order to progress matters in respect of the structuring and financing of the proposed Thames Tideway Tunnel project. As the project began to approach the procurement exercise for the main works and the market engagement ahead of tendering for the Infrastructure Provider (IP) the Board instituted specific governance measures to address any potential conflict concerns and, as part of these, the Committee’s membership was reconstituted.

The reformed Thames Tideway Tunnel Committee was established in October 2013 and has a delegation of authority from the Board to take the necessary decisions in respect of procurement and any other matters relating to the project that it or the Board considers could give rise to a conflict.

During the year the Committee met six times before being disbanded and the reconstituted Committee met on four occasions.

Relations with shareholders

Dialogue with shareholders

The Board considers that there is sufficient dialogue with shareholders and that shareholders' are engaged on all major shareholder issues and concerns. The current structure of the Board ensures that all of the shareholders are directly represented on the Board.

The Chairman, the Senior Independent Director, the Chief Executive Officer, Chief Financial Officer and the chairmen of the Board's Committees are available to meet shareholders on request. The Senior Independent Director has a specific responsibility to be available to shareholders who have concerns, and for whom contact with the Chairman, Chief Executive Officer or Chief Financial Officer has either failed to resolve their concerns, or for whom such contact is inappropriate.

Constructive use of AGM

As a private company, the Company does not hold an Annual General Meeting but, where there is a requirement to hold a shareholders' general meeting, this is conducted in accordance with the Shareholders' Agreement, Articles of Association and the Companies Act with each separate issue being proposed as a separate resolution.

Compensation & Human Resources Committee Report

Chairman's Statement



I am pleased to provide you with this year's annual report on remuneration. This is our first report under the new Remuneration Reporting Regulations (set out in the Large and Medium-sized Companies and Groups Accounts and Reports Amendment Regulations 2013). The remuneration of executives is governed by the Company's Compensation & HR Committee ("the Committee") which functions as both remuneration and nomination committee.

The Committee's responsibilities include making recommendations to the Board on the Company's executive remuneration policy and directors' terms of appointment. During the year, the Committee advised the Board of Directors and received advice and input from various directors and specialist staff within the Company, including the CEO and the Human Resources Director (both of whom are invited to attend meetings from time to time).

This year's report is split into two parts:

- The directors' remuneration policy, setting out the Company's policy on remuneration during this regulatory period. A review of this policy will take place during 2014/15 in preparation for the start of the five year regulatory period commencing in April 2015; and
- The annual report on remuneration, which sets out payments and awards made to the directors and details the link between Company performance and remuneration for the 2013/14 financial year. This section includes the total remuneration awarded for services to the Group, the element of this total that is awarded for services to the Company and the element that relates to regulatory performance.

The Company has faced challenges in relation to achieving its financial and customer service targets. Although significant improvements have been made in customer service satisfaction scores and we have seen the number of customer complaints reduce by approximately a third, customer satisfaction remains below our targets. The Board and Executive Team are fully committed to improving customer service performance and see it as the main priority for the business both in the coming year, and into the next AMP period. To reinforce the importance of this area of performance, and to ensure that the interests of Executives and managers within the Company are aligned with delivering improvements, the Committee has included improvements in Customer Satisfaction (CSAT) as a condition for the payment of bonuses in 2014/15. This means that if the Company's Customer Satisfaction target is not achieved, total bonus payments will be reduced by 50%. The Committee believes that this will support the delivery of improved customer service throughout the business.

Over the last year, the Company's financial performance has been strong. We have delivered our EBITDA and cash flow targets despite the impact of the wet weather which saw our operational costs increase. Our strong financial performance was supported by a Business Improvement Programme which was created to focus on delivering increased financial and customer service performance. Successful delivery against this programme has meant we have reduced costs in a number of areas and improved service, delivering real benefits for customers which are expected to continue into the final year of the regulatory period.

All of the above factors have been reflected in the level of bonus and long term incentive payments made for 2013/14.

Looking forward to 2014/15, we have reviewed the structure of the annual bonus scheme to ensure that it remains challenging and is truly incentivising strong performance for the benefit of customers. As set out above, the importance of improving our customer service performance is being reinforced by introducing an underpin whereby if the Company does not achieve its customer satisfaction target then all bonus payments will be reduced by 50%.

The Long Term Incentive Plan is a five year scheme that is in place until the end of the current regulatory period. During the coming year we will be reviewing our executive remuneration arrangements including developing a replacement for the LTIP for the start of the new AMP period on 1 April 2015. There have been no changes to the executive members of the Board during the year. There have been some changes to the non-executive members which are detailed within the Corporate Governance Report set out on page 66.

Remuneration Policy

In 2010 the Committee undertook a full review of its reward policy, with support from PricewaterhouseCoopers LLP and specialist staff within the Company. From this review a new remuneration framework was agreed and implemented for all executives incorporating base salaries, short and long term incentives and benefits. This framework has been reviewed annually as each element has been implemented, and where required, has been updated to ensure that it remains appropriate to the market and aligned with business needs. A full formal review will take place in 2014/15 in preparation for the start of the next regulatory period and any changes will be reviewed and approved by the Board on behalf of all shareholders.

The Committee makes all of its decisions relating to the remuneration policy against the following list of underlying principles:

- arrangements should attract, retain, motivate and reward high calibre directors and executives;
- remuneration should be aligned with the interests of the Group's stakeholders, in particular its shareholders and its customers;
- remuneration should be commensurate with those provided by other companies of similar size and complexity, taking into account individual contribution and experience;
- policy should establish firm links between an executive's performance and remuneration and between the Group's performance and the executive's total remuneration; and
- remuneration should include a mix of fixed and variable pay made up of basic salary plus performance related incentives.

Comparator groups

In determining suitable benchmarks for the remuneration of executive directors, base salaries and total compensation are reviewed against market practice for similar roles at a blend of companies reflecting the size and complexity of Thames Water and the Utilities sector. The Committee agreed that the relevant comparator groups outlined below would be used with adjustments being made for the size of the Company:

- divisions of companies;
- utility companies in the FTSE 350; and
- listed industrial companies.

Balancing short and long term remuneration

The Committee carefully considers the blend of remuneration linked to regulatory, financial, customer and operational performance in order to produce well balanced short-term and long-term incentive plans. Fixed annual elements, such as salary, pension and benefits, are set to ensure current and future market competitiveness enabling us to attract and retain high performing executives. The short and long term incentives are to motivate and reward them for making the Company successful on a sustainable basis, incentivising value creation and a high quality, value for money service to customers. The Committee will continue to review arrangements regularly to ensure that they remain effective and appropriate to the Company's circumstances and prospects, and to monitor the level of potential awards, with a full review scheduled to take place in the coming year.

Future policy

We present below the various elements of remuneration for Executive Directors and provide details of how these will support the Company's strategic objectives, how the elements of remuneration will operate, the maximum potential value and payment threshold. Additionally we set out the performance metrics we will use to establish variable pay and the applicable time periods for each element.

Base Salary

Element	Operation of the element	Maximum potential value and payment at threshold	Performance metrics used, weighting and time period applicable
To recognise status and responsibility to deliver strategy.	<p>Base salary is paid in 12 monthly instalments during the year.</p> <p>Salaries are reviewed annually by the Committee taking into account an individual's performance, the external market and internal and external economic factors.</p> <p>Any changes are effective from 1 July in the relevant financial year.</p>	<p>Annual salary increases will not normally exceed average increases for employees. There may be occasions where increases may be larger where the Committee considers this to be necessary such as if there are changes to the scope and responsibility of a role, where market conditions indicate a level of under competitiveness and the Committee judges there is a risk in respect of attracting and retaining executives. Where the Committee exercise its discretion to recommend increases above the average for other employees, the resulting salary will not exceed the competitive market range.</p> <p>The annual rate for each Executive Director is set out in the Statement of Implementation of Remuneration Policy for 2012/13 and 2013/14 on pages 84 to 89.</p>	Salary levels will be determined by individual performance, the external market and internal and external factors.

Benefits

Element	Operation of the element	Maximum potential value and payment at threshold	Performance metrics used, weighting and time period applicable
To provide benefits consistent with role.	Benefits are paid in 12 monthly instalments during the year or are benefits that are available as and when required on a one-off basis where applicable.	Benefits will include payments for car allowance, private medical insurance, life assurance, group income protection and a general entitlement to 25 days holiday. The CEO will also receive a housing allowance.	None

Pension or pension allowance

Element	Operation of the element	Maximum potential value and payment at threshold	Performance metrics used, weighting and time period applicable
To provide cost effective saving benefits for employees.	Payments are made in 12 monthly instalments during the year, directly to the individual or into their pension scheme.	Contribution of 25% of base salary for Executive Directors.	None

Long Term Incentive Plan (LTIP)

Element	Operation of the element	Maximum potential value and payment at threshold	Performance metrics used, weighting and time period applicable
To reward performance over the whole regulatory period (2010-2015), balancing the need for excellent performance in both the short and long term.	<p>As the Company is privately owned, the LTIP is a cash scheme, not share based.</p> <p>Payments are paid over the years 2013-2017 and depend on performance from the start of the regulatory period (2010) with payments in 2015-2017 representing performance over the whole regulatory period.</p> <p>New joiners after 1 April 2010 are eligible to participate in the LTIP 2010 at the discretion of the CEO. For new joiners the first payment will be made on the next vesting date following completion of two years' service. This will be pro-rated based on part year service.</p> <p>No amount will be received if there is less than two years' service for that award and awards are not pro-rated where the new joiner has served over three years of the performance period.</p> <p>Pro-rating also applies to good leavers and is subject to the Committee's discretion. Directors must be employed by the Group at the end of the relevant performance period to receive the pay-out unless the Committee exercises its discretion to make a payment in other circumstances.</p> <p>In exceptional circumstances the pay-outs in 2016 and 2017 may be reduced, for example, through material deterioration in financial performance or a significant fall in service after 2015. The Committee has the discretion not to pay under the regulatory and customer area if failure to meet targets in any area leads to regulatory action.</p>	<p>Annual target award of 75% of base salary. Annual maximum award of 150% of base salary.</p> <p>Award determined by performance set out in the plan and as set out by the Committee.</p>	<p>Vesting is conditional on specific performance conditions to include:</p> <p>Financial measures (40%):</p> <ul style="list-style-type: none"> • Regulated net capital expenditure • Group cash flow before funding • Group EBITDA • Operating expenditure <p>Sustainability (40%) which includes strategic initiatives linked to improving future performance, developing the AMP6 business plan, employee engagement and health & safety.</p> <p>Customer measures (20%) which refer to the Company's KPI dashboard and Ofwat's measure of customer satisfaction as quantified by their Service Incentive Mechanism (SIM) score.</p>

Annual Bonus

Element	Operation of the element	Maximum potential value and payment at threshold	Performance metrics used, weighting and time period applicable
<p>To motivate the Executive Directors to achieve the Company's key financial, customer, operational and strategic objectives through a combination of financial, corporate and personal performance targets.</p> <p>The bonus is structured to reward significant improvements in the Group's financial, customer and operational performance.</p>	<p>Annual bonuses are paid three months after the end of the financial year to which they relate. The Committee reserves the right to reduce bonus payments if overall Group performance does not warrant payment.</p>	<p>Annual target of 56.25% of base salary and maximum of 112.5% of base salary.</p> <p>There will be no minimum payment and an underpin has been introduced whereby if the Company's last quarter average Customer Satisfaction ("CSAT") score is not 4.3 or higher, all bonuses will be reduced by 50%.</p>	<p>Financial measures (45%):</p> <ul style="list-style-type: none"> • Regulated net operating expenditure • Group cash flow before funding • Group EBITDA <p>Corporate challenges (40%):</p> <ul style="list-style-type: none"> • PR14 Business Plan • Customer service • Health and safety • Transformation programme delivery <p>Personal performance (15%) is measured throughout the year.</p>

Performance measures and targets

The Committee selected the performance conditions which are central to the Company's overall strategy and are the key metrics used by the Board and Executive Team to oversee the operation of the business. The performance targets are proposed by management and approved by the Board through the Committee. The Committee is of the opinion that the performance targets for the annual bonus and LTIP are commercially sensitive and that it would be detrimental to the Company to disclose them before the start of the financial year. From 2014/15 the targets will be disclosed after the end of the relevant financial year in that year's remuneration report.

Differences in remuneration policy for all employees

All employees in the Company are entitled to a base salary, benefits and corporate pension scheme, which is either a defined benefit or defined contribution scheme depending on when the employee joined the scheme. Employees in management grades also receive a car allowance and are eligible to receive private medical insurance and participate in the annual bonus scheme. The maximum opportunity available is based on the grade of the role. The Long Term Incentive Plan is only available to certain members of the senior management team and participation is by invitation from the CEO only.

Consideration of employment conditions elsewhere in the Company

The Committee invites the HR Director to present proposals for the annual salary review for managers and employees in either February or May each year along with any other changes to remuneration policy within the Company as and when they arise. The Committee takes into account the salary increases for employees when approving the salary increases for Executives.

The HR Director consults with the Committee on approving the performance targets for all bonuses and Long Term Incentive arrangements along with the remuneration packages offered to senior managers within the Company. The Committee approves any payments made under these schemes to Executives and also approves the levels of payments under the corporate elements of these schemes for all levels of management.

Approach to Remuneration on Recruitment

The Committee and Board approve the remuneration to be offered to Executive Directors on recruitment and takes the approach that offers will be in line with the market and that it will pay no more than is necessary to attract appropriate candidates to a role. Any new Executive Director's remuneration would include the same elements, and be subject to the same constraints, as those for existing Executive Directors, as shown below. It is not the Company's policy to make any additional payments arising from forfeited payments from a previous employer. Should the situation arise it would need to be approved by the Committee.

Element of Remuneration	Policy/Maximum Percentage of Salary
Salary	-
Benefits	£12,500 car allowance (£15,000 for CEO) 25 days holiday Life assurance and income protection Family medical cover
Annual bonus maximum opportunity	112.5%
Long-term incentive annual maximum opportunity	150%
Pension contribution/allowance	25%

Service contracts and policy on payment for loss of office

The following table sets out the key features of the service contracts for Executive and Non-Executive Directors:

Standard Provision	Policy	Details
Notice periods in Executive contracts.	12 months' notice from Company 6 months' notice from Executive.	Executives may be required to work during the notice period or may be provided with pay in lieu of notice or placed on gardening leave at the discretion of the Company.
Compensation for loss of office in service contracts.	No payment unless in the case of redundancy whereby only statutory redundancy payments are made.	In the event that the Company wished to terminate an Executive Director's contract, other than in circumstances where the Company is entitled to summarily dismiss an Executive Director, it would need to give either 12 months' notice or make a payment in lieu of salary. If the reason for dismissal is redundancy then the Executive would be entitled to a statutory redundancy payment.
Non-Executive Directors	No notice period. Independent NEDs are appointed for an initial three year term. NEDs are appointed without a fixed end date.	For NEDs, no compensation would be payable in the event of early termination.

Standard Provision	Policy	Details
Treatment of unvested long-term incentive awards on termination under the plan rules.	No payment unless employed on the date of vesting except for 'good leavers', death, ill-health, normal retirement, redundancy, TUPE, change of control and other circumstances at the Committee's discretion.	<p>Good leavers will be entitled to a payment pro-rated to the period of service during the year, in line with the specific plan rules on pro-ration.</p> <p>Payments will be made on the normal payment date and based on actual performance. The Committee has discretion to vary the level of vesting.</p>
Treatment of annual bonus on termination under plan rules.	No payment unless employed on the date of payment of bonus except for 'good leavers', death, ill-health, redundancy and other circumstances at the Committee's discretion.	<p>Leavers through ill health or death will be entitled to a bonus pro-rated to the period of service during the year. Leavers who have left through compulsory redundancy having completed the full bonus year remain eligible for a payment even if they are not employed on the payment date. Payments are made on normal payment date and be based on actual performance.</p> <p>The Committee has discretion to vary the level of payment. This is intended to be used only to provide flexibility in unusual circumstances.</p>
Outside appointments	Executive Directors may accept external appointments with consent. Consideration is given to the appropriateness of the outside appointment and whether it may impact on their ability to perform the role appropriately.	<p>The Chairman's approval must be sought before accepting an external appointment. Fees may be retained by the Executive for services relating to outside appointments.</p> <p>None of the Executives currently hold an external appointment.</p>

Dates of directors service contracts/letters of appointment

The dates of the service contracts for the Executive Directors and their notice periods are set out below:

	Contract Start Date	Service Period	Notice Period
M Baggs, CEO	05/03/2010	N/A	6 months by employee 12 months by Company
S Siddall, CFO	20/09/2011	N/A	6 months by employee 12 months by Company

The dates of the service contracts for the Non-Executive Directors and their notice periods are set out overleaf:

	Initial Contract Start Date	Length of Each Period of Appointment	Expiry Date of Current Contract
Chairman:			
Sir P Mason	01/12/2006	3 Years	01/04/2017
Independent Non-Executive Directors:			
Dame D Hutton	22/07/2010	3 Years	21/07/2015
M Pavia	01/12/2006	3 Years	21/07/2015
E Richards	22/07/2010	3 Years	21/07/2015
Non-Executive Directors			
E Beckley	26/03/2008	N/A	N/A
R Blomfield-Smith	29/11/2012	N/A	N/A
D Buffery	13/12/2013	N/A	N/A
C Deacon	01/12/2006	N/A	N/A
Dr P Dyer	31/07/2013	N/A	N/A
S Eaves	20/01/2012	N/A	N/A
C Heathcote	21/06/2013	N/A	N/A
N Horler	14/04/2014	N/A	N/A
G Parsons ¹	10/06/2010	N/A	N/A
K Roseke ²	02/01/2013	N/A	N/A
D J Shah	15/10/2007	N/A	N/A
L Webb	21/11/2011	N/A	N/A
D Xu	29/10/2012	N/A	N/A

¹Gordon Parsons resigned with effect from 21 June 2013

²Keven Roseke resigned with effect from 24 May 2013

The Chairman and Independent Non-Executive Directors have fixed appointment periods. The other Non-Executive Directors do not as they are appointed and can be removed without notice by the shareholders of the Company in line with the Shareholder Agreement.

Total remuneration opportunity

The total remuneration for each of the Executive Directors that could result from the proposed remuneration policy in 2014/15 under different performance levels is shown overleaf. The following information has been incorporated in the production of this data:

- fixed pay represents the base salary for 2014/15 plus the value of pension contributions and benefits. The value of pension is as a fixed percentage of the basic salary;
- on-target performance is the level of performance required to deliver 50% (56.25% of base salary) of the maximum annual bonus and 50% (75% of base salary) of the full LTIP award;
- maximum performance would result in the maximum bonus payment (112.5% of base salary) and 100% vesting of LTIP award (150% of base salary); and
- when calculating LTIP payments the salary as at the date of award has been used, in line with the scheme rules, rather than current base salary.

Martin Baggs:

Fixed pay	100%			£632,375
On target	52.18%	21.51%	26.30%	Total £1,211,844
Maximum	35.30%	29.11%	35.59%	Total £1,791,313

Stuart Siddall:

Fixed pay	100%			Total £414,125
On target	50.58%	21.94%	27.48%	Total £818,731
Maximum	33.85%	29.36%	36.78%	Total £1,223,338

= Fixed Pay (Includes base salary, pension, benefits and allowances)

= Variable Pay (Bonus)

= Variable Pay (LTIP)

The tables below summarises the total cash elements of the package of the Executive Directors and their value as a percentage of salary.

Martin Baggs, CEO:

	2014/15 Value (% Salary)		2013/14 Value (% Salary)	
	Target	Maximum	Target	Maximum
Salary	100.00	100.00	100.00	100.00
Pension/Allowance	25.00	25.00	25.00	25.00
Bonus	56.25	112.50	56.25	112.50
Benefits/Allowances	11.43	11.43	11.77	11.77
LTIP	68.82	137.65	70.89	141.78
Total	261.50	386.58	263.91	391.05
Variable pay – Bonus & LTIP (% total)	47.83	64.71	48.18	65.02
Long-term pay – LTIP & Pension (% total)	35.88	42.07	36.33	42.65

Stuart Siddall, CFO:

	2014/15 Value (% Salary)		2013/14 Value (% Salary)	
	Target	Maximum	Target	Maximum
Salary	100.00	100.00	100.00	100.00
Pension/Allowance	25.00	25.00	25.00	25.00
Bonus	56.25	112.50	56.25	112.50
Benefits/Allowances	4.70	4.70	4.84	4.84
LTIP	70.47	140.93	36.29	72.58
Total	256.42	383.13	222.38	314.92
Variable pay – Bonus & LTIP (% total)	49.42	66.15	41.61	58.77
Long-term pay – LTIP & Pension (% total)	37.23	43.31	27.56	30.99

Non-Executive Director (NED) fee policy

Remuneration levels are set to enable us to attract NEDs who have a broad range of experience and skills to oversee the implementation of our strategy. NED fees are proposed by the Committee and approved by the Board as a whole. The Chairman's fees are also set by the Committee and are approved by the Board.

The annual fees will be paid in 12 equal monthly instalments throughout the year and are reviewed on a regular basis against those of NEDs in companies of a similar scale and complexity and requiring a similar time commitment. The fees were last reviewed and increased with effect from 1 July 2013. NEDs are not eligible to receive further benefits, do not participate in any performance related arrangements and do not participate in pension plans.

Statement of consideration of shareholder views

Each year, the Committee and Board review and approve the basic salaries, bonus scheme design, bonus payments and long term incentive plan payments that are recommended for the Executives. The Board is made up of representatives of each of the shareholders therefore their views are directly taken in to account when determining these matters.

Changes to remuneration policy

There have been no changes to the remuneration policy from that operating in 2013/14 with the exception that the annual bonus for the Executive Directors will be amended for 2014/15 to ensure that the targets remain stretching and to reinforce the importance of improving customer service performance. An underpin arrangement will be introduced whereby if the Company's Customer Satisfaction target is not achieved, all bonuses will be reduced by 50%.

Statement of Implementation of Remuneration Policy in 2013/14

This section has been prepared in accordance with The Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013. The information has been audited as indicated.

Base salary (audited)

Base salaries for the Executive Directors are reviewed annually, taking into account their individual performance, the external market and internal and external economic factors, with any changes taking effect from 1 July each year. Base salaries are a fixed sum payable monthly. No base salary increases were awarded to the Executive Directors in the year and details are shown below:

	Base Salary 01/07/2012	Base Salary 01/07/2013	Percentage Increase
Martin Baggs	£450,000	£450,000	0%
Stuart Siddall	£310,000	£310,000	0%

NED annual fees (audited)

The Chairman and NEDs receive a fixed fee for their duties which reflects their responsibilities and time commitments. They are not entitled to any annual bonus, long term incentives, pension benefits or benefits in kind. NED fees were increased with effect from 1 July 2013. Fee rates for 2012 and 2013 are shown below:

	Total Annual Fees 01/07/2012	Total Annual Fees 01/07/2013	Percentage Increase
Chairman	£300,000	£300,000	0%
Independent NEDs	£45,000	£49,000	9%
NEDs	£45,000	£45,000-£49,000	0%-9%
Chair of Audit Committee ¹	£55,000	£59,000	7%

¹ This is the normal Non-Executive Director fee plus an additional £10,000 in respect of services as Chair of the Audit Committee

Single Total Figure for Remuneration for Executives and Non-Executives (audited)

The remuneration of the Executive and Non-Executive Directors during 2012/13 and 2013/14 is set out below:

Current Directors:

	Salary/Fees		Benefits and allowances		Bonus		LTIP		Pension related benefit		Total Group		Total Company	
	£'000		£'000		£'000		£'000		£'000		£'000		£'000	
	2014	2013	2014	2013	2014	2013	2014	2013	2014	2013	2014	2013	2014	2013
Executive Directors:														
M Baggs ¹	450	450	53	53	274	274	404	366	113	113	1,294	1,256	906	879
S Siddall ²	310	308	15	15	239	188	143	-	78	77	785	588	550	412
Chairman:														
Sir P Mason	300	300	-	-	-	-	-	-	-	-	300	300	180	180
Independent NEDs:														
Dame D Hutton	48	45	-	-	-	-	-	-	-	-	48	45	48	45
M Pavia	58	55	-	-	-	-	-	-	-	-	58	55	58	55
E Richards ³	48	45	-	-	-	-	-	-	-	-	48	45	48	45
Non-Executive Directors:														
E Beckley ⁴	45	45	-	-	-	-	-	-	-	-	45	45	-	-
C Heathcote ⁴	34	-	-	-	-	-	-	-	-	-	34	-	-	-
Dr P Dyer	30	-	-	-	-	-	-	-	-	-	30	-	-	-
R Blomfield-Smith ⁶	48	15	-	-	-	-	-	-	-	-	48	15	-	-
C Deacon ⁵	48	45	-	-	-	-	-	-	-	-	48	45	-	-
S Eaves ⁴	45	45	-	-	-	-	-	-	-	-	45	45	-	-
D J Shah	48	45	-	-	-	-	-	-	-	-	48	45	-	-
D Buffery ⁴	15	-	-	-	-	-	-	-	-	-	15	-	-	-
L Webb ⁴	45	45	-	-	-	-	-	-	-	-	45	45	-	-
D Xu ⁴	45	19	-	-	-	-	-	-	-	-	45	19	-	-
Total	1,617	1,462	68	68	513	462	547	366	191	190	2,936	2,548	1,790	1,616

Non Executive Directors that have left in the period:

	Salary/Fees		Benefits and allowances		Bonus		LTIP		Pension related benefit		Total Group		Total Company	
	£'000		£'000		£'000		£'000		£'000		£'000		£'000	
	2014	2013	2014	2013	2014	2013	2014	2013	2014	2013	2014	2013	2014	2013
Non-Executive Directors:														
G Parsons ⁴	11	45	-	-	-	-	-	-	-	-	11	45	-	-
K Roseke ⁴	8	11	-	-	-	-	-	-	-	-	8	11	-	-
Total	19	56	-	-	-	-	-	-	-	-	19	56	-	-

¹ The CEO received no pay increase in 2013 and has elected to reduce his bonus payment for 2013/14 to the same level as that of the previous financial year, in recognition of the external economic environment. Included within benefits and allowances is £15,000 car allowance, £36,000 housing allowance and £2,000 private medical insurance which are taxable benefits.

² Included within benefits and allowances is £12,500 car allowance and £2,000 private medical insurance which are taxable benefits.

³ Directors fees paid to Ofcom

⁴ Director's fees are paid to the shareholder's nominated Company and not to the individual

⁵ In addition consultancy fees of £40,000 (2013 £60,000) were paid for work on the Tideway improvements project

⁶ In addition consultancy fees of £nil (2013 £36,000) were paid

No fees are paid to Alternate Directors for their services as Alternate Directors. The cash bonus was paid in full at the appropriate time and is not a deferred payment.

Of total executive directors' remuneration of £2,079,000 (2013: £1,844,000), £1,456,000 (2013: £1,291,000) is for the executive directors for their services to Thames Water Utilities Limited and has been disclosed within Note 5 to the financial statements. In addition, the executive directors received total remuneration of £624,000 (2013: £553,000) for their services to other companies within the Group. The Group is Kemble Water Holdings Limited and the Company refers to TWUL. No operational distinction is made between services provided by the directors to one or the other.

Additional requirements in respect of the single total remuneration figure table
Annual bonus (audited)

The 2013/14 annual bonus plan aimed to reward significant improvement in the Group's financial and corporate performance including customer performance whilst recognising individual contribution. The maximum level of award for the 2013/14 scheme for Executive Directors was 112.5% of salary based on three performance areas: financial, corporate challenge and personal.

The financial targets and corporate challenges were selected as being the most critical for the organisation during 2013/14. The personal performance element of the bonus is based on the performance of the Executive Directors against their key business objectives which link to the Group's overall key operational, customer and strategic objectives. Bonuses are earned by reference to the financial year and usually paid in July following the end of the financial year. Performance against the bonus targets and the resulting bonuses payable to the Executive Directors in respect of 2013/14 are shown below:

	Maximum payable		Actual payable		Martin Baggs		Stuart Siddall	
	% of max bonus	% of salary	% of max bonus	% of Salary	Max	Actual ¹	Max	Actual
					£'000	£'000	£'000	£'000
Capital Efficiency	11.11	12.50	3.54	3.98	56.2	17.8	38.7	12.3
Cash flow before Funding	11.11	12.50	11.11	12.5	56.2	56.2	38.7	38.7
EBITDA ²	33.35	37.50	25.33	28.48	168.8	128.1	116.3	88.2
Thames Tunnel	8.33	9.38	6.33	7.12	42.2	32.0	29.1	22.1
Customer Service	8.33	9.38	2.00	2.25	42.2	10.1	29.1	6.9
Business Improvement	8.33	9.37	3.00	3.51	42.2	15.8	29.1	10.6
Waste Serviceability	8.33	9.37	8.33	9.37	42.2	42.1	29.1	29.1
Personal Performance	11.11	12.50	8.88	9.99	56.2	44.8	38.7	31.0
Totals	100.00%	112.50%	68.52	77.2	506.2	346.9	348.8	238.9

¹ The CEO received no pay increase in 2013 and has elected to reduce his bonus payment for 2013/14 to the same level as that of the previous financial year, in recognition of the external economic environment. The table set out above shows the actual payment before this reduction.

² The Committee exercised its discretion to adjust the EBITDA actual payout level to recognise increased costs incurred relating to the securitisation agreement.

There was a requirement that all related regulatory outputs must be achieved for the net capital expenditure measure to pay out and that there must be no increase in operating expenditure creditor days for the cash flow before funding measure to pay out. These were both achieved. Furthermore, there was a financial underpin on the personal element of the 2013/14 bonus whereby no payment would be made against the personal element of the annual bonus unless the Group cash flow before funding target was achieved, which was also attained.

The payments under this scheme will be made in July 2014.

The following table sets out the amount of the bonus which is attributable to regulatory performance for 2013/14:

Executive Director	Amount Determined by Regulatory Performance
Martin Baggs, CEO	£232,522
Stuart Siddall, CFO	£203,143

LTIP (audited)

The performance measures selected for the LTIP are considered to be aligned to the creation of value for the Company, meeting and exceeding regulatory and customer performance requirements and managing key strategic initiatives to deliver improved future performance.

A new five year LTIP was introduced in 2010 for the Executive Directors and senior managers in key strategic positions across the Company. The performance period of the plan runs from 1 April 2010 to 31 March 2015. The plan focuses on the key objectives, customer, financial and strategic, for the current regulatory period which is critical to the Company's business plan. This is a five year plan where participants at the Executive Director level were granted five times their annual target award of 75% of basic salary in 2010. No further grants will be made to participants over the performance period.

For threshold performance, half the award will vest, rising to two times the award for maximum performance. If performance does not reach the threshold level for any of the targets, no payment will be made under the plan.

Under normal circumstances 20% of the total award can be paid each year from 2013 to 2017, usually in July, based on performance achieved as follows:

- 20% of the award was paid in July 2013, based on performance from March 2010 to March 2013;
- 20% of the award will be paid out in July 2014, based on performance from March 2010 to March 2014;
- the remaining 60% of the award will vest in March 2015 based on performance from March 2010 to March 2015 and will be paid out in three equal tranches over July 2015 – July 2017.

In exceptional circumstances the pay-outs in 2016 and 2017 may be reduced, for example in the event of a material deterioration in financial performance or a significant fall in service after the AMP5 period. In addition, the Committee has the discretion not to pay under the regulatory and customer area if failure to meet targets in any area leads to regulatory action.

The Executive Directors' performance against the targets set out in the LTIP over the period 1 April 2010 to 31 March 2014 are set out overleaf:

LTIP Measure	Maximum payable % max LTIP	Maximum payable % of salary	Actual payable % max LTIP	% of Max Achieved % of salary
Cumulative operational expenditure	10.0	15.0	5.5	8.2
Cumulative EBITDA	10.0	15.0	6.6	9.9
Cumulative capital efficiency	10.0	15.0	10.0	15.0
Cumulative cash flow before funding	10.0	15.0	10.0	15.0
Service incentive mechanism	10.0	15.0	0.0	0.0
Operational KPI dashboard	10.0	15.0	5.0	7.5
AMP6 planning and outcome	10.0	15.0	7.5	11.3
Employee engagement	10.0	15.0	7.5	11.3
Health & safety engagement	10.0	15.0	7.5	11.3
Strategic initiatives	10.0	15.0	3.8	5.6
Totals	100.0	150.0	63.4	95.1

The actual payments to be made in July 2014 under the LTIP 2010 represent a payout of 63.4% of the maximum in line with the table above. The values of these payments are set out below (no discretionary elements were applied to any of the payments).

The following table sets out the vested and unvested awards under the LTIP 2010. The potential values shown are the maximum cash levels attainable subject to the performance conditions being achieved. The expected

value shows the level of vesting (cash to be paid) anticipated based on estimates of current performance, and will only be payable if performance continues at the same level and if the Executive remains employed at the end of the performance period, unless the Committee exercises their discretion to make a payment in other circumstances.

£'000	July 2014		July 2015		July 2016		July 2017	
	CEO	CFO	CEO	CFO	CEO	CFO	CEO	CFO
Potential value of awards held at 31/03/2013	638	225	638	450	638	450	638	450
Potential value of awards granted during the year	-	-	-	-	-	-	-	-
Value of awards vesting during or related to the year ²	404	143	-	-	-	-	-	-
Value of awards lapsed during the year	234	82	-	-	-	-	-	-
Potential value of awards held at 31/03/2014	-	-	638	450	638	450	638	450
Group expected value of awards held at 31/03/2014 ¹	404	143	307	217	307	217	307	217
Company expected value of awards held at 31/03/2014	283	100	215	152	215	152	215	152

1 Based on performance to date and forecast performance for remainder of performance period
2 Will be paid in July 2014

The expected value of the awards attributed to the Company relate fully to regulatory performance.

The amounts shown in the above table are the total amounts that potentially will vest on maturity. The amounts accrued in the year are shown in note 5, page 123 of the financial statements.

Total pension entitlements (audited)

The Executive Directors are eligible to participate in the Company's defined contribution pension scheme, with the Company making contributions equivalent to 25% of base salary. No element of bonus or LTIP is pensionable. Where contributions in to the scheme would be in excess of the annual allowance limit, or where the individual has reached the life time allowance, a cash allowance in lieu of these pension contributions can be paid. For 2013/14, Martin Baggs received contributions in the defined contribution scheme and a cash allowance as set out in the table below and Stuart Siddall received only a cash allowance. Neither of the Executive Directors participates in a defined benefit pension scheme.

Executive Director	Payments to DC Scheme	Cash Allowance in Lieu of Pension	Total Payments 2013/14	Total Payments 2012/13
Martin Baggs, CEO	£50,000	£62,500	£112,500	£112,500
Stuart Siddall, CFO	-	£77,500	£77,500	£76,875
Total	£50,000	£140,000	£190,000	£189,375

Aggregate directors emoluments (audited)

	2013/14	2012/13
Salaries	£760,000	£758,000
Taxable benefits/allowances	£68,000	£68,000
Bonuses	£512,546	£462,004
Pension payments	£190,000	£189,375
NED fees	£876,000	£836,000
Total	£2,406,546	£2,313,379

Note: LTIPs are not deemed to be emoluments therefore they are not included within this table. Information relating to LTIPs can be found within the Single Figure for Remuneration table and LTIP section of this report.

Payments for loss of office (audited)

There have been no changes to the Executive Directors in the year hence no payments for loss of office have been made.

Payments to past Directors (audited)

As disclosed in last year's remuneration report former Chief Operating Officer, Steve Shine, also received a payment of £258,000 under the 2010 Long Term Incentive Plan in July 2013 with no further payments due.

Performance Graph and CEO pay in last five financial years

As a privately held Company, total shareholder return ("TSR") is not a relevant or meaningful measure for the Company; therefore a benchmark TSR performance graph has not been included in this report.

Percentage change in CEO remuneration compared to all employees

The following shows the percentage change in CEO remuneration by comparison to all employees in the Company. This has been presented to show remuneration on a like-for-like basis to the prior year:

	Salary (£'000)			Benefits (£'000) ¹			Bonus (£'000)		
	12/13	13/14	% change	12/13	13/14	% change	12/13	13/14	% change
Martin Baggs	450	450	0%	53	53	0%	274	274	0%
All Employees (Manager Grade)	20,457	20,457	0%	1,974	1,974	0%	2,117	2,044	-3.5%
All Employees (Non-Manager Grade)	110,222	112,978	2.5%	-	-	-	-	-	-

¹ Benefits include a car allowance and private medical insurance. For the CEO this also includes a housing allowance

Relative importance of spend on pay

The following table sets out the percentage change in operating profit, shareholder distributions and overall spend on pay in the year ending 31 March 2013, in the year 2012/13 and 2013/14.

	12/13	13/14	Year on year change	
	£m	£m	£m	%
Operating Profit	549.3	655.1	105.8	19.2%
Shareholder Distributions	92.0	100.0	8.0	8.7%
Total payroll costs including pensions	213.4	220.1	6.7	3.1%

The Directors believe that the distributions to the Ultimate Shareholders are the most relevant measures to use as a comparison.

Statement of Implementation of Remuneration Policy in the Following Financial Year

The remuneration policy will be implemented during 2014/15 as follows:

Salary

£'000	Base Salary 01/07/2013 (£'000)	Base Salary 01/07/2014 (£'000)	Percentage Increase (%)
Martin Baggs	450.0	463.5	3.0%
Stuart Siddall	310.0	319.3	3.0%

Performance measures for long-term incentives to be awarded in 2014/15

We will not be making any further awards under the LTIP in 2014/15 although there will be amounts accruing. Any payments made will be made under the LTIP 2010 and the performance measures which are contained within the scheme, which have been outlined previously. As with the Company bonus scheme, performance targets for the LTIP are deemed to be commercially sensitive and will not be disclosed before the start of the financial year.

Annual bonus targets for 2014/15

The performance targets for the annual bonus for 2014/15 for Executive Directors will be based on the weightings shown below:

Measurement area	Weight for 2014/15
Financial Performance:	
Regulated net operating expenditure	15%
Group cash flow before funding	15%
Group earnings before interest tax depreciation and amortisation (EBITDA)	15%
Corporate Challenges:	
Customer service	10%
Health and safety	10%
PR14 Business Plan	10%
Transformation program delivery	10%
Personal Performance:	
Based on performance against objectives	15%

As in the 2013/14 bonus, the related regulatory outputs must be achieved before the capital expenditure efficiency measure will pay out and there must be no increase in creditor days for the cash flow before funding target to pay out. To reinforce the importance of improving customer service performance there will be an underpin whereby if the Company's satisfaction ("CSAT") score is not met, all bonus payments will be reduced by 50%. The Committee is of the opinion that the performance targets for the annual bonus are commercially sensitive and it would be detrimental to the Company to disclose them before the start of the financial year. The targets will be disclosed after the end of the year in the relevant financial year in that year's remuneration report.

Non-Executive Director Fees in 2014/15

The fees for the independent Chairman and the non-executive directors can be summarised below:

£'000	01/07/2013	01/07/2014	Percentage Increase
Chairman	300	325	8.33%
Independent NED	49	49	0%
NED	45-49	45-49	0%
Chair of Audit Committee ¹	59	59	0%

¹ This is the normal Non-Executive Director Fee plus an additional £10,000 in respect of services as Chair of the Audit Committee

Consideration by the Directors of Matters Relating to Directors Remuneration

The Compensation and Human Resources Committee is responsible for recommending the remuneration policy and remuneration packages for Executive Directors and the Executive Team, to the Board. They are also responsible for recommending the structure of other aspects of remuneration for all employees, including the structure of annual and long term incentive arrangements for managers.

Members of the Committee

Members of the Committee are all non-executives who are members of the Board. They are appointed to the Committee on an ongoing basis. The following table sets out the attendance of the members of the Committee during the year.

Committee Member	Number of Meetings during Term	Number of Meetings Attended
Sir Peter Mason (Chair)	5	5
Michael Pavia	5	5
Christopher Deacon	5	5
Edward Beckley (Appointed 21/06/13)	4	3
Gordon Parsons (Resigned 21/06/13)	1	1

Committee's activities

The Committee's activities cover a range of subjects including succession planning, people strategy and executive remuneration. The following activities relating to remuneration were as follows:

Meeting	Activities
February 2013	Reviewing bonus plan for 2013/14
May 2013	Reviewing performance against targets 2012/13 for annual bonus and 2010-2013 for long term incentive plan. Reviewing salaries for Executive Team for 2013/14 Finalising bonus plan for 2013/14
June 2013	Board meeting to approve bonus payments for 2012/13 and 2010-2013 LTIP payment. Board meeting to approve salary reviews for Executive Team for 2013/14. No increases awarded.
February 2014	Reviewing bonus plans for 2014/15
May 2014	Reviewing performance against targets 2013/14 bonus and 2010-2014 LTIP targets. Resulting payments to be made July 2014 Reviewing salaries for Executive Team 2014/15. Finalising bonus plan for 2014/15
June 2014	Board to approve bonus and LTIP pay-outs 2013/14 and any salary reviews for the Executive Team for 2014/15.

Advisors to the Compensation and HR Committee

The Committee is advised when necessary by PricewaterhouseCoopers LLP but in the year 2013/2014 their services were not utilised.

The directors' remuneration report was approved by the Board on 10 June 2014, and signed on its behalf by:



Sir Peter Mason
 Chairman

Audit and Risk Review Committee Report

Chairman's statement

As in prior years, the Board reviews risk management arrangements and the effectiveness of the Company's internal control systems through the work of the Audit and Risk Review Committee (the "ARRC" or the "Committee").

The Committee has been involved in a variety of discussions with executive management and the Board over the last year, the Committee's primary objectives were adhered to throughout our work, namely:

- exercising oversight over the accuracy and completeness of the Annual Report and Accounts ("AR&A"), including ensuring that the AR&A presents a fair, balanced and understandable view of the Company;
- ensuring the AR&A gives a true and fair view of the Company's results as is in compliance with financial reporting requirements, regulatory accounting guidance and corporate governance;
- making informed decisions regarding accounting policies, practices and disclosures, assessing whether the key estimates and judgements made by management are appropriate;
- reviewing the scope and results of internal and external audits;
- assessing the adequacy of the Company's internal control framework to ensure compliance with policies approved by the Board;
- maintaining open lines of communication between the Board, management and the external auditor; and
- monitoring compliance with the risk management framework in relation to financial operational matters.

The ARRC also reviews the Company's procedure for handling allegations from whistleblowers as set out in the Company's Honest and Ethical Behaviour Policy. Any whistleblowing events are brought to the attention of the ARRC and are promptly investigated by the Head of Internal Audit and Assurance.

Review of the year

The ARRC reviewed several presentations throughout the year from senior management to ensure the Committee was fully informed of key matters under their remit. The Committee was actively involved in regularly assessing the following significant issues with management throughout the year ended 31 March 2014:

- level of bad debt provision;
- management's judgement of the level of provisions; and
- management's application of the Company's policy in respect of overheads to be capitalised.

More detail on these areas is considered overleaf.

In order to gain a deeper insight into other areas, the ARRC has asked that management present papers throughout the year on the following additional topics:

- external assurance performed on the PR14 Business Plan submitted by the Company on 2 December 2013;

- review of the Company's tax arrangements and approval of a the Company's tax policy which has been updated to specifically refer to and incorporate the seven principles of good tax governance published by the Confederation of British Industry ("CBI") in May 2013;
- the top ten corporate risks for the Company; and
- management's processes and controls around maintaining data quality throughout the business.

This was in addition to the ARRC's continuing discussions with Internal Audit, which included detailed reviews of Internal Audits report and discussions on the adequacy of Internal Audit resources.

Composition and Experience

The ARRC comprises two non-executive directors (Rosamund Blomfield-Smith and Chris Heathcote) and one independent non-executive director, Michael Pavia, who is the Committee Chairman. The ARRC is attended by the CEO and CFO and other senior managers as appropriate. The external auditors also attended these meetings.

The Committee met four times during the financial year ended 31 March 2014. In addition to the formal meetings of the Committee, the Chairman of the Committee also met with both the Head of Internal Audit and the external audit lead partner and manager as required throughout the year.

Michael Pavia is a member of the Institute of Chartered Accountants in England and Wales (ICAEW) with extensive financial and accounting experience. The Board regards Michael Pavia as the member of the Committee possessing recent and relevant financial experience. Further biographical details of the members are set out on pages 54 to 59.

Financial Reporting and Significant issues

The Committee considered, prior to recommending their approval to the Board, the integrity of the financial statements of the Company and, in conjunction with the Regulatory Committee, reviewed the Regulatory Financial Statements. In undertaking this review, the Committee discussed the critical accounting policies and judgements applied with management and the external auditors, including meetings with KPMG LLP not in the presence of the executive directors. It discussed a report from the external auditors identifying the significant accounting and judgemental issues that arose in the course of the audit. The ARRC also considered the management letter for issues and judgements raised and monitored action taken by management as a result of any audit recommendations.

After discussion with both management and the external auditor, the Committee reviewed work on the following key estimates and judgements within the Company's financial statements. Based on the ARRC's review of papers covering the above topics, the Committee is satisfied on the appropriateness of the basis for key judgemental areas. In reaching this conclusion the members of the ARRC also considered the responses received to their questions and the reporting provided by KPMG LLP in these judgemental areas. Further detail on the ARRC's review of such items is provided below.

- The level of bad debt provisions recognised by the Company, including the judgemental impact of the level of historic and current cash collections, the effect of cancelling billings on expected debt recovery (for example where the property occupier has moved without informing us or where the Company was unable to invoice for a period of time when the property was unoccupied) and the levels of debtors due to be collected on our behalf (Water-only Company debtors);

The Committee reviewed management's key assumptions underlying the bad debt provision via reviews of papers presented by management on the topic throughout the year, including a review of the debtors ageing and the basis for cash collection and write-off rates in the year. Based on this review, the Committee was satisfied that potential bad debt was adequately provided for in the financial statements.

- Management's judgement of the level of provisions required to be carried in relation to contractor claims for work performed on our capital projects and network operations, insurance provisions, litigation and regulatory matters, on which the Committee receives regular updates from our General Counsel where applicable;

The Committee reviewed the levels of provisions held by the Company on the issues noted above, questioning and challenging the basis for such provisions. A more detailed review and analysis of contractor claims against capital projects by management was completed upon the recommendation of the Committee. The Committee also ensured that appropriate disclosure of such provisions had been made by management through their review of the statutory financial statements. Based on this review, the Committee decided that the level of provisions for the above matters was appropriate.

- Management's application of the Company's policy applicable in respect of overheads to be capitalised taking into consideration the nature of work performed.

Through review and discussion of the interim and year end financial statements, and discussion of the levels of overheads capitalised in the year, the Committee concluded that adequate rigour had been applied by management to ensure appropriate application of the Company's capitalisation policy. A summary of the policy was reviewed by the ARRC, which included the management basis of capitalisation applied under generally accepted accounting standards and regulatory guidance for capitalisation. The ARRC also reviewed specific judgemental areas where a more detailed review of capitalisation of certain costs was performed by management. This was further supplemented by the Committee's discussion with KPMG LLP on their audit work performed in this area at year end. Based on this review, the Committee was satisfied with management's application of the Company's capitalisation policy.

The above three items represented the key estimates and significant judgements reviewed by the ARRC during the year, and align to those identified by KPMG LLP in their audit report. However, the Committee did consider other areas of estimates and judgements during the year. These included review and discussion of management's papers on the group restructuring, whereby certain holding companies within the wider group structure were reorganised with the intention of simplifying the Group structure.

The committee also considered in detail management's review of both interim and full year results.

The consistency of accounting policies across the Company and the methods used to account for significant or unusual transactions were reviewed by the Committee. It assessed whether the Company had followed appropriate accounting standards and had made appropriate estimates and judgements, taking into account the views of KPMG LLP. The Committee further considered whether appropriate disclosure had been made in the financial statements, the strategic report and the Corporate Governance report. The Committee reviewed all statutory financial reporting prior to these being presented to the directors or Board for formal approval.

At the request of the Board, the ARRC considered whether the 31 March 2014 Annual Report was fair, balanced and understandable and whether it provided the necessary information for all stakeholders to assess TWUL's performance, business model and strategy. Based on consideration of the above items, and the other

work performed by the Committee as noted in this report, the ARRC was satisfied that, taken as a whole, the Annual Report is fair, balanced and understandable.

Confidential reporting procedures and whistleblowing

The Committee Chairman reported formally to the Board on the ARRC's proceedings and on all matters within its duties and responsibilities at each subsequent Board meeting. The Committee made recommendations to the Board as it deemed appropriate on any area within its remit where action or improvement was needed and reported to the Directors on its activities through the circulation of the Committee minutes. The Head of Internal Audit was given direct access to the Chairman of the Committee and to the Chairman of the Board.

The Committee reviewed the Company's arrangements for its employees and contractors to raise concerns, in confidence, about possible wrongdoing in financial or regulatory reporting or other matters. The Committee ensured that these arrangements allowed proportionate and independent investigation of such matters and appropriate follow up action. It considered the Company's procedures for detecting fraud and its systems and controls for the prevention of bribery and received reports from internal audit of any investigations and the Company's compliance. In addition, the Committee discussed the results of internal investigations conducted by the Company's forensic audit department.

Internal Audit

The Committee monitored and reviewed the effectiveness of the Company's internal audit function in the context of the Company's overall risk management systems. In particular, the Committee considered and approved the remit and activities of the internal audit function (which is led by an experienced qualified member of management with over 10 years of audit experience), ensuring that it had adequate resources and appropriate access to information to enable it to perform its function effectively, in accordance with the relevant professional standards, and was free from management or other restrictions. It reviewed and assessed the annual internal audit plan and any reasons for changes or delays to that programme. The ARRC considered reports on the Company from the internal auditors, including management's responsiveness to the findings and recommendations of the internal audit team. The ARRC Chairman, Michael Pavia discussed any internal audit report which had less than satisfactory results directly with the relevant members of management to ensure he had a thorough understanding of the matters raised and the process for resolution.

Based on the above work, the ARRC is satisfied with the scope and effectiveness of the Internal Audit function throughout the year, and that all less than satisfactory internal audit reports were being adequately addressed by management.

External audit

The Committee is responsible for overseeing relations with the external auditors, including the approval of fees, and makes recommendations to the Board on their appointment and reappointment.

Details of total remuneration for auditors for the year, including audit services, audit related services and other non-audit services, can be found in note 4 of the statutory financial statements.

The Committee oversaw the relationship with the external auditors KPMG LLP including (but not limited to) whether fees for audit or non-audit services were appropriate. It reviewed KPMG LLP's terms of engagement, engagement letter and the scope of their audit work. The Committee assessed the independence and objectivity of the external auditors, taking into account relevant UK professional and regulatory requirements

and the relationship with the auditors as a whole, including the provision of any non-audit services in accordance with the Policy for the Provision of Non-Audit Services.

Auditor independence and objectivity

The independence of the external auditors is essential to the provision of an objective opinion on the true and fair view presented in the financial statements. Auditor independence and objectivity is safeguarded by reviewing the nature and value of non-audit services performed by the external auditors, ensuring that employees of the external auditors who have worked on the audit in the past two years are not appointed to senior financial positions within the Company, and the rotation of the key audit partner every seven years and the lead engagement partner at least every five years. The current lead engagement partner has held the position for two years, and has been a key audit partner for six years.

The ARRC regularly monitors the non-audit services provided to the Company by KPMG LLP. The auditor does not:

- self-review;
- make management decisions for the Company;
- have a mutuality of financial interest with the Company; or
- act in the role of advocate for the Company.

Non-audit services

To safeguard the objectivity and independence of the external auditors, approval from the ARRC is required for any services provided by the external auditor for which the fee is likely to be in excess of £100,000. As part of this process the ARRC ensures that the external auditors are not permitted to perform any work that they may subsequently need to audit, could create a conflict of interest or constitute a breach of the external auditors' independence and objectivity. Non-audit services are normally limited to assignments which are closely related to the performance of the audit or where detailed knowledge of the Company is necessary for its completion.

Details of the fees paid to the external auditor during the year ended 31 March 2014 for audit and non-audit services are set out in note 4 to the statutory financial statements. Total fees for audit and non-audit services incurred during the year amounted to £2.9 million (2013: £2.0m).

This included £1.8 million (2013: £1.4m) of fees in respect of consultancy advice provided on the Thames Tideway Tunnel. These costs have been capitalised as part of the design phase of the project. The contract for these services was subject to competitive tender in line with the Company's procurement process, where all firms that provided proposals were considered and shortlisted by reference to predetermined and objective selection criteria. The Company determined that KPMG LLP provided the most comprehensive proposal, and was satisfied that the project would be delivered by the firms' advisory division which is separated from the audit team hence not impacting on their objectivity or independence.

Other assurance services of £0.5m related to work performed in the submission of the PR14 business plan to Ofwat, where KPMG LLP was appointed based on their detailed knowledge of the Company. The business plan included forecasts for the next regulatory period and this work was determined by the ARRC to be substantially different in scope to the audit of these financial statements and not to impact on the objectivity or independence of the external auditors.

The ARRC considered the level of non-audit fees and safeguards put in place relating to non-audit work, including written representations from KPMG LLP which confirmed their independence, and was satisfied that the non-audit fees incurred have not resulted in a loss of independence or objectivity of KPMG LLP.

Audit quality

To maintain audit quality and provide comfort on the integrity of financial reporting, the Committee reviewed the proposed external audit plan to ensure that KPMG LLP have identified all key risks and developed robust audit procedures. The Committee also considered KPMG LLP's response to accounting, financial control and audit issues as they arose, and met with them during the year without management present providing the external auditors with the opportunity to raise any matters in confidence.

Auditor appointment

A review will be conducted by the Committee of the effectiveness of KPMG LLP as our external auditors for the first time after completion of the audit of the year end 31 March 2014. This review will consider the external audit process across the Company and the performance, expertise and the Company's relationship with KPMG LLP. This will include the feedback from Thames Water employees engaged with the audit and members of the Committee. The results of this review will be considered by the Committee at its meeting in August 2014.

In October 2013, our external auditor informed us that for administrative reasons they wished formally to change the entity which conducts the Thames Water Utilities Ltd audit from KPMG Audit Plc to KPMG LLP. The appointment of KPMG LLP as external auditor to the Company was approved by the Board of Directors.

Audit tender

The Company adopts the same approach to audit tendering as a FTSE 100 company and the ARRC will therefore keep under review legislative proposals from the EU and the Competition Commission. The ARRC may recommend that the Company puts the audit out to tender at any time, based on the results of the assessments of auditor independence and audit quality outlined above. KPMG was appointed after a competitive tender for the 31 March 2009 financial year end audit. There are no contractual obligations restricting our choice of external auditors and no auditor liability agreement has been entered into by the Company.

Audit information

Having made appropriate enquiries, so far as the Directors in office at the date of the approval of this report are aware, there is no relevant audit information of which the auditors are unaware and each Director has taken all reasonable steps to make themselves aware of any relevant audit information and to establish that the auditors are aware of that information.

Internal control, risk and compliance

The Board has overall responsibility for the Company's systems of internal control. These systems are designed to manage rather than eliminate the risk of failure to meet business objectives and can only provide reasonable, not absolute, assurance against material misstatement or loss. The key features of the systems of internal control and risk management are as follows:

- a control environment with clearly defined organisational structures operating within a framework of policies and procedures covering every aspect of the business;
- comprehensive business planning, risk assessment and financial reporting procedures, including the annual preparation of detailed operational budgets for the year ahead and projections for subsequent years;
- regular monitoring of risks and control systems throughout the year, supported by the use of risk registers;
- a self-certification process whereby management is required to note whether the system of internal control is operating effectively or, if not, what remedial action is proposed;
- an internal audit function providing independent scrutiny of internal control systems and risk management procedures; and
- a review of reports produced by internal and external audit.

The Directors routinely review the effectiveness of the systems of internal control and risk management, principally by means of:

- regular presentations to the ARRC and the Executive Team by heads of individual business units and functional heads, describing their risk management strategies and detailing the status of significant business risks;
- reports of significant changes to the Company's overall risk profile, which are also reported to the ARRC;
- standing reports from Internal Audit to the ARRC;
- reports to the ARRC on the results of the self-certification process and independent reports thereon by Internal Audit; and
- an annual review of the effectiveness of the Company's systems of risk management and internal control by the Board.

The Company's risk management process is integrated within the business and is designed both to identify emerging risks and to minimise the adverse impact of emerging and existing risks.

Each business area is responsible for managing its risks and maintaining a risk register. Significant risks are escalated and reviewed by the Executive Team, and the process is reported to the ARRC.

The Committee kept the adequacy and effectiveness of the Company's internal controls and risk management systems under review and approved for recommendation to the Board the statements to be included in any statutory or regulatory reports concerning internal controls and risk management. The Committee reviewed the risk management strategy approved by the Board and was satisfied that the Board received regular and sufficient reports on internal controls from management.

The Committee ensured that there were clear reporting lines for all issues associated with risk management and reviewed the adequacy of structures, processes and responsibilities for identifying and managing key risks facing the organisation. It reviewed and agreed the policies for compliance with relevant regulatory, legal and code of conduct requirements, their operational effectiveness and implementation. The Committee was satisfied that appropriate audit work was undertaken on risk management.

The Committee reviewed the material risks and uncertainties appearing on pages 45 to 51.

Directors' Report

The Directors present their report and the audited financial statements for the year ended 31 March 2014. These are the Company's statutory accounts as required to be delivered to the Registrar of Companies, and also include the Company's regulatory financial statements. The preparation of regulatory financial statements is a requirement under the conditions of appointment of the Company under the Water Industry Act 1991. This Directors' Report includes certain disclosures required under the Companies Act 2006.

The Directors consider that the annual report and the audited financial statements, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's performance, business model and strategy.

The Directors have voluntarily complied with the Disclosure and Transparency Rules ("DTR"), to the extent that these can be reasonably applied to the Company. The Company is required, under its licence, to publish information about its results as if it were a company with a Premium Listing on the London Stock Exchange.

Directors and their interests

A full listing of the Directors which held office during the year, including any interest in the shares of the Company, has been included within the Compensation and Human Resources Committee report on pages 74 to 92.

Corporate Governance

The Company's compliance with the UK Corporate Governance Code is reported on pages 60 to 61.

Dividends

The Company's dividend policy is to pay a progressive dividend commensurate with the long-term returns and performance of the business, after considering the business' current and expected regulatory and financial performance, regulatory restrictions, management of economic risks and debt covenants. Directors, in assessing the dividend to be paid (to a maximum of statutory distributable reserves), are required to ensure that:

- sufficient liquidity is maintained to enable the business to meet its financial obligations for at least 15 months;
- The Company maintains a minimum of 2% headroom on its Regulated Asset Ratio covenant restrictions (see page 37); and
- post-dividend financial ratios remain within their agreed limits at both the balance sheet date and on a forward-looking basis.

The Company paid interim dividends totalling £208.5m during the year (2012/13: £231.4m). The Board does not recommend the payment of a final dividend (2013: £nil).

Post balance sheet events

These have been detailed within the notes to the financial statements on page 148.

Material financial instruments

Financial risk management and information on financial instruments is covered on pages 42 to 43 within the Chief Financial Officer's Report section of the Strategic Report.

Intellectual property

The Company protects intellectual property of material concern to the business as appropriate, including the filing of patents where necessary.

Employees

Information relating to the Company's employees has been covered in the Strategic Report on pages 25 to 27.

Research and development

The Company's research and development programme consists of a portfolio of projects designed to address technical needs across the range of water cycle activities, delivering innovative technical solutions aligned with business needs to address challenges for AMP5 and also provide specialist technical support to the business. Expenditure on research and development totaled £3.9m for the year (2012/13: £3.9m).

Political donations

No political donations were made by the Company (2013: £nil).

Going concern

The Directors believe, after due and careful enquiry, that the Company has sufficient resources for its present requirements and, therefore, consider it appropriate to adopt the going concern basis in preparing the 2013/14 financial statements. In forming this assessment the Directors have considered the following information:

- The Company's business activities, together with the factors likely to affect its future development, performance and position are set out in the Strategic Report on pages 5 to 14. The financial position of the Company, its cash flows, liquidity position and borrowing facilities are described in the Strategic Report on pages 36 to 44.
- Day to day working capital requirements are funded by the business. During the year, £715.0m, gross of bond issuance costs, of new debt was secured and there is no current requirement to raise additional finance to meet future project obligations. There are also cash balances and liquid resources of £863.8m and undrawn committed facilities of £1,200.0m.
- The undrawn committed facilities consist of £1,200.0m facilities with a group of banks made up of a £750.0m revolving credit facility that expires in September 2017 that is not expected to be used in the ordinary course of business, and £450.0m of 364-day liquidity facilities due for renewal in August 2014. The liquidity facilities can only be used if the Securitised Group is in standstill.
- The Company is in compliance with its financial covenant requirements as at 31 March 2014.
- The Company's forecasts and projections, taking account of reasonably possible changes in trading performance, show that the Company should be able to operate within the level of its current facilities and covenant restrictions for at least 12 months from the date of this report.

Greenhouse Gas Emissions

The disclosures concerning greenhouse gas emissions required by law have been included within the strategic report on pages 33 to 34.

Directors' indemnities

The Company has made qualifying third party indemnity provisions for the benefit of its Directors and for the benefit of other persons who are directors of associated companies and these remain in force at the date of this report.

Insurance

The Company maintains a comprehensive insurance programme, renewed annually. This includes cover for a range of insurance classes including Public Liability, Property, Employers Liability, Construction, Motor, and Directors & Officer liability cover.

The insurance coverage has been reviewed and approved by an independent insurance adviser retained to ensure that the Company's insurances are consistent with Good Industry Practice, have regard to the risk being covered and address the interests of the Company.

Statement of directors' responsibility in respect of the annual report and the financial statements

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 they have elected to prepare the financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice).

Under company law, the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, 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 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 adequate accounting records that are sufficient to show and explain the Company's transactions and 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 have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Disclosure of information to the auditor

The directors who held office at the date of approval of this directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditor is unaware and each director has taken all the steps that they ought to have taken as a director to make themselves aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

Auditor

KPMG Audit Plc resigned as auditor on 30 October 2013 pursuant to section 516 of the Companies Act 2006. At the Extraordinary General Meeting held on 30 October 2013, KPMG LLP was appointed as auditor of the Company under section 485 of the Companies Act.

The Directors' Report was approved by the Board of Directors on 10 June 2014 and signed on its behalf by:



Joel Hanson
Company Secretary

Thames Water Utilities Limited
Clearwater Court
Vastern Road
Reading
Berkshire
RG1 8DB

Statutory Financial Statements

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Independent Auditor's Report to the Members of Thames Water Utilities Limited

Opinions and conclusions arising from our audit

1. Our opinion on the financial statements is unmodified

We have audited the financial statements of Thames Water Utilities Limited for the year ended 31 March 2014 set out on pages 110 to 149. In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 March 2014 and of its profit for the year then ended;
- have been properly prepared in accordance with UK Accounting Standards; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

2. Our assessment of risks of material misstatement

In arriving at our audit opinion above on the financial statements the risks of material misstatement that had the greatest effect on our audit were as follows:

- **Classification of costs between operating expenditure (£1,300.4 million) and capital expenditure (£1,156.5 million):**
Refer to page 95 (Report from the Audit and Risk Review Committee), page 114 (accounting policy) and pages 121 and 127 (financial disclosures).

The risk – The appropriate recording of costs between operating expenses and capital expenses is one of the key judgemental areas in our audit because of the significant impact this judgement has on both the Company's profit and balance sheet. The Company has detailed policies in place to determine whether expenditure should be capitalised and the policies are reviewed on a regular basis by the Directors. The Company's tangible fixed assets include both infrastructure and non-infrastructure assets. Both initial and subsequent expenditure, including employee and other internal expenditure, on non-infrastructure assets is capitalised if it is directly attributable to the asset, provides probable economic benefit and can be measured reliably. There is therefore a high degree of judgement involved in determining whether costs meet the relevant criteria for capitalisation.

All expenditure incurred on infrastructure assets is initially capitalised. The maintenance element is expensed through the Infrastructure Renewals Charge ("IRC") based on the Company's expenditure plans for the period 2010 to 2025. The Directors use their experience and judgement to determine whether:

- the costs incurred on infrastructure assets represent expenditure required to maintain the operating capability of network within defined service standards, and therefore forms part of the projected IRC expenditure; and
- the current level of that expenditure requires a change in the anticipated IRC charge over the period 2010 to 2025.

Our response – In this area our audit procedures included, among others, the assessment of both the Company's capitalisation policy, to confirm compliance with accounting standards, and for a sample of projects the application of this policy to costs incurred in the year. We tested controls over the classification of expenditure as either operating or capital in accordance with the Company's accounting policies. Our controls testing included selecting a sample of projects throughout the financial year to confirm that the classification of expenditure is subject to management review and authorisation, and that the judgements made are appropriate, based on the nature of expenditure, and lead to an appropriate classification being made under the Company's accounting policy. We performed comparative analysis over the level of operating expenditure and capital expenditure against prior year balances and current year budget information to identify material variances from our expectations in the nature or quantum of costs capitalised, including the level of internal costs expenditure re-charged to capital expenditure. Where material variances from our expectations were identified, we requested further explanation from the Directors and obtained corroborative evidence to confirm that the classification of costs had been made in accordance with the Company's accounting policy and in line with the accounting standards. We also compared the IRC to the long-term average projected Infrastructure Renewals Expenditure over the period 2010 to 2025.

- **Completeness and valuation of the provisions for contractor claims (included within accruals and deferred income of £290.4 million):**

Refer to page 95 (Report from the Audit and Risk Review Committee), page 120 (accounting policy) and page 129 (financial disclosures).

The risk –The completeness and valuation of the contractor claims provision is one of the key judgemental areas in our audit as a result of the impact that a material contractor claim could have on the Company's financial statements.

Our response – In this area our audit procedures included, among others, a consideration of the processes that the Company has in place for identifying and reporting material claims, and discussions with management, internal legal counsel and the Company's quantity surveyors to understand the nature of claims and the judgements applied in recording any provisions. We considered the information obtained from these discussions, as well as any other information obtained during our wider audit procedures, including our work on capital accruals, to check the completeness of the claims included in management's internal reporting on material claims and the appropriateness of the related provisions recognised. We inspected supporting evidence including the claim from the contractors; any relevant correspondence between the contractors and the Company; and any third party advice on the claim if obtained by the Company. In assessing the appropriateness of the provisions recognised we have considered the Company's historical accuracy of providing for and resolving these claims as well as the findings of our audit work over capital accruals. We have also considered the adequacy of the Company's disclosures about the degree of estimation involved in arriving at the provisions.

- **Accuracy of the provision for doubtful debtors (included within trade debtors of £224.2 million)**

Refer to page 94 (Report from the Audit and Risk Review Committee), page 118 (accounting policy) and page 129 (financial disclosures).

The risk – The provision calculation is considered a key audit risk as a result of the complexity of the calculation. There are a number of different components, each with a number of steps, which are required

to ensure that all irrecoverable debts are appropriately provided for. Debtors can be outstanding for a number of years and therefore the anticipated recovery of these debts requires a complex calculation.

The doubtful debt provision includes a number of different components:

For amounts billed directly by the Company, the provision is calculated using the year end debtor aging report. For each aging category, management extrapolate the historic trend over the previous 12 months, in cash collection and billing cancellations, into the future to determine the amount of debt not considered recoverable. Management adjust the collection and cancellation rates applied where there is a material difference between the historic trend and the expected future performance. The provision calculation also takes into account the anticipated loss on future cancellations as a result of cancelling unpaid customer bills after the balance sheet date and then issuing a new bill for the same property at a lower value than the original bill. A cash collection rate is then applied to any amounts expected to be re-billed on the basis that not all amounts re-billed are fully recoverable. Any revenue that is not re-billed is accounted for as a reduction in revenue.

For amounts billed by Water Only Companies ('WOCs') on behalf of the Company, where the Company provides waste water services only, the provision is calculated based on the historic and forecast trend in bad debt write offs.

An error in the calculation methodology or formulae could result in a material variance in the level of provision required. A significant level of judgement is needed to determine the level of future cash collection and billing cancellation rates, including any loss on amounts cancelled and then re-billed; the forecast level of Water Only Companies ('WOC') write offs; and the period of historic write offs used to calculate the WOC provision. A change in any of these key assumptions could give rise to a material variance in the level of the provision.

Our response - In this area our audit procedures, among others, included an assessment of whether the calculation incorporated all relevant information, risks and data. This included a consideration of whether the provision methodology incorporates the necessary components and appropriate steps to accurately calculate the level of irrecoverable debt; a recalculation of the bad debt provision calculation to test the mathematical accuracy, including the use of our own modelling specialists due to the risks associated with formulae error and the complexity of the calculation; testing the completeness and accuracy of the data extracted from the Company's billing system used to calculate the provision, including the data in respect of historic cash collection, cancellation and loss on re-bill rates; and testing the completeness and accuracy of data used to calculate the specific WOC provision by agreeing the data back to returns provided by the WOCs, including historic write offs. We challenged the assumptions over the cash collection and cancellation rates as well as the anticipated loss on re-bill, based on our analysis of historic trends, operational performance, historic write offs, and the level of provisioning across the industry. We also challenged management on the level of forecast WOCs write offs and whether the period of historic write offs used in the calculation is appropriate, including a comparison between the total WOC provision, WOC industry provisioning levels and the proportion of debt provided for billed directly by the Company. We have also considered the adequacy of the Company's disclosures about the degree of estimation uncertainty involved in calculating the provision.

3. Our application of materiality and an overview of the scope of our audit

The materiality for the financial statements as a whole was set at £22 million. This has been determined with reference to a benchmark of the Company's total assets (of which it represents 0.15%), which we consider to be one of the principal considerations for members of the Company in assessing its financial performance.

Our audit of the Company was undertaken to the materiality level specified above and was performed at the Company's head office in Reading and at the customer service centre in Swindon.

We agreed with the audit committee to report to it all corrected and uncorrected misstatements we identified through our audit with a value in excess of £1 million, in addition to other audit misstatements below that threshold that we believe warranted reporting on qualitative grounds.

4. Our opinion on other matters prescribed by the Companies Act 2006 and under the terms of our engagement is unmodified

In addition to our audit of the financial statements, the directors have engaged us to audit the information in the Directors' Remuneration Report that is described as having been audited, which the directors have decided to prepare as if the Company were required to comply with the requirements of Schedule 8 to The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008 No. 410) made under the Companies Act 2006.

In our opinion:

- the part of the Directors' Remuneration Report which we were engaged to audit has been properly prepared in accordance with the requirements of Schedule 8 to The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 made under the Companies Act 2006, as if those requirements were to apply to the Company; and
- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

5. We have nothing to report in respect of the matters on which we are required to report by exception

Under ISAs (UK and Ireland) we are required to report to you if, based on the knowledge we acquired during our audit, we have identified other information in the annual report that contains a material inconsistency with either that knowledge or the financial statements, a material misstatement of fact, or that is otherwise misleading.

In particular, we are required to report to you if:

- we have identified material inconsistencies between the knowledge we acquired during our audit and the Directors' statement that they consider that the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's performance, business model and strategy; or
- the Report from the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.

Under the Companies Act 2006 and under the terms of our engagement we are required to report to you if, in our opinion:

- adequate accounting records have not been kept by the Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements and the part of the Directors' Remuneration Report which we were engaged to audit 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.

In addition to our audit of the financial statements, the Directors have engaged us to review their Corporate Governance Statement as if the Company were required to comply with the Listing Rules and the Disclosure Rules and Transparency Rules of the Financial Conduct Authority in relation to those matters. Under the terms of our engagement we are required to review:

- the Directors' statement, set out on page 101 in relation to going concern; and
- the part of the Corporate Governance Statement on pages 53 to 103 relating to the Company's compliance with the nine provisions of the 2010 UK Corporate Governance Code specified for our review.

We have nothing to report in respect of the above responsibilities.

Scope of report and responsibilities

As explained more fully in the Directors' Responsibilities Statement set out on page 102, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate. This report is made solely to the Company's members as a body and is subject to important explanations and disclaimers regarding our responsibilities, published on our website at www.kpmg.com/uk/auditscopeukco2013b, which are incorporated into this report as if set out in full and should be read to provide an understanding of the purpose of this report, the work we have undertaken and the basis of our opinions.



William Meredith (Senior Statutory Auditor)

for and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants

15 Canada Square

London

E14 5GL

10 June 2014

Profit and loss account

For the year ended 31 March

	Note	2014 £m	2013 £m
Turnover		1,943.7	1,791.9
Operating costs	2	(1,300.4)	(1,249.2)
Other operating income	6	11.8	6.6
Operating profit		655.1	549.3
Profit on sale of fixed assets	7	22.0	10.8
Interest payable and similar charges	8	(470.8)	(491.8)
Interest receivable and similar income	9	62.4	86.5
Other finance costs	27	(9.4)	(9.9)
Profit on ordinary activities before taxation		259.3	144.9
Tax on profit on ordinary activities	10	87.4	5.1
Profit for the financial year	22	346.7	150.0

All of the Company's activities above are derived from continuing activities.

Statement of total recognised gains and losses

For the year ended 31 March

	Note	2014 £m	2013 £m
Profit for the financial year		346.7	150.0
Actuarial gain/(loss) recognised in the pension schemes	27	41.8	(106.8)
Deferred tax arising on gains/(losses) in the pension schemes		(21.7)	21.3
Total recognised gains in the year		366.8	64.5

There is no difference between the profit on ordinary activities before tax and the retained profit for the year stated above and their historical cost equivalents

The accounting policies and notes on pages 113 to 149 are an integral part of these financial statements.

Balance sheet

As at 31 March

	Note	2014 £m	2013 £m
Fixed assets			
Tangible assets	12	9,914.9	9,297.9
Investments	13	0.1	0.1
		9,915.0	9,298.0
Current assets			
Stocks	14	8.9	8.4
Debtors (including £2,015.0m (2013: £2,015.0m) due after one year)	15	2,600.7	2,587.8
Investments		857.2	748.7
Cash at bank and in hand		6.6	-
		3,473.4	3,344.9
Creditors: amounts falling due within one year	16	(1,335.5)	(957.3)
Net current assets		2,137.9	2,387.6
Total assets less current liabilities		12,052.9	11,685.6
Creditors: amounts falling due after more than one year	17	(9,527.7)	(9,216.0)
Provisions for liabilities	19	(978.3)	(1,044.4)
Net assets excluding net pension liabilities		1,546.9	1,425.2
Total of defined benefit schemes: with net assets	27	25.3	23.0
with net liabilities	27	(180.2)	(214.5)
Net pension liability		(154.9)	(191.5)
Net assets including net pension liability		1,392.0	1,233.7
Capital and reserves			
Called up share capital	20	29.0	29.0
Share premium account	21	100.0	100.0
Profit and loss account	22	1,263.0	1,104.7
Shareholders' funds	23	1,392.0	1,233.7

The accounting policies and notes on pages 113 to 149 are an integral part of these financial statements.

The financial statements were approved by the Board of Directors on 10 June 2014 and signed on its behalf by:



Stuart Siddall
Chief Financial Officer

Company registered number: 02366661 (England and Wales)

Cash flow statement

For the year ended 31 March

	Note	2014 £m	2013 £m
Net cash inflow from operating activities	28(a)	1,158.5	1,057.0
Returns on investments and servicing of finance			
Interest received		107.6	122.7
Interest paid		(353.9)	(375.4)
Interest element in finance lease payments		(4.2)	(8.4)
		(250.5)	(261.1)
Taxation (group relief)		(0.9)	-
Capital expenditure			
Gross cost of purchased fixed assets		(1,000.9)	(903.5)
Infrastructure renewals expenditure		(167.6)	(185.7)
Receipt of grants and contributions		49.7	51.4
Sale proceeds of tangible fixed assets		16.0	12.8
		(1,102.8)	(1,025.0)
Equity dividends paid	11	(208.5)	(231.4)
Cash Inflow/(outflow) before management of liquid resources and financing		(404.2)	(460.5)
Management of liquid resources			
(Increase)/decrease in current asset investments	28(b)	(108.5)	(129.3)
Net cash outflow before financing		(512.7)	(589.8)
Financing			
Capital element in finance lease payment		(107.0)	(74.5)
New loans		830.4	1,064.6
Repayment of loans		(137.1)	(470.0)
	28(b)	586.3	520.1
Increase/(decrease) in cash	28(d)	73.6	(69.7)

The cash flow statement should be read in conjunction with the notes on pages 146 to 147. The accounting policies and notes on pages 113 to 149 are an integral part of these financial statements.

Accounting policies

The following accounting policies have been adopted in the preparation of these financial statements. They have been applied consistently in dealing with items which are considered material, except as noted below.

Basis of preparation

The financial statements on pages 110 to 149 are prepared in accordance with the historical cost convention and with applicable accounting standards in the UK and, except for the treatment of certain capital contributions, with the Companies Act 2006. An explanation of this departure from the requirements of the Act is given in the fixed asset section below.

The Directors have considered the financial position of the Company and have concluded that it has sufficient resources for its present requirements and is able to meet its liabilities as they fall due for the foreseeable future. For these purposes the foreseeable future is taken to mean a period of at least 12 months from the date of approval of these financial statements. On this basis the Directors consider it appropriate to prepare the financial statements on a going concern basis.

The Company has exercised the exemption under section 400 of the Companies Act 2006 from the requirement to prepare group financial statements as the Company and its subsidiaries are included within the consolidated financial statements of its ultimate parent company Kemble Water Holdings Limited, an entity registered in the United Kingdom. These financial statements present information about the Company as an individual undertaking and not about its group.

Changes to accounting policies

There have been no changes to the accounting policies from those used in the preparation of the prior period financial statements.

Revenue recognition

Turnover represents the fair value of the income receivable in the ordinary course of business for goods and services provided which is recognised in accordance with FRS 5 "Reporting the Substance of Transactions". Turnover is recognised at the time of delivery of the service. Should the Company consider that the criteria for revenue recognition are not met at the time of a transaction, recognition of the associated turnover would be deferred until such time as the criteria have subsequently been met. No adjustment is made to turnover for estimated bad debt charges. These are charged to operating expenses.

For metered customers, turnover includes an estimate of the sales value of water supplied and waste water charges to customers between the date of the last meter reading and the period end, exclusive of value added tax. The estimated usage is based upon historical data, judgment and assumptions; actual results could differ from these estimates, which would result in turnover being adjusted in the period for which the revision to the estimates is determined. The amounts recognised in turnover, but unbilled at the balance sheet date are recorded within accrued income.

When a new property is connected to the Company's networks, an estimate is made of the sales value of water supplied and waste water charges to customers between the date of connection and the period end.

For customers who do not have a meter, the amount billed is dependent upon the ratable value of the property, as assessed by an independent rating officer. The amount billed is apportioned in turnover over the period to which the bill relates.

Additional charges added to a customer's account as a result of debt recovery activity, such as court costs or solicitors fees, are not recognised in turnover. They are recognised as a reduction in operating costs when payment is received, offsetting the associated costs which have already been incurred.

The Company only raises bills in the name of the "occupier" when it has evidence that an unmeasured property is occupied, but cannot confirm the name of the occupier. When the Company identifies the occupants the bill is cancelled and re-billed in the customer's name. If the Company has not identified an occupant within 6 months the bill is cancelled and the property is classified as empty.

A provision charge is recognised, as a reduction in revenue, for differences between the amount initially billed and the amount rebilled.

Tangible fixed assets

Tangible fixed assets are comprised of infrastructure assets (mains, sewers, pumped raw water storage reservoirs and sludge pipelines) and non-infrastructure assets (plant and equipment, land and buildings, and assets in the course of construction).

The Company capitalises the directly attributable costs of procuring and constructing tangible fixed assets in accordance with FRS 15. These costs include employee costs and other internal costs that are incremental to the business due to the scale and nature of the capital implementation programme of the Company. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. Interest costs are not capitalised.

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in the profit and loss account.

a) Infrastructure assets

Infrastructure assets comprise networks of below ground systems (water and sewage networks). All expenditure on infrastructure assets is capitalised at cost. The planned element incurred in maintaining the operating capability of the network in accordance with defined service standards is expensed as Infrastructure Renewals Charge ("IRC"). This is included within the total depreciation charge recognised in the profit and loss account.

The IRC recognised for the year ended 31 March 2014 reflects the Company's expenditure plans for infrastructure assets for the period 2010 to 2025 (AMPs 5 to 7) as presented in the 2009 Final Business Plan. The level of charge is kept under review and updated annually to reflect the current level of infrastructure renewals expenditure and forecasts including those contained within our business plan submissions.

Capital contributions received in respect of the infrastructure assets have been deducted from the cost. This is not in accordance with Schedule 1 to Statutory Instrument 2008/410 made under the Companies Act 2006, which requires fixed assets to be stated at their purchase price without deduction of contributions, with the contributions being accounted for as deferred income. This departure from the requirement of the Act is, in the opinion of the directors, necessary for the financial statements to give a true and fair view because

infrastructure assets do not have a determinable finite life. As infrastructure assets are accounted under renewals accounting, related capital contributions are not recognised in the profit and loss account.

The effect of this treatment on the value of tangible fixed assets is disclosed in note 12, and is consistent with industry practice.

Grants and capital contributions received towards the cost of non-infrastructure assets are accounted for as deferred income and released to the profit and loss account over the estimated economic lives of the assets.

b) Land and Buildings

Land and buildings are stated at cost less accumulated depreciation. Freehold land is not depreciated. Freehold buildings are depreciated down to their residual value over 15 to 60 years on a straight-line basis. Long leasehold buildings are depreciated on a straight line basis over the terms of the lease.

c) Plant and equipment

Plant and equipment are stated at cost less accumulated depreciation. Plant and equipment consists of operational structures, operational assets, fixtures, fittings, vehicles and computers, and fixed and mobile plant. These assets are depreciated down to their residual values on a straight-line basis as follows:

Operational structures	15 – 100 years
Other operational assets	5 – 40 years
Fixtures and fittings	5 – 7 years
Vehicles	4 – 5 years
Computers	3 – 7 years
Fixed and mobile plant	3 – 40 years

The estimated useful economic lives of fixed assets and their residual values are based on management's judgement and experience of the type of asset. These judgements are reviewed annually and when management identifies that the actual useful lives of a specific asset or group of assets differ materially from the estimates used, the depreciation charge is adjusted prospectively. Assets with lives greater than 50 years are reviewed annually for impairment.

d) Assets in the course of construction

Assets in the course of construction represent the directly attributable costs of projects that are expected to result in a tangible fixed asset being commissioned and capitalised at the end of the project. The balance is not depreciated as assets are not considered to commence their economic lives until they are commissioned (and transferred into the appropriate classification of tangible fixed assets).

e) Impairment of tangible fixed assets

Fixed assets are assessed for impairment whenever there is an indication of impairment to determine whether any assets may have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss, if any. Where the asset does not generate cash flows that are independent from other assets, the Company estimates the recoverable amount of the cash-generating unit to which the asset belongs.

The recoverable amount is the higher of fair value less costs to sell and value in use. Value in use represents the net present value of expected future cash flows discounted on a pre-tax basis using a rate that reflects

current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. Impairment of fixed assets is recognised in the profit and loss account within operating costs.

Where an impairment loss subsequently reverses, it is recognised in the profit and loss account and the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but not so as to exceed the carrying amount that would have been determined had no impairment loss been recognised in prior years.

The calculation of estimated future cash flows and residual values is based on the directors' best estimates of future prices, output and costs and is subjective.

Fixed Asset Investments

Investments in subsidiary undertakings are stated at cost less any provisions for impairment.

Stocks

Stocks are stated at the lower of cost and net realisable value. Costs comprise direct materials and, where applicable, direct labour costs and those overheads that have been incurred in bringing the inventories to their present location and condition. Cost is calculated using the weighted average method. Net realisable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

Taxation

The total tax expense or credit for the year represents the sum of current tax and deferred tax.

a) Current taxation

Current taxation, including UK corporation tax, is based on the taxable profit for the period and is provided at amounts expected to be paid or recovered using the tax rates and laws that have been enacted or substantively enacted at the balance sheet date.

Taxable profit differs from the profit on ordinary activities before tax as reported in the profit and loss account because it excludes items of income or expense that are taxable or deductible in other years, includes the effect of tax allowances and further excludes items that are never taxable or deductible.

b) Deferred taxation

Deferred taxation is recognised, without discounting, in respect of all timing differences between the treatment of certain items for taxation and accounting purposes, which have arisen but not reversed by the balance sheet, except as otherwise required by FRS 19 "Deferred tax".

A net deferred tax asset is recognised only when it is regarded as recoverable, in that it is considered more likely than not that there will be suitable taxable profits against which to recover carried forward tax losses and from which the future reversal of underlying timing differences can be deducted.

Deferred taxation is measured at the tax rates that are expected to apply in the periods in which the timing differences are expected to reverse based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is charged or credited in the profit and loss account except when it relates to items directly charged or credited to the statement of total recognised gains and losses.

Leased assets

Leases are classified according to the substance of the transaction. A lease that transfers substantially all the risks and rewards of ownership to the lessee is classified as a finance lease. All other leases are classified as operating leases.

a) Finance leases

Finance leases are capitalised in the balance sheet at their fair value or, if lower, at the present value of the minimum lease payments, each determined at the inception of the lease. Such assets are depreciated over the shorter of their estimated useful lives and the period of the lease to the first break clause.

The corresponding liability is shown as a finance lease obligation owed to the lessor. Leasing repayments comprise both a capital and a finance element. The finance element is charged to the profit and loss account so as to produce an approximately constant periodic rate of charge on the outstanding obligation.

During the year the Company settled its finance leases and as a result the Company no longer has any assets held under finance lease arrangements.

b) Operating leases

Operating lease rentals are charged to the profit and loss account on a straight-line basis over the period of the lease.

Pensions

The Company operates two defined benefit pension schemes. These schemes are closed to new employees. The Company accounts for these schemes in accordance with FRS 17 "Retirement Benefits".

These schemes are independently administered funds. Actuarial valuations are carried out as determined by the pension scheme trustees using the projected unit credit method for both pension schemes at intervals of not more than three years, the rates of contribution payable and the pension cost being determined on the advice of the actuaries, having regard to the results of these valuations. The Company believes that the assumptions utilised in recording obligations under the two schemes are reasonable based on prior experience, market conditions and the advice of scheme actuaries. However, actual results may differ from such assumptions. For any intervening reporting period, the actuaries review the continuing appropriateness of the contribution rates.

Defined benefit assets are measured at fair value while liabilities are measured at present value.

The difference between the assets and liabilities of the schemes are recognised as a surplus (to the extent that the surplus is recoverable) or obligation in the balance sheet, net of associated deferred tax.

The cost of providing pension benefits to employees is included in the profit and loss account within the cost of employee benefits. The expected return on scheme assets and interest on scheme liabilities are included within other finance expense in the profit and loss account.

Actuarial gains and losses are recognised outside the profit and loss account in retained earnings and are presented in the Statement of total recognised gains and losses.

In addition to the defined benefit schemes, the Company operates a Defined Contribution Stakeholder Pension Scheme ("DCSPS"), managed through Standard Life Assurance Limited ("Standard Life"). From 1 April 2011, the DCSPS is the only scheme to which new entrants to the Company will be eligible. The assets of the DCSPS are held separately from those of the Company and the amounts charged to the profit and loss account represents contributions payable to the scheme.

The Company also operates two closed defined contribution pension schemes. The Company has no further payment obligations for these schemes. However, defined funds for individuals are held within these schemes.

Foreign currencies

Transactions in foreign currencies are recorded using the rate of exchange current at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into sterling using the rate of exchange current at the balance sheet date. Gains and losses arising on retranslation are included in the profit and loss account for the year.

Cash and liquid resources

Cash and cash equivalents includes cash at bank and in hand, deposits, and short-term highly liquid investments which are readily convertible on initial investment into known amounts of cash at any time without penalty or if a maturity or period of notice of not more than 24 hours or one working day has been agreed.

Provision for doubtful debts

The Company's bad and doubtful debts provision policy has remained unchanged and has been consistently applied in both the current and prior years. Included within the provision is an assessment of the recoverability of debts which will ultimately be cancelled, and may or may not be rebilled, and of debts which have not yet been billed, but are part of the metered sales accrual.

At each reporting date, the Company evaluates the recoverability of trade receivables and records provisions for doubtful receivables based on experience. These provisions are based on, amongst other things, comparisons of the relative age of the individual balance and consideration of actual write-off history. Higher provisioning percentages are applied to older categories of debt such that all debt greater than four years old is fully provided for. The provisioning rates applied in the calculation are reviewed on an annual basis to reflect the latest historical collection performance data from the Company's billing system, management's expectation of future performance and industry trends.

Provision is also made for debts due from Water Only Companies ("WOCs") who bill their customers on our behalf for the sewage service we provide. As detailed information about the debt, including the ageing is unavailable to the Company the level of provision is calculated with reference to the level of historical and forecast write-offs.

The actual level of debtors collected may differ from the estimated levels of recovery, which could impact operating results positively or negatively. At each reporting date, the Company evaluates the recoverability of cancellations that will occur in the future against turnover booked, and not to be rebilled. The provision is based on history of cancellations and subsequent rebills, which could affect operating results positively or negatively.

Debt is only written off after all available economic options for collecting the debt have been exhausted and the debt has been deemed to be uncollectable. This may be because the debt is considered to be impossible, impractical, inefficient or uneconomic to collect, and is assessed by management judgement on a case-by-case basis.

Financial liabilities and equity

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the Company after deducting all of its liabilities.

Equity instruments issued by the Company are recorded at the proceeds received, net of direct issue costs.

a) Borrowings

Interest bearing bank loans and overdrafts are recorded as the proceeds received, net of direct issue costs. Finance charges, including premiums payable on settlement or redemption and direct issue costs, are accounted for on an amortised cost basis in the profit and loss using the effective interest method and are added to the carrying amount of the instrument to the extent that they are not settled in the period in which they arise.

b) Financial instruments and derivatives

Interest rate swap agreements and financial futures are used to manage interest rate exposure. Cross currency forward exchange contracts are used to manage foreign exchange exposure associated with borrowings that are not denominated in sterling.

Foreign currency and interest rate swaps are all in economic hedging relationships and amounts payable or receivable on these derivatives are accounted for on an amortised cost basis. Swaps are included within the appropriate caption in note 18.

The Company has not adopted FRS 26 "Financial Instruments: Recognition and Measurement", and accordingly the disclosure requirements of FRS 29 "Financial Instruments: Disclosures" are not applicable. The presentation requirements of FRS 25 "Financial Instruments: Presentation" and FRS 13 "Derivatives and financial instruments: disclosures" have been applied.

c) Financial Guarantees

The Company is part of a whole business securitisation group. Companies in the whole business securitisation group raise debt in external debt markets through the issuance of secured bonds and issue of loans. Thames Water Utilities Holdings Limited, Thames Water Utilities Limited, Thames Water Utilities Finance Limited, Thames Water Utilities Cayman Finance Holdings Limited and Thames Water Utilities Cayman Finance Limited have guaranteed the principal and interest payments due under the terms of the bonds. Where the Company enters into financial guarantee contracts to guarantee the indebtedness of other companies within this group, the Company considers these to be insurance arrangements and accounts for them as such. In this

respect, the Company treats the guarantee contract as a contingent liability until such time as it becomes probable that the Company will be required to make a payment under the guarantee.

Provisions and contingencies

The Company is subject to a number of claims that are incidental to the normal conduct of its business. These relate to and include commercial and contractual claims, which are handled and defended in the ordinary course of business. The Company routinely assesses the likelihood of any adverse judgments or outcomes to these matters as well as ranges of probable and reasonably estimated losses. Reasonable estimates involve judgments made by management after considering information including notifications, settlements, estimates performed by independent parties and legal counsel, available facts, identification of other potentially responsible parties and their ability to contribute, and prior experience.

Provisions are recognised when the Company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated. Provisions for insured liabilities are recognised or released by assessing their adequacy using current estimates of future cash flows under insurance contracts.

Related party disclosures

As the Company is a wholly owned subsidiary of Kemble Water Holdings Limited, a company registered in the United Kingdom, the Company has taken advantage of the exemption contained within FRS 8 and has therefore not disclosed transactions or balances with wholly owned subsidiaries which form part of the group.

Dividends

Dividends unpaid at the balance sheet date are only recognised as a liability at that date to the extent that they are appropriately authorised and are no longer at the discretion of the Company. Unpaid dividends that do not meet these criteria are disclosed in the notes to the financial statements.

Long Term Incentive Plans (“LTIP”) and bonus

Cash based LTIP awards are accrued in the financial statements for the duration of the award. The accrual is based on the values assessed for the applicable schemes taking into account the duration of the individual scheme and by comparing the Company’s performance against the assumptions used to award payments.

Bonus payments are accrued in the year based on assessments of performance against targets set at the beginning of the financial year. Bonuses are paid in the following financial year once actual performance has been measured against the targets set.

Exceptional items

Items that the directors consider one-off in nature and are of such significance that individually or combined they require disclosure to understand the performance of the business are disclosed as exceptional items. There are no such items for the year ended 31 March 2014 (2013: none).

Research and development

Expenditure on research and development is written off to the profit and loss account in the year in which it is incurred.

Notes to the financial statements

1. Segmental analysis

The Directors consider that the Company has a single class of business, being the supply of water and collection and treatment of wastewater, operating in London and the Thames Valley. This business is conducted wholly within the United Kingdom.

2. Operating costs

	Note	2014 £m	2013 £m
Employment costs	3	218.4	216.4
Materials and consumables		154.1	142.9
Provision for bad and doubtful debts		60.0	93.7
Other operating charges		493.6	470.1
Depreciation – owned assets (infrastructure renewals charge)	12	165.3	135.3
Depreciation – owned assets (non-infrastructure)	12	334.8	312.6
Depreciation – assets held under finance leases (non-infrastructure)	12	5.6	9.6
Operating lease rental – hire of plant and machinery		3.5	5.8
Operating lease rental – other		5.2	6.3
Research and development expenditure		3.9	3.9
Gross operating costs		1,444.4	1,396.6
Own work capitalised – staff costs		(84.5)	(85.4)
Own work capitalised – other costs		(59.5)	(62.0)
Net operating costs		1,300.4	1,249.2

During the year the Company settled its finance leases, though still retaining title to the underlying assets, and as a result the Company no longer has any assets held under finance lease arrangements. Subsequent to this depreciation of these assets has been included within the disclosure of non-infrastructure owned assets.

3. Employee information

The average number of persons employed by the Company (including executive directors) during the year, analysed by category, was as follows:

	2014 Number	2013 Number
Support	448	402
Operations	4,234	4,279
Total persons employed	4,682	4,681

3. Employee information (continued)

The aggregate payroll costs of these persons were as follows:

	Note	2014 £m	2013 £m
Salaries and wages		179.9	175.8
Social security costs		16.5	16.6
Pension costs – defined benefit schemes	27	20.5	18.8
Pension costs – defined contribution schemes	27	3.2	2.2
Severance costs		-	4.9
Gross employment costs		220.1	218.3
Less employment cost included within R&D expense		(1.7)	(1.9)
Gross employment costs charged to operating costs		218.4	216.4

All employees were based in the United Kingdom.

4. Auditor's remuneration

Amounts receivable by the Company's auditor are shown below in respect of the following services to the Company:

	2014 £'000	2013 £'000
Fees payable for the audit of the Company's financial statements	241	235
Fees payable to the Company's auditor and its associates for other services:		
Audit related assurance services	85	87
Other assurance services	508	49
Taxation compliance services	9	9
Other tax advisory services	106	105
Corporate finance services	1,827	1,384
All other non-audit services	163	97
Total aggregate remuneration	2,939	1,966

Fees for corporate finance services include £1.8m (2013: £1.4m) in respect of advice on the Thames Tideway Tunnel. These costs have been capitalised as part of the design phase of the project. The contract was awarded to KPMG LLP following a competitive tendering process in line with the Company's procurement processes.

No fees, other than those disclosed, were payable to KPMG LLP in respect of this Company in this year or KPMG Audit Plc in the prior year.

5. Directors' emoluments

	2014 £'000	2013 £'000
Salary/fees	906	941
Pension & pension allowances	134	98
Bonus	359	324
Long term incentive plan (LTIP)	383	593
Other benefits	48	48
Total aggregate emoluments	1,830	2,004

Included in the table above, is £1,456,000 (2013: £1,593,000) for the executive directors for their services to the Company. In addition, the executive directors received total remuneration of £623,000 (2013: £683,000) for their services to other companies within the Group. Included within fees is £40,000 for consultancy services relating to work on the Tideway improvements project.

At 31 March 2014 no benefits were accruing to any directors (2013: £nil) under the Group's defined benefit scheme in respect of services to the Company. In addition, the Company contributed cash of £141,000 (2013: £140,000) as a pension supplement for 2 directors (2013: 2 directors). The Company contributed £35,000 (2013: £50,000) into the Company's defined contribution pension scheme for 1 director (2013: 1 director).

Detailed disclosures of other items of remuneration, including those accruing under LTIPs can be found within the Compensation & Human Resources Committee report on pages 74 to 90.

Highest paid director

Total emoluments, including payments and accruals under long term incentive schemes of the highest paid director in respect of work done for the Company during the year were £1,094,000 (2013: £993,000). The highest paid director is a member of the Company's defined contribution pensions scheme and the Company made contributions of £35,000 to the scheme in the year (2013: £35,000) in relation to director's services to the Company. In addition, emoluments of £469,000 (2013: £426,000) were paid to the highest paid director for services to other companies within the Group.

6. Other operating income

	2014 £m	2013 £m
Other operating income	11.8	6.6

Included within amounts in the current year is net income of £5.8m relating to the settlement of finance leases in the year. As a result the Company no longer has any assets held under finance lease arrangements. The remaining amount of £6.0m (2013: £6.6m) relates to income derived from the sale of internally generated electricity to the grid.

7. Profit on sale of fixed assets

	2014 £m	2013 £m
Net profit on disposal of fixed assets	6.6	3.8
Gains on insurance claims for material damage	15.4	7.0
Total	22.0	10.8

The effect of the above is to increase the taxation charge by £4.7m (2013: 2.6m). Included within the gain from insurance claim is £8.2m (2013: £7.0m) for damage caused to the Company's assets resulting from a fire at Beddington Sewage Treatment Works, which has now been settled in full. The remaining amount refers to damage caused to the Company's assets due to the effect of flooding incidents in the winter of 2013/14.

8. Interest payable and similar charges

	2014 £m	2013 £m
On bank and other loans		
Interest expense	17.7	20.9
RPI accretion on loans	52.1	50.9
Amortisation of debt issue costs	1.1	1.9
	70.9	73.7
On intercompany loans		
Interest expense	313.2	328.2
RPI accretion on loans	78.5	80.8
Amortisation of debt issue costs	7.8	3.2
	399.5	412.2
Finance charges in respect of finance leases	0.4	5.9
Total	470.8	491.8

9. Interest receivable and similar income

	2014 £m	2013 £m
Receivable from group undertakings	25.4	44.7
Net swaps receivable	33.3	37.6
Other	3.7	4.2
Total	62.4	86.5

The net interest receivable on swaps is the aggregate effect of all swaps held in the Company. Included within interest receivable from group undertakings is £25.4m received from Thames Water Utilities Holdings Limited. In line with the definitions contained within the whole business securitisation group agreement (see page 119) this has not been included in the adjusted interest cover ratio calculations as included within the strategic report on page 36.

10. Taxation

	2014 £m	2013 £m
Current tax:		
Amounts payable in respect of group relief for the year	11.2	1.1
Adjustment in respect of prior years	(16.1)	-
	(4.9)	1.1
Deferred tax:		
Origination and reversal of timing differences	52.1	33.9
Adjustment in respect of prior years	0.9	-
Adjustment in respect of corporation tax rate changes	(132.2)	(41.8)
Net timing difference on pension cost charge	(3.3)	1.7
	(82.5)	(6.2)
Tax on profit on ordinary activities	(87.4)	(5.1)

The water industry has recently reached agreement with HMRC on the availability of capital allowances on certain assets at water and waste water treatment works. This is responsible for the recognition of a credit in respect of current tax for prior years.

The current tax charge for the year is lower (2013: lower) than the standard rate of corporation tax in the UK of 23% (2013: 24%). The differences are explained below:

	2014 £m	2013 £m
Profit on ordinary activities before tax	259.3	144.9
Current tax at 23% (2013: 24%)	59.6	34.8
<i>Effects of:</i>		
Capital allowances in excess of depreciation and other timing differences	(52.1)	(33.9)
Pension tax relief in excess of pension costs in financial statements	(2.7)	(3.6)
Disallowable expenditure less non-taxable income	6.4	3.8
Adjustments to tax charge in respect of prior periods	(16.1)	-
Total current tax (credit)/charge	(4.9)	1.1

Reductions in the UK corporation tax rate from 26% to 24% (effective from 1 April 2012) and to 23% (effective 1 April 2013) were substantively enacted on 26 March 2012 and 3 July 2012 respectively. Further reductions to 21% (effective from 1 April 2014) and 20% (effective from 1 April 2015) were substantively enacted on 2 July 2013. This will reduce the Company's future current tax charge accordingly. The deferred tax liability at 31 March 2014 has been calculated based on the rates of 20% and 21% substantively enacted at the balance sheet date.

11. Dividends

	2014 £m	2013 £m
June (2014: no dividend; 2013: 19.6p per share)	-	201.4
September (2014: 442.3p per share; 2013: no dividend)	128.5	-
March (2014: 275.4p per share; 2013: 103.0p per share)	80.0	30.0
Dividends paid in the year (717.7p per share; 2013 122.6p per share)	208.5	231.4

From 5 October 2012 the Company's issued share capital of £1,029.0m was reduced to £29.0m, in shares of £1, each fully paid and all of which was held by the Company's immediate parent company, Thames Water Utilities Holdings Limited. This has accordingly reduced the number of shares in issue, affecting the per share payment of dividend.

The application of the dividends paid in the year are analysed as follows:

	2014 £m	2013 £m
Distribution to ultimate shareholders:		
External dividend distributions	45.1	74.5
Interest to Kemble Water Eurobond Plc debt	54.9	17.5
	100.0	92.0
Distributions not distributed to ultimate shareholders:		
Interest on Kemble Water Finance Limited debt	60.0	60.0
Group relief settlement payments	-	40.0
Distribution to Kemble Water Structure Limited	3.5	-
Distribution to Thames Water Utilities Holdings Limited	45.0	39.4
	108.5	139.4
Total equity dividends paid	208.5	231.4

There are no dividends proposed and not recognised as liabilities as at the year end (2013: £nil).

Included within the payments to Kemble Water Eurobond Plc in the current period is a payment of £17.0m (2013 £nil) relating to interest payments falling due in the year to March 2013 but paid in September 2013.

The distribution payment to Kemble Water Structure Limited of £3.5m (2013: £nil) was used to fund the activities of Thames Water Commercial Services Limited, a company within the Thames Water group.

The distribution paid to Thames Water Utilities Holdings Limited of £45.0m (2013: 39.4m) was used to fund interest payments made to the Company.

12. Tangible fixed assets

	Land & buildings £m	Plant & equipment £m	Infrastructure assets £m	Assets in course of construction £m	Total £m
Cost					
At 1 April 2013	2,766.0	5,222.4	5,167.1	1,692.2	14,847.7
Additions	22.0	-	-	1,134.5	1,156.5
Transfers between items	307.0	482.4	189.9	(979.3)	-
Disposals	(3.5)	(10.3)	-	-	(13.8)
At 31 March 2014	3,091.5	5,694.5	5,357.0	1,847.4	15,990.4
Contributions					
At 1 April 2013	-	-	(702.3)	-	(702.3)
Additions	-	-	(33.6)	-	(33.6)
At 31 March 2014	-	-	(735.9)	-	(735.9)
Depreciation					
At 1 April 2013	(721.6)	(2,788.0)	(1,337.9)	-	(4,847.5)
Charge in the year	(44.9)	(295.5)	(165.3)	-	(505.7)
Disposals	3.5	10.1	-	-	13.6
At 31 March 2014	(763.0)	(3,073.4)	(1,503.2)	-	(5,339.6)
Net book value					
At 31 March 2014	2,328.5	2,621.1	3,117.9	1,847.4	9,914.9
At 31 March 2013	2,044.4	2,434.4	3,126.9	1,692.2	9,297.9

During the year the Company settled its finance leases and hence has no further obligations under finance lease arrangements, though acquiring title to the underlying assets, and as a result the Company no longer has any assets held under finance lease arrangements. The cost of the assets held under finance leases as at 31 March 2013 was £263.2m, depreciation was £156.0m and net book value was £107.2m.

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

	2014 £m	2013 £m
Freehold land and buildings	2,249.9	2,034.5
Leasehold land and buildings – under 50 years	2.4	2.6
Leasehold land and buildings – over 50 years	76.2	7.3
Land and buildings net book value	2,328.5	2,044.4

13. Fixed asset investments

	2014 £m	2013 £m
Cost of shares in subsidiary undertakings	0.1	0.1

At 31 March 2014 the companies which represent the Company's subsidiary undertakings are as follows:

	Nominal value and class of shares	Percentage of shares held	Principal activity	Country of incorporation
Thames Water Utilities Finance Limited	£1 Ordinary	100%	Finance company	United Kingdom
Thames Water Utilities Cayman Finance Holdings Limited	\$1 Ordinary	100%	Holding company	Cayman Islands
Thames Water Utilities Cayman Finance Limited	\$1 Ordinary	100%	Finance company	Cayman Islands

Both Thames Water Utilities Cayman Finance Holdings Limited and Thames Water Utilities Cayman Finance Limited were incorporated and registered in the Cayman Islands. Both are resident in the United Kingdom for tax purposes.

14. Stocks

	2014 £m	2013 £m
Raw materials and consumables	8.9	8.4

15. Debtors

	2014 £m	2013 £m
Amounts falling due after one year		
Amounts owed by group undertakings	2,015.0	2,015.0
Amounts falling due within one year		
Trade debtors	224.2	200.0
Amounts owed by group undertakings	25.3	45.2
Amounts receivable in respect of group relief	2.9	-
Amounts receivable in respect of corporation tax	1.0	-
Other debtors	70.9	67.7
Insurance claims receivable	57.3	62.0
Prepayments and accrued income	204.1	197.9
	585.7	572.8
Total	2,600.7	2,587.8

Amounts owed by group undertakings due after more than one year are unsecured and the directors do not anticipate any repayment of principal within the next 12 months and has not been included within the Company's covenant calculations. Interest is charged at the London Interbank Offered Rate ("LIBOR") + 0.35%. Included within amounts due in one year is interest receivable on this loan of £24.9m (2013: £44.5m). All other amounts are unsecured, interest free and repayable on demand. Prepayments and accrued income as at 31 March 2014 includes water and wastewater income not yet billed of £171.4m (2013: £161.1m).

16. Creditors: amounts falling due within one year

	Note	2014 £m	2013 £m
Bank overdraft		-	67.0
Obligations under finance leases	12	-	10.5
Trade creditors – operating		315.1	287.3
Trade creditors – capital		146.4	160.4
Amounts owed to group undertakings		277.6	156.9
Amounts payable in respect of group relief		-	2.1
Other taxation and social security		6.6	5.1
Derivative collateral liability		-	1.3
Accruals and deferred income		290.4	266.7
Secured bank loans	18	299.4	-
Total		1,335.5	957.3

Amounts due to group undertakings include interest payable of £144.5m (2013: £142.8m), an amount of £116.8m (2013: £nil) owed to Thames Water Utilities Cayman Finance Limited on the loans detailed within note 17 and £16.3m (2013: £14.1m) which are unsecured, interest free and repayable on demand. Accruals and deferred income includes £79.3m (2013: £77.8m) of receipts in advance relating to amounts received from customers for water and wastewater charges and amounts received in advance in respect of operating costs in respect of 2014/15.

17. Creditors: amounts falling due after more than one year

	Note	2014 £m	2013 £m
Secured bank loans	18	1,637.9	1,198.7
Obligations under finance leases	12	-	102.3
Amounts owed to group undertakings	18	7,554.0	7,634.7
Other loans and financial instruments	18	165.8	106.9
Accruals and deferred income		170.0	173.4
Total		9,527.7	9,216.0

The secured bank loan refers to an arrangement whereby each Obligor (representing each of the companies within the securitisation group, see page 119) has entered into a Security Trust and Inter-creditor Deed ("STID") with the Security Trustee. Pursuant to this arrangement, Thames Water Utilities Holdings Limited has guaranteed the obligations of each other Obligor under the finance documents. Additionally Thames Water Utilities Limited, and its wholly owned subsidiaries, has guaranteed the obligations of each other under the finance documents, in each case to the Security Trustee.

Amounts owed to group undertakings are unsecured and include the following:

- £2,836.7m (2013: £2,797.5m) owed to Thames Water Utilities Finance Limited, a subsidiary undertaking. Financing costs arising in Thames Water Utilities Finance Limited are directly recharged under mirrored interest terms for all loans except for one loan, a £225.0m 6.59% secured bond due in 2021, which was loaned on with a margin of one basis point.
- £4,763.4m (2013: £4,864.0m) owed to Thames Water Utilities Cayman Finance Limited, a subsidiary undertaking. All costs are directly recharged under mirrored interest terms, except for the issued bonds which has an additional margin of ten basis points charged.
- Net finance costs capitalised in respect of the above arrangements of £46.1m (2013: £26.8m), which reduces the overall amount owed.

18. Derivatives and other financial instruments

The narrative and numerical disclosures relating to financial instruments are set out below. The Company has taken advantage of the exemption available under FRS 13 "Derivatives and other financial instruments: disclosures" not to provide numerical disclosures in relation to short term debtors and creditors. Narrative disclosures with respect to the Company's treasury and risk management policies have been included within the report by the Chief Financial Officer on pages 42 to 43.

The Company's sources of borrowing for funding and liquidity purposes come from a range of committed bank facilities and through short-term and long-term issuances in the capital markets which includes bank loans and publicly listed bonds and private placements that are issued through the financing subsidiaries Thames Water Utilities Cayman Finance Limited and Thames Water Utilities Finance Limited. A breakdown of the bank loans, derivative financial instruments and intercompany borrowings and the main terms of the borrowings are given below.

Breakdown of secured bank loans

	Note	2014 £m	2013 £m
£100.0m Class B floating rate loan due 2015 (a)		99.7	99.4
£200.0m Class A floating rate loan due 2015 (a)		199.7	-
£150.0m floating rate loan due 2017		150.0	150.0
£200.0m 0% Index linked loan due 2017		202.1	199.0
£100.0m floating rate loan due 2018 (a)		99.7	-
£60.0m 1.23% Index linked loan due 2019		71.0	69.0
£60.0m 1.415% Index linked loan due 2020		70.7	68.8
£60.0m 1.513% Index linked loan due 2020		70.3	68.4
£60.0m 1.38% Index linked loan due 2020		70.0	68.1
£60.0m 1.356% Index linked loan due 2020		69.9	68.0
£100.0m floating rate loan due 2020 (a), (c)		99.6	-
£75.0m 1.35% Index linked loan due 2021		80.3	78.4
£100.0m floating rate loan due 2021 (a), (c)		99.9	-
£215.0m 0.46% Index linked loan due 2023 (a)		222.9	216.6
£215.0m 0.38% Index linked loan due 2032 (a), (b)		215.2	-
£100.0m 3.28% index linked loan due 2043 (a), (d)		116.3	113.0
Total secured bank loans		1,937.3	1,198.7
Less amounts included within creditors falling due within one year	16	(299.4)	-
Total secured bank loans falling due after more than one year	17	1,637.9	1,198.7

(a) These loans are shown net of issue costs.

(b) This debt amortises in equal tranches from 2017 onwards.

(c) The interest margins of these two loans are based on a ratings grid and will increase should the Securitisation Group Senior Debt credit rating be downgraded by both Standard and Poor's and Moody's.

(d) This debt amortises from 2023 to 2033 in tranches of £3m, followed by tranches of £0.750m until maturity where there will be a bullet payment of £25m.

18. Derivatives and other financial instruments (continued)

Breakdown of amounts owed to group undertakings

	Note	2014 £m	2013 £m
£438.0m 3.64% fixed rate bond due 2016 (b)		438.0	438.0
£96.6m 5.20% class B private placement due 2019 (b), (d)		95.1	95.1
£200.0m 5.05% index linked bond due 2020 (c)		217.7	214.5
£225.0m 6.59% fixed rate bond due 2021 (c)		225.0	225.0
£175.0m 3.38% index linked bond due 2021 (c)		250.8	243.4
£100.0m 1.99% index linked bond due 2022 (b)		108.3	98.5
£96.6m 4.15% class A private placement due 2022 (b)		96.6	32.2
£128.7m 4.30% class A private placement due 2024 (b)		128.7	128.7
£550.0m 5.37% class B Fixed rate bond due 2025 (b), (d)		547.5	546.7
£161.1m 4.53% class A private placement due 2027 (b)		161.1	161.1
£330.0m 6.75% fixed rate bond due 2028 (c)		328.1	327.9
£300.0m 5.75% class B Fixed rate bond due 2030 (b)		297.2	296.9
£200.0m 6.50% fixed rate bond due 2032 (c)		198.2	198.1
£300.0m 4.37% fixed rate bond due 2034 (b), (d)		295.0	294.8
£600.0m 5.13% fixed rate bond due 2037 (c)		596.7	596.6
¥20.0bn 3.28% fixed rate bond due 2038 (b)		116.9	139.9
£200.0m 0.21% index linked bond due 2039 (c)		235.4	229.0
£50.0m 3.85% index linked bond due 2040 (b)		58.3	56.7
£500.0m 5.50% fixed rate bond due 2041 (b)		489.6	489.2
£50.0m 1.98% index linked bond due 2042 (b)		61.0	59.4
£55.0m 2.09% index linked bond due 2042 (b), (d)		65.0	63.2
£40.0m 1.97% index linked bond due 2045 (b), (d)		45.1	43.9
£300.0m 4.63% fixed rate bond due 2046 (b), (d)		293.0	292.8
£100.0m 1.85% index linked bond due 2047 (b)		122.1	118.8
£200.0m 1.82% index linked bond due 2049 (b), (d)		243.6	237.2
£300.0m 1.68% index linked bond due 2053 (c)		387.2	376.0
£300.0m 1.68% index linked bond due 2055 (c)		387.2	376.0
£200.0m 1.77% index linked bond due 2057 (b), (d)		243.6	237.1
£400.0m 7.24% fixed rate bond due 2058 (a), (b), (d)		399.0	398.8
£100.0m index linked -0.098% due 2060 (b), (d)		116.8	113.6
£350.0m 1.76% index linked bond due 2062 (b), (d)		426.2	415.0
Revolving credit facility fees		(3.2)	(3.9)
Fees		-	30.1
Total amounts owed to group undertakings		7,670.8	7,634.7
Less amounts included within creditors falling due within one year		(116.8)	-
Total falling due after more than one year	17	7,554.0	7,634.7

18. Derivatives and other financial instruments (continued)

- (a) £400m Class A bond issued with a final maturity date of 9 April 2058 with a fixed coupon of 7.241% until 9 April 2018. If at this date interest rates have risen, the bond will be "put" at par by investors and redeemed by the Company. Should interest rates have fallen, the bond will be called by the Company and either re-marketed for the remaining 40-year period at the underlying Puttable, Callable, Resettable ("PCR") rate of 4.572% plus the prevailing credit spread or the Company will settle related derivative contracts with bank counterparties and redeem the bond at par. The net unrecognized fair value liability relating to the instrument is £76.1m reflecting the potential future value of cash flows relating to the remarketing of the loan, see note 25 for additional information.
- (b) These loans are back-to-back inter-group loans from Thames Water Cayman Finance Limited to the Company. Thames Water Cayman Finance Limited charges the Company a margin of ten basis points in respect of the loans.
- (c) These loans are back-to-back inter-group loans from Thames Water Utilities Finance Limited to the Company. Thames Water Utilities Finance Limited charges the Company a margin of one basis point in respect of the loans.
- (d) These loans are shown net of issue costs.

Breakdown of other loans and financial instruments

The other loans and financial instruments recognised below refer to foreign exchange movements and RPI indexation accretion on the following derivative transactions:

	Note	2014 £m	2013 £m
Cross currency swaps ¥20bn-£153.5m 2038 (a)		36.7	13.7
Index linked swap £94.05m 2038 (b)		1.3	14.1
Index linked swap £200m 2032 (b)		41.6	34.9
Index linked swap £600m 2037 (b)		98.9	80.1
Total swaps		178.5	142.8
Less capitalised fees		(12.7)	(35.9)
Total other loans and financial instruments	17	165.8	106.9

- (a) These swaps contain an optional break clause in August 2018. On this date (and every five years thereafter) the counterparty has the right to break the contract, at which point the outstanding mark-to-market is settled to the counterparty in-the-money. The fair value of the swap at 31 March 2014 is £60.2m (2013: £59.5m) and represents an obligation to the Company, though subject to future market movement of rates. This has not been included on the balance sheet.
- (b) The accretion pay downs on these swaps are at frequencies not less than 5 years.

18. Derivatives and other financial instruments (continued)

Interest rate risk profile of financial liabilities

The currency and interest rate profile of the Company's financial liabilities, including the weighted average interest rate on the fixed rate and RPI linked debt and the weighted average period until maturity for which the rate is fixed at fixed rate and RPI linked debt as at 31 March 2014 is presented below:

	Period until maturity Years	Fixed and RPI linked interest rate %	Total at floating rates £m	Total at fixed rates £m	Total at RPI linked rates £m	Total book value £m
Bank loans and overdraft						
£ Sterling	10.8	1.1%	734.1	14.5	1,188.7	1,937.3
Other loan and finance lease						
£ Sterling	23.7	3.5%	-	3,932.5	3,904.1	7,836.6
Total	23.6	3.5%	734.1	3,947.0	5,092.8	9,773.9

The comparative information as at 31 March 2013 is presented below:

	Period until maturity Years	Fixed and RPI linked interest rate %	Total at floating rates £m	Total at fixed rates £m	Total at RPI linked rates £m	Total book value £m
Bank loans and overdraft						
£ Sterling	10.0	1.2%	300.2	15.0	950.5	1,265.7
Other loan and finance lease						
£ Sterling	22.5	3.5%	73.3	3,969.5	3,812.9	7,855.7
Total	21.9	3.4%	373.5	3,984.5	4,763.4	9,121.4

Short term floating rate borrowings bear interest at rates linked to the short-term LIBOR rate prevailing at the time. All cash held at bank is benchmarked against the Bank of England base rate.

Interest rate risk profile of financial assets

The currency and interest rate profile of the Company's financial assets is presented below:

	Total at Floating Rates		Total Book Value	
	2014 £m	2013 £m	2014 £m	2013 £m
Cash at bank and in hand				
£ Sterling	6.6	-	6.6	-
Short term investments				
£ Sterling deposits	489.0	132.4	489.0	132.4
£ Sterling money market funds	368.2	616.3	368.2	616.3
Total	863.8	748.7	863.8	748.7

The totals in the above table are treated as available cash for covenant calculation purposes. As at 31 March 2014 the short term investments have an average maturity of 134 days.

18. Derivatives and other financial instruments (continued)

Liquidity risk profile of financial liabilities

The maturity profile of the debt held by the Company on an amortised cost basis is presented below:

	2014 £m	2013 £m
Due within one year or repayable on demand		
Bank loans and overdrafts	299.4	67.0
Finance leases	-	10.5
Other loans including intercompany	116.8	1.3
Total due within one year or repayable on demand	416.2	78.8
Due within one to two years		
Bank loans and overdraft	-	99.5
Finance leases	-	45.7
Other loans including intercompany	200.0	100.0
	200.0	245.2
Due within two to five years		
Bank loans and overdraft	451.8	349.0
Finance leases	-	56.6
Other loans including intercompany	530.0	634.2
	981.8	1,039.8
Due after more than five years		
Bank loans and overdraft	1,186.1	750.2
Other loans including intercompany	6,989.8	7,007.4
	8,175.9	7,757.6
Total due in over one year	9,357.7	9,042.6

Borrowing facilities

As at 31 March 2014 the Company had access to committed facilities and term loans of £3,138.7m (2013: £2,816.4m) of which £1,938.7m (2013: £1,201.4m) had been drawn at the balance sheet date.

Finance Lease Liabilities

During the year, the Company settled all finance lease obligations. The total liability of £112.8m was extinguished with a cash payment of £106.9m. The gain on settlement of £5.9m has been recognised within other operating income (see note 4).

18. Derivatives and other financial instruments (continued)

Fair value disclosures

The fair value of the financial assets and financial liabilities represents the price that would be received to sell an asset or paid to transfer a liability between informed and willing parties, other than in a forced or liquidation sale at the measurement date. The fair value of intercompany loans disclosed as "Other loans" represents the market value of the publicly traded underlying bonds. For private placements the fair value is determined by discounting expected future cash flows using a risk-free rate plus the Company's credit spread. The fair value of the derivative financial instruments is adjusted for the Company's and counterparties own credit risk. The fair value of floating rate debt instruments is assumed to be the nominal value of the primary loan and adjusted for credit risk if this is significant. The fair value of index linked debt instruments is based on the nominal value of the debt plus accretion already accrued and accretion expected to accrue to maturity.

The table below sets out a comparison of the book and fair values of the Company's financial instruments.

	Book Value		Fair Value	
	2014 £m	2013 £m	2014 £m	2013 £m
Financial assets				
Deposits	489.0	132.4	489.0	132.4
Money market funds	368.2	616.3	368.2	616.3
Cash at bank and in hand	6.6	-	6.6	-
Financial liabilities				
Overdraft	-	(67.0)	-	(67.0)
Bank loans	(1,937.3)	(1,198.7)	(1,937.3)	(1,198.7)
Other loans and finance leases	(7,658.1)	(7,712.9)	(8,244.9)	(8,935.7)
Derivative financial instruments				
Interest rate swaps	-	-	(79.9)	(89.6)
Cross currency swaps	(36.6)	(13.6)	(60.2)	(59.5)
Index linked swaps	(141.9)	(129.2)	(313.5)	(384.1)
Total	(8,910.1)	(8,372.7)	(9,772.0)	(9,985.9)

Other loans include bonds issued by group undertakings, which are publically traded and the proceeds from these transactions is loaned to the Company through intercompany agreements. The Company does not issue any bonds directly to the public markets.

Cross currency swaps hedge currency risk on £1,168.0m (2013: £1,256.6m) of foreign currency borrowing through conversion to sterling. Index linked swaps of £1,394.1m (2013: £1,394.1m) swapped intercompany fixed rate debt to index linked debt. All swaps are included at their notional amount. Total accretion on the index linked swaps is £141.9m (2013: £129.2m).

19. Provisions for liabilities

	Deferred Tax £m	Insured Liabilities £m	Restructuring Provision £m	AMP4 Provision £m	Other Provisions £m	Total £m
At 1 April 2013	961.2	62.0	4.6	-	16.6	1,044.4
Utilised during the year	-	-	(4.0)	-	-	(4.0)
Charge to profit and loss	(79.2)	(4.7)	-	8.5	13.3	(62.1)
At 31 March 2014	882.0	57.3	0.6	8.5	29.9	978.3

The elements of deferred taxation are as follows:

	2014 £m	2013 £m
Accelerated capital allowances	888.1	967.3
Other timing differences	(6.1)	(6.1)
	882.0	961.2

The total deferred tax position is as follows:

	Note	2014 £m	2013 £m
Included above		882.0	961.2
Net deferred tax asset on net pension deficit	27	(38.7)	(57.2)
Total		843.3	904.0

The insured liability provision is in respect of insurance claims notified. A debtor in respect of these obligations is included in note 15 representing the reimbursement value from captive and third party insurance companies.

The restructuring provision principally relates to severance costs as a result of the Company's restructuring and reorganisation.

The AMP4 provision represents settlement in respect of an information request received from Ofwat issued under section 203 of the Water Industry Act 1991 concerning the properties claimed as safeguarded from internal sewer flooding by capital schemes completed in 2009/10.

Other provisions principally relate to a number of legal claims against the Company and represents management's best estimate of the value of settlement and costs. It is estimated that some claims will be settled in more than one year.

20. Called up share capital

	2014 £m	2013 £m
Allotted, called up and fully paid		
29,050,000 (2013: 29,050,000) ordinary shares of £1 each	29.0	29.0

21. Share premium account

	2014 £m	2013 £m
At 1 April and 31 March	100.0	100.0

22. Profit and loss account

	Note	2014 £m	2013 £m
At 1 April		1,104.7	271.6
Capital reduction		-	1,000.0
Profit for the year		346.7	150.0
Actuarial gain/(loss) recognised in the pension schemes	27	41.8	(106.8)
Deferred tax arising on gains/(losses) in the pension schemes		(21.7)	21.3
Dividends paid	11	(208.5)	(231.4)
At 31 March		1,263.0	1,104.7

From 5 October 2012 the Company's issued share capital of £1,029.0m was reduced to £29.0m, in shares of £1, each fully paid and all of which was held by the Company's immediate parent company, Thames Water Utilities Holdings Limited.

The capital reduction increased distributable reserves by £1,000.0m and was in preparation for the adoption of new UK GAAP recognising that there will be accounting and presentational adjustments made to the financial statements. New UK GAAP will require the Company to bring on to its balance sheet the market value of its debt related swaps and hedges affecting the Company's reserves.

Total shareholder's funds were unaffected by this transaction.

23. Reconciliation of movements in shareholder's funds

	Note	2014 £m	2013 £m
At 1 April		1,233.7	1,400.6
Profit for the year	22	346.7	150.0
Actuarial gain/(loss) recognised in the pension schemes	27	41.8	(106.8)
Deferred tax arising on gains/(losses) in the pension schemes		(21.7)	21.3
Dividends paid	11	(208.5)	(231.4)
At 31 March		1,392.0	1,233.7

24. Capital commitments

	2014 £m	2013 £m
Contracted for but not provided	547.6	842.5

In addition to these commitments, the Company has long-term capital investment plans under its business plan submitted to Ofwat to provide for future growth and maintenance of the infrastructure network.

25. Contingent Liabilities

There are claims arising in the normal course of business, which are in the process of negotiation. The Company has set aside amounts considered appropriate for all legal and similar claims as per note 19.

As explained in note 18, in April 2018, a bond with a net fair value liability of £76.1m will either be remarketed for the remaining 40 year period or the Company will settle the related derivative contract. The Company expects that it will be able to successfully remarket the bonds at fair value and a cash settlement will not be required and so no provision has been reflected to record this potential liability in these financial statements (under UK GAAP).

26. Operating leases

At 31 March 2014 the Company was committed to making the following annual payments in respect of non-cancellable operating leases:

	Land & Buildings		Other	
	2014 £m	2013 £m	2014 £m	2013 £m
Leases which expire				
Within one year	0.1	0.2	0.9	1.1
In the second to fifth year inclusive	0.1	0.4	0.1	0.9
Over five years	6.8	6.1	-	-
Total	7.0	6.7	1.0	2.0

See note 12 for further information regarding obligations under finance leases.

27. Pension scheme

The Company operates three pension schemes, one of which is a defined contribution scheme and the other two are defined benefit.

In addition to the cost of the UK Pension arrangements, the Company operates arrangements under which it augments benefits on retirement in certain circumstances of redundancy. These augmentations are funded by way of additional employer contributions to the schemes. In the year ended 31 March 2014 the related payments amounted to £0.2m (2013: £0.2m).

Defined contribution pension scheme

This scheme was set up in April 2011, managed through Standard Life, and is open to all new employees of the Company. The pension cost charge for the period represents contributions payable by the Company to the scheme and amounted to £3.2m (2013: £2.2m). There were no outstanding or prepaid contributions either at the beginning or end of the financial year.

Defined benefit pension schemes

Pension arrangements for the majority of the Company's employees are provided through two defined benefit Group pension schemes:

- (e) Thames Water Pension Scheme ("TWPS")
- (f) Thames Water Mirror Image Pension Scheme ("TWMIPS")

Both represent final salary pension schemes. Their assets are held separately from those of the rest of the Group in independently administered funds in the United Kingdom. On 1 April 2011 the defined benefit arrangements were closed to new entrants and replaced with a defined contribution scheme.

27. Pension scheme (continued)

Both schemes cover employees within the Thames Water Group. However the Company is the principal employer in both schemes and hence funds the vast majority of the contributions into the schemes. Accordingly, the directors have decided it is appropriate to recognise the net deficit of the two Group pension schemes within these financial statements.

The service cost of the Company, as included in the profit and loss account, represents the net of the total service cost of the Group schemes and the pension contributions made by the other group companies into the schemes in the financial period.

The most recent full actuarial valuation was as at 31 December 2010 on behalf of the pension Trustees by AON Hewitt Limited ("Hewitt"), the independent and professionally qualified consulting actuary to the schemes. The production of a full valuation as at 31 December 2013 is currently in progress. The 2010 valuation has been updated to 31 March 2014 by Mercer Limited ("Mercer"), independent and professionally qualified consulting actuaries, using revised assumptions that are consistent with the requirements of FRS 17 and shown in this note to the accounts.

Thames Water Group has taken advice from Mercer in respect of the funding position of the Group pension schemes.

Net pension liability

	TWPS		TWMIPS	
	2014 £m	2013 £m	2014 £m	2013 £m
Present value of defined benefit obligations	(1,202.0)	(1,235.0)	(657.7)	(681.2)
Fair value of plan assets	976.8	956.4	709.4	736.9
(Deficit)/surplus	(225.2)	(278.6)	51.7	55.7
Effect of asset limit	-	-	(20.1)	(25.8)
Related deferred tax asset/(liability)	45.0	64.1	(6.3)	(6.9)
Net Pension (Liability)/asset	(180.2)	(214.5)	25.3	23.0

The Company has recognised a surplus in the TWMIPS to the extent that it may possibly be able to recover it by paying a reduced rate of contributions in the future. The recognisable surplus has been calculated in accordance with FRS 17 as the present value of the current service cost projected over the future working lifetime of all active members of the scheme, using the assumptions adopted at 31 March 2014.

27. Pension scheme (continued)

Movement in the present value of defined benefit obligations

	TWPS		TWMIPS	
	2014 £m	2013 £m	2014 £m	2013 £m
At 1 April	1,235.0	1,039.6	681.2	616.9
Current service cost	15.0	13.7	5.5	5.2
Interest cost	52.8	47.9	28.7	28.0
Contributions by members	0.1	0.1	-	0.1
Benefits paid	(30.4)	(30.8)	(34.3)	(34.3)
Termination benefits	0.7	0.1	0.6	0.1
Actuarial (gains)/losses	(71.2)	164.4	(24.0)	65.2
At 31 March	1,202.0	1,235.0	657.7	681.2

Movements in fair value of plan assets

	TWPS		TWMIPS	
	2014 £m	2013 £m	2014 £m	2013 £m
At 1 April	956.4	849.6	736.9	690.4
Expected return on scheme assets	39.9	36.1	32.2	29.9
Contributions by contributing employers	31.5	32.4	10.2	10.9
Contributions by members	0.1	0.1	-	0.1
Benefits paid	(30.4)	(30.8)	(34.3)	(34.3)
Contributions for termination benefits	0.7	0.1	0.6	0.1
Actuarial gains/(losses)	(21.4)	68.9	(36.2)	39.8
At 31 March	976.8	956.4	709.4	736.9

Income/(expense) recognised in the profit and loss account

	2014 £m	2013 £m
Current service cost	(20.5)	(18.8)
Interest on defined benefit pension scheme obligations	(81.5)	(75.9)
Expected return on defined benefit pension scheme assets	72.1	66.0
Total	(29.9)	(28.7)

27. Pension scheme (continued)

The net expense is recognised in the following line items in the profit and loss account:

	2014 £m	2013 £m
Operating costs	(20.5)	(18.8)
Other finance costs	(9.4)	(9.9)
Total	(29.9)	(28.7)

Analysis of amount recognised in the statement of total recognised gains and losses

	2014 £m	2013 £m
Actuarial gains/(losses) immediately recognised	37.6	(120.9)
Adjustment relating to irrecoverable surplus	5.7	14.1
Adjustment in respect of prior periods	(1.5)	-
Total	41.8	(106.8)
Cumulative actuarial gains/(losses) recognised	(394.3)	(436.1)

Fair value of scheme assets and long-term expected return on these assets

The fair value of the assets held by the pension schemes, the long-term expected rate of return on each class of assets and the average expected long-term rate of return obtained by weighting the individual rates in accordance with the anticipated balance in the schemes' investment portfolio are shown in the following two tables:

	TWPS		TWMIPS	
	2014 %	2013 %	2014 %	2013 %
Equities	7.50%	7.15%	7.35%	7.15%
Corporate bonds	4.60%	4.30%	4.35%	4.30%
Fixed interest government bonds	3.50%	3.15%	3.35%	3.15%
Index linked government bonds	3.25%	2.90%	3.10%	2.90%
Property	6.50%	6.15%	6.35%	6.15%
Cash	3.50%	3.15%	3.35%	3.15%
Weighted average expected return	5.40%	4.60%	4.35%	4.60%

In the prior period weighted average expected returns were used in calculating the fair value of the scheme assets of both schemes. In the current year scheme-specific assumptions have been employed as shown above.

27. Pension scheme (continued)

	TWPS		TWMIPS	
	2014 £m	2013 £m	2014 £m	2013 £m
Equities	419.0	413.8	151.0	161.9
Corporate Bonds	68.2	57.0	65.8	64.1
Fixed interest government bonds	38.7	6.2	35.2	36.1
Index linked government bonds	380.0	396.3	398.7	415.7
Property	61.2	56.0	45.6	43.9
Cash	9.7	27.1	13.1	15.2
Total fair value of scheme assets	976.8	956.4	709.4	736.9

The Company employs a building block approach in determining the long-term rate of return on pension plan assets. Historical markets are studied and assets with higher volatility are assumed to generate higher returns consistent with widely accepted capital market principles. The assumed long-term rate of return on each asset class is set out within this note. The overall expected rate of return on assets is then derived by aggregating the expected return for each asset class over the actual asset allocation for the schemes.

Principal actuarial assumptions

The main financial assumptions used for FRS 17 purposes are as follows

	TWPS		TWMIPS	
	2014 %	2013 %	2014 %	2013 %
Price inflation – RPI	3.45%	3.50%	3.35%	3.50%
Price inflation – CPI	2.50%	2.80%	2.40%	2.80%
Rate of increase in salaries	-	-	3.85%	4.00%
Rate of increase to pensions in payment – RPI	3.45%	3.50%	3.35%	3.50%
Rate of increase to pensions in payment – CPI	2.50%	2.80%	2.40%	2.80%
Discount rate	4.60%	4.30%	4.35%	4.30%

In the prior period weighted average actuarial assumptions were used in valuing the scheme assets and defined benefit obligations of both schemes. In the current year scheme-specific assumptions have been employed as shown above.

In valuing the liabilities of the pension schemes at 31 March 2014, mortality assumptions have been made as indicated overleaf. These mortality assumptions are based on standard mortality tables, the recent actual mortality experience of members within the schemes and the assumptions also allow for future improvements to mortality rates.

27. Pension scheme (continued)

	TWPS		TWMIPS	
	2014 Years	2013 Years	2014 Years	2013 Years
Life expectancy from age 60				
Male	28	27	27	26
Female	30	29	30	28
Life expectancy from 60, currently aged 40				
Male	30	29	29	28
Female	32	31	32	30

History of schemes

The history of the schemes for the current and prior periods is as follows:

	2014 £m	2013 £m	2012 £m	2011 £m	2010 £m
Fair value of scheme assets	1,686.2	1,693.3	1,540.0	1,403.8	1,317.4
Present value of scheme liabilities	(1,859.7)	(1,916.2)	(1,656.5)	(1,510.0)	(1,466.6)
Net deficit in schemes	(173.5)	(222.9)	(116.5)	(106.2)	(149.2)

The experience adjustments in the schemes for the current and prior periods are as follows:

	2014 £m	2013 £m	2012 £m	2011 £m	2010 £m
Gains on scheme assets					
Amount	57.6	108.7	77.6	14.1	220.6
Percentage of scheme assets	3.4%	6.4%	5.0%	1.0%	16.7%
Losses on scheme liabilities					
Amount	-	-	(11.0)	-	-
Percentage of scheme liabilities	-	-	0.7%	-	-

The Company expects to contribute approximately £33.1m to TWPS and £10.7m to TWMIPS in the next financial year.

28. Notes to the cash flow statement

a. Reconciliation of operating profit to net cash inflow from operating activities

	2014 £m	2013 £m
Operating profit	655.1	549.3
Depreciation – infrastructure renewals charge	165.3	135.3
Depreciation – non-infrastructure	340.4	322.2
Difference between pension charge and cash contribution	(22.5)	(24.8)
Decrease/(increase) in stocks	(0.4)	1.1
Decrease/(increase) in debtors and prepaid expenses	(29.6)	80.1
Increase in creditors and accrued expenses	51.9	12.9
(Decrease)/increase in provisions	17.8	(5.5)
Release of deferred income	(13.7)	(13.6)
Gain on settlement of finance lease obligations	(5.8)	-
Net cash inflow from operating activities	1,158.5	1,057.0

b. Reconciliation of net cash flow to movement in net debt

	2014 £m	2013 £m
Increase/(decrease) in cash in the year	73.6	(2.7)
Cash inflow from increase in liquid resources	108.5	129.3
Cash (outflow) from movement in net debt and financing	(586.3)	(587.1)
Increase in net debt resulting from cash flows	(404.2)	(460.5)
Gain on settlement of finance leases	5.8	-
Non-cash increase in net debt	(139.0)	(136.7)
Total increase in net debt	(537.4)	(597.2)
Opening net debt	(8,372.7)	(7,775.5)
Closing net debt	(8,910.1)	(8,372.7)

The non-cash increase in net debt comprises amortisation of bond fees and the carrying value of RPI accretion, of a number of RPI index-linked bonds and swaps. This adjustment for RPI index-linked bonds and swaps is in accordance with FRS 4 "Capital instruments".

28. Notes to the cash flow statement (continued)

c. Analysis of movement in net debt

	2013 £m	Cash flow £m	Transfer to current £m	Non-cash £m	2014 £m
Cash at bank and in hand	-	6.6	-	-	6.6
Overdraft	(67.0)	67.0	-	-	-
	(67.0)	73.6	-	-	6.6
Current asset investments	748.7	108.5	-	-	857.2
Debt due within one year	(1.3)	1.3	(416.2)	-	(416.2)
Debt due after one year	(8,940.3)	(694.6)	416.2	(139.0)	(9,357.7)
Finance leases	(112.8)	107.0	-	5.8	-
	(8,305.7)	(477.8)	-	(133.2)	(8,916.7)
Total net debt	(8,372.7)	(404.2)	-	(133.2)	(8,910.1)

d. Movement in cash

	2014 £m	2013 £m
Unrestricted cash movement	74.9	(71.0)
Restricted cash movement	(1.3)	1.3
Total	73.6	(69.7)

Included in the prior period overdraft and shown within the decrease in cash in the cash flow statement is a restricted cash receipt of £1.3m. This receipt was held within "Creditors: amounts falling due within one year" as a short term loan. The net effect of this transaction has a neutral effect on the Company's net debt.

This restricted cash relates to collateral posted by derivative counter parties that have failed to meet minimum credit rating criteria assigned by Moody's.

29. Off-balance sheet arrangements

The Company is party to a number of contractual arrangements for the purposes of its principal activities that are not required to be included on its balance sheet. The principal off-balance sheet arrangements are listed below:

- (g) Operating leases (see note 26)
- (h) Outsourcing contracts
- (i) Guarantees

In respect of outsourcing contracts, the Company has entered into various arrangements to outsource the provision of certain back-office and operational functions with third party providers. These outsourced arrangements include aspects of IT support, Legal Services, Supply Chain, Metering and Capital Delivery. These arrangements are on commercial terms and no associated penalty or termination clauses will have a material impact on the financial position of the Group.

The Company is part of a whole business securitisation group. Companies in the whole business securitisation group raise debt in external debt markets through the issuance of secured bonds and issue of loans. Thames Water Utilities Holdings Limited, Thames Water Utilities Limited, Thames Water Utilities Finance Limited, Thames Water Utilities Cayman Finance Holdings Limited and Thames Water Utilities Cayman Finance Limited have guaranteed the principal and interest payments due under the terms of the bonds. Where the Company enters into financial guarantee contracts to guarantee the indebtedness of other companies within this group, the Company considers these to be insurance arrangements and accounts for them as such. In this respect, the Company treats the guarantee contract as a contingent liability until such time as it becomes probable that the Company will be required to make a payment under the guarantee.

30. Post balance sheet events

On 22 April 2014 the Company issued an announcement to the London Stock Exchange launching the consent solicitation process to seek the approval of secured creditors to change the terms of certain finance documents. Bondholder meetings took place on 15 May 2014 and the proposal was passed on 16 May 2014. Further to this consent, the proposed changes will be implemented on satisfaction of further specific conditions which are the issue of the Thames Tideway Tunnel Project Specification Notice and the affirmation of credit ratings at specific levels as set out in relevant finance documents.

Whilst these changes are considered important to the securitisation group, there is no immediate financial effect.

31. Intermediate and ultimate parent company and controlling party

Thames Water Utilities Holdings Limited, a company incorporated in the United Kingdom, is the immediate parent company.

Kemble Water Finance Limited, a company incorporated in the United Kingdom, is an intermediate parent company and the smallest group to consolidate these financial statements.

The directors consider that Kemble Water Holdings Limited, a company incorporated in the United Kingdom, is the ultimate and controlling party and the largest group to consolidate these financial statements.

Copies of the accounts of all of the above companies may be obtained from The Company Secretary's Office, Thames Water, Clearwater Court, Vastern Road, Reading, Berkshire, RG1 8DB.

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Explanatory note and licence condition disclosures

The regulatory accounts and required regulatory information on pages 154 to 200 are provided to comply with Condition F of the Instrument of Appointment of Thames Water Utilities Limited as a water and sewerage undertaker under the Water Industry Act 1991. See Condition F section below for further explanation of these requirements.

The regulatory accounts are prepared in accordance with the Regulatory Accounting Guidelines ("RAG") issued by Ofwat in February 2013. Subsequent to the RAG's, Ofwat issued information notice IN 14/05 on 7 February 2014 with further guidance effective for the financial year ended 31 March 2014. These revised RAGs and IN 14/05 have been adopted in the preparation and presentation of these regulatory accounts. There has been no other guidance issued up to June 2014 changing RAG requirements.

There are differences between UK Generally Accepted Accounting Practice and the RAG. Where different treatments are specified under each, the RAG takes precedence.

The regulatory financial statements should be read in conjunction with the statutory Annual report and financial statements ("AR&A"). The AR&A include:

- Strategic report (pages 5 to 51); which contain:
 - information in respect of the Company's charitable donations (page 24).
- Directors' report (pages 100 to 103), which contain:
 - a statement as to the disclosure of information to the auditor (page 103); and
 - the dividend policy of the Company which also applies to the appointed business (page 100).
- Directors' remuneration report (pages 74 to 92) includes information linking their remuneration with standards of regulatory performance; and
- Corporate governance report (pages 60 to 73). In September 2013, Ofwat published a paper setting out expectations and principles for all companies in the areas of Board leadership, transparency and governance. This included Ofwat's expectations around the composition of the Board: independent non-executive directors to be the single largest group on the Board, fewer investor representatives than independents, and fewer executives than independent non-executive directors. Ofwat expects companies to put in place a code showing how the principles are applied, with full compliance by 1 April 2015. Thames Water has submitted its Key Principles to Ofwat and subject to obtaining the shareholder consent required is confident of full compliance by April 2015.

Condition F: Accounts and accounting information

Further to the statutory reporting requirements of Company law, the directors are required to prepare accounting statements which comply with the requirements of Condition F of the Instrument of Appointment of the Company as a water and sewerage undertaker under the Water Industry Act 1991 and Regulatory Accounting Guidelines issued by Ofwat.

This purpose of Condition F is to ensure that:

- the financial affairs of the appointed business can be assessed and reported on separately from other businesses and activities of the Company, as if its sole business consisted of being a water undertaker and sewerage undertaker having its equity share capital listed on the International Stock Exchange of United Kingdom and Republic of Ireland Ltd;
- information on revenues, costs, assets and liabilities attributable to specified activities of the appointed business can be provided and reported on;
- transactions between the appointed business and any other business or activity of the Company or any, associated company can be assessed and reported on;
- there is no cross-subsidy between the appointed business and any other business of the Company or between the appointed business and any associated company;
- the transfer of assets (including the provision of financial support) to associated companies does not adversely affect the Company's ability to carry out its functions as a water and sewerage undertaker or to finance those activities;
- Ofwat is furnished with regular accounting and other information to enable it to compare the financial position and performance (including, without limitation, costs) of the appointed business and of so much of the respective businesses and activities of all other undertakers holding appointments made under Chapter I of Part II of the Water Industry Act 1991 as consists of the carrying out of the Regulated Activities; and
- the appointee has at its disposal sufficient financial and managerial resources to carry out the regulated activities (including the investment programme necessary to fulfil its obligation under the appointment).

Condition K: Ring fencing and disposal of land

Paragraph 3.1 of Condition K requires that the Company shall at all times ensure, so far as reasonably practicable, that if a special administration order were made in respect of the Company, the Company would have sufficient rights and assets (other than financial resources) to enable the special administrator to manage the affairs, business and property of the Company that the purposes of such order could be achieved.

In the opinion of the directors, the Company was in compliance with paragraph 3.1 of Condition K of the Instrument of Appointment at the end of the financial year.

Definitions of appointed and non-appointed business

The appointed business comprises the regulated activities of the Company as defined in Condition A of its license. These are activities necessary in order for a company to fulfil the function and duties of a water and sewerage undertaker under the Water Industry Act 1991.

In addition to its duties as an appointed business, the Company also undertakes certain non-appointed activities. All of these activities are conducted on an arms lengths basis from the appointed business. These

activities include third-party discharges to Sewerage Treatment Works ("STWs"), gravel sales and other commercial activities including property searches and CESS treatment. The results of the non-appointed business include charitable donations. These donations are considered to be made out of shareholders' interests and are not funded by customers.

Statement of Directors' responsibilities for regulatory information

Further to the requirements of Company law, the Directors are required to prepare accounting statements which comply with the requirements of Condition F of the Instrument of Appointment of the Company as a water and sewerage undertaker under the Water Industry Act 1991 and Regulatory Accounting Guidelines issued by Ofwat. This requires the Directors to:

- confirm that, in their opinion, the Company has sufficient financial resources and facilities, management resources and methods of planning and internal control for the next 12 months;
- confirm that, in their opinion, the Company has sufficient rights and assets to enable a special administrator to manage the affairs, business and property of the Company;
- confirm that, in their opinion, the Company has contracts with any associate Company with the necessary provisions and requirements concerning the standard of service to be supplied to ensure compliance with the Company's obligations as a water and sewerage undertaker;
- report to Ofwat changes in the Company's activities, which may be material in relation to the Company's ability to finance its regulated activities;
- 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
- keep proper accounting records, which comply with Condition F and RAG 5.04.

These responsibilities are additional to those already set out in the statutory financial statements.

Disclosure of information to the auditor

The directors who held office at the date of approval of this directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditor is unaware and each director has taken all the steps that they ought to have taken as a director to make themselves aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

A glossary of regulatory terms is shown on pages 204 to 205.

Historic cost profit and loss account

For the year ended 31 March

	2014			Re-stated * 2013		
	Appointed business £m	Non- Appointed business £m	Total £m	Appointed business £m	Non- Appointed business £m	Total £m
Turnover	1,912.5	31.2	1,943.7	1,758.9	33.0	1,791.9
Operating costs	(782.7)	(9.8)	(792.5)	(773.1)	(12.0)	(785.1)
Infrastructure renewals charge	(163.1)	-	(163.1)	(135.3)	-	(135.3)
Historical cost depreciation	(332.1)	(0.9)	(333.0)	(321.2)	(1.0)	(322.2)
Operating income	22.0	-	22.0	10.8	-	10.8
Operating profit	656.6	20.5	677.1	540.1	20.0	560.1
Other income	2.3	(2.3)	-	2.6	(2.6)	-
Net interest payable	(417.7)	(0.1)	(417.8)	(415.0)	(0.2)	(415.2)
Profit on ordinary activities before taxation	241.2	18.1	259.3	127.7	17.2	144.9
Taxation: - current	9.1	(4.2)	4.9	2.9	(4.0)	(1.1)
- deferred	82.2	0.3	82.5	6.4	(0.2)	6.2
Profit on ordinary activities after taxation	332.5	14.2	346.7	137.0	13.0	150.0
Dividends	(194.3)	(14.2)	(208.5)	(218.4)	(13.0)	(231.4)
Retained profit/(loss) for the year	138.2	-	138.2	(81.4)	-	(81.4)

* See the additional information required by the licence on page 164 for an explanation of the re-statement of the comparative information for the year ended 31 March 2013.

Statement of total recognised gains and losses (historical cost accounting) for appointed business

For the year ended 31 March

	2014 £m	2013 £m
Profit for the year	332.5	137.0
Actuarial gain/(loss) on post-employment plans	41.8	(106.8)
Deferred tax relating to actuarial gain/(loss)	(21.7)	21.3
Total recognised gains for the year	352.6	51.5

Historic cost balance sheet

As at 31 March

	2014			2013		
	Appointed business £m	Non- Appointed business £m	Total £m	Appointed business £m	Non- Appointed business £m	Total £m
Fixed assets						
Tangible assets	9,842.6	7.8	9,850.4	9,221.3	6.8	9,228.1
Investments						
- loan to group company	2,015.0	-	2,015.0	2,015.0	-	2,015.0
- other	0.1	-	0.1	0.1	-	0.1
Total fixed assets	11,857.7	7.8	11,865.5	11,236.4	6.8	11,243.2
Infrastructure renewals prepayment	64.5	-	64.5	69.8	-	69.8
Other current assets	1,458.4	-	1,458.4	1,329.9	-	1,329.9
Creditors: amounts falling due within one year:						
Borrowings	(416.2)	-	(416.2)	(78.8)	-	(78.8)
Other creditors	(902.5)	(7.5)	(910.0)	(865.1)	(6.2)	(871.3)
Total creditors: amounts falling due within one year	(1,318.7)	(7.5)	(1,326.2)	(943.9)	(6.2)	(950.1)
Net current asset / (liabilities)	204.2	(7.5)	196.7	455.8	(6.2)	449.6
Total assets less current liabilities	12,061.9	0.3	12,062.2	11,692.2	0.6	11,692.8
Creditors: amounts falling due after more than one year						
Borrowings	(9,357.7)	-	(9,357.7)	(9,042.6)	-	(9,042.6)
Other creditors	(41.9)	-	(41.9)	(44.6)	-	(44.6)
Total creditors: amounts falling due after more than one year	(9,399.6)	-	(9,399.6)	(9,087.2)	-	(9,087.2)
Provisions for liabilities and charges	(1,270.3)	(0.3)	(1,270.6)	(1,371.3)	(0.6)	(1,371.9)
Net assets employed	1,392.0	-	1,392.0	1,233.7	-	1,233.7
Capital and reserves	1,392.0	-	1,392.0	1,233.7	-	1,233.7

Historical cost reconciliation between statutory and regulatory accounts – profit and loss account

	2014		Explanation
	Statutory accounts £m	Regulatory accounts £m	
Turnover	1,943.7	1,943.7	There is no difference between statutory and regulatory reported turnover.
Operating costs	(794.7)	(792.5)	The difference of (£2.2m) is due to the the following: <ul style="list-style-type: none"> Regulatory operating costs include (£11.8m) of "other operating income", as detailed below, which is shown as a separate caption within the statutory profit and loss account. Regulatory operating costs include £2.2m of infrastructure renewals charge in respect of customer side leakage pipe replacement. This reclassification is necessary to ensure compliance with RAG 4.04, whereby all customer side leakage should be treated as operating costs within the regulatory accounts. This reclassification has no impact on operating profit. See 'Changes to methodology as a result of change to the application of the capitalisation policy' section on page 163 of these regulatory accounts for further information. Regulatory operating costs exclude deferred grants of £7.4m, which have been netted off against depreciation. Deferred grants are shown within operating costs within the statutory financial statements.
Infrastructure renewals charge	(165.3)	(163.1)	See explanation for operating costs above.
Depreciation	(340.4)	(333.0)	See explanation for operating costs above.
	(1,300.4)	(1,288.6)	The difference of £11.8m relates to "other operating income" shown as a separate caption in the statutory accounts, but included within operating costs within the regulatory accounts, see below.

Other operating income	11.8	-	- The difference of £11.8m is net income of £5.9m relating to settlement of finance leases in the year and £5.9m receipt of income from energy generation, included in operating costs within the regulatory accounts.
Operating income	-	22.0	Profit on sale of fixed assets of £22.0m is shown above operating profit within the regulatory accounts, but below operating profit within the statutory accounts as profit on sale of fixed assets.
Operating profit	655.1	677.1	See explanation for operating income above.
Profit on sale of fixed assets	22.0	-	- See explanation for operating income above.
Profit before taxation	259.3	259.3	Profit before taxation is unaffected by the above reclassifications.

Historical cost reconciliation between statutory and regulatory accounts – balance sheet

	2014		
	Statutory accounts £m	Regulatory accounts £m	Explanation
Fixed assets			
Tangible fixed assets (net book value)	9,914.9	9,850.4	The difference of £64.5m is due to the infrastructure renewals prepayment excluded from the fixed assets net book value in the regulatory accounts. Section 1.4.6 of RAG 1.05 disapplies elements of FRS 15, for regulatory accounting purposes, whereby the presentation of the difference between IRE and IRC is classified as an infrastructure renewals prepayment in these regulatory financial statements. For more detail see page 172.
Investments – loan to group company	-	2,015.0	A loan to the immediate parent company, Thames Water Utilities Holdings Limited is classified as an investment within the regulatory accounts, but is classified as a debtor: amounts falling due after more than one year within the statutory financial statements. This difference in presentation is in accordance with RAG 3.07 and RAG 4.04.
Debtors : amount falling due after more than one year	2,015.0	-	As above.
Current Assets			
Infrastructure renewals prepayment	-	64.5	The difference of £64.5m reflects the application of section 1.4.6 of RAG 1.05. See explanation for tangible fixed assets above.
Short-term and long-term creditors			
Deferred income – grants and contributions:	(137.4)	-	Deferred grants and contributions of £137.4m within the statutory accounts are analysed between creditors: amounts falling due within one year (£9.3m) and creditors: amounts falling due after more than one year (£128.1m). This is in contrast to the regulatory accounts, which shows total deferred grants and contributions within provisions for liabilities and charges. This difference in presentation is in accordance with

RAG 3.07 and RAG 4.04.

Net pension liabilities	(154.9)	-	Net pension liabilities are shown as a separate caption within the statutory accounts, but are included within provisions within the regulatory accounts. This difference in presentation is in accordance with RAG 3.07 and RAG 4.04.
Provision for liabilities and charges	(978.3)	(1,270.6)	As above.

Additional information required by the licence

Basis of preparation

In accordance with Condition F of the Instrument of Appointment, these regulatory financial statements have been prepared in order to show separately, in respect of the appointed business, non-appointed business and total business, a profit and loss account and balance sheet prepared on a historical cost basis.

In accordance with the requirements of FRS 18, the directors review the Company's accounting policies to ensure that they remain the most appropriate to its particular circumstances for the purpose of giving a true and fair view.

The regulatory financial statements have been prepared in accordance with the historical cost convention and, except:

- for the classification of profit on the sale of fixed assets as explained in note (a) below,
- the treatment of infrastructure renewals expenditure as explained in note (b) below and
- the treatment of certain capital contributions as explained in note (c) below, have been prepared in accordance with the Companies Act 2006.

These departures from applicable UK Accounting Standards are necessary to comply with regulatory reporting requirements, within RAG 3.07 and RAG 4.04 as laid down by Ofwat.

Accounting separation - methodology

The Company has also produced an accounting separation methodology statement in respect of the operating costs and associated fixed asset book values in notes on pages 178 to 183. This separate statement has been published and is available on the Thames Water website.

This methodology statement details the assumptions used in the allocation of costs into the relevant Accounting Separation business units in accordance with RAG 4.04, and also includes a summary of the Company's capitalisation policy. A definition of household and non-household properties is also included within the methodology statement. This separate statement has been published and is available on the Thames Water website.

In addition to the accounting separation methodology statement, the Company has also produced an upstream services methodology statement detailing the assumptions used in the Wholesale upstream services table, issued as an appendix to these regulatory accounts, as required by Ofwat in IN 14/05.

The Company's application of the capitalisation policy has remained unchanged from the prior year. The Company has, however, changed the application of the capitalisation policy to enable the capitalisation of the replacement and relining of customer side pipes as IRE, as detailed in the 'Changes to methodology section' below.

Basis of attribution and allocation

Finance data within the Company's finance system (SAP) is recorded by expenditure type within a cost centre.

Where possible, costs are attributed at the lowest level within the cost centre hierarchy i.e. the relevant process level appropriate to the type of cost and accounting separation unit. However, certain costs are recorded at a higher level in the cost centre hierarchy where they do not specifically relate to a process or if the cost is a support related cost.

The costs to be allocated are assessed by management with regard to the nature and type of cost and an appropriate rule is created within SAP; known as an assessment cycle. This assessment cycle, allocates costs from a sender cost centre to a receiver cost centre. These are defined in the Company's methodology statement.

The assessment cycles are reviewed by Management at least annually to ensure that they remain appropriate and valid. This review is designed to take into account any business unit reorganisation, any operational process changes and the latest Ofwat guidance.

This review is undertaken by finance managers with operational management responsible for each cost centre within the regulatory hierarchy. Any changes to assessment cycles within SAP, following the review, are undertaken by the Regulatory Finance Reporting Manager. A cost centre control file is maintained, which details all relevant cost centres regulatory information, including assessment cycles.

Changes to methodology

Changes to methodology as a result of latest Ofwat guidance

Management continually reviews its accounting separation methodology as part of its continuing improvement process for regulatory reporting.

Certain changes have been made to the basis of allocation to comply with Ofwat's IN 14/05 issued on 7 February 2014, which required the following services to be allocated as detailed below:

- **Scientific services:** sampling of drinking water at customers' taps is now treated as a wholesale activity; in 2012/13 these costs were allocated to retail.
- **Regulation costs:** costs are now split equally across all nine accounting separation units; in 2012/13 costs were allocated pro-rata to the direct costs incurred by each of the nine accounting separation units.

Changes to methodology as a result of management review

In addition to the two changes noted above, the Company has also changed its methodology for the allocation of general and support costs within the Retail table. Previously these costs were allocated between household ("HH") and non-household ("NHH") pro-rata to the level of direct costs reported within these two services. In 2013/14, the Company has chosen to allocate general and support costs pro-rata to the number of customer accounts within HH and NHH. This is in line with guidance provided for PR14. Management considers that this change in methodology is appropriate and more closely aligns with the way the resources are consumed within the retail business.

There are no other changes to the methodology or any changes in management judgment that the Company has used in the accounting separation tables, see note 3 pages 178 to 183, other than those noted above.

Changes to methodology as a result of change in the application of the capitalisation policy

During the year ended 31 March 2014, the Company has reviewed the application of its capitalisation policy and have extended it to the following:

Customer side leakage

The Company has changed the application of its capitalisation policy in respect of Customer Side Leakage ("CSL") replacement and relining of customer side pipes. Under this new policy, the Company will reline and replace customer side pipes, free of charge to customers. This change to relining and replacement of customer side pipes is considered to be more efficient than repairing the damaged pipe.

In this regulatory period, costs associated with the replacement and relining of customer side pipes have been capitalised as Infrastructure Renewals Expenditure ("IRE"), as management considers that such expenditure meets the criteria of IRE as defined in RAG 1.01. In the period the amount capitalised as IRE was £3.3m.

In accordance with the guidance in RAG 1.01 in respect of the accounting for IRE, the Company has charged £2.2m of the above IRE as an Infrastructure Renewals Charge ("IRC") in the year as depreciation within the statutory accounts.

However, to comply with the guidance provided in RAG 4.04 and IN 14/05, the Company has reclassified the IRC as operating cost within the historical and current cost regulatory accounts. There have been no other changes to methodology as a result of a change in the application of the capitalisation policy.

None of the changes in methodology as highlighted above have any retrospective impact on the prior year regulatory financial statements; therefore there is no restatement of prior year to be disclosed.

Prior to 2013/14, all costs associated with CSL were charged to operating costs.

Enabling costs

Following a review of the areas of operational activity that act as enabling costs to capital expenditure the Company has identified two areas that should be treated as enabling costs and therefore are now being capitalised.

- Leak detection – the Company carries out a programme of leak detection and where it is found that a repair is required and is to be capitalised, the cost of detection of the leak is also capitalised as part of the repair. The amount capitalised in the year was £6.4m, of which £4.1m relates to prior years.
- Traffic management – the Company incurs the cost of the initial street works permit and does not pass this onto the contractor. The cost of the permit is retrospectively allocated to the ensuing capital project. The amount capitalised in the year was £7.0m, of which £3.9m relates to prior years.

Restatement of 2012/13 actuals

Other income

The Company has amended the reporting of the recharge of operating costs from the appointed to non-appointed business associated with rental income that is reported within non-appointed turnover. This operating cost recharge had been reported as negative operating expenditure within the appointed business contrary to RAG 4.04, which requires this to be reported as other income. The Company has therefore restated the following financial statements to reflect this change in treatment:

- its 2012/13 regulatory historic profit and loss account;
- the regulatory current cost profit and loss account for the appointed business; and
- the regulatory current cost cash flow statement for the appointed business.

There is no impact on the profit after tax for this change in restatement.

Accounting separation tables

The Company has also amended the regulatory current cost profit and loss account for the appointed business to correctly reflect the following activities, which were incorrectly classified within Retail in the prior year:

- providing connections for developers;
- metering installation and maintenance (including current cost depreciation on meter assets); and
- support for trade effluent compliance.

The Company is not required to include comparatives for the accounting separation tables within note 3. However, the following table is provided detailing the changes to the accounting separation tables previously published for the incorrectly classified retail activities above and the change in treatment for other income.

All changes listed were required to fully comply with RAG 4.04, as provided in the Company's supplementary regulatory account disclosures, published in November 2013. This document is available on the Company's website at <http://www.thameswater.co.uk/about-us/4229.htm>.

2012/13 operating expenditure

	Water £m	Sewerage £m	Retail £m	Total £m
Total operating costs(as reported)	527.4	587.3	217.4	1,332.1
Changes in presentation:				
Developer services	1.9	-	(1.9)	-
Meter installation and maintenance*	0.0	-	(0.0)	-
Trade effluent support	-	0.7	(0.7)	-
Current cost depreciation on meter assets	18.8	-	(18.8)	-
Operating cost recharge	1.2	1.4	-	2.6
Total adjustment	21.9	2.1	(21.4)	2.6
Total operating costs (adjusted)	549.3	589.4	196.0	1,334.7

* The identified operating cost was £15,000.

Historic cost accounting policies

The same accounting policies as those used for the year ended 31 March 2013 have been applied in these financial statements.

(a) Profit on sale of fixed assets

Profit and loss on sale of fixed assets has been included within operating profit, as operating income, in accordance with RAG 3.07. This represents a departure from FRS 3 as adopted in the Company's 31 March 2014 statutory financial statements in which profit and loss on sale of fixed assets are shown separately after operating profit.

(b) Infrastructure renewals accounting

Infrastructure renewals accounting is used for long-life network assets and is based on the operational assessment of activity needed to maintain the serviceability of the network over a medium to long-term period. Accordingly Infrastructure renewals expenditure ("IRE") net of Infrastructure Renewals Charge ("IRC") has been accounted for in accordance with RAG 3.07.

The Company's statutory financial statements disclose IRE net of IRC in accordance with FRS 15 "Tangible Fixed Assets" which requires this amount to be included within fixed assets. However, in accordance with RAG 3.07 the Company reports IRE net of IRC within the regulatory historic cost Balance sheet as 'infrastructure renewals prepayment' for the year ended 31 March 2014, see 'Adjustment for infrastructure renewals accounting' table on page 172, for details of the movement in IRE and IRC in the year. This table shows the IRE spend of £160.0m compared to an IRC profit and loss account movement of £165.3m, resulting in a reduction of the opening prepayment position from £69.8m to £64.5m as at 31 March 2014.

(c) Capital contributions

Capital contributions received in respect of infrastructure assets have been deducted from the cost of fixed assets. This is not in accordance with Schedule 4 to the Companies Act 2006, which requires fixed assets to be stated at their purchase price without deduction of contributions, with the latter accounted for as deferred income. This departure from the requirement of the Act is, in the opinion of the directors, necessary for the financial statements to give a true and fair view because infrastructure assets do not have a determinable finite life. Accordingly, related capital contributions are not be recognised in the profit and loss account.

(d) Attribution of costs

All direct costs are attributed immediately to the activity to which they relate, either within the appointed business or non-appointed business. Indirect costs and overheads are apportioned on an appropriate basis to reflect the incidence of such costs. Indirect costs include the provision of support services.

(e) Revenue recognition

Turnover represents the fair value of the income receivable from the regulated activities in the ordinary course of business for water and sewerage services provided and are recognised in accordance with FRS 5 "Reporting the Substance of Transactions". Turnover is recognised excluding value added tax and is at the time of delivery of the service. Should the Company consider that the criteria for revenue recognition are not met at the time of a transaction, recognition of the associated turnover would be deferred until such time as the criteria have subsequently been met. No adjustment is made to turnover for estimated bad debt charges. These are charged to operating expenses.

For metered customers, turnover includes accrued income which comprises an estimated sales value of water supplied and waste water charges to customers between the date of the last meter reading and the period end, exclusive of value added tax. Historical data is used to generate estimated usage by active customer accounts; where this is not available the historical data is sampled to generate an estimate by tariff type for each account. Where there is evidence that exceptional circumstances such as weather conditions have caused historical usage to be out of alignment with current consumption trends, management will investigate and make an adjustment to accrued income if it considers that this will provide a true and fair view. When actual results differ from estimated usage, turnover is adjusted in the period for which the revision to the estimates is determined. The amounts recognised in turnover, but unbilled at the balance sheet date, are recorded as a prepayment.

Where an invoice has been raised or payment made, but the service has not been provided in the year this will be treated as a payment in advance. This will not be recognised within the current year's turnover but will instead be recognised within creditors.

When a new property is connected to the Company's networks, an estimate is made of the sales value of water supplied and waste water charges to customers between the date of connection and the period end.

For customers who do not have a meter, the amount billed is dependent upon the rateable value of the property, as assessed by an independent rating officer. The amount billed is apportioned in turnover over the period to which the bill relates.

Additional charges added to a customer's account as a result of debt recovery activity, such as court costs or solicitors fees, are not recognised in turnover. They are recognised as favorable operating costs when payment is received. There is no difference between the revenue recognition policies in the statutory financial statements and in these regulatory accounts.

Charging policy

Water and sewerage charges fall into the following three categories:

- 1) charges which are payable in full
- 2) charges which are payable in part
- 3) not chargeable (void properties)

The circumstances in which each of the above applies are set out below. All of the charges covered in parts 1 and 2 are included in turnover.

1) Charges payable in full

Charges are payable in full in the following circumstances.

a) Occupied and furnished

Water (and sewerage) charges are payable in full from the date of connection or change of customer on all properties which are recorded as occupied and furnished.

b) Unoccupied and furnished

Water (and sewerage) charges are payable in full on unoccupied, furnished premises. These include properties:

- left with bedding, a desk or other furniture;
- used for multiple occupation with shared facilities;
- used as holiday, student, hostel or other accommodation; and
- used for short-term occupation or letting where the occupation or terms of tenancy is less than 6 months.

Exceptions to this, where water (and sewerage) charges are not payable, include where the customer is:

- in a care home;
- in long-term hospitalisation;
- in prison;
- overseas long-term; or
- in the event of the death of the customer.

c) Unoccupied and unfurnished

Water (and sewerage) charges are payable in full on unoccupied, unfurnished premises where water is being consumed. This includes:

- premises where renovation, redecoration or building work is being undertaken,
- premises being used as storage,
- premises not normally regarded as being occupied such as cattle troughs and car parks; and
- non-household agricultural properties

2) Charges payable in part

The following charges only are payable in certain circumstances:

- a) metered standing charges - payable on unoccupied, metered properties which are still connected;
- b) surface water charge - payable on unmeasured properties which are temporarily disconnected;
- c) sewerage unmeasured tariff - payable on unmeasured, occupied properties where the water supply is disconnected but sewerage is still provided; and
- d) surface water and highway drainage - payable on furnished properties where the water supply is disconnected.

3) Not chargeable

Properties which are unoccupied, unfurnished and disconnected are not chargeable for water and sewerage, therefore no billing is raised and no turnover recognised in respect of these properties.

Occupied properties policy

An occupier is any person who owns a premises or who has agreed with the Company to pay water and sewerage services in respect of the premises. No bills are raised in the name of "the occupier", other than in the circumstances outlined in the 'Unoccupied properties policy' section below. The property management process is followed to identify whether the property is occupied or not.

The property management process consists of the following:

- Physical inspections;
- Mailings;
- Customer contacts;
- Meter reading for metered properties; and
- Land registry checks.

When a new customer is identified they are required to provide documentary evidence to establish the date that they became responsible for water and sewerage charges at the property. This is normally the date at which they moved into the property. The new customer is charged retrospectively from the date at which they became responsible for water and sewerage charges of the premises.

Unoccupied properties policy

A property is deemed to be unoccupied when the Company has completed the property management process and not identified the property as occupied. To be classified as an unoccupied a property must meet at least one of the following criteria:

- A new property has been connected but is empty and unfurnished;
- The Company has been informed that the customer has left the property; it is unfurnished and not expected to be reoccupied immediately;
- It has been disconnected following a customer request;
- The identity of the customer is unknown; or
- The Company has been informed that the customer is in a care home, in long term hospitalisation, in prison or overseas long term.

The Company only raises bills in the name of the "occupier" when it has evidence that an unmeasured property is occupied but cannot confirm the name of the occupier. When the Company identifies the occupants the bill is cancelled and re-billed in the customer's name. If the Company has not identified an occupant within 6 months the bill is cancelled and the property is classified as empty.

The Company has a process for dealing for empty properties. When a property is classified as empty, a defined process is followed to verify when the property becomes occupied and/or obtain the name of the customer in order to initiate billing. The empty property process comprises a number of steps which include using external and internal information for desk-top research to confirm the property status (occupied/empty) and where possible identify the occupier name.

Where this is unavailable the Company also undertakes physical visits to a property to confirm whether the property is empty or occupied, and if possible confirm the name of the occupier. If the occupier name is not obtained at point of physical visit the property will remain classified as empty and a subsequent review is re-started after 1 to 6 months. If these steps confirm that a property appears to be empty then the supply may be turned off.

The property will only cease to be classified as empty when a named customer is identified and billed. The Company does not recognise income in respect of empty properties. If the Company has turned off the supply of water at the mains to a property at a customer's request then water supply charges are not payable.

A customer may request the supply to be turned off in instances such as the property is to be demolished or where a house previously converted into flats (and additional supplies made) is to be converted back into a house.

New properties

All new properties are metered. Charges accrue from the date at which the meter is installed. The developer is billed between the date of connection and first occupancy and this is recognised as turnover.

If the developer is no longer responsible for the property and no new occupier have been identified the property management process referred to above is followed to identify the new occupier. Until the new occupier has been identified the property is treated as unoccupied and is not billed.

Disconnections policy

Premises listed in Schedule 4A of the Water Industry Act 1991 (e.g. any dwelling occupied by a person as his or her only or principal home) cannot be disconnected for non-payment of charges. However, the following provisions do apply in respect of any disconnections:

1. If the water supply to any premises is disconnected for any reason, but we continue to provide sewerage services to those premises, the customer will be charged the appropriate Sewerage Unmeasured Tariff unless it can be demonstrated that the premises will be unoccupied for the period that the premises are disconnected, in which case there is no charge. Revenue is recognised for sewerage services up to the point we are aware the property becomes unoccupied.
2. If it is found subsequently that the premises were occupied for any period when we were advised that the premises would be unoccupied, the appropriate Sewerage Unmeasured Tariff will then apply to that period, appropriate retrospective bills are raised and revenue recognised at that point.
3. In the event that we suspect that a property is occupied but we have no record of the occupier, we take steps to establish the identity of the occupier in order that billing can commence and revenue be recognised. Occupier is defined to include any person who owns premises as set out in the 'Occupied properties policy' above and also any person who has agreed with us to pay water supply and/or sewerage charges in respect of any premises (e.g. a Bulk Meter Agreement).

(f) Provision for bad debt

The Company's bad and doubtful debts provision policy has remained unchanged and has been consistently applied in the current and prior years. There has been no significant movement in the bad debt provision from the prior year.

The bad debt provision is charged to operating costs to reflect the Company's assessment of the risk of non-recoverability of debtors. It is calculated by applying expected collection rates to debts outstanding at the end of the accounting period. These collection rates take into account the age of the debt and type of debt.

The bad debt provision also takes into account the recoverability of debts which will ultimately be cancelled and may or may not be rebilled, and of debts which have not yet been billed, but are part of the metered sales accrual.

Bad debt provisioning rates are updated annually to reflect the latest collection performance data from the Company's billing system. All debt greater than 4 years old is fully provided for. Higher provisioning percentages are applied to older categories of debt. The actual amounts recovered may differ from the estimated levels of recovery which could impact operating results. Future expected performance is also used to validate our provisions to ensure that use of historic performance will not result in a material misstatement.

We also provide for debts from Water Only Companies ("WOCs") who bill and collect for our sewage service on our behalf. Since detailed information about the debt is unavailable to us, we provide for the debt based on the historical write offs. This provisioning methodology has remained unchanged since last year.

The Company only raises bills in the name of the "occupier" when it has evidence that a property is occupied but cannot confirm the name of the occupier. When the Company identifies the occupants the bill is cancelled and rebilled in the customer's name. If the Company has not identified an unmeasured occupant within 6 months the bill is cancelled and the property is classified as empty. As such the level of occupied billing is very small at any given point. As the bad debt provision is based on overall information from the Company's billing system rather than specific debts, we do not specifically provide for debt such as "billed in the name of the Occupier" however small.

(g) Bad & doubtful debt write-off policy

The Company's bad debt write-off policy has remained unchanged and has been consistently applied in the current year compared with the previous year.

There has been a decrease in the level of write off from £76.9m for the year ended 31 March 2013 to £73.5m for the year ended 31 March 2014. Debt is only written off after all available economic options for collecting the debt have been exhausted and the debt has been deemed to be uncollectable. This may be because the debt is considered to be impossible, impractical, inefficient or uneconomic to collect. Situations where this may arise and where debt may be written off are as follows.

- where the customer has absconded without paying and strategies to trace their whereabouts and collect outstanding monies have been fully exhausted;
- where the customer has died without leaving an estate or has left an insufficient estate on which to levy execution;

- where the value of the debt makes it uneconomic to pursue – all debts of less than £5 are written off;
- where the age of the debt exceeds the statute of limitations – all debts of greater than 6 years old are written off;
- where county court proceedings and attempts to recover the debt by debt collection agencies (multiple in some cases) have proved unsuccessful including where the customer does not have any assets/has insufficient assets on which to levy execution; and
- where the customer has been declared bankrupt, is in liquidation or is subject to insolvency proceedings or a debt relief order and no dividend has been or is likely to be received;

For debt to be written off there must be a legitimate charge against the debtor. If it is considered that part or all of the debt is incorrect or unsubstantiated, then such elements are dealt with by cancelling the original bill and rebilling the customer.

Reconciliation of tangible fixed assets shown in the statutory financial statements and their regulatory financial equivalents

	Other assets £m	Infra-structure assets £m	Total £m
Cost			
At 31 March 2014 as per statutory accounts (FRS 15)	10,633.4	5,357.0	15,990.4
Infrastructure renewals expenditure capitalised in previous years	-	(1,408.6)	(1,408.6)
Infrastructure renewals expenditure capitalised in the year	-	(160.0)	(160.0)
Disposals in prior years	-	0.9	0.9
Cost at 31 March 2014 per regulatory accounts (RAG 3)	10,633.4	3,789.3	14,422.7
Capital contributions			
Contributions at 31 March 2014 as per statutory accounts (FRS 15)	-	735.9	735.9
Contributions at 31 March 2014 as per regulatory accounts (RAG 3)	-	735.9	735.9
Depreciation			
At 31 March 2014 as per statutory accounts (FRS 15)	3,836.4	1,503.2	5,339.6
Infrastructure renewals charge in previous years	-	(1,338.8)	(1,338.8)
Infrastructure renewals charge in the year	-	(165.3)	(165.3)
Disposals in prior years	-	0.9	0.9
Depreciation at 31 March 2014 per regulatory accounts (RAG 3)	3,836.4	-	3,836.4
Net book value			
At 31 March 2014 as per statutory accounts (FRS 15)	6,797.0	3,117.9	9,914.9
Adjustment for infrastructure renewals accounting (see below)	-	(64.5)	(64.5)
At 31 March 2014 per regulatory accounts (RAG 3)	6,797.0	3053.4	9,850.4

Adjustment for infrastructure renewals accounting

	Total £m
Net infrastructure renewals reclassification:	
Infrastructure renewals prepayment at 31 March 2013	69.8
Infrastructure renewals expenditure capitalised in the year	160.0
Infrastructure renewals charge in the year – see analysis below	(165.3)
Infrastructure renewals prepayment at 31 March 2014	64.5
Infrastructure renewals charge in the year:	
Shown within Infrastructure renewals charge in the historical profit and loss account	(163.1)
Shown within operating costs in the historical profit and loss account (i)	(2.2)
Total infrastructure renewals charge in the year	(165.3)

(i) Management have reclassified £2.2m of infrastructure renewals charge to operating cost in respect of customer side leakage pipe replacement. This reclassification is necessary to ensure compliance with RAG 4.04, whereby all customer side leakage should be treated as operating costs within the regulatory accounts. This reclassification has no impact on operating profit.

Current cost profit and loss account for the appointed business

For the year ended 31 March

	Note	Water £m	2014 Sewerage £m	Total £m	Water £m	Restated * 2013 Sewerage £m	Total £m
Turnover							
Unmeasured - household		497.6	508.1	1,005.7	480.1	477.8	957.9
- non-household		7.4	7.5	14.9	7.2	6.5	13.7
Measured - household		208.6	271.9	480.5	183.0	231.1	414.1
- non-household		174.5	137.2	311.7	156.6	127.4	284.0
Trade effluent		-	8.4	8.4	-	6.8	6.8
Bulk supplies / inter company payments		3.6	-	3.6	3.0	-	3.0
Other third party services (incl non- potable water)		3.1	1.3	4.4	2.2	1.0	3.2
Other sources		40.4	42.9	83.3	39.2	37.0	76.2
Total turnover	2	935.2	977.3	1,912.5	871.3	887.6	1,758.9
Current cost operating costs - retail	3	(99.5)	(76.0)	(175.5)	(85.5)	(110.5)	(196.0)
Current cost operating costs - wholesale	3	(607.0)	(622.4)	(1,229.4)	(549.3)	(589.4)	(1,138.7)
Total current cost operating cost		(706.5)	(698.4)	(1,404.9)	(634.8)	(699.9)	(1,334.7)
Operating income		11.9	11.7	23.6	4.7	4.8	9.5
Working capital adjustment		4.0	3.9	7.9	5.2	5.3	10.5
Current cost operating profit		244.6	294.5	539.1	246.4	197.8	444.2
Other income		1.1	1.2	2.3	1.2	1.4	2.6
Net interest				(417.7)			(415.0)
Financing adjustment				60.2			50.8
Current cost profit before taxation				183.9			82.6
Net revenue movement out of tariff basket		0.5	0.2	0.7	0.6	-	0.6
Back billing amount identified				3.5			5.6

* Refer to the additional information required by the licence on page 164 for an explanation of amounts restated.

Current cost cash flow statement – Appointed business only

For the year ended 31 March

	2014 £m	Restated * 2013 £m
Current cost operating profit	539.1	444.2
Working capital adjustment	(7.9)	(10.5)
Movement in working capital	18.6	50.1
Receipts from other income	2.3	2.6
Current cost depreciation net of deferred grants	459.2	429.0
Current cost profit on sale of fixed assets	(23.6)	(9.5)
Infrastructure renewals charge	163.1	135.3
Difference between pension charge and cash contribution	(22.5)	(24.8)
Other non-cash items (Including movement in provisions)	9.7	9.8
Net cash inflow from operating activities	1,138.0	1,026.2
Returns on investments and servicing of finance	(250.4)	(260.9)
Taxation (paid)/received	3.3	4.0
Capital expenditure and financial investment		
Gross cost of purchased fixed assets	(998.9)	(903.4)
Receipt of grants and contributions	49.7	51.4
Infrastructure renewals expenditure	(167.6)	(172.2)
Disposal of fixed assets	16.0	12.8
Net cash outflow from investing activities	(1,100.8)	(1,011.4)
Equity dividends paid	(194.3)	(218.4)
Net cash inflow from management of liquid resources	(108.5)	(129.3)
Net cash outflow before financing	(512.7)	(589.8)
Net cash inflow from financing	586.3	520.1
Increase/(decrease) in cash	73.6	(69.7)

* Refer to the additional information required by the licence on page 164 for an explanation of amounts restated.

Notes to the current cost accounts

1. Current cost accounting policies

These financial statements have been prepared in accordance with guidance issued by Ofwat 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 which assets are valued at their current cost value to the business.

These financial statements have been prepared in accordance with applicable RAG. In respect of cost allocations, the Company has continued to allocate costs by cost centre as in previous years rather than on an activity based method, which is the preferred system under RAG 3.07.

The principal current cost accounting policies used are the same as those adopted in the regulatory historical cost financial statements, except as set out below.

Accounting policies

The same accounting policies, including the Company's capitalisation policy, used for the year ended 31 March 2013 have been applied in these financial statements.

(a) Valuation bases for determining the current cost of fixed assets

(i) Tangible fixed assets

The assets have been valued in accordance with RAG 1.05, on a Modern Equivalent Asset ("MEA") basis. Depreciation is charged over the estimated remaining economic life of the asset. Infrastructure assets are not depreciated.

Additions during the year are taken at their historical cost values. Disposals are stated at the value of the replacement assets.

• Land and buildings

Non-specialised operational properties are valued on the basis of estimated open market value for existing use at 31 March 1991, indexed since that date by the movement in the RPI, except for certain properties which have been valued at 31 March 1995 by professionally qualified employees of the Company.

Specialised operational properties acquired since 31 March 1990 are valued at the lower of depreciated replacement cost and recoverable amount, restated annually, between periodic reviews of replacement costs, by adjusting for inflation as measured by changes in the RPI.

• Infrastructure assets

Mains, sewers, impounding and pumped raw water storage reservoirs, and sludge pipelines are stated at their MEA value, in the manner described above. Due to the nature of these assets, the MEA value is calculated based on the length of sewer or pipe, or the capacity of the asset.

Following the repeal of Section 24 of the Public Health Act 1936 by the Water Act 1989, the Company assumed responsibility for the maintenance and operation of a significant length of additional sewers. The Company has

estimated the length of these pipes in order to include their asset values in these accounts. The value is £6,926m (2013: £6,732m) based upon a pipe length of 19,000km (2013: 19,000km).

- **Specialised/non-specialised assets**

Specialised operational assets include those assets, used routinely in operating the business, which are directly attributable to water supply or sewerage services.

Non-specialised assets are those assets used routinely within the business, which cannot be directly attributed to either part of the business.

- **Surplus land**

Surplus land is valued at recoverable amounts less, where appropriate, that part of any proceeds to be passed on to customers under Condition B of the Licence.

- (ii) **Capital contributions**

All third party capital contributions received since 31 March 1990 are carried forward as deferred income to the extent that any balance has not been credited to revenue, or deducted from net operating assets in the case of infrastructure assets. The balance carried forward is restated in accordance with the change in the RPI for the year.

- (b) **Real finance capital maintenance adjustments**

The following adjustments are made to historical cost profit in order to arrive at profit after the maintenance of financial capital in real terms.

- (i) **Depreciation adjustment** - this is the difference between depreciation based on the current cost value of assets in these financial statements and depreciation charged in arriving at historical cost profit.

- (ii) **Working capital adjustment** - this is calculated by applying the change in the RPI over the year to the working capital of the Company at the beginning of the year.

- (iii) **Disposal of fixed assets adjustment** - this is the difference between the net book values of assets disposed realised assets in the current cost financial statements and their historical cost equivalent values as shown in the historical cost financial statements.

- (iv) **Financing adjustment** - this represents the impact of general inflation on the Company's borrowings excluding index rate linked debt, and is calculated by applying the change in the RPI over the year to the opening balance of borrowings.

- (c) **Operating costs**

In note 2, most direct costs are specific either to water, sewerage or retail services. Where costs cannot be directly attributed to a sub function within these three services, an apportionment has been made on an appropriate basis, using the most accurate allocation method available as outlined in the Company's separately disclosed methodology statement.

2. Analysis of current cost turnover

Reconciliation of actual current cost turnover compared to Final Determination

Appointed turnover for the year ended 31 March 2014 of £1,912.5m is £2.9m less than the final determination target of £1,915.4m. The reasons for this under/over performance against the final determination are set out in the reconciliation below.

	2014 £m	2013 £m
Final determination	1,799.2	1,739.0
Impact of inflation	116.2	107.3
Price rise abated for equity issuance costs not incurred	-	(45.2)
Final determination at 2013/14 prices	1,915.4	1,801.1
<i>Movements:</i>		
Large users and special agreements	(2.6)	(4.4)
Rechargeable works and other income	(4.5)	(6.5)
Main charges income	4.6	(29.6)
Other movements	(0.4)	(1.7)
Total movements	(2.9)	(42.2)
Actual outturn	1,912.5	1,758.9

Inflation represents the difference between actual inflation based on RPI as at 30 November 2013, applicable for the current period, and inflation assumed in the final determination.

3 Operating costs (wholesale business only) for year ended 31 March 2014

Water Services

	Water Resources £m	Raw water distribution £m	Water Treatment £m	Treated Water distribution £m	Total £m
Operating expenditure					
Power	10.3	3.8	31.0	6.7	51.8
Service charges	14.8	-	-	0.8	15.6
Bulk supply imports	0.1	-	-	-	0.1
Other operating expenditure	9.7	6.5	39.4	115.1	170.7
Local authority rates	2.5	3.0	4.6	42.3	52.4
Total operating expenditure excluding third party services	37.4	13.3	75.0	164.9	290.6
Capital maintenance					
Infrastructure renewals charge	5.1	14.7	-	94.3	114.1
Current cost depreciation	15.8	3.4	103.6	78.5	201.3
Amortisation of deferred credits	(0.1)	(0.1)	(0.3)	(1.3)	(1.8)
Total capital maintenance excluding third party services	20.8	18.0	103.3	171.5	313.6
Third party services					
Operating expenditure	0.5	-	1.5	0.8	2.8
Total operating costs	58.7	31.3	179.8	337.2	607.0

3 Operating costs (wholesale business only) for year ended 31 March 2014

Sewerage Services

	Sewerage collection £m	Sewerage treatment £m	Sludge treatment £m	Sludge disposal £m	Total £m
Operating expenditure					
Power	13.5	35.4	9.6	-	58.5
Income treated as negative expenditure	-	-	(5.9)	-	(5.9)
Service charges	-	4.6	0.1	-	4.7
Other operating expenditure	96.2	73.8	34.7	22.0	226.7
Local authority rates	-	25.2	8.8	1.2	35.2
Total operating expenditure excluding third party services	109.7	139.0	47.3	23.2	319.2
Capital maintenance					
Infrastructure renewals charge	49.0	-	-	-	49.0
Current cost depreciation	51.9	158.6	46.0	2.5	259.0
Amortisation of deferred credits	(7.9)	(0.6)	(0.1)	-	(8.6)
Total capital maintenance excluding third party services	93.0	158.0	45.9	2.5	299.4
Third party services					
Operating expenditure	1.0	1.7	0.4	0.7	3.8
Total operating costs	203.7	298.7	93.6	26.4	622.4

3 Operating costs (retail business only)

	Household £m	Non-household £m	Total £m
Operating expenditure - direct costs			
Customer services	43.8	5.8	49.6
Debt management	20.0	2.3	22.3
Doubtful debts	54.1	6.0	60.1
Services to developers	-	0.9	0.9
Meter reading	6.7	2.9	9.6
Other operating expenditure	21.1	1.8	22.9
Local authority rates	0.9	0.1	1.0
Total operating expenditure	146.6	19.8	166.4
Capital maintenance			
Current cost depreciation	8.5	0.6	9.1
Total capital maintenance	8.5	0.6	9.1
Total operating costs	155.1	20.4	175.5
Debt written off	68.2	5.3	73.5

Total Services

	Water £m	Waste £m	Retail £m	Total £m
Operating expenditure	290.6	319.2	166.4	776.2
Third party operating expenditure	2.7	3.8	-	6.5
Total operating expenditure	293.3	323.0	166.4	782.7
Capital maintenance				
- Infrastructure renewals charge	114.1	49.0	-	163.1
- Current cost depreciation net of deferred grants	199.6	250.4	9.1	459.1
Total capital maintenance	313.7	299.4	9.1	622.2
Total operating costs	607.0	622.4	175.5	1,404.9

The above table is not a requirement under RAG 3.07, however the Company has chosen to voluntarily disclose the above total services table.

Current cost analysis of fixed assets

Water Services current cost fixed assets

	Water Resources £m	Raw Water Distribution £m	Water Treatment £m	Treated Water Distribution £m	Total £m
Non-Infrastructure assets					
Gross replacement cost					
At 1 April 2013 (restated)	411.8	61.7	2,899.3	1,992.7	5,365.5
RPI adjustment	10.0	1.5	71.0	48.9	131.4
Disposals	(5.6)	(1.6)	(45.6)	(83.7)	(136.5)
Additions	3.1	5.9	86.2	108.0	203.2
At 31 March 2014	419.3	67.5	3,010.9	2,065.9	5,563.6
Depreciation					
At 1 April 2013 (restated)	236.9	38.7	1,585.3	960.1	2,821.0
RPI adjustment	5.8	1.1	38.8	23.6	69.3
Disposals	(5.6)	(1.6)	(45.6)	(83.6)	(136.4)
Charge for year	15.8	3.4	103.7	78.5	201.4
At 31 March 2014	252.9	41.6	1,682.2	978.6	2,955.3
Net book amount at 31 March 2014	166.4	25.9	1,328.7	1,087.3	2,608.3
Net book amount at 1 April 2013 (restated)	174.9	23.0	1,314.0	1,032.6	2,544.5
Infrastructure assets					
Gross replacement cost					
At 1 April 2013	556.9	1,262.2	0.2	10,918.9	12,738.2
RPI adjustment	13.7	31.0	-	267.9	312.6
Disposals	-	-	-	(28.9)	(28.9)
Additions	3.1	-	-	38.5	41.6
At 31 March 2014	573.7	1,293.2	0.2	11,196.4	13,063.5

Note: The disposal of £28.9m (2013: £43.4m) of infrastructure assets within Treated water distribution, shown above, relates to the MEA value of the length of main abandoned as a result of the Victorian mains replacement programme.

Sewerage Services current cost fixed assets

	Sewage collection £m	Sewage treatment £m	Sludge treatment £m	Sludge disposal £m	Total £m
Non-Infrastructure assets					
Gross replacement cost					
At 1 April 2013	2,318.7	6,003.5	1,079.7	109.5	9,511.4
RPI adjustment	56.8	147.4	26.5	2.6	233.3
Disposals	(26.1)	(96.1)	(24.9)	-	(147.1)
Additions	146.3	178.2	166.6	0.2	491.3
At 31 March 2014	2,495.7	6,233.0	1,247.9	112.3	10,088.9
Depreciation					
At 1 April 2013	1,336.1	3,325.8	476.4	26.3	5,164.6
RPI adjustment	32.7	81.6	11.5	0.8	126.6
Disposals	(26.1)	(96.0)	(24.8)	-	(146.9)
Charge for year	51.9	158.6	46.0	2.5	259.0
At 31 March 2014	1,394.6	3,470.0	509.1	29.6	5,403.3
Net book amount at 31 March 2014	1,101.1	2,763.0	738.8	82.7	4,685.6
Net book amount at 1 April 2013	982.6	2,677.7	603.3	83.2	4,346.8
Infrastructure assets					
Gross replacement cost					
At 1 April 2013	78,592.4	22.8	3.1	-	78,618.3
RPI adjustment	1,928.1	0.6	0.1	-	1,928.8
Additions	258.6	-	-	-	258.6
At 31 March 2014	80,779.1	23.4	3.2	-	80,805.7

Retail current cost fixed assets

	Household £m	Non-household £m	Total £m
Non-Infrastructure assets			
Gross replacement cost			
At 1 April 2013 (restated)	136.4	21.4	157.8
Reclassification adjustment	10.4	(10.4)	-
RPI adjustment	3.5	0.3	3.8
Disposals	(0.2)	-	(0.2)
At 31 March 2014	150.1	11.3	161.4
Depreciation			
At 1 April 2013 (restated)	83.1	12.5	95.6
Reclassification adjustment	5.8	(5.8)	-
RPI adjustment	2.2	0.2	2.4
Disposals	(0.2)	-	(0.2)
Charge for year	8.5	0.6	9.1
At 31 March 2014	99.4	7.5	106.9
Net book amount at 31 March 2014	50.7	3.8	54.5
Net book amount at 31 March 2013 (restated)	53.3	8.9	62.2

Management has reclassified £10.4m gross book value and £5.8m cumulative depreciation of retail assets as at 31 March 2013, from non-household to household. This reclassification reflects a change in methodology of allocating retail assets based on number of customer accounts. Prior to this change in methodology, retail assets were allocated to household and non-household using analysis of metered customers as the appropriate cost driver on the premise that the depreciation associated with domestic meters was main constituent of Retail's depreciation charge. With the transfer of meters from retail to treated water distribution during the prior period, using metered customers as the cost driver is no longer considered to be appropriate.

Analysis of capital expenditure, grants and land sales

	Gross £m	2014 Grants & contributions £m	Net £m	Gross £m	2013 Grants & contributions £m	Net £m
Capital expenditure - water						
Base						
Infrastructure Renewals Expenditure	91.7	9.1	82.6	113.7	14.7	99.0
Maintenance non-infrastructure (MNI)	147.0	2.8	144.2	138.3	2.3	136.0
Enhancements						
Infrastructure enhancements	41.6	11.0	30.6	29.4	19.4	10.0
Non-infrastructure enhancements	56.2	-	56.2	40.0	-	40.0
Total capital expenditure	336.5	22.9	313.6	321.4	36.4	285.0
Grants and contributions – water						
Infrastructure charge receipts - new connections	-	10.4	-	-	9.3	-
Total grants and contributions	-	10.4	-	-	9.3	-
Capital expenditure - sewerage						
Base						
Infrastructure Renewals Expenditure	86.9	9.5	77.4	91.9	18.6	73.3
Maintenance non-infrastructure (MNI)	148.0	3.2	144.8	151.4	3.7	147.7
Enhancements						
Infrastructure enhancements	145.7	-	145.7	86.7	-	86.7
Non-infrastructure enhancements	254.9	-	254.9	280.9	-	280.9
Large projects capex						
Infrastructure enhancements	112.9	-	112.9	76.0	-	76.0
Non-infrastructure enhancements	88.3	-	88.3	33.2	-	33.2
Total capital expenditure	836.7	12.7	824.0	720.1	22.3	697.8
Grants and contributions – sewerage						
Infrastructure charge receipts - new connections	-	12.2	-	-	10.3	-
Total grants and contributions	-	12.2	-	-	10.3	-
Total capital expenditure	1,173.2	58.2	1,115.0	1,041.5	78.3	963.2
Land sales - Proceeds from disposals of protected land	-	5.6	-	-	6.4	-

Analysis of working capital – appointed business only

	2014 £m	2013 £m
Stocks	8.9	8.4
Trade debtors:		
- Measured household	76.0	65.1
- Unmeasured household	94.9	88.4
- Measured non-household	38.1	33.3
- Unmeasured non-household	5.6	1.4
- Other	9.6	11.8
Total trade debtors	224.2	200.0
Measured income accrual	171.4	161.1
Prepayments and other debtors	32.7	36.7
Trade creditors	(315.1)	(287.3)
Deferred income – customer advance receipts	(79.3)	(77.8)
Capital creditors	(146.4)	(160.4)
Accruals and other creditors	(210.1)	(187.9)
Total working capital	(313.7)	(307.2)
Total revenue outstanding		
- household	309.1	298.5
- non-household	78.9	67.5

Accruals and other creditors include capital receipts in advance of £21.6m (2013: £17.8m) and external interest liabilities of £13.5m (2013: £15.3m), which are both excluded from the movement in working capital as disclosed in the current cost cash flow statement on page 174. The inclusion of these 2 items in the above table is consistent with the disclosure of accruals and deferred income, within the creditors: amounts falling due within one year in the statutory accounts.

Year on year movement on trade debtors

	2014 £m
Trade debtor balance as at 31 March 2013	200.0
<i>Movements:</i>	
K and RPI increase compared to 2012/13 K and RPI movement	20.6
Reduction in bad debt provision	6.1
Other movements	(2.5)
Trade debtor balance as at 31 March 2014	224.2

Retrospective review of measured income accrual

Appointed turnover for the year ended 31 March 2013 included a measured income accrual of £125.5m. The value of billing subsequently recognised in the year ended 31 March 2014, for consumption in the prior year was £125.6m. This has resulted an increase in the current year's turnover due to the under-estimation of the prior year's measured income accrual as detailed below.

	2014 £m
Measured income accrual as at 31 March 2013	
Measure income accrual as at 31 March 2013	161.1
Less measured income accrual from Water Only Companies ("WOC's")	(35.6)
Measured income accrual net of WOC's	125.5
Amounts actually billed during the year	
Billing, matched and unwound	119.9
Additional billing, including transfers into measured from unmeasured	5.7
Total actually billed in the year	125.6
Amount of measured income accrual overwind compared to actually billed during the year	(0.1)

Analysis of net debt, gearing and interest costs

	Fixed rate £m	Floating rate £m	Index linked £m	Total £m
Borrowings	(3,947.0)	(734.1)	(5,092.8)	(9,773.9)
Investment				857.2
Cash				6.6
Net debt				(8,910.1)
Regulatory capital value				11,569.5
Gearing				77.0%
Full year equivalent nominal interest cost	(215.2)	(11.6)	(203.1)	(429.9)
Full year equivalent cash interest payment	(215.2)	(11.6)	(76.3)	(303.1)
Indicative interest rates				
Indicative weighted average nominal interest rate	N/A	N/A	4.0%	4.4%
Indicative weighted average cash interest rate	N/A	N/A	1.5%	3.1%
Weighted average years to maturity	17.6	5.3	26.2	21.2

The gearing presented above is calculated based on Ofwat methodology and hence differs to the figure presented on page 36 of the strategic report.

Non-financial information

For the year ended 31 March

	2014		2013	
	Water	Sewerage	Water	Sewerage
Number of properties ('000s)				
Households billed	3,384.3	5,208.4	3,363.9	5,184.1
Non-households billed	213.6	296.9	214.1	297.6
Household voids	67.9	116.7	65.9	113.5
Non-household voids	21.8	32.5	22.9	33.1
Properties served by new appointee in supply area as at 1 April 2009	-	-	-	-
Per capita consumption (excluding supply pipe leakage) l/h/d*				
Unmeasured household	164.6	-	164.1	-
Measured household	136.9	-	131.9	-
Volume (Ml/d)**				
Bulk supply export	85.4	-	95.2	-
Bulk supply input	0.4	1.0	0.4	1.0
Distribution input	2,567.3	-	2,526.1	-

*litres per household per day ("l/h/d")

** Megalitres per day ("Ml/d")

Supply of trade

Introduction

RAG 3.07 requires the Company to disclose transactions with associated companies in accordance with the guidance provided in RAG 5.05. The following disclosures comply with RAG 3.07.

During the period there were no contracts in excess of 0.5% (£9.7m) of the Company's turnover with any subsidiary of the Kemble group of companies.

The Company, however, has chosen to voluntarily disclose all transactions with associated companies of Kemble Water Holdings Limited, and any transactions with companies whereby certain directors of the Company have interests in the companies listed.

Service provided by the Company and recharged to the following associated companies

Service	Company	Turnover of associate in the period (£'000)	Terms of supply *	Value (£'000)
Support services	Thames Water Limited	-	At cost	1,843
Group relief tax received	Thames Water Utilities Holdings Limited	-	At cost	4,824
Support services	Thames Water Property Services Limited	509	At cost	33
Site sales and support services	Kennet Properties Limited	7,540	Third party	2,165
Support services	Thames Water Commercial Services Limited	272	At cost	762
				9,627

Service provided to the Company by the following associated companies

Service	Company	Turnover of associate in the period (£'000)	Terms of supply *	Value (£'000)
Management support	Thames Water Limited	-	At cost	93
Group relief tax paid	Thames Water Limited	-	At cost	5,680
Property management	Thames Water Property Services Limited	509	Third party	516
Rechargeable work	Kennet Properties Limited	7,540	Third party	109
				6,398

Directors' interest

Service	Company	Terms of supply *	Value (£'000)
Advisory fees *	Macquarie Group Limited	Agreed cost	4,558
Subscription fees	Water UK	Agreed cost	845
Rent of parking spaces	National Car Parks	At cost	218
Maps	Cranfield university	Agreed cost	127
Land management	The Crown Estate	Agreed cost	27
Radio License	Office of Communications	Agreed cost	2
Smart metering	Argiva Limited	Agreed cost	16
			5,793

* Advisory fees of £4.6m paid to Macquarie Group Limited during the year. Included within this amount is a payment of £1.2m for the termination of an advisory services contract in relation to the Thames Tideway Tunnel. This has been accounted for as a non-appointed item.

The terms of supply as shown in the above tables are defined as:

- At cost: where the cost incorporates a discount on the external market price;
- Agreed cost: the cost is based on contractual arrangements; and
- Third party: costs based on market testing.

Borrowings

All borrowings from the Company's wholly owned subsidiaries are as follows at 31 March 2014:

Instrument	Borrowed £'000	Total book value * £'000
Thames Water Utilities Cayman Finance Limited ("TWUCFL")		
\$156m 3 month US\$ LIBOR + 0.95% floating rate bond due 2015	93,761	93,761
€500m 3.25% Fixed rate bond due 2016	413,257	413,257
£400m 7.24% Fixed rate bond due 2018	400,000	399,004
\$150m USPP Fixed rate bond due 2019	90,155	88,614
€113m 2.30% CPI index linked bond due 2022	93,396	100,820
\$150m USPP Fixed rate bond due 2022	90,155	90,155
\$200m USPP Fixed rate bond due 2024	120,207	120,207
£550m 5.38% Fixed rate bond due 2025	550,000	547,457
\$250m USPP Fixed rate bond due 2027	150,258	150,258
£300m 5.75% Fixed rate bond due 2030	300,000	297,247
20bn Yen 3.28% Fixed rate bond due 2038	116,900	116,900
£50m 3.85% Index linked bond due 2040	50,000	58,268
£500m 5.5% Fixed rate bond due 2041	500,000	489,547
£50m 1.98% Index linked bond due 2042	50,000	61,025
£55m 2.09% Index linked bond due 2042	55,000	65,048
£40m 1.97% Index linked bond due 2045	40,000	45,071
£100m 1.85% Index linked bond due 2047	100,000	122,050
£200m 1.82% Index linked bond due 2049	200,000	243,593
£200m 1.77% Index linked bond due 2057	200,000	243,578
£350m 1.76% Index linked bond due 2062	350,000	426,249
£300m 4.375% Fixed rate bond due 2034	300,000	295,003
£300m 4.625% fixed rate bond due 2046	300,000	293,014
Total	4,563,089	4,760,126
Thames Water Utilities Finance Limited ("TWUFL")		
£200m 4.90% Fixed rate bond due 2015	200,000	200,000
£200m 5.05% Fixed rate bond due 2020	200,000	200,000
£175m 3.38% Index linked bond due 2021	175,000	250,794
£225m 6.59% Fixed rate bond due 2021	225,000	225,000
£330m 6.75% Fixed rate bond due 2028	330,000	328,077
£200m 6.50% Fixed rate bond due 2032	200,000	198,125
£600m 5.13% Fixed rate bond due 2037	600,000	596,721
£300m 1.68% Index linked bond due 2053	300,000	387,221
£300m 1.68% Index linked bond due 2055	300,000	387,211
Total	2,530,000	2,773,149
Grand total	7,093,089	7,533,275

* Total book value includes interest accretion of index linked bonds and unamortised bond fees.

To the best of the directors' knowledge, all appropriate transactions with associated companies have been disclosed. TWUCFL and TWUFL lend the proceeds of external borrowings on to the Company, net of derivatives of £83.6m. Under these arrangements the Company owes TWUCFL £4,780.2m and TWUFL £2,836.7m.

Directorships held in Associated Companies

The Company discloses the following information as part of its compliance with RAG 5.05, listing those directors of the Company who held directorships in the following Group Companies during the year ended 31 March 2014 and up to the date of signing the Annual report and financial statements 2014:

Kemble Water Holdings Limited, Kemble Water Eurobond Public Limited Company, Kemble Water Liberty Limited, Kemble Water Structure Limited, Kemble Water Finance Limited, Kemble Water Investments Limited, Kemble Water Limited, Thames Water Holdings Limited, Thames Water Limited, Thames Water Utilities Holdings Limited, and Thames Water Utilities Limited.

Director	Appointment	Resignation
Sir Peter Mason KBE – Chairman		
E Beckley		
R Blomfield-Smith		
D Buffery	13/12/2013	
C R Deacon		
Dr P Dyer	31/07/2013	
S R Eaves		
C J Heathcote	21/06/2013	
N Horler	14/04/2014	
G I W Parsons		21/06/2013
D Rees		24/05/2013
K Roseke		24/05/2013
D J Shah		
L Webb		
D Xu		

The following directors have formally appointed alternate directors to represent them when they are unavailable. These alternate directors also held alternate directorships in Thames Water Limited and Thames Water Utilities Holdings Limited:

Director			Alternate Director		
Name	Appointment	Resignation	Name	Appointment	Resignation
E Beckley			G Parsons		
R Blomfield-Smith			P Noble		
D Buffery	13/12/2013		D Rees	22/04/2014	
C Deacon			R Evenden		16/08/2013
Dr P Dyer	31/07/2013		R Greenleaf	31/07/2013	
S Eaves			M Hill		
C Heathcote	21/06/2013		G Parsons	21/06/2013	
G Parsons		21/06/2013	E Beckley		21/06/2013
K Roseke		24/05/2013	D Rees		24/05/2013
D J Shah			C Van Heiningen		01/04/2014
			K Roseke	01/04/2014	
L Webb			C Pham		
D Xu			F Sheng		

Thames Water Utilities Limited conducts its appointed business so as to ensure arm's length trading and avoidance of cross-subsidy in the spirit of Condition F of the Instrument of Appointment.

No directorships are held by Thames Water Utilities Limited directors in circumstances, which might in practice; result in conflicts of interest in intra-group trading relationships.

Dividends paid to associated undertakings

During the period, the Company paid interim dividends totaling £208.5m (2013: £231.4m) to Thames Water Utilities Holdings Limited.

Transfer of assets by or to the appointee

There was no transfer of assets or liabilities by or to the Company in excess of the materiality limit (2013: £nil).

Guarantees or other forms of security by the appointee

The Company as part of the Whole Business Securitisation (WBS) capital structure guarantees unconditionally and irrevocably all the borrowings and derivatives of Thames Water Utilities Finance Limited, and Thames Water Utilities Cayman Finance Limited as listed on page 119.

Omissions of rights

There were no omissions of rights during the period.

Waiver of any considerations, remuneration or other payments by the appointee

There were no waiver of any considerations, remuneration or other payments by the appointee during the period.

Directors' Certificate under Condition F6A of the Company's Appointment

This is to certify that at their meeting on 5 June 2014 the directors of Thames Water Utilities Limited ("the Appointee") resolved as follows:

- that, in the opinion of the directors', the Appointee will have available to it sufficient financial resources and facilities to enable it to carry out, for at least the next 12 months, the Regulated Activities (including the investment programme necessary to fulfil the Appointee's obligations under the Appointment.
- that, in the opinion of the directors, the Appointee will, for at least the next 12 months, have available to it:
 - (a) Management resources.
 - (b) Systems of planning and internal control.

which are sufficient to enable it to carry out those functions as required by sub-paragraph 6A.1(1).

- that, in the opinion of the directors, all contracts entered into with any associated company include all necessary provisions and requirements concerning the standard of service to be supplied to the Appointee, to ensure that it is able to meet all its obligations as a water and a sewerage undertaker.

The main factors the directors have taken into account in compliance with the Directors' Certificate under Condition F6A of the Company's appointment are:

- that the processes and systems of internal control operated as expected.
- that the Company operated as if it were substantially the Appointee's sole business and that the Company were a separate public limited Company.
- that financial resources and facilities are adequate to enable the Appointee to meet its regulatory obligations.
- the strength of the Company's key performance indicators as shown from page 21 of the strategic report.
- the investment grade ratings as shown on page 36 of the Chief Executive Officer's Strategic Review. Whilst, Moody's have placed the Company on negative outlook, reflecting incremental value of Thames Tideway Tunnel delivery risk, its high gearing and expected reduction in cash flow in AMP6, and not the underlying strength of the Company's ability to maintain its interest cover and other covenant ratios.
- borrowing facilities, which include significant, undrawn bank facilities.
- the forecast performance compared to the 2009 regulatory price review for the five year period to 31 March 2015.
- the submission of a PR14 Business Plan in December 2013 that the directors believe is financeable across AMP 6, and Ofwat's review of the plan, which is being evaluated; the Company will be resubmitting

its PR 14 Business Plan in June 2014.

- the preparation of the accounts on a going concern basis as disclosed in the statutory accounts.

A handwritten signature in black ink, consisting of several loops and a long horizontal stroke that curves upwards at the end.

S Siddall
Chief Financial Officer

10 June 2014

Risk and compliance statement 2013/14

Background and explanation

Purpose of this document

Ofwat expects every water company to produce a yearly risk and compliance statement which sets out how they have complied with relevant statutory, licence and regulatory obligations. This is one of Ofwat's key regulatory tools and allows companies to demonstrate their accountability to their customers and demonstrate to Ofwat that they are complying with their obligations.

Introduction

We are responsible for providing our customers with good quality water, sanitation and drainage services.

Since Thames Water Utilities Limited was privatised in 1989, a regulatory framework has been in place to ensure that consumers receive high standards of service at a fair price. We must also comply with national and European legislation.

Our activities are licensed and monitored by a number of different regulatory bodies, including the European Commission, the Department for Environment, Food and Rural Affairs, Ofwat, the Environment Agency, the Drinking Water Inspectorate, the Competition and Markets Authority and the Consumer Council for Water.

This is the third year that we have produced a Risk and Compliance Statement and have done so in response to a requirement from Ofwat, our economic regulator.

We support the use of a Risk and Compliance Statement to demonstrate that Thames Water is accountable to its customers and to demonstrate to Ofwat that the Company is complying with its Obligations (as defined below).

Scope of the Statement

Ofwat expects all water companies to produce a statement setting out how they have complied with their relevant statutory, licence and regulatory obligations for which Ofwat is the relevant enforcement authority ("Obligations").

In assessing compliance with these Obligations, we have reviewed compliance against the following:

- our Instrument of Appointment ("Licence");
- 7 pieces of European legislation;
- 12 key pieces of national legislation for which Ofwat is the relevant enforcement authority¹; and
- an additional 69 pieces of environmental and corporate national legislation

The Statement applies to the period 1 April 2013 to 31 March 2014, unless otherwise stated.

Requirements of the Statement

In its guidance² Ofwat sets out a number of details of the statements and reports which it expects companies to make. For the sake of clarity and completeness, we set these out below:

1. A statement that the Company considers it has a full understanding of and is meeting its Obligations;

2. A statement that the Company has taken steps to understand and meet customer expectations;
3. A statement confirming that the Company has satisfied itself that it has sufficient processes and internal systems of control to fully meet its Obligations, together with an explanation if it considers it is unable to make this statement;
4. A statement that the Company has appropriate systems and processes in place to allow it to identify, manage and review its risks; and
5. A report, by exception, of where delivery of outputs is materially different to our final determination, being applicable only to outputs not covered by the key indicators (for example, requirements to deliver specific schemes).

1 Ofwat states in its website (at <http://www.ofwat.gov.uk/industryoverview/today/legislation/national>) that it considers these to be the key legislation with which water and sewerage companies must comply

2 On 29 March 2012 Ofwat published its document "Risk and Compliance Statement – Guidance". In this document Ofwat sets out its expectations for all companies to produce a statement setting out how they have complied with their relevant statutory, licence and regulatory Obligations.

The Statements

Thames Water fully recognises its accountability to its customers, its regulators and its other stakeholders and is pleased to provide the following statement to demonstrate that it complies with its Obligations and is managing its risk in an appropriate manner.

1. The Company considers it has a full understanding of and is meeting its Obligations

For the reporting year 2013/14, the Company has assessed its compliance with our Obligations. A Company-wide self-certification exercise was led by the Company's Compliance Team, which is part of the Audit and Assurance function. Returned information is reviewed on a sample basis and continuous improvement actions are tracked to completion through a monthly follow-up process. Additionally, the Company has employed the services of external assurance providers to independently audit the information contained in its Annual Return 2014 and confirm compliance with its reporting Obligations to Ofwat.

Based on the results of these exercises, the Company has identified (in addition to the risks raised in relation to delivery of Company outputs, listed below at Statement 5) that, save for the Licence Condition C issue detailed below, the Company has identified that there are no material exceptions to the statement that the Company "considers it has a full understanding of and is meeting its Obligations".

The one exception identified relates to our Obligations under Licence Condition C, in particular, the Company's duty, as soon as reasonably practicable, to inform sewerage undertakers where we connect a property to our water supply. We have identified that we have not always shared information on new connections with our neighbouring water companies, and similarly we have not always received the relevant information on new connections made by other water companies in areas where we provide the sewerage service. This means that some customers have not been charged for their sewerage connection or services. We took immediate steps to rectify this issue and are now working with neighbouring companies to implement a longer term solution.

2. The Company has taken steps to understand and meet customer expectations

For the reporting year 2013/14, the Company has carried out research to understand and meet customer expectations.

The Company continually gathers customer feedback and engages with its customers in order to understand their expectations. During the reporting year 2013-14, the Company has ensured that our communications adhere with Ofwat's information principles. The Company has:

- Used its 2,000-strong customer panel to review topics such as:
 - 2015-2020 business plan; and
 - long term strategy.
- Met regularly with the Customer Challenge Group to help shape its plans for the 2014 Price Review.
- Held consultations and focus groups on its Water Resources Management Plan, and on two current major projects, the Thames Tideway Tunnel and the upgrade to Deephams Sewage Treatment Works.
- Developed websites www.thameswater.co.uk/deephams and www.thamestidewaytunnel.co.uk to share significant projects with customers and stakeholders, and www.thameswater.co.uk/haveyoursay for the Water Resources Management Plan and Business Plan consultation.
- Engaged with numerous groups on local issues and a customer engagement portal, for internal use, is being finalised to share all engagement and consultation activity
- Held deliberative workshops and focus groups on topics including our:
 - service levels;
 - value propositions;
 - non-household customers satisfaction;
 - developer services;
 - water efficiency campaigns; and
 - responsible sewer usage.
- Undertaken customer satisfaction surveys at key customer touch points such as at the end of a telephone call and following a customer appointment.
- Conducted complaint analysis to identify root cause and trends in order to continue to improve our service (full case management).

More broadly, the Company's current business plan is based on extensive customer research undertaken as part of the 2014 Price Review.

From listening to our customers and the feedback that they have given us, we have been able to shape our programme of improvements. We have put in place a customer satisfaction ("CSAT") improvement plan comprising a programme of fifty initiatives covering our billing and operational activities in areas where our customers have told us that we need to improve.

Specific examples of where we have utilised customer feedback to improve our performance are:

- employed more staff to speak to customers when they call us;
- improved skill levels, so that staff answering calls are more able to resolve issues without needing to pass the caller to a colleague;
- improved call transfer procedures, so that customers do not need to repeat themselves to a second member of staff;
- introduced dedicated case managers to resolve an issue if a customer has to telephone us a second time;
- created two new calling cards, to keep customers better informed about work we are carrying out in roads across our region; and

- introduced text message updates for some of the main issues about which customers regularly contact us. These have been a success, and we plan to use them more widely.

We know we have some way to go, but feel confident that the steps we have already taken, together with further changes planned, will deliver a sustained improvement in customer satisfaction. To help us gauge the success of initiatives, we will continue to refine and use our internal customer satisfaction monitor. This provides us with daily feedback from our customers on our level of service.

We report on our customer service performance during 2013/14 in our Annual Performance Report.

3. The Company has satisfied itself that it has sufficient processes and internal systems of control to fully meet its Obligations

The Company has processes and internal systems of control in place to support meeting its Obligations. These controls are monitored through the Company's self-certification and risk management processes. The Internal Audit function provides a risk based programme of audits, which review the design, and operating effectiveness of internal controls in place to meet the Obligations.

Any control weaknesses identified during an audit are flagged to management and an action plan to mitigate the associated risks is agreed. The status of all Internal Audit actions is tracked monthly and reported to the Executive and Board. Evidence is required to confirm the agreed control improvements have been implemented before any audit action is closed and removed from the tracker.

4. The Company has appropriate systems and processes in place to allow it to identify, manage and review its risks

The Company is able to demonstrate appropriate systems to identify, manage and review its risks.

We include within this Statement any risks to delivering the Company's strategic objectives (as defined in our Statutory Annual Report and Financial Statements), regulatory and statutory Obligations, performance targets and specified outputs.

When identifying and assessing risks, the Company is mindful of the key outputs for customers that were required by Ofwat's Final Determination of November 2009, namely:

- ensuring there is no deterioration in service to customers, or in the level of compliance with all environmental consents and licences;
- maintaining all our asset systems so that we can sustain stable serviceability throughout the period and beyond;
- installing a water meter for all those customers that take up the option for a measured service and allowing any customer to revert to an unmeasured service if requested within the time limits set down;
- meeting changes in demand for water service both from new and existing customers, promoting the efficient use of water by our customers and ensuring that leakage is kept at or below the target level;
- meeting all changes in demand for sewerage services both from new and existing customers while complying with all environmental discharge consents;
- delivering the programmes for improving the quality of drinking water and the environment as specified; and
- delivering the programme of other service improvements.

No risk management process can prevent all risks from materialising. The Company has well established processes that identify, manage and review risks including:

- monthly performance reporting, that includes regulatory measures, compiled by a central team independent of operational responsibility;
- regular review by the Company's Regulatory Performance Group, a subset of the Executive Team, which looks both at performance and risk;
- oversight by the Company's Regulatory Committee, a subset of the Board; and
- the corporate risk management process, which considers risks and response plans to all Company issues. The summarised risk register is reviewed by the Board and Executive Team monthly and by the Audit and Risk Review Committee quarterly.

Each year we publish our principal risks and uncertainties within the Annual Report and Financial Statements which set out the material risks the Company is currently facing, together with mitigation steps it is taking. These can be located in the strategic report section of this report on pages 45 to 51.

5. Delivery of outputs

For 2013/14, the Company has materially delivered its outputs set by Ofwat in the Final determination of 2009.

As part of its Annual Return submission to Ofwat, the Company has provided:

- a completed KPI dashboard as required by Ofwat in which performance against key performance measures in 2013/14 is presented; and
- a comprehensive Outputs Report showing delivery against its 2009 Final Determination outputs for 2013/14.

These reports have been audited by independent assurance providers, who have confirmed the reported performance.

Ofwat's expectation is that companies should report by exception if delivery of outputs is materially different to their final determination. The Company's interpretation of materiality is based upon the Ofwat financial significance test of two per cent of annual turnover, combined with significant impact on its customers or its reputation.

The Company has identified two material exceptions to delivery of the final determination outputs in 2013/14. These are as follows:

Delivery of 'stable' serviceability

Last year our performance assessment for our underground wastewater assets continued to be marginal, meaning we remain outside of the performance targets set by Ofwat. This assessment was driven by high numbers of sewer flooding and pollution incidents. We are continuing to implement our recovery and action plans and forecast our performance to return 'stable' over the next year.

We intend to return around £15 million to customers, through a bill adjustment from April 2015 onwards, to reflect our performance in this area in recent years.

Customer service performance

We made some significant improvement to our performance in 2013/14, but we recognise we still have some way to provide the consistently high level of service that our customers rightly expect.

In 2013/14 we improved our SIM performance to a score of 70.67, a rise of nearly eight points, over 12% compared to 2012/13. This was our best performance yet and shows that over recent years our drive to improve customer service is taking effect.

We have made significant progress in reducing the need for unnecessary customer contacts, improving our performance by over 25% from the previous year. Quarterly surveys by Ofwat saw customer satisfaction rise from 3.88 to 4.03 out of five. Although this was good news, we continued to lag behind the reported performance of other companies.

We believe we can continue to improve upon our performance by consistently fixing urgent problems quickly, keeping our promises and ensuring we inform customers about progress and disruption to services.

With respect to delivery of the Company's five year obligations, we are forecasting that we will achieve our target sewer flooding register size for around £145m less than was allowed for at the last price review. We will therefore be returning this money to customers through a bill adjustment from April 2015 onwards.

Board endorsement

The Board confirms that, insofar as it is aware, having made reasonable enquiries, the information contained in the Risk and Compliance Statement is materially accurate at the date below.

For and on behalf of the Board of Thames Water Utilities Limited



Sir Peter Mason KBE
Chairman



Martin Baggs
Chief Executive Officer



Michael Pavia
Independent Non-Executive Director

10 June 2014

Independent Auditor's Report to the Water Services Regulation Authority and the Directors of Thames Water Utilities Limited

We have audited the Regulatory Accounts of Thames Water Utilities Limited ('the Company') for the year ended 31 March 2014 on pages 154 to 192 which comprise:

- the regulatory historical cost accounting statements, comprising the regulatory historical cost profit and loss account, the regulatory historical cost balance sheet, the regulatory historical cost statement of total recognised gains and losses and the historical cost reconciliation between statutory and regulatory accounts; and
- the regulatory current cost accounting statements for the appointed business, comprising the current cost profit and loss account, 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 Water Services Regulation Authority ('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 for our audit work, for this report or for the opinions we have formed. We will accept such responsibility to the WSRA on condition that the WSRA agrees in writing to the WSRA's Contract by signing the WSRA's Contract.

Respective responsibilities of the directors and auditors

As explained more fully in the Statement of Directors' Responsibilities set out on page 153, 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 and 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 165 and 175, the state of the Company's affairs at 31 March 2014 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 (including the accounting separation methodology).

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') or International Financial Reporting Standards as adopted by the European Union ('IFRSs'). Financial information other than that prepared on the basis of UK GAAP or IFRSs 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 154 to 156 have been drawn up in accordance with Regulatory Accounting Guideline 3.07, in that infrastructure renewals accounting as applied in previous years should continue to be applied and accordingly, that the relevant sections of UK Financial Reporting Standards 12 and 15 be disapplied. The effect of this departure from UK 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 pages 159 to 160.

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 2014 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.



William Meredith
For and on behalf of KPMG LLP
Chartered Accountants
15 Canada Square
London
E14 5GL
10 June 2014

Glossary of regulatory terms

AMP adjustment – The revision in the real value of fixed assets arising periodically from improved information in the five-year Asset Management Plan process.

Appointed Business – The appointed business comprises the regulated activities of the Company which are activities necessary in order for a company to fulfil the function and duties of a water and sewerage undertaker under the Water Industry Act 1991.

Arm's-length trading – Trading in which the Company treats the other party, usually an associate company on the same basis as an external party.

Asset Management Plan (AMP) – A plan agreed with Ofwat on a five-yearly basis for the management of water and wastewater assets. The plan runs for a five-year period. AMP5 covers the investment period April 2010 to March 2015.

Associate company – Condition A of the Licence defines an associate company to be any group or related company. Condition F of the Licence requires all transactions between the Company and its associated companies to be disclosed subject to specified materiality considerations.

Capital Incentive Scheme ("CIS") – Under this mechanism Ofwat sets a baseline capital expenditure plan, which they believe companies should be able to deliver. Companies are rewarded or penalised during AMP 5 for submitting a business plan, which is lower or higher than the baseline respectively. Companies will then be further rewarded or penalised at the start of AMP 6 for underspending or overspending against that business plan.

CIS will apply to capital expenditure only, not to operational expenditure and will not apply to large projects such as the Lee Tunnel.

Final determination – The conclusion of discussions on the scale and content of the asset management plan for the forthcoming five-year AMP period. It is accompanied by a determination of the allowable K factor for the forthcoming AMP.

Financing adjustment – The impact of RPI on the real value of net finance for the business.

K factor – The annual increase, set by Ofwat, in charges that companies in the water industry can make. The amount by which a company can increase (or must decrease) its charges is controlled by the price limit formula $RPI + or - "K" + "U"$. RPI is expressed as the percentage increase in the Retail Price Index in the year to November before the charging year. "K" is a number determined by Ofwat for each company, usually at a price review, for each year to reflect what it needs above or below inflation in order to finance the provision of services to customers and "U" is the amount of "K" not taken up by a company in previous years.

Licence – The Instrument of Appointment dated August 1989 under Section 11 and 14 of the Water Act 1989 (as in effect on 1 August 1989) under which the Secretary of State for the Environment appointed Thames Water Utilities Limited as a water and sewerage undertaker under the Act for the areas described in the Instrument of Appointment, as modified or amended from time to time.

Modern Equivalent Asset (MEA) – The cost of an asset of equivalent productive capability to satisfy the remaining service potential of the asset being valued if the asset would be worth replacing, or the recoverable amount if it would not. The gross MEA value is what it would cost to replace an old asset with a technically up to date new asset with the same service capability allowing for any difference both in the quality of output and in operating costs. The net MEA value is the depreciated value taking into account the remaining service potential of an old asset compared with a new asset, and is stated gross of third-party contributions.

Non-appointed business – The non-appointed business activities of the Company are activities for which the Company as a water and sewerage undertaker is not a monopoly supplier (for example, the sale of laboratory services to an external organisation) or involves the optional use of an asset owned by the Company (for example, the use of underground assets for cable television).

Ofwat – The name used to refer to the Water Services Regulation Authority (WSRA). The WSRA acts as the economic regulator of the water industry.

Periodic Review (PR) – The price determination process undertaken by Ofwat every five years. Each water and sewerage undertaker submits an Asset Management Plan covering the five-year period for which Ofwat will determine prices (the K factor – see above).

Price limit – The name given to the combination of the RPI and K.

Regulatory Accounting Guidelines (RAG) – The accounting guidelines for regulatory accounts issued, and amended from time to time, by Ofwat.

Regulatory Capital Value (RCV) – The capital base used in setting price limits. The value of the appointed business that earns a return on investment. It represents the initial market value (200-day average), including debt at privatisation, plus subsequent net new capital expenditure including new obligations imposed since 1989. The capital value is calculated using the Ofwat methodology (i.e. after current cost depreciation and infrastructure renewals accrual).

Retail Price Index (RPI) – The RPI is compiled and published monthly by the Office for National Statistics. RPI is an average measure of change in the prices of goods and services bought for the purpose of consumption by the vast majority of households in the United Kingdom.

Service Incentive Mechanism (SIM) – Ofwat's measure of customer satisfaction based on surveys of customers who have contacted the Company and the number of contacts received which express dissatisfaction.

Third-party contributions since 1989/90 – Grants and third-party contributions received in respect of infrastructure assets and any deferred income relating to grants and third-party contributions for non-infrastructure assets.

Working capital – The aggregate of stocks, trade debtors and trade creditors, if material.

Working capital adjustment – The impact of RPI on the real value of working capital to the business.

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