

Registered no 02366661 (England and Wales)

**Thames Water Utilities Limited**  
Annual report and financial statements  
For the year ended 31 March 2013



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# Thames Water Utilities Limited

## OPERATING SUMMARY for 2012/13

- **Customers and environment benefited from ongoing, record investment**
- **Water bills remained second-lowest in the industry**
- **Leakage-reduction target hit for seventh consecutive year**
- **Additional costs incurred due to exceptional weather (drought then flooding)**
- **Bad debt increased as customers continued to be affected by the economic downturn**
- **Improved health and safety performance - 24% fall in reportable injuries**

### Customers

- Customer service improved but still far below desired level – a key area of on-going focus
- Drought water restrictions imposed to conserve supplies between April and June 2012, as a result of the driest two-year period on record
- Increased incidence of flooding of some customers' properties due to what became England's rainiest year on record – resources deployed to limit extent of flooding

### Investment

- Nearly £1bn of essential improvements to networks for third consecutive year
- Construction of £635m four-mile Lee Tunnel sewer progressing
- £140m upgrade of Mogden sewage works completed – 54% increase in treatment capacity
- Submission of development consent order for Thames Tideway Tunnel
- £250m committed investment in thermal hydrolysis technology to increase energy from waste output

### Performance

- Met annual leakage-reduction target for the seventh consecutive year
- Quality of customers' tap water remains among the best in the country
- "Security of supply" of water to customers at top level
- Environmental compliance of 350 sewage works remains close to best level ever
- Greenhouse emissions cut 12.5% on 1990 levels, on track to hit 20% by 2015
- Desalination plant used for the first time to boost water supplies during drought
- Waste network under pressure - additional costs incurred tackling increased sewer flooding, pollutions and blockages
- 100% of sewage sludge put to beneficial use

### Innovation

- UK's largest wastewater recycling plant contributed to the success of Olympic Park
- Deal agreed to run London's main sewage works on green energy
- UK first using food industry technology to "de-water" sewage sludge, substantially saving costs

## FINANCIAL SUMMARY

- Underlying operating profit\* for the year fell 9% to £549.3m (2011/12 £603.9m) due to increased bad debt expense, rising power costs, network maintenance costs and the exceptional weather
- Underlying profit after tax\* for the year fell 31% to £150.0m (2011/12 £216.8m)
- Annual revenue of £1.8bn (2011/12 £1.7bn) rose 6% largely due to RPI
- Customer bad debt charge increased 33% to £93.7m (2011/12 £70.6m)
- The Company paid dividends of £231.4m (2011/12 £279.5m), of which £92.0m (2011/12 £200.0m) was ultimately distributed to shareholders, a reduction of 54%

\*Underlying operating profit and underlying profit after tax exclude the impact of exceptional items 2012/13 £nil (2011/12 £40m (before associated tax charge of £9.6m) pension curtailment gain)

## Thames Water Utilities Limited

### Looking ahead

- Fundamental business review under way to generate cost-savings and service improvements
- Plans being developed to apply to Ofwat to recover significant unfunded costs resulting from transfer of private sewers, bad debt and the Thames Tideway Tunnel
- Alliance formed with contractors to deliver the 2015-2020 investment programme
- Capital efficiencies totalling £90m secured since 2010 will be reinvested in the business

**Martin Baggs, Chief Executive of Thames Water, said:** "Over the past financial year exceptional weather conditions have presented tough challenges for the business. The period began with a drought, following the driest two-year period on record, and ended with widespread flooding after becoming England's rainiest 12 months on record.

"Despite these challenges we have for the third year running carried out a further £1bn of improvements to our networks, while the average household bill in our region is the second-lowest in the country. Our operational performance remains strong.

"We are now focussed on the significant challenges ahead, including continuing to improve customer service and continuing to support and promote the Thames Tideway Tunnel."

*Safe, reliable services for customers - reliable returns for shareholders*

# Thames Water Utilities Limited

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



We have **14 million customers**



**27%** of the UK's population

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



We operate **2,500** pumping stations



We operate

**26**

major **reservoirs**

Each day we treat

**4.2 billion**



litres of sewage

**350**

We operate

**sewage works**

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



We operate



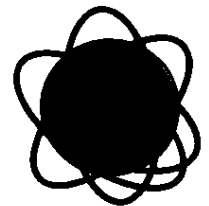
**102** water treatment works

We built the UK's **first 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 20%** of our **power renewably** – from sewage

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

[www.thameswater.co.uk](http://www.thameswater.co.uk)

# Thames Water Utilities Limited

## Chairman's Statement

### Review of 2012/13

This has been a testing year for Thames Water. The exceptional weather aggravated a series of operational challenges and increased costs. The economic downturn caused customer bad debt to rise and standards of customer service, while now recovering, dipped during the year.

The early part of 2012 was marked by a drought, caused by the driest two-year period on record, whereas the end of the year saw widespread flooding resulting from record rainfall. In the intervening period the Company, in its official capacity of Water and Wastewater Services Provider, played a key role in the smooth running of the London Olympic Games.

A further £1bn of improvements to our infrastructure took place, including a major expansion of west London's main sewage works and good progress on the £635m Lee Tunnel sewer. Another notable success was a further improvement in safety performance, with a 24% reduction in reportable injuries. A significant and unavoidable downside to our work to manage the impact of both floods and droughts, however, was an increase in operational costs.

Rising customer bad debt is an ongoing concern for the Board, as is the Company's Service Incentive Mechanism ("SIM") score. The Board is focussed on supporting the Chief Executive and his executive team to deliver a fundamental review of the structure and operation of every part of the business.

The challenges contributed to a fall in underlying operating profit\* to £549.3m (2011/12 £603.9m). This dip in financial performance led to the Board's decision to reduce dividends declared this year to £231.4m (2011/12 £279.5m), and it was duly agreed that there would be no distributions to the shareholders of Kemble Water Holdings Limited, which owns Thames Water, in the second half of the year. External distributions for the whole 12-month period fell 54% to £92.0m (2011/12 £200.0m).

In last year's annual report we increased our public disclosure, and we have taken note of Ofwat's recent calls for increased transparency and clearer explanations of governance structures. The Board remains committed to meeting high standards of governance, and being fully accountable to our customers.

### Regulatory developments

Working together with the wider industry we were able to agree to Ofwat's proposed changes to Thames Water's licence. These changes enable Ofwat to carry out two separate price-setting controls at the industry review of prices in 2014 ("PR14"). One would be for retail (customer services and account handling) and another for wholesale (pipes and treatment works) activities. The Board welcomes these changes and their wider aim of expanding, over time, the competitive market within the water industry for the benefit of customers.

# Thames Water Utilities Limited

## Chairman's Statement (continued)

### Future outlook

I do not expect the coming year to provide any less of a test for the Company. Preparations for PR14 will be a key area of focus. In December 2013, Thames Water will submit its business plan to Ofwat for the five years from 2015. Before this submission the Company will complete a major consultation with its customers to ensure the plan meets their expectations while keeping bills as low as possible.

In addition to planning for the next five-year regulatory period, the Company is defining its water resource plans for the period to 2040, by which time it expects to be supplying 1.4 million more people than today. Customers are also being asked for their views on these plans.

In the near term the Company will continue to work with Government and Ofwat to finalise a funding structure for the nationally important Thames Tideway Tunnel. The proposed structure envisages a separately regulated company will construct and own the Thames Tideway Tunnel, thus minimising the cost to Thames Water customers.

The tunnel is urgently needed to tackle major discharges of sewage into the River Thames for London's overstretched Victorian sewerage network. It is essential if the UK is to meet the requirements of the Urban Wastewater Treatment Directive.

In taking forward these plans we will not lose sight of our essential purpose – 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 KBE**  
Chairman  
6 June 2013

# Thames Water Utilities Limited

## Chief Executive Officer's report

### Our mission

We provide the essential service that is at the heart of daily life, health and enjoyment

### Our vision

If customers had a choice, they would choose Thames Water

### Our customer experience

Customers choose Thames Water because

- They **trust** us
- We are **easy** to do business with
- We really **care**

### Safe, reliable services for customers and reliable returns for shareholders

Our strategy to deliver these expectations is to keep customer bills as low as possible whilst investing efficiently in our assets to ensure our customers' needs are met. We aim to meet or beat our regulatory outputs and financial settlement to provide the returns our shareholders require and expect, whilst maintaining affordable customer bills.

Our shareholders' equity is crucial to the company's ability to carry out its day-to-day activities affordably both now and in future. In the same way we deliver safe, reliable services to our customers, we aspire to provide reliable returns to our shareholders, 70% of whom are pension funds.

### Summary for the year ended 31 March 2013

Exceptional weather presented tough challenges for the business last year. It began with a drought, following the driest two-year period on record, and ended with widespread flooding after becoming England's rainiest year since records began.

We were very disappointed that we had to impose water restrictions in April 2012 on our 9m water customers in London and the Thames Valley, but in the circumstances we had no choice.

Our desalination plant, at Beckton in east London, was used for the first time to boost water supplies during the drought. This helped ensure "security of supply" to customers remained at the top level.

With London hosting the Queen's Diamond Jubilee celebrations and the Olympic Games, keeping water running in the capital was crucial.

Water for irrigation and toilet-flushing supplied by Old Ford, the UK's largest wastewater recycling plant, helped cut the Olympic Park's reliance on tap water by up to 58%.

By the end of the year, following record rainfall, our focus was protecting our customers from sewer flooding as rivers burst their banks and inundated some parts of our network. A fleet of tanker trucks was deployed to relieve overloaded sewers.

Dealing with drought and flooding cost us an additional £17m. This cost was borne by shareholders, who are exposed to these risks so our customers do not have to be. It also meant that our carbon emissions, which had fallen in previous years, increased in 2012/13.

Also adding to our running costs were rising power prices, increased bad debt due to the economic downturn, and having to maintain an additional 40,000km of sewers transferred to our ownership following a law change in October 2011.

Since privatisation in 1989, we have delivered a total of £17bn in upgrades to our ageing infrastructure. As a result, our operational performance remains close to its best ever level. This transformation was facilitated by the regulatory regime following privatisation.



# Thames Water Utilities Limited

## Chief Executive Officer's report (continued)

We outperformed our annual leakage-reduction target, agreed with the regulator Ofwat, for the seventh consecutive year. The quality of water to our customers' taps remained among the best in the industry. The performance of our 350 sewage works remained close to its best-ever level. Our safety performance also improved. Reportable injuries at our sites fell 24% over the period.

We remain committed to improving customer service. While we've seen a significant reduction in complaints last year, we still have a long way to go. We are currently redesigning our processes with the aim of delivering service improvements for our customers.

To achieve further value for customers over the long term, we plan to carry out around 50% of our investment programme for the next five-year regulatory period, 2015 to 2020, using an alliance of our contractors and Thames Water. Last year we started our "early contractor involvement" tender process, marking a radical change for the industry.

Work progressed to plan on the £635m Lee Tunnel to tackle sewage overflows to the River Lee from London's overstretched Victorian sewer network. A £140m upgrade of Mogden, one of five major London sewage works, is also now complete. This work is part of a £5.4bn programme to significantly reduce the number of sewage overflows to the tidal River Thames.

The final part of this programme is the £4.2bn Thames Tideway Tunnel. A development consent order for this scheme was submitted to the Planning Inspectorate in February 2013. Work is set to start on the tunnel in 2016. Thames Water is not expected to finance or build the tunnel, although we will continue to support its promotion and development.

In the first three years of our £1bn-a-year 2010 to 2015 programme of work to improve our water mains, sewers and other facilities we have beaten our budget by £130m. We plan to reinvest £90m of these cost-savings in further operational, safety and customer service-related improvements.

Last year 12.5% - 151 Gigawatt hours ("GWh") - of our 1,200 GWh electricity requirement was self-generated from renewable sources, chiefly sewage sludge. The installation of £250m of thermal hydrolysis "pressure cookers" at six of our main sewage works will increase our energy from waste production to our target of 20% by 2015.

Once again we put 100% of our sewage sludge to beneficial use, sending much of it to farmers as soil conditioner. We installed the first of 19 Bucher presses - a UK first - at one of our sewage works. Until now the presses have been used by cider-makers to squeeze juice from apples. We are using them to "de-water" sludge. This will reduce its volume, saving £2m a year in removal costs by reducing the number of lorries on the roads.

We signed a historic deal that will see Beckton, the UK's largest sewage works, running on green energy generated from bio fuels from April 2015. We will buy around 60% of the electricity produced by a new power station, the largest of its type in the world. We also plan to provide much of the fuel needed to run it, in the form of waste fat harvested from London restaurants. This will provide the further benefit of helping to reduce the amount of sewer-blocking fat entering our network.

Finally our people - many have worked tirelessly to manage the challenges presented by drought, the Olympics and the exceptionally wet weather. I am very grateful for the continued dedication shown by our staff and contractors in these circumstances. I am also pleased that continued focus on health and safety has delivered a 24% reduction in reportable injuries, but as we know, we must strive to ensure that everyone goes home safely every day.



**Martin Baggs**  
Chief Executive Officer

# Thames Water Utilities Limited

## Business review

### Key Performance Indicator summary

The following Key Performance Indicators ("KPI") are considered crucial to measuring the success of our business and are monitored by the Board. They provide a snapshot of performance during 2012/13



\*Ofwat KPIs

Most indicators are "green", but there are four which are "amber"

- sewer flooding because of the number of incidents of property flooding following the wettest year on record,
- wastewater asset performance (below ground) due to the downgrading of our waste water network from stable to marginal,
- pollution incidents due to the number of incidents which exceeded the industry average for 2008 to 2010, and,
- post tax return, which has fallen below the target mainly as a result of the rising levels of bad debt caused by customers not paying their bills due to the economic downturn

In this Business review we discuss the KPIs and the impacts on the operational and financial results of the business

# Thames Water Utilities Limited

## Business review (continued)

### Caring for our customers

We are committed to delivering a good service and aim to put customers at the heart of everything that we do. We have made some big improvements over the year, but customer service remains a top priority and we realise that we have to keep doing better

Providing a good service to our customers is really important to us. We aim to

- do the right thing for our customers
- deliver the basics and get things right first time
- improve our services so that things go wrong less often and customers are pleased with the work that we do
- invest in our people to build a stronger customer service culture

Our commitment to providing a high-quality service is detailed in our Customer Guarantee Scheme, which sets out our standards and the compensation payments we will make if we fail to meet them. The Scheme is available on our website

(<http://www.thameswater.co.uk/tw/common/downloads/literature-customer-guarantee-scheme/customer-guarantee-scheme-detailed-version.pdf>)

#### How did we do?

KPI Service Incentive Mechanism ("SIM") 62.90 points (2011/12 62.61 points)
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SIM is a mechanism used to measure the quality of service provided to customers, with both qualitative and quantitative elements

We are disappointed with our customer service performance. Simply put, we did not do as well as

we wanted to. It was a challenging start to the year and the introduction of a new IT system, together with the ongoing heavy rainfall, put a strain on our resources and the service we were able to provide.

We took steps to put things right, including developing and implementing a 10 point plan to improve customer service. As a result, the second half of the year has seen a significant drop in the number of written complaints we received and our call handling and follow up activities improved for customers.

Written complaints fell by 6% compared to 2011/12. In total, we received and responded to 32,000 written complaints (2011/12 34,000).

Based on quarterly Ofwat-commissioned customer satisfaction surveys, our overall score was 3.9 out of 5. This is a disappointing drop from the 4.1 achieved last year.

Our overall annual SIM performance has seen a small improvement, from 62.61 out of 100 to 62.90. Although under Ofwat's criteria this level of performance is given a "green" status, we recognise that it is simply not good enough.

We have the plans in place to improve and recognise that we need to continue to improve our service to customers with this remaining a key focus of the Board into 2013/14 and beyond.

# Thames Water Utilities Limited

## Business review (continued)

### 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. Our vision is to achieve zero incidents and zero harm, to our staff, contractors and everyone affected by our work, by never compromising on health and safety

KPI Reportable injuries 0.25 injuries per 1,000 employees (2011/12 0.33 injuries per 1,000 employees)
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#### Health, safety and wellbeing

This is our top priority. Our shared vision for our employees, contractors and visitors is zero accidents, zero harm and zero compromise.

Overall the position is good and during 2012/13 our health and safety performance has showed improvement, with a reduction in the number of significant incidents and a 24% decrease in the number of Reporting of Injuries, Diseases and Dangerous Occurrences Regulations ("RIDDOR") reportable injuries. Our KPI is therefore given a green status.

However, there is still more that can be done, for example, our lost time injuries have increased slightly in 2012/13 (from 0.91 to 0.95 injuries per 1,000 employees).

We have taken significant steps to help us improve our performance. These included:

- a 50% increase in health and safety site inspections compared to 2011/12, with 11,389 completed during the year
- delivery of an extensive health and safety training programme with over 6,000 days of training delivered in 2012/13
- working in partnership with our contractors through an established Health and Safety Leadership Team to set a series of essential standards for high risk activities

During 2012/13, we developed a wellbeing and stress policy for our employees.

Training and guidance for managers was developed to help them recognise and manage employees with symptoms of stress related ill-health, and to help employees to recognise and manage their own stress levels.

However, we recognise that there is still some way to go to achieve the vision of zero accidents

and zero harm.

#### Recruiting and retaining

Thames Water is committed to developing new talent. We have been operating a successful Apprenticeship Programme for many years. We currently have 47 apprentices in the business and are investing in another 15 apprentices in 2013/14, including for the first time, higher apprenticeships in our laboratories.

We also have a Graduate Programme which seeks to nurture future people managers and leaders. During 2012/13 we recruited 23 graduates onto this programme.

#### Providing support and opportunities

We realise the success of our business is highly dependent on the quality and performance of our employees. Learning and development is fundamental to ensuring we have capable, confident and skilled people throughout the business. We use our Talking Talent process to identify individuals' potential, retention risks and strengthen our succession planning.

During 2012/13, over 7,000 formal learning and development days were completed. In addition, 6,000 days of Health & Safety training were completed.

#### Employee involvement

The Chief Executive Officer ("CEO") and the Executive team hold quarterly management briefings with managers to provide the opportunity to discuss performance and how the Company can continue to move forward. There were also a series of "Roadshows" during the year when the executive team visited 40 of our sites to brief and engage with the site teams. We have also launched an "adopt a site" programme in which senior managers provide support to a specific operational site.

Internal publications ("Management toolkit" and "The Source") provide ongoing support for the changes and transformation happening across the

# Thames Water Utilities Limited

## Business review (continued)

**Company** This is in addition to the further improvement of the Company's corporate and local communication channels that deliver regular communication, information and updates to employees. Corporate communications include Company-wide Team Talk briefings, a weekly e-brief containing a message from the CEO, the Company's internal portal web pages and specific priority news updates and managers' key information.

Formal consultation with employees is undertaken in partnership with the recognised Trade Unions. Consultation with management level employees typically takes place on an individual basis, except in the case of changes that affect whole areas of the business. In these circumstances, consultation takes place on a Company-wide basis with employee representatives being

elected for the relevant area.

### Engaged and focused

We run an annual employee engagement survey, which gives our people the chance to provide confidentially their honest views on what it is like to work for Thames Water. During 2012/13 we saw a slight dip in the overall engagement survey results. The survey took place against a challenging business backdrop and it is our aim to address areas identified in the coming year.

We have a performance and development review process (PDR) that is core in setting expectations, performance objectives and development with our people every year, focussing employees on what is important in their roles.

## Caring for our community and stakeholders

We aim to contribute positively to the community, to be a good neighbour and to act on the views of our stakeholders.

KPI Corporate responsibility index Platinum (2011/12 Platinum)

### Listening to our stakeholders

Listening to and acting on the views of our stakeholders is really important to us and over the past year we did this in a number of ways:

- we consulted with our customers and other stakeholders on major projects such as the upgrade of Deephams sewage works
- we also consulted on our long-term business strategy
- we held our annual stakeholder event to meet with key interest groups to discuss how we were doing and what we had planned
- we also met regularly with our "Customer Challenge Group", made up of a range of stakeholders, to discuss and be challenged on our longer term plans

The feedback provides extremely useful information, which we are using to develop our plans for the future, including those for submission as part of the 2014 price review.

In October 2012, we contacted over 2 million of our wastewater-only customers to highlight the impact of the Thames Tideway Tunnel on their future bills.

### Being a good neighbour

One area in which we seek to contribute to our communities is our community speaker programme. Our employee volunteers gave over 100 talks to schools and community groups.

In addition we are developing education centres at our Slough, Walthamstow, Maple Lodge and Didcot sites and have completed the new angling academy at our Walthamstow Reservoirs fishery.

# Thames Water Utilities Limited

## Business review (continued)

### 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 meets all health and safety requirements, while making sure that water reaches our customers' taps all day, every day

#### Providing safe and clean drinking water

KPI Drinking water quality 99.97% (2011/12 99.98%)

Our drinking water quality remains among the best in the world. During the year ended 31 December 2012, we carried out more than 400,000 tests to ensure our water met stringent UK and European standards and achieved a compliance score of 99.97%. This is slightly lower than for the year ended 31 December 2011, but remains above the industry average.

The number of drinking water quality related contacts we received from customers remained very low at 0.69 per 1,000 people. This compares favourably to the industry average of 1.91.

#### Providing a reliable supply of water

KPI Supply interruptions 0.22 hours (2011/12 0.21 hours)

Reliability of supply is measured by the number of interruptions to supply which our customers experienced last year. On average, each property was without supply for 0.22 hours (13 minutes). This performance is slightly worse than last year due to teething troubles with a new IT system (which affected the speed at which we responded to such incidents), but continues to be assessed as good in comparison to other companies.

KPI Security of Supply Index 100 (2011/12 100)

Longer term reliability is measured by the security of supply index. This measures the balance between the amount of water available and the demand for water from our network. We have achieved an index of 100, the maximum, for the last three years which means that we should never have to introduce severe water use

restrictions, but may need to apply a (temporary use) hosepipe ban during a really dry year. This happened in April 2012. However, the following months were so wet that we were able to lift the restrictions in June 2012.

To encourage and support customers to use water wisely we have a metering and water efficiency programme.

About 30% of our domestic customers have water meters. Our customers can request a meter free of charge and in 2012/13 we installed 29,083 meters for customers who requested one.

As well as making sure that water is used wisely, we completed work at two water treatment works (Manor Road and Ashdown Park) to increase our available supplies by 4 million litres per day. These projects cost £1m and are required to serve the additional customers expected from population growth in our area.

#### Looking after our assets

KPI Asset performance (above ground) Stable (2011/12 Stable)

KPI Asset performance (below ground) Stable (2011/12 Stable)

The 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 has remained "Stable" this year. This means that we are investing the right amount.

#### Delivering our outputs

In 2012/13, we have successfully met all the key outputs required by our regulators for the water service. We invested £237m in maintaining existing water assets and £69m developing new ones.

# Thames Water Utilities Limited

## Business review (continued)

### A safe and reliable wastewater service

We will provide a safe and reliable wastewater service that is available when our customers require it

This means disposing of our wastewater in a way that meets all health and environmental standards, whilst taking away customers' wastewater without inconvenience every day

#### Transporting wastewater from homes to treatment works safely

KPI Repeat sewer flooding 549 incidents (2011/12 355 incidents)

Most of the time we got this right, however when we get it wrong this is extremely distressing for the customers affected as it can cause gardens and properties to flood

The sewer flooding KPI measures incidents of internal flooding at properties which have also flooded in previous years. This is because companies should take action to prevent repeat flooding. This year there were 549 such repeat incidents, an increase of 194 in comparison to the previous year.

The record rainfall in the year caused large quantities of groundwater and river water to enter our sewers. We deployed tankers around the clock to take away excess water from overloaded sewers to prevent the sewers from overflowing and flooding properties. However, in some areas the network could not cope and sewers overflowed causing flooding. We recognise, however, that regardless of these exceptional circumstances, we have not always provided the best service to our customers.

Preventing sewer flooding is one of our key priorities and we have a range of measures to help us to improve, including work to reduce blockages as well as work to increase the capacity of our sewers in pinch point areas.

#### Managing and treating wastewater reliably

KPI Discharge compliance 99.13%, (2011/12 99.71%)

The Environment Agency sets a quality target for each of our 350 sewage treatment works. During 2012/13, we achieved a compliance level of over 99%, which is a leading position across the industry.

#### Sludge disposal

KPI Sludge disposal 100% (2011/12 100%)

Sewage sludge is the main solid left behind after wastewater has been treated.

The KPI measures the percentage of sewage sludge disposed of satisfactorily. All of our sludge was disposed of safely, therefore this measure shows a green status.

#### Limiting odour from works

We aim to be a good neighbour, minimising the odour occasionally caused by our works. We have completed work to improve odour control at six sites with a further three sites to be completed by 2015.

In addition, as part of the £140m upgrade of Mogden sewage works, which increased capacity by 54%, we have installed odour monitoring equipment further improving existing odour control. During the year, long running group legal proceedings relating to odour from Mogden have also concluded.

#### Looking after our assets

KPI Asset performance (above ground) Stable (2011/12 Stable)

KPI Asset performance (below ground) Marginal (2011/12 Stable)

The rating for our sewers and pumping stations moved from "stable" to "marginal" this year, which is a real concern. This was due to the increase in the number of sewer flooding and pollution incidents from our sewer network. We have plans in place to address this as quickly as possible.

#### Overall delivery of regulatory outputs

In 2012/13, we invested £225m in maintaining existing wastewater assets and £447m developing new ones. We met our targets for delivery of specific projects to maintain and improve our assets. However, as described above, we did not meet our target for a "stable" rating for our sewers and pumping stations.

# Thames Water Utilities Limited

## Business review (continued)

### Limiting our environmental impact

What we do impacts on the environment in many ways. We have a duty to protect the environment, both now and in the future and we take this very seriously

#### Limiting and responding to climate change

Climate change requires us to act today so we are prepared for tomorrow

Understanding and addressing the causes of climate change and adapting to its consequences are key elements of our business planning. Recent exceptional weather cannot be ignored and has a major impact on our business

#### Reducing emissions

KPI Greenhouse gas emissions 770 KtCO<sub>2</sub>e (2011/12)  
741 KtCO<sub>2</sub>e

**By 2015 we aim to have cut our greenhouse (GHG) emissions (CO<sub>2</sub>e – carbon dioxide equivalent) by 20% compared with 1990 levels**

To date we have reduced emissions by 12.5%, despite serving the equivalent of 3 million more customers than in 1990 and having to meet today's higher treatment standards. The reduction is lower than the previous year due to the increased pumping and treatment of wastewater resulting from record rainfall.

We generated 156GWh of renewable energy at our operational sites. We used 151GWh of this electricity ourselves and exported the remaining GWh to the National Grid. In total, 12.5% of our electricity needs were covered by self-generated renewable electricity.

In 2012/13 we increased our renewable energy generation capacity by 1,001.5 kW by

- Installing an additional 990.0kW of photovoltaic solar energy generation capacity across 10 sites
- Installing a small (11.5kW) hydroelectric turbine at Oxford sewage treatment outfall

Since 2007/08 we have reduced our consumption of energy by 5% from 1,348 GWh to 1,282 GWh. Last year, we delivered 20.3 GWh of new energy efficiencies through installing sub meters at sites to identify opportunities to cut energy usage and

through improving pumping station and sewage treatment work performance

Our efforts to reduce carbon emissions are recognised by our accreditation to the Carbon Trust Standard

#### Preventing pollution incidents

KPI Pollution incidents  
All sewerage 68.5 incidents per 10,000 km sewer  
(2011/12 37.8 incidents per 10,000 km sewer)  
Serious sewerage 2.3 incidents per 10,000 km sewer  
(2011/12 2.9 incidents per 10,000 km sewer)

The EA categorises pollution incidents on a scale from one (most serious) to four (no significant environmental impact). It maintains the official database of all reported pollution incidents and confirms numbers for each calendar year.

For the year ended 31 December 2012, the total number of Category 1 and 2 pollutions were 16 (21 in 2011). The number of Category 3 pollutions increased 89% to 461.

The two pollution incident KPIs are flagged as "amber", reflecting the comparison with the 2008-10 water industry average (as required by Ofwat).

One of our most serious incidents was at Beddington sewage works where a fire destroyed the powerhouse and control room, resulting in total loss of treatment capability. This caused significant pollution to the River Wandle. Despite our immediate response, a number of fish were killed. This was very disappointing given all the hard work and investment to improve the river after a more serious pollution incident in 2007.

The overall increase in pollution incidents last year was partly due to record levels of rainfall, with some sewers overflowing and causing pollution as a result. It was also partially due to an improvement in our processes which meant that we were able to identify more incidents and report these to the Environment Agency ("EA"). However, we think that our performance last year also had an impact, for example the sheer volume of rainfall during the year led to a significant increase in the number of incidents, which in turn affected the



# Thames Water Utilities Limited

## Business review (continued)

speed at which we are able to respond to incidents  
We are working hard to improve our performance

As part of this plan we have introduced a 24/7 pollution and tankering desk to speed up response to incidents. We also have a team focused on cleaning and maintenance at blockage hotspots, and we have improved alarm systems to help identify problems with our sewers and pumping stations before they cause a pollution incident.

### Managing leakage

KPI Leakage 646 million litres per day (2011/12 637 million litres per day)
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Leakage remains a key issue for the business, reflecting the priorities of our customers and stakeholders. Although leakage is slightly higher than in 2011/12 due to a colder winter, we have beaten our leakage target for the seventh year in succession. This has been achieved by repairing leaks and replacing 73 km (202 km in 2011/12) of old pipes. Since April 2007 we have replaced 1,886 km of water mains out of around 31,000 km, or 6% of the network at a cost of £797.5m.

To completely replace the water network with modern equivalent assets and effectively minimise leakage would take a number of years and cost in excess of £12bn. In anybody's estimation this is a significant cost to the business, which would impact customers' bills – it is simply not viable.

In order to manage leakage we use a number of tools and initiatives:

- Trunkminder – Monitors our trunk mains to identify underground leaks as soon as they occur. This allows time to repair a leak before it causes the pipe to burst. If a burst does occur, the technology raises the alarm so that the pipe can be fixed more quickly.
- "Smart" Metering – A trial carried out using water meter technologies. This allows for meters to be read remotely on a more regular basis to help identify leaks from water supply pipes and respond quickly.
- JD7 Pipescan+ technology - to get full life use out of existing pipes and to build knowledge of their deterioration rates. This will help to reduce operational and maintenance costs and disruption.

We have reduced leakage from over 790 mld in 2006/7 to 646 mld in 2012/13, however, significant parts of our water network are over 100 years old and it is an ongoing challenge to maintain them to the standard required, both in terms of physically performing the work safely and without causing significant disruption. As part of our AMP 6 plans we are proposing to reduce leakage by a further 53 mld by 2020, through a combination of further mains replacement and efficient management of the network. It is estimated that the investment needed to achieve this reduction is in the region of £300m on top of the current level of investment in the water network.

Managing and reducing leakage remains a priority for the Company and investing to reduce leakage is one of the tools used to ensure that there is enough water available to serve our customers. This is, however, an economic and environmental equation and in order to have affordable bills for customers we must balance up the costs of reducing leakage, the costs and environmental impacts of water abstraction, and the cost and ability to develop new sources of water such as trading with other companies.

### Environmental and wildlife improvements

KPI Condition of SSSI's 99% (2011/12 100%)
--

We are custodians of a number of Sites of Special Scientific Interest ("SSSI"). 99% of these were classified either as "favourable" or "unfavourable recovering" conditions. This Key Performance Indicator is green as we are above the 95% target set by Natural England.

We improved access to the Crossness Southern Marshes and Crossness Nature Reserve, at which a rare bumblebee, the Shril Carder, was spotted. Its presence demonstrates successful habitat management.

### Recycling waste

We continue to lead the way in recycling material excavated from our street works. This was recycled as reinstated road and pavement surfaces once the work was complete.

We recycled an average of 99.5% of all wastes produced from capital projects in 2012/13.

# Thames Water Utilities Limited

## Business review (continued)

### Providing value for money and investment

We aim to give value for customers' money whilst also providing appropriate returns for the investors who provide the capital that we spend on behalf of customers. At a time when household budgets are tight, it is more important than ever that we find cost-effective ways to deliver our services.

#### Financial Key Performance Indicators (KPIs)

Key Performance Indicator	Units	Description	2013	2012	2013 Target	
Average household bill	£ per financial year	The average combined water and wastewater bill for household customers	336	348	376	Industry average
Post tax return*	% financial year	Current cost operating profit less tax as a return on regulatory capital value	4.31	6.34	4.85	Final determination (FD)
Credit rating*	Rating	Indicates the Company's ability to comply with its licence requirement to maintain an investment grade credit rating	Baa1	Baa1		Investment grade credit rating
Gearing*	% financial year	This shows net debt as a percentage of total regulatory capital value at financial year end	77.4	78.8	85%	Covenant trigger
Interest cover*	Ratio of earnings to interest payments	The interest coverage ratio is a measure of the number of times the Company could make the interest payments on its debt with its earnings before interest and taxes. This measures the Company's ability to repay its debt based on available cashflow	1.7	1.4	1.1	Covenant trigger

\*KPIs we are required to report on by Ofwat

#### Financial KPI commentary

The financial KPIs show that despite the operational challenges experienced in 2012/13 and their resultant impact on the Company's financial performance, the overall position remains sound.

Our average household bill, which represents the cost of our services to customers, was £336 for 2012/13, £40 below the industry average.

This average reflected a 6.7% increase from 2011/12 in regulated bills (RPI of 5.2% and real terms increase of 1.5%). The Company chose to forego a further increase of 2.7% in 2012/13 to which it was entitled in the AMP 5 determination. This increment had been allowed to fund costs that the Company no longer expected to incur during AMP 5. It was appropriate to pass this saving on to Customers now rather than waiting for the regulatory process to complete for AMP 6.

For 2013/14 customers will see their bills rise by around 5.5% (RPI of 3% plus real terms increase of 2.5%) to enable the continuing investment in infrastructure to deliver the quality and standard of services our customers and other stakeholders expect.

The post-tax return, which represents a measure

of the return the Company makes on its asset base and hence to its ultimate shareholders, was 4.31%. This represents a significant reduction from 6.34% in 2011/12 and 4.85% return expected in the final determination, hence this has been classified as Amber. The reduction has been driven by the increased bad debt charges, network costs and drought costs. The restructuring and efficiency programme currently being undertaken should impact the post-tax return positively during the remainder of AMP 5 as cost savings are realised.

The Company maintained its strong investment grade credit ratings from S&P and Moody's. The Corporate Family Rating ("CFR") assigned by Moody's remained at Baa1, this rating reflects the aggregate rating of the different classes of outstanding debt obligations issued by the financing subsidiaries of the Company. It is a licence requirement to use all reasonable endeavours to maintain an investment grade CFR. Maintaining this ensures the Company can access the debt funding needed to deliver the investment programme in an efficient and cost effective manner.

The Company's gearing reduced 0.9% to 77.4% and interest cover increased from 1.4 times for 2011/12 to 1.7 times for 2012/13.

# Thames Water Utilities Limited

## Business review (continued)

### Financial results

	Total Company			Regulated business		
	2013	2012	% Change	2013	2012	% Change
Turnover	1,791.9	1,694.9	5.7	1,758.9	1,670.9	5.3
Underlying operating expenditure	(785.1)	(675.4)	16.2	(769.8)	(665.8)	15.6
Depreciation and infrastructure renewals charge	(457.5)	(415.6)	10.1	(456.5)	(414.6)	10.1
Underlying operating profit	549.3	603.9	(9.0)	543.4	594.4	(8.6)
Underlying profit before tax	144.9	182.2	(20.5)	128.4	169.0	(24.0)
Total net capital expenditure	969.2	1,063.8	(8.9)	963.2	1,056.1	(8.8)

Underlying measures exclude the impact of exceptional items 2012/13 £nil (2011/12 £40m pension curtailment gain)

The regulated business shows the financial results of the Company's regulated activities. These are the 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.

#### Turnover

Turnover for the year was £1,791.9m (2011/12 £1,694.9m), 5.7% up from the previous year. This increase reflected a 6.7% increase in regulated bills. This increase was partially offset by lower metered consumption of £9.5m. This reflects our campaign to use water wisely during the drought at the beginning of the year and then lower usage in the second half of the year during the wettest year on record.

#### Operating expenditure

Operating expenditure increased significantly in 2012/13 to £785.1m. On an underlying basis this represents an increase of £109.7m from 2011/12. This reflects operating costs increases in our networks and customer service functions and increased bad debt expense, as well as general inflationary pressures.

In the networks there was a significant increase of activity. In the water network additional resource was mobilised to reduce leakage ahead of the Olympics, as during the games there were restrictions on how we were able to work in London. There has also been significant expenditure on the waste network. This included clearing more blockages than anticipated and the tankering of waste out of the network, to try to minimise sewer

flooding as a result of the second wettest year since records began. The sheer volume of rain, especially later in the year when it was falling on to already saturated ground has overwhelmed the sewer network in a number of locations. The network was simply not designed to cope with this amount of water. We have done what we can to assist customers in these circumstances, but we also recognise the significant distress that sewer flooding causes.

We also invested in customer service, spending an additional £2m employing more people to answer the phone to customers and to deal with customer correspondence and complaints. This additional expenditure is above the level anticipated in the Final Determination by Ofwat and is therefore not being paid for by customers.

The Company's bad debt charge in the year has increased by £23.1m compared to 2011/12 to £93.7m. This charge represents 5.3% of regulated turnover, significantly ahead of that experienced on average during AMP 4 (2.5%).

During the year there was a continued focus on the Company's debtor collections. Reduced collection rates have required us to review our provisions to ensure they reflect the harsh economic environment. This has led to an increased level of provisioning to reflect the current levels of collections following a

# Thames Water Utilities Limited

## Business review (continued)

comprehensive review of the judgments taken by management in this area. The bad debt charge of £93.7m compares to a final determination allowance of £39.8m. The level of bad debt charge is a notifiable item in the final determination and so, if certain trigger levels are met, the Company can apply for an interim determination of K ("IDoK") to recover these additional costs during the current AMP.

Going forward, it is feared that the continuation of the current economic conditions mean that we will continue to see bad debt charges of around £60m per year as customers continue to be affected by the economic downturn.

### Saving money through innovation

Last year we delivered a number of innovative projects.

Some of these innovations are listed below.

In water treatment, we investigated a number of new ways to minimise biological threats and reduce costs. For example, algal blooms restrict the capacity of our water treatment works and increase treatment costs by around £3.6m a year. A new approach to combatting this problem was to install a "living filter" of baffles and plants at the outlet tower of one of our reservoirs in Oxford, to encourage an ecology that eats algae.

We are also trialling an emerging product called BioBullets to reduce the amount of zebra mussels which build up in our raw water tunnels and treatment works, causing significant clearance costs.

We committed to invest £250m in thermal hydrolysis process at six sewage treatment works to increase the production of renewable energy.

We are installing Europe's first phosphorus-recovery system, in Slough sewage works. By recovering phosphorus, the operation of the site is improved and energy needed to pump sludge reduced. The recovered phosphorus is turned into a slow-release fertiliser. By applying this fertiliser to land we can help close the phosphorus loop and reduce the loss of this important natural resource.

We have been trialling a novel sludge dryer unit that turns sewage sludge into sustainable solid fuel with the same energy content as wood chip. Trial batches have been used in our sludge powered generator (SPG) at Crossness sewage works.

### Operating profit

In addition to the increase of £109.7m in operating expenditure, depreciation increased by £41.9m in 2012/13, reflecting the high level of capital investment over the first three years of AMP 5. The increases in operating expenditure and depreciation more than offset the increase in turnover (£97.0m) and so operating profit fell to £549.3m for 2012/13, down 9% on an underlying basis.

### Net interest payable and similar charges

Net interest payable of £405.3m (2011/12 £423.2m) reduced by £17.9m (4.2%). The reduction was driven by the lower level of RPI in 2012/13 (3.1% compared to 4.8% in 2011/12). This meant there was a smaller charge to interest in the year in respect of the Company's index linked instruments compared to 2011/12. This impact has been partly offset by increased interest expense due to the increase in net debt to £8,372.7m at 31 March 2013 (31 March 2012 £7,775.5m). New borrowing was incurred to fund the Company's investment programme, repay debt maturing in the year and maintain a high level of liquidity.

### Taxation

The Company's taxable profits have been substantially reduced by the continuing availability of capital allowances on the investment programme. HMRC's capital allowance regime permits companies to delay the payment of corporation tax, not avoid it, by providing accelerated tax relief for capital investment. The allowances are intended to encourage companies to carry out crucial investment – crucial for business and customers, and also crucial for the economy at large.

We have been investing around £1bn each year in assets which qualify for capital allowances. The mechanism has resulted in a deferred tax liability of £961.2m being recognised on the Company's balance sheet. This balance represents tax that is expected to be paid in future years. The remaining taxable profits of the business have been offset by tax losses claimed from other members of the group.

Although the Company has not paid any corporation tax in the period, it continues to pay business rates, account for income tax and national insurance on employee remuneration, and pay other taxes for which it is liable. These payments were approximately £150m in 2012/13. The Company's expenditure with its suppliers and contractors generates substantial additional tax revenues in the wider economy.

# Thames Water Utilities Limited

## Business review (continued)

The credit for taxation shown in the profit and loss account of £5.1m (2011/12 £25.0m credit) includes a credit of £41.8m (2011/12 £80.7m credit) from a reduction in the carrying value of the deferred tax liability. This resulted from the announcement of the reduction in the rate of corporation tax from 24% to 23% with effect from 1 April 2013 (2011/12 reduction from 26% to 24%). The current tax charge on profits for the year reflects a benefit of £33.9m from the capital allowances available on the investment programme as noted above which is shown as additional deferred tax for the year.

### Net cash flow before financing activities

Net cash outflow before financing activities of £589.8m (2011/12 outflow £641.0m) has decreased by £51.2m compared to the prior year. This reduction in the cash outflow is driven by an increase in cash in flow from operating activities to £1,057m (2011/12 £924.7m) and the reduction in dividends paid (£231.4m (2011/12 £279.5m), partially offset by an increase in current asset investments of £129.3m (2011/12 decrease of £156.4m).

### Balance sheet

Net assets are £166.9m lower than 31 March 2012, reflecting profit for the period of £150.0m, 2012/13 dividend payments of £231.4m and a post-tax actuarial loss in relation to the pension schemes in the period of £85.5m. As a result of continued investment, net debt has increased by £597.2m.

### Capital expenditure

2012/13 has been another successful year for the delivery of the capital investment programme. The third year of AMP 5 has seen around £1bn invested in delivering all of the Company's capital regulatory outputs.

In the year the Company has capitalised £199m on its infrastructure assets (water and waste networks) spending money on essential work to improve the networks by replacing, repairing and modernising the pipes, sewers and associated equipment. The plant and machinery fixed asset balance increased by £457m for works capitalised in relation to the Company's water and sewage treatment works and related facilities. The assets under construction balance also increased by £178m, reflecting the large number of projects that the Company is committed to delivering in AMP 5.

One of the major areas of spend continues to be the London Tideway improvements programme. This project includes the construction of the £635m Lee

Tunnel which is designed to prevent an average of 16m tonnes a year of untreated sewage entering the River Lee from London's Victorian sewerage network. London's five main sewage treatment works (Beckton, Crossness, Long Reach, Mogden and Riverside) are also being upgraded at a cost of £660.0m. The London Tideway improvement programme is designed to reduce discharging of untreated sewage into the tidal River Thames. The upgrades to the Mogden site (£140m) and the first phase at Long Reach (£40m) were completed in 2012/13.

The Company has also spent around £33m in 2012/13 acquiring the sites required for the construction of the Thames Tideway tunnel. These sites will be used during the construction of the Tunnel and then, where practical and not required for ongoing maintenance access, will be sold off to ensure that customers do not pay more than is absolutely necessary for the Tunnel.

The Company is on track to deliver its required investment programme of £4.9bn over this regulatory period. This level of investment in the Company's assets is necessary to ensure that we can continue to provide the water supplies that customers require and treat the sewage in an efficient and effective manner.

### Dividends

The Company paid interim dividends totalling £231.4m during the year (2011/12 £279.5m). Of this, £92.0m was ultimately paid to the shareholders of Kemble Water Holdings Limited (the Company's ultimate parent) with the remainder used to service debt obligations higher up the Group and settle intercompany transactions. The £92.0m received by shareholders compares to £200.0m in the year ended 31 March 2012, reflecting the operational and financial performance of the business during the financial year. Since the Company was acquired by the Kemble consortium in November 2006, the Company has paid £1.4bn in distributions, of which £0.9bn was paid to the Company's ultimate shareholders. This compares to cumulative profits of £1.7bn and RCV at 31 March 2013 of £10.9bn. The Company's dividend policy is detailed in the Directors' report on page 23.

### Pensions

The Company is the sponsoring employer of two pension schemes, Thames Water Pension Scheme ("TWPS") and Thames Water Mirror Image Pension Scheme ("TWMIPS"). Both schemes are closed to new entrants, although existing members continue to accrue benefits. The combined pension liability

# Thames Water Utilities Limited

## Business review (continued)

(net of deferred tax) as at 31 March 2013 was £191.5m (2011/12 £119.2m), a deterioration of £72.3m. This was principally as a result of a post-tax actuarial loss (net of deferred tax) in relation to the pension schemes of £85.5m.

The Company made a deficit repair payment of £25.2m to the pension funds in the year as part of an agreement with the trustees.

### Adoption of new UK Generally Accepted Accounting Practice ("UK GAAP")

The Financial Reporting Council has issued a new set of UK GAAP accounting standards for UK companies (FRS 100, 101 and 102) which are broadly in line with International Financial Reporting Standards. These new standards will be required to be applied by the Company initially for the financial 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 accounts. For example, both options will require the Company to bring on to its balance sheet the market value of its debt related swaps and hedges, which in turn will impact the Company's reserves and increase the volatility of its profit or loss between accounting periods.

In order to strengthen the reserves ahead of conversion, on 3 October 2012 the Company completed the legal process of a capital reduction by solvency statement as laid out in sections 641 to 644 of the Companies Act 2006. The Board of directors, at a meeting on 3 October 2012, approved the reduction of the Company's share capital from £1,029.0m to £29.0m and the capital reduction became effective on 5 October 2012.

This reduction in share capital increases the Company's profit and loss reserve by £1,000.0m. Total shareholder funds remain unchanged at £1,314.5m after conversion. This capital reduction was consistent with the Company's financing arrangement and will not compromise its dividend policy. Furthermore, it neither affected the Company's gearing ratio, nor its credit rating.

### Principal risks and uncertainties

The Company is exposed to a number of risks and uncertainties that could have a material impact on its long-term performance. These include:

**Delivery of the Thames Tideway Tunnel** – 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. These include the need to secure a number of construction sites in central London, obtaining planning consent via the process for major projects set out in the Planning Act 2008 and managing the inevitable disruption caused by construction activities. 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 ratings. The Government has indicated that it will provide support to the IP for certain of the exceptional risks involved in the project, but the details of this support and the residual risk to the Company have yet to be finalised.

**Mitigation.** The Company is working closely with the Government and Ofwat to agree the funding model and the appropriate organisational structure. The preferred route of the stakeholders is to establish an independent IP which will raise funding and deliver and operate the tunnel. This will provide value for money and transparency around risk and reward, and it is expected that the Company will be prevented from investing in the IP but will continue to be involved through, amongst other things, a contractual relationship with the IP and significant activities of its own in respect of the project. A development consent application has been submitted and accepted for examination by the Planning Inspectorate.

**Price Review 14 ("PR14") determination** – 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. Failure to demonstrate the Company's case to Ofwat's satisfaction may mean that it is unable to invest in asset improvements and/or provide services that the Company believes will benefit its customers in the long term or to finance its business plans.

**Mitigation.** The Company is well advanced in developing capital plans and has consulted widely with customers and the Customer Challenge Group. Operating plans are in progress, looking to minimize costs. Our approach builds on the experience gained during previous Price Reviews.

# Thames Water Utilities Limited

## Business review (continued)

**Increased competition in the water industry** – The draft Water Bill published in July 2012 develops Government's competition proposals from the previous Water White Paper. The legislation will change existing retail and upstream markets by allowing a choice of retailer for all business customers. Further liberalisation of upstream water and sewerage markets is enabled by the draft Bill but the full scope and timing of any change remain very uncertain.

**Mitigation:** The Company is responding to increased competition for commercial customers by creating a key accounts team to provide bespoke services suitable for our larger customers. Compliance with competition law and applicable regulation will remain a key focus. The full response to market liberalisation may require structural change.

**Employee pension scheme funding** – 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. Under current assumptions, the deficit is expected to increase and this could cause increased employer contributions.

**Mitigation:** The Company has closed the defined benefit schemes to new joiners, and moved a number of senior employees onto a defined contribution scheme. In addition, for the larger scheme benefits are now being accrued on a career average related earnings basis. Together with the scheme trustees, the Company continues to review mechanisms that can reduce its risk, while maintaining adequate funding of the schemes.

**Failure to maintain adequate funding arrangements** – The Company will need to renew £450.0m of 364 day committed facilities by August 2013. 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 (as defined by the Company's capital structure).

**Mitigation:** The Company has an established funding strategy which is reviewed by the Board annually. As of 31 March 2013, the Company has adequate liquid funds of £681.7m (2011/12: £622.1m) and undrawn committed bank facilities of £1,615.0m (2011/12: £1,200.0m) in place to provide liquidity as required.

**Customer experience** – Ofwat measure companies customer service performance using the Service Incentive Mechanism ("SIM"). The Company is currently at the bottom of the industry's SIM ranking and has seen a decrease in qualitative customer satisfaction in 2012/13. Failure to meet the SIM target for the Company over the remaining years of this regulatory period could lead to a financial penalty in the next regulatory period, although it is not clear how the penalty would be applied.

**Mitigation:** The Company has responded to this ranking position by developing a 10-point plan to improve customer service which was implemented in 2012/13. In addition, significant extra resource has been brought into the customer service team. These changes have contributed to a marked reduction in the number of written complaints in 2012/13. The Company is currently redesigning its processes across all customer facing functions with the aim of delivering significant service improvements for our customers.

**AMP 4 sewer flooding programme** – The Company responded to an information request 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, specifically concerning evidence that properties were likely to have flooded in the past. The principal question will be whether the Company has met its legal obligations by complying with the relevant guidance, and Ofwat has indicated that it is unlikely to conclude its investigations until the end of 2013. If Ofwat concludes the Company has mis-reported its sewer flooding outputs, it may seek to impose sanctions including financial penalties of up to 10% of Company turnover attributable to regulated sewerage services.

**Mitigation:** The Company has provided all the information that has been requested to support the numbers claimed and has met with Ofwat on several occasions to discuss its concerns. The Company awaits the conclusion of Ofwat's investigation and will continue to work with Ofwat and will provide any further information required.

# Thames Water Utilities Limited

## Business review (continued)

**Credit rating** – Any change to the regulatory landscape, including increased competition and any changes to the licence, could have a detrimental effect on the credit rating of the sector. The Company's credit rating may also be affected if the delivery model for the Thames Tideway Tunnel project exposed the Company to increased risk, or in the event of an unfavourable determination in respect of AMP 6. A downgrade in the credit rating would increase borrowing costs and reduce access to long-term debt markets, putting at risk the ability to meet financial covenants and potentially preventing the Company from paying dividends.

**Mitigation** The Company is working to ensure that its Price Review preparations, Thames Tideway Tunnel plans and other significant business changes are credit rating neutral. The Company is working with Government and Ofwat to ensure the financing impact of future changes to licence conditions are fully considered. Licence changes implemented for 2015-20 are viewed by Moody's as likely to be credit rating neutral.

**Failure to meet regulatory targets** – The Company is required to meet targets set by Ofwat, the EA, the Drinking Water Inspectorate and other regulators. In order to achieve this, the Company must continue to deliver cost and efficiency savings in line with a challenging Final Determination, while maintaining and improving operational performance and the standard of customer service. The Company has a regulatory target to maintain the serviceability of its assets as at least stable. During 2012/13 there have been increased incidences of pollution from its waste network, and as a consequence the reported status of the wastewater network (wastewater asset performance below ground) has been downgraded from "stable" to "marginal".

**Mitigation** Performance against regulatory measures is the subject of regular management review. Specifically in relation to the wastewater network, the Company has put increased financial and management resource into managing the network. In addition, the Company continues to develop plans to return the wastewater network to stable serviceability by identifying and then implementing the additional activity necessary to reverse the trend in performance.

**The effects of climate change and long-term changes in weather patterns** – 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

**Mitigation** The Company has been working on measures to reduce demand, 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. Together with other water companies and regulators, the Company is actively participating in work to identify the wider water resources needs across South East England.

**Future changes in laws or regulations** – The Company is not funded by Ofwat for changes in obligations that would affect the whole economy. Consequently the Company may, for example, have to meet the obligations resulting from changes in environmental legislation without adequate funding.

**Mitigation** Changes that are specific to, or are more material for, the water industry may be funded by Ofwat as a relevant change of circumstance. The Company engages actively with regulators where a change is likely, to ensure the implications are understood, and monitors the impact of recent changes to ensure it can demonstrate the case for additional funding where it is justified.

**Failure of a major asset** – 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. The impact would be both financial and reputational.

**Mitigation** The Company has a specific compliance process to manage each of the identified risks.

**Impact of low inflation or deflation** – In return for their capital investment in assets, regulated water companies earn a return on their RCV, which is adjusted by the 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.

**Mitigation** 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.



# Thames Water Utilities Limited

## Business review (continued)

### Impact of recession on our bad debt charge –

Continued economic weakness will make our customers more likely to default on their water bills, leading to increased bad debt expense to the Company

**Mitigation** The Company keeps its debtor collection process under review to ensure that it is fit for purpose. During the year the process has been externally benchmarked and a new stage in the collection process has been added. The Company is planning to submit an Intermediate Determination of K to Ofwat for the increases in bad debt linked to the recession. If agreed this would increase customers' bills in 2014/15

### Financing

Primarily via the Company's financing subsidiary, Thames Water Utilities Cayman Finance Limited ("TWUCFL"), the Company has been a regular issuer of debt in the capital markets since the establishment of the Whole Business Securitisation in 2007. The Company has demonstrated an ability to access a variety of sources of debt funding, including international markets, to ensure it can maintain the necessary liquidity to fund the business going forward.

Details of the treasury policy are set out in the Governance report.

The Company operates within a Whole Business Securitisation (WBS) capital structure alongside Thames Water Utilities Holdings Limited (which is the immediate parent company) and the Company's financing subsidiaries Thames Water Utilities Finance Limited, Thames Water Utilities Cayman Finance Holdings Limited and Thames Water Utilities Cayman Finance Limited. Together these companies are known as the "Securitisation Group". The WBS structure and financial covenants define the key financial metrics the Company must maintain in order to support a strong investment grade credit rating.

Within the WBS there are two "classes" of debt, known as "Class A" and "Class B" debt obligations. Class A is the senior class of debt within the Securitisation Group, rated A3/A- by Moody's and S&P respectively. Within the WBS Class A debt cannot exceed 75% of stated RCV. Class B debt is subordinated to Class A, specifically it ranks behind Class A debt in terms of priority of repayment and it is therefore of lower credit quality. Class B debt is rated Baa3/BBB by Moody's and S&P respectively. Under the WBS Class A and Class B debt combined

cannot exceed 85% of RCV.

During the year TWUCFL issued two £300m Class A fixed rate bonds, maturing in 2034 and 2046 respectively. In addition the Company arranged and drew £300m of bank loans from a relationship bank, consisting of a £100m Class B floating rate loan that matures in 2015 and a £200m Class A RPI-linked loan that matures in 2017. The Company also signed a new £430m loan facility from the European Investment Bank (EIB), £215m of which was drawn in RPI-linked form, maturing in 2023. The Company repaid capital of £74.5m relating to outstanding finance leases and also a €500m bond issued by TWUCFL that matured in the year.

The Company held £681.7m of cash and liquid funds (net of overdraft) at 31 March 2013 (31 March 2012 £622.1m) and also had access to undrawn committed facilities in place with a syndicate of 14 relationship banks to the value of £1,615.0m (31 March 2012 £1,200.0m), including the £215m undrawn element of the new EIB facility signed in the year. These facilities, together with the cash and current asset investments provide the Company with the necessary liquidity to fund the operation of the business for at least the next fifteen months based on the Company's budget for 2013/14 and forecasts for the remainder of AMP 5, forming the basis of the directors' assessment of the Company as a going concern.

# Thames Water Utilities Limited

## Business review (continued)

### Covenant compliance

Under the terms of its finance documents (see Treasury section in Governance), the Company is required to comply with various covenants such as interest cover (post-maintenance interest cover ratio ("PMICR")) and net debt to RCV. These covenants are measured and submitted to the Security Trustee semi-annually and involve both actual data and forecasts. PMICR is the ratio of the cash generated by the business, after maintenance expenditure, to the net external interest paid. The two main ratios are discussed further below.

**Senior adjusted Interest cover ratio (trigger: 1.1x)<sup>1</sup>**. For the year to 31 March 2013 the ratio was 1.7x (2011/12 1.4x). The improvement in the ratio was driven by the increase in cash inflow from operating activities in 2012/13, partially offset by higher capital maintenance expenditure and net interest paid compared to 2011/12.

**Senior Debt/RCV ratio (trigger: 85%)<sup>2</sup>**. At 31 March 2013 the ratio was 77.4% (31 March 2012 78.3%).

There are other variations on these ratios on class A and Senior Debt, which the Company is also required to calculate to show compliance with its covenants. The Company is compliant with these ratios as at 31 March 2013 and is forecast to remain compliant.

### Regulatory Capital Value

The RCV is calculated by Ofwat annually and was £10,897m at 31 March 2013. The RCV is a measure of the Company's value as assessed by the regulator and is used to determine the expected returns to investors in the final determination. Internally we monitor economic RCV, which is expected (in April 2015) to be around £800m lower.

<sup>1</sup> Following the occurrence of a Trigger Event and at any time until such an event has been waived by the Security Trustee or remedied, no Obligor within the securitisation group may make any Restricted Payment. The definition of Restricted Payment includes Distribution, which is also a defined term to include any payments including any payments of distributions, dividends, bonus issues, return of capital, fees, interest, principal or other amounts whatsoever. Adjusted Interest Cover Ratio is calculated as operating cashflow adjusted for expenditure on depreciation and infrastructure renewals divided by interest paid.

<sup>2</sup> Following the occurrence of a Trigger Event and at any time until such an event has been waived by the Security Trustee or remedied, no Obligor within the securitisation group may make any Restricted Payment. The definition of Restricted Payment includes Distribution, which is also a defined term to include any payments including any payments of distributions, dividends, bonus issues, return of capital, fees, interest, principal or other amounts whatsoever.

than the Ofwat calculated RCV as at 31 March 2015 as a result of inflation related adjustments which are expected to be implemented in the Ofwat calculated RCV. Our policy requires the Company to ensure that the forecast net debt is at least 2% below the trigger ratio of 85% from April 2015.



**Martin Baggs**  
Chief Executive Officer  
6 June 2013

# Thames Water Utilities Limited

## Directors' report

The directors present their report and the audited financial statements for the year ended 31 March 2013. These are the Company's statutory accounts as required to be delivered to the Registrar of Companies.

### Principal activities and likely future developments

The principal activities of the Company (Registered number 02366661) are the supply of water and the collection and treatment of sewage, serving approximately 14m customers in London and the Thames Valley.

### Business review

The Business review (which forms part of the Directors' report) comprises an analysis of the development and performance of the business and includes an assessment of future prospects, details of important events that have occurred since 31 March 2013 and Key Performance Indicators ("KPIs"), see pages 6 and 14.

Details of parent and subsidiary undertakings are given in notes 11 and 29 to the Financial statements, on page 78 and 98 respectively, and the Company has no branches outside the United Kingdom.

### Results and dividends

The profit and loss account on page 61 gives the Company's financial results for the year.

The Company paid interim dividends totalling £231.4m during the year (2011/12 £279.5m).

The Company's dividend policy is:

- To pay a progressive dividend commensurate with the long-term returns and business performance, after considering the business's 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.
- post-dividend financial ratios remain within their agreed limits at both the balance sheet date and on a forward-looking basis.

The Board does not recommend a final dividend (2012 £nil).

### 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.

Kemble Water Holdings Limited is owned by a consortium of long term infrastructure investors. The investors include British and international pension funds, sovereign wealth funds, insurance companies and experienced global institutional investors led by funds managed by the Macquarie Infrastructure and Real Assets division of Macquarie Group.

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 or the Company's website [www.thameswater.co.uk](http://www.thameswater.co.uk).

# Thames Water Utilities Limited

## Directors' report (continued)

### Directors

Details of the directors who served from 1 April 2012 to the date of this report are shown below. The composition of the Board is covered in more detail in the Company's Governance report, which can be found on pages 28 to 46.

("NEDs"), with the exception of Martin Baggs (Chief Executive Officer) and Stuart Siddall (Chief Financial Officer). The independent non-executive directors required by the Company's licence are Dame Deirdre Hutton, Michael Pavia and Edward Richards.

All Board members from 1 April 2012 to 31 March 2013 inclusive were non-executive directors.

Directors serving from 1 April 2012 to the date of signing of this report are as follows:

Director	Appointment	Resignation
Sir Peter Mason KBE – Chairman		
M W Baggs		
E Beckley		
R Blomfield-Smith	29 November 2012	
C R Deacon		
S R Eaves		
Dame D M Hutton CBE		
G I W Parsons		
M J Pavia		
D Rees	29 October 2012	2 January 2013
E C Richards		
K Roseke	2 January 2013	24 May 2013
D J Shah OBE		
Y Shi		28 September 2012
S J Siddall		
M S W Stanley		7 September 2012
R Verrion		29 October 2012
L Webb		
D Xu	29 October 2012	

The following directors have formally appointed alternate directors, during the year, to represent them when they are unavailable:

Name	Director		Name	Alternate Director	
	Appointment	Resignation		Appointment	Resignation
E Beckley			G I W Parsons		
R Blomfield-Smith	29 November 2012		P Noble	29 November 2012	
C R Deacon			R Evenden		
S R Eaves			M C Hill		
G I W Parsons			E Beckley		
D Rees	29 October 2012	2 January 2013	S Kolenc	29 October 2012	2 January 2013
K Roseke	2 January 2013	24 May 2013	D Rees	2 January 2013	24 May 2013
D J Shah OBE			K Roseke		2 January 2013
			C Van Heijningen	2 January 2013	
Y Shi		28 September 2012	F Sheng		28 September 2012
R Vernon		29 October 2012	S Kolenc		29 October 2012
L Webb			C Pham		
D Xu	29 October 2012		F Sheng	29 October 2012	

# Thames Water Utilities Limited

## Directors' report (continued)

### Material financial instruments

Financial risk management is covered on page 38 of the Governance report

### Key suppliers and contractors

In 2012/13 the Company spent in excess of £1.4bn on construction, goods and services with a range of suppliers and contractors (2011/12 in excess of £1.1bn). Approximately 19 key suppliers (2011/12 23) were engaged with a spend greater than £10m each. The Company's policy is to establish trading arrangements, which are made following an open non-discriminatory, competitive bidding process. Procurement processes reflect the Company's corporate responsibility commitments and, where applicable, comply with the requirements of the Utilities Contracts Regulations 2006 (as amended).

### Procuring supplies efficiently and sustainably

In 2012/13 we reduced the number of suppliers we used from almost 5,000 to 3,200 to improve our efficiency.

In our capital procurement programme, we continued to work closely with major contracting partners to extend our buying power and influence further down their supply chains.

In preparation for the next five-year investment period from 2015, we consulted more than 40 companies in our extended supply chain. As a result we are focusing on delivering enhanced value for our customers and shareholders through longer term relationships with our suppliers.

### 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. Research and development delivers innovative technical solutions through a research programme aligned with business needs to address challenges for AMP5 and also provide specialist technical support to the business. Expenditure on research and development totalled £3.9m for the year (2011/12 £3.9m).

### 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 Business review on pages 8 to 9.

### Policy and practice on payment of creditors

The Company's policy is to pay all suppliers, contractors and service providers according to pre-agreed terms. During the year under review, the average amount due to trade creditors represented 63 days (2011/12 60 days) purchases received from these creditors.

### Market value of land and buildings

The directors have considered the market value of the Group's land and buildings and are satisfied that their market value is not less than their net book value.

### Political and charitable donations and expenditure

No political donations were made by the Company (2012 £nil). The Company made charitable donations totalling £551,599 (2012 £1,019,340). Details of these charitable donations are:

- £284,360 (2011/12 £743,759) to Ten for Ten projects, of which £30,360 went to various educational and recreational projects and £254,000 to the Thames Water Trust Fund for income deprived families,
- £154,443 (2011/12 £118,680) to the Charities Aid Foundation,
- £19,294 (2011/12 £61,129) to the Company's principal charity, WaterAid,
- £85,000 (2011/12 £60,000) to Thames 21, a range of charities which assist in cleaning rivers and streams within the Thames Valley,
- £8,502 (2011/12 £35,772) of other donations.

In addition, fund raising activities by employees and contractors raised £113,000, to which the Company added matched funding of £62,167 (included in the donations shown above).

# Thames Water Utilities Limited

## Directors' report (continued)

### 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 2012/13 financial statements

The Company's business activities, together with the factors likely to affect its future development, performance and position are set out in the Business review on pages 6 to 22. The financial position of the Company, its cash flows, liquidity position and borrowing facilities are described in the Business review on pages 21 to 22.

Day to day working capital requirements are funded by the business. During the year, £657.1m, net 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 of £681.7m and undrawn committed facilities of £1,615.0m. The undrawn committed facilities consist of the following:

- £215.0m bilateral amortising loan facility that is expected to be utilised in 2013/14
- £200.0m bilateral loan facility that must be drawn down by 30 September 2013 and has a maturity of 2 years from date of draw down
- £1,200.0m facilities with a group of banks made up of a £750.0m revolving credit 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 to renewal in August 2013. The liquidity facilities can only be used if the Securitised Group is in standstill.

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 for at least 15 months.

### 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.

### 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.

### Auditor

Pursuant to Section 487 of the Companies Act 2006, the auditor will be deemed to be reappointed and KPMG Audit Plc will therefore continue in office.

Approved by the Board of directors on 6 June 2013 and signed on its behalf by



Joel Hanson  
Company Secretary

Clearwater Court  
Vastern Road  
Reading  
Berkshire  
RG1 8DB

# Thames Water Utilities Limited

## Statement of directors' responsibilities 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 year. 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.

# Thames Water Utilities Limited

## Governance

### Letter from the Chairman

As Chairman and on behalf of my Board colleagues, I recognise the importance of good corporate governance and, in particular, applying "the UK Corporate Governance Code 2010" (the Code) as far as possible. As with previous years, we have evaluated our performance and reported on our compliance with the Code in this Annual report.

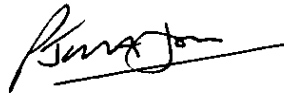
The Board accepts that it is responsible to its shareholders, customers and other stakeholders for the performance of the Company and in promoting its long term success. The way in which we operate as a Board, we believe, already reflects good corporate governance, but we welcome the emerging developments in this area. Our view is that such changes can only enhance the performance of companies for the benefit of all stakeholders and we will positively address any changes as required.

The Board is confident that it acts independently and that it takes decisions objectively in the best interests of the Company. It also believes that it has demonstrated its commitment to ensuring that the Company's obligations to its stakeholders are understood and met, and that the necessary financial and management resources and systems of planning and internal control are in place to fulfil these obligations. Supported by the CEO and the executive team, the Board continues to take positive action towards regenerating the Company's values and standards and establishing a clear strategic direction for the future.

A schedule of matters on which decisions are reserved to the Board and the authority given to the CEO and his Executive team is set out in the schedules of Board reserved matters and delegated authority ("SODA") respectively.

The Board is fully supportive of the strategic aims and initiatives of the CEO and his executive team. Our role is to ensure that we provide strategic oversight, constructive challenge and support to the executive team. As Chairman, I fully embrace my position as leader of the Board and ensuring that, as individuals, we operate collectively in our decision-making to achieve our vision for the company and with the intention of furthering its long term success.

As individuals, and as a Board, my fellow directors and I have many years' experience across a wide range of activities and industries relevant to Thames Water, as can be demonstrated in the biographies section of this report (pages 29 to 31).



**Sir Peter Mason KBE**  
Chairman  
6 June 2013



# Thames Water Utilities Limited

## Governance

### Overview of the Board

The directors have specialist knowledge of the water industry and other regulated utilities and have a wide range of experience to draw upon. Recent appointments have built on existing strengths and add to the diversity of the Board and its discussions. This provides sufficient challenge and support to the strategic decision making process and the necessary continuity to ensure decisions are taken with the background knowledge of the recent history of the group. Non-executive directors (NED) are supported in their ability to seek independent specialist advice.

Dame Deirdre Hutton (Chair, UK Civil Aviation Authority), Michael Pavia (former Chief Financial Officer of the London Electricity Group) and Edward Richards (Chief Executive of Ofcom) are considered independent NEDs.

The Company does not consider the Chairman independent. The Company does not currently appoint a senior independent non-executive director as it considers that the shareholders have

appropriate access to the Chairman, Chief Executive Officer and Chief Financial Officer through their Board representation.

The Board of directors is appointed in accordance with the shareholders' agreement and comprises 2 Executive directors, 10 NEDs (including the Chairman) and 3 independent NEDs (see Directors report for appointment details of individual directors). The NEDs are nominated and appointed by the shareholders of Kemble Water Holdings Limited in accordance with the terms of the shareholders' agreement and are therefore, not determined to be independent.

The Chairman's responsibilities include leadership of the Board, ensuring its effectiveness, setting its agenda and ensuring effective communication with the Company's shareholders. Additionally, he is responsible for ensuring that the directors receive accurate, timely and clear information and that constructive relations exist between the Board and the executive team.

### Board of Directors

#### **Sir Peter Mason KBE, Chairman (66)**

Sir Peter became Chairman of Thames Water 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 is currently the senior non-executive director of BAE Systems plc and of Subsea 7 SA, and until October 2008 was a Board member of the 2012 Olympic Delivery Authority. He is a non-executive member of the Board of Spie SA. Sir Peter was made a Knight Commander of the British Empire (KBE) for services to international trade in 2002.

#### **Martin Baggs, Chief Executive Officer (48)**

Martin was appointed Chief Executive Officer of Thames Water on March 2010, having previously served as Interim Chief Executive Officer from December 2009. Before joining Thames Water Utilities as a non-executive director in 2006, Martin was Managing director at South East Water, managing the divestiture of the company from Macquarie Capital Funds (Europe) Limited. Prior to that, Martin served as Operations and Assets director at Southern Water. Martin has extensive water industry experience covering all aspects of the utility business. He has a recognised successful track record in the delivery and implementation of new initiatives and the

leadership and management of diverse functions through organisational change. His past roles have included asset management, operations and the delivery of large construction programmes.

#### **Stuart Siddall, Chief Financial Officer (60)**

Stuart joined Thames Water 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 (37)**

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

# Thames Water Utilities Limited

## Governance (continued)

### **Rosamund Blomfield-Smith (64)**

Rosamund became a non-executive director of Thames Water Utilities 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 chairman of Moat Homes Limited, a director of the Wales Audit Office and recently retired after ten years on the Board at British Empire Securities, a FTSE 250 investment trust.

### **Christopher Deacon (65)**

Christopher became a non-executive director of Thames Water Utilities 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 member of the Franco British Council.

### **Simon Eaves (45)**

Simon became a non-executive director of Thames Water Utilities 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, have 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.

### **Gordon Parsons (45)**

Gordon became a non-executive director of Thames Water Utilities in June 2010. He is an executive director in the Macquarie Infrastructure and Real Assets division of Macquarie Group Limited and is responsible for the asset management of UK managed assets.

### **Dipesh Shah (60)**

Dipesh became a non-executive director of Thames Water Utilities in October 2007. He is a non-executive director on the Boards of Canaccord Financial Inc., JKX 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 (42)**

Lincoln became a non-executive director of Thames Water Utilities 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 (41)**

Dapeng became a non-executive director of Thames Water Utilities 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 (64)**

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

### **Michael Pavia (66)**

Michael became a non-executive director of Thames Water Utilities in December 2006. 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.

# Thames Water Utilities Limited

## Governance (continued)

### **Edward Richards (47)**

Ed Richards was appointed as an independent non-executive director of Thames Water Utilities 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 e-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 is responsible for the day-to-day running of the business. Our Executive consists of the Chief Executive Officer (CEO) and Chief Financial Officer (CFO) and eight executives.

### **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.

### **Natalie Beckerman, Customer Service Director**

Natalie was appointed as Customer Service Director in August 2011 and is the Executive team member with responsibility for customer service and the end-to-end proposition.

She also looks after our contact centre in Swindon and leads the transformational change required to improve service, processes and experience for our customers.

### **Janet Burr, Human Resources Director**

Janet was appointed Human Resources Director

on 25 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.

### **Piers Clark, Commercial Director**

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

### **Bob Collington, Operations Director**

Bob was appointed as Operations Director on 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.

### **Nick Fincham, Strategy and Regulation Director**

Nick was appointed Strategy and Regulation Director in April 2011, having previously served as Head of Regulation from June 2010.

### **Michael Gerrard, Managing Director for the Thames Tideway Tunnel**

Michael was appointed Managing Director for the Thames Tideway Tunnel project in May 2011.

### **Lawrence Gosden, Asset Director**

Lawrence was appointed Asset Director in May 2013, having previously been Capital Delivery Director since Oct 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.

# Thames Water Utilities Limited

## Governance (continued)

### Compliance Regime

The term "corporate governance" is generally taken to refer to the supervision of the way in which a company is operated and managed. It embraces, *inter alia*, regulation, corporate structure and the function of the Board of directors and its committees.

The Company's directors, shareholders and the shareholders of the ultimate parent company are committed to maintaining high standards of corporate governance. Under the terms of its Licence from Ofwat, the Company is required to have particular regard to the UK Corporate Governance Code (the "Code"), which is something that generally applies only to companies whose shares are listed on the London Stock Exchange. The Code acknowledges that departure from its provisions may be justifiable in

particular circumstances and requires that companies explain those departures.

This corporate governance report also describes how the Board and its committees discharge their duties and how we apply the main principles of the Code. This report together with the remuneration reports on pages 47 to 58, forms part of, and should be read in conjunction with, the directors' report set out on pages 23 to 26.

The Company complies with the code, unless it is inappropriate in which case the Company's position is explained. The table below provides a summary of our compliance with sections of the Code which require a specific response or statement.

# Thames Water Utilities Limited

## Governance (continued)

Code provision	Comply (✓) or Explain (E)	Notes
<p><b>A 1 1</b> The annual report should include a statement of how the board operates, including a high level statement of which types of decisions are to be taken by the board and which are to be delegated to management</p>	<p>✓</p> <p>✓</p> <p>✓</p>	<p>The Board meets regularly and is responsible for setting the strategy of the Company and has responsibility for the internal control systems operated across the Group, allowing assessment and management of the key issues and risks impacting the business</p> <p>The Board has a formal schedule of matters reserved to it, which ensures that it is responsible for approving the Company's overall strategic direction, values and standards, reviews management performance and assesses whether the company has the necessary resources in place to meet its objectives</p> <p>The authority given to the Chief Executive Officer and the executive team is set out in the Schedule of Delegated Authority ("SoDA")</p>
<p><b>A 1 2</b> The annual report should identify the chairman, deputy chairman (where there is one), the chief executive, the senior independent director and the chairmen and members of the board committees. It should also set out the number of meetings of the board and its committees and individual attendance by directors</p>	<p>✓</p> <p>✓</p> <p>E</p>	<p>The names of our Chairman, Chief Executive Officer, members of our Board and committees and chairs thereof are set out on pages 40 to 45</p> <p>The number of meetings of the board and committees and the individual attendance at such meetings by directors is set out on page 36</p> <p>The Company does not appoint a Senior Independent NED since the shareholders have representation on the Board and therefore have appropriate access to the Chairman, Chief Executive Officer and Chief Financial Officer</p>
<p><b>B 1 1</b> The board should identify in the annual report each Non Executive Director it considers to be independent</p>	<p>✓</p> <p>E</p>	<p>Michael Pavia, Edward Richards and Dame Deirdre Hutton are considered Independent NED</p> <p>The remaining 10 NEDs are nominated and appointed by the shareholders of Kemble Water Holdings Limited and are therefore not determined to be independent</p>

## Thames Water Utilities Limited

### Governance (continued)

<p><b>B 2 4</b> A separate section of the annual report should describe the work of the nomination committee, including the process it has used in relation to board appointments</p>	<p>✓</p> <p>E</p>	<p>The activities of the Compensation &amp; Human Resources Committee ("CHR committee") which broadly includes the role of a nominations committee are described on page 46 and also in the Directors' remuneration Report on pages 47 to 58</p> <p>Although the CHR committee is involved in selection of independent NEDs, Board appointments are made by the Company's shareholders and are, therefore, not considered by a separate nomination committee</p>
<p><b>B 6 1</b> The board should state in the annual report how performance evaluation of the board, its committees and its individual directors has been conducted</p>	<p>✓</p> <p>E</p>	<p>For the Board &amp; Committee Evaluation please refer to page 37</p> <p>In light of the Company's ownership structure, the performance of individual directors is not evaluated</p>
<p><b>C.1 1</b> The directors should explain their responsibility for preparing the annual report and accounts, and there should be a statement by the auditor about their reporting responsibilities</p>	<p>✓</p>	<p>A statement of Directors' responsibilities is included in the annual report on page 27</p>
<p><b>C.1.2</b> The directors should include in the annual report an explanation of the basis on which the company generates or preserves value over the longer term (the business model) and the strategy for delivering the objectives of the company</p>	<p>✓</p>	<p>The Company's prime function is to provide a safe, reliable and sustainable water and waste services to its customers and stakeholders. It is regulated by Ofwat and aims to meet or beat its regulatory outputs and financial settlement to provide the returns our shareholders expect and require whilst maintaining affordable customer bills</p>
<p><b>C.1.3</b> The directors should report in the annual and half yearly financial statements that the business is a going concern, with supporting assumptions or qualifications as necessary</p>	<p>✓</p>	<p>A 'Going Concern' statement is made as part of the Directors' Report on page 26</p>

## Thames Water Utilities Limited

### Governance (continued)

<p><b>C 3 3</b> The terms of reference of the audit committee, including its role and the authority delegated to it by the board, should be made available. A separate section of the annual report should describe the work of the audit committee in discharging those responsibilities.</p>	<p>✓</p>	<p>The terms of reference of the ARRC are approved by the Board. Details of the responsibilities and work of the Audit &amp; Risk Review Committee can be found on pages 41 to 43.</p>
<p><b>C 3 7</b> The annual report should explain to shareholders how, if the auditor provides non-audit services, auditor objectivity and independence is safeguarded.</p>	<p>✓</p>	<p>The annual report sets out the Auditor's independence and objectivity on page 42.</p>
<p><b>E 1 2</b> The board should state in the annual report the steps they have taken to ensure that the members of the board, and in particular, the Non Executive Directors, develop an understanding of the views of major shareholders about the company, for example through direct face-to-face contact, analysts' or brokers' briefings and surveys of shareholder opinion.</p>	<p>✓</p>	<p>The NEDs are all nominated and appointed by the shareholders of Kemble Water Holdings Limited (the ultimate parent) and the shareholders, therefore, have representation on the Board. Therefore, the Board considers that it has an appropriate understanding of the Company's shareholders and is able to seek such views as specific issues should this be requested.</p>

# Thames Water Utilities Limited

## Governance (continued)

### The Board of directors

The names of our current directors who served during the year and their biographies are set out on pages 29 to 31. The Board met six times during the year and in addition held three telephone meetings during the year. The table below shows the attendance of each of our directors at Board and standing committee meetings including where

they are not formally Committee members

All directors are entitled to attend Board meetings either in person or by telephone and are also entitled to attend and observe Committee meetings. Certain members of the Company's senior management team will also attend Board and Committee meetings by invitation.

	Board	Audit & Risk Review	Regulatory	Health, Safety & Environment	Compensation & HR	Tideway Tunnel	Customer Service	AMP 6 Capital Works
<b>Total number of meetings held</b>	<b>9</b>	<b>4</b>	<b>7</b>	<b>4</b>	<b>7</b>	<b>10</b>	<b>4</b>	<b>5</b>
Sir Peter Mason	9	-	-	(1)	7	10	-	5
Martin Baggs	9	(4)	(7)	(4)	(7)	(10)	(4)	(5)
Edward Beckley	9	-	2	-	-	5	-	-
Rosamund Blomfield-Smith <sup>(i)</sup>	4	-	-	-	-	(1)	-	-
Christopher Deacon	9	-	(6)	(1)	7	(10)	-	4
Simon Eaves	6	-	(1)	-	-	(3)	-	-
Dame Deirdre Hutton	7	-	-	3	-	-	4	-
Gordon Parsons	8	4	7	3	(7)	6	2	-
Michael Pavia	9	4	(6)	-	7	10	-	-
David Rees <sup>(ii)</sup>	3	-	(1)	-	-	(1)	-	-
Ed Richards	7	(1)	5	-	-	-	4	-
Kevin Roseke <sup>(iii)</sup>	1	-	-	-	-	-	-	-
Dipesh Shah	8	(1)	6	3	-	7	-	-
Yaping Shi <sup>(iv)</sup>	1	-	-	-	-	-	-	-
Stuart Siddall	9	(4)	(5)	-	(3)	(10)	(1)	(2)
Martin Stanley <sup>(v)</sup>	0	-	-	-	0	-	-	-
Rob Verrion <sup>(vi)</sup>	2	2	-	(1)	-	-	2	-
Lincoln Webb	3	-	-	-	-	-	-	-
Dapeng Xu <sup>(vii)</sup>	5	-	-	-	-	-	-	-

### Key

(i) Appointed 29/11/12

(ii) Appointed 29/10/12, resigned 02/01/13

(iii) Appointed 02/01/13, resigned 24/05/13

(iv) Resigned 28/09/12

(v) Resigned 07/09/12

(vi) Resigned 29/10/12

(vii) Appointed 29/10/12

( ) figures in brackets denote additional attendance at Committee meetings



# Thames Water Utilities Limited

## Governance (continued)

### Board and Committee Evaluation

As recommended by the Code, the Board undertakes an annual evaluation of its own performance and that of its committees. Typically, the Company engages the services of an external Board evaluation consultant at least one year out of three. In between the external evaluations, reviews are facilitated by the Company's Secretariat.

A Board effectiveness review was carried out in March 2013. This involved the use of a questionnaire to all directors and covered a range of issues around Board and committee processes, Board roles and responsibilities. Questionnaires are confidential between the individual and the facilitator and responses are analysed and thereafter presented to and discussed by the Board.

The findings of the review were considered by the Board at the 25 April 2013 Board meeting, with several improvements suggested as a result.

### Induction and Training

On joining the Company, directors are offered induction material and are invited to receive a tailored induction programme and the opportunity to meet other directors, the Company Secretary and Executive Team as well as being given the opportunity to visit operational sites.

During 2012/13, guidance was provided to the whole Board on topics such as the proposed new regulations within the water industry. Half Day meetings are arranged in advance of Board meetings to update the Board and other stakeholders on key matters in more depth. Our major regulators are also invited to meet with the Board from time to time.

### Conflicts of Interest

Since October 2008, all directors have been under a statutory duty to avoid any situation in which they have, or can have, a direct or indirect interest which conflicts or possibly may conflict with the interests of the Company. As is permitted, our articles of association contain provisions which permit the unconflicted directors to authorise conflict situations and procedures have been put in place for the disclosure of any conflicts by the directors to the Board and for the consideration and, if appropriate, authorisation of such conflicts. The procedures permit any authorisation to be subject to any terms and/or conditions that the unconflicted directors think fit. All directors are

asked on an annual basis if their other commitments and interests have changed and are given the opportunity at each Board meeting to disclose any new conflicts or interests. In any case, all directors are required to notify the Chairman or Company Secretary if they believe a conflict situation has arisen or might arise.

### Information, support and advice

The Chairman is responsible for ensuring that directors receive accurate, timely and clear information on a regular basis to enable them to perform their duties properly. Supported by the Company Secretariat meeting papers are made available seven days in advance of scheduled Board meetings to enable directors to obtain a thorough understanding of the matters to be discussed and seek clarification if required.

All directors have sufficient resources and access to independent professional advice, at the Company's expense, in order to discharge their responsibilities. Additionally, all directors have access to the advice and services of the Company Secretary, who is responsible to the Board for ensuring that Board procedures are complied with. The appointment and removal of the Company Secretary is a matter reserved for the Board.

In addition to such indemnity protection as may be provided by the Company itself under law, the Company has in place appropriate insurance cover in respect of legal action against its directors.

### Tax Policy

The Company's tax department carries out its activities in accordance with policies approved by the Board of directors. The Company is committed to complying with its obligations to HM Revenue and Customs, and does not engage in any tax planning activities that would be considered as artificial or aggressive tax avoidance.

### Treasury policy

The Board oversees the Company's treasury activities, reviewing policy and approving the Treasury plan and policy on an annual basis.

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 Treasury function does not act as a profit centre and does not undertake any speculative trading activity. The key objectives of the funding strategy

# Thames Water Utilities Limited

## Governance (continued)

are defined by the regulatory regime within which the Company operates and are intended to ensure that it meets all funding related requirements under the terms of its Licence. This includes maintaining cash reserves and access to undrawn committed bank facilities sufficient to fund at least 12 months net cash flow (as discussed on page 23 – the Company's dividend policy extends this to a 15 month period) and to use all reasonable endeavours to maintain an investment grade credit rating (see "Debt financing" section below) as set out in Condition F of the Licence.

A key objective of treasury policy is to ensure compliance with financial covenants, including interest cover and gearing ratios, maintain liquidity and a balanced debt maturity profile, and ensure that at least 85% of the interest cost within the Securitisation Group, (being Thames Water Utilities Holdings Limited, the Company, Thames Water Utilities Finance Limited, Thames Water Utilities Cayman Finance Holdings Limited and Thames Water Utilities Cayman Finance Limited) is based on either fixed or RPI-linked interest rates.

### Financial risk management

The Company's Executive Team ("the Executive"), 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 operation of the treasury function is governed by policies and procedures, which, amongst other things, set out 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.

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

Derivative financial instruments, including cross currency swaps, interest rate swaps and forward currency contracts are employed to manage the interest rate and currency risk arising from the primary financial instruments used to finance the Company's activities. Matching of assets and liabilities in foreign currencies is also applied wherever practicable. The Company actively maintains a broad portfolio of debt, diversified by source and maturity and designed to ensure the Company has sufficient available funds for operations.

The Company is exposed to commodity price risk, especially energy price risk, as a result of its operations. The Company aims to manage its risk by fixing contract prices where appropriate.

### Debt financing

Debt financing is raised by the Company or through the Company's wholly owned subsidiary, Thames Water Utilities Cayman Finance Limited. Previously, debt had been raised through Thames Water Utilities Finance Limited, another wholly owned subsidiary.

Moody's Investor Service ("Moody's") rates Class A debt issued by Thames Water Utilities Cayman Finance Limited, A3 long term with stable outlook and Class B debt at Baa3 with stable outlook. Moody's also issues a Corporate Family Rating for the Securitisation Group of companies, which stands at Baa1, with stable outlook. Standard and Poor's Rating Services ("Standard and Poor's") rates Class A debt as issued by Thames Water Utilities Cayman Finance Limited at A- and Class B debt at BBB. Accordingly, the Company maintains an investment grade issuer credit rating.

### Capital structure

Key features of the Company's capital structure are as follows:

- all debt issued by the Securitisation Group is documented pursuant to a Common Terms Agreement as part of the Whole Business Securitisation entered into in August 2007
- net debt issued by the Securitisation Group Class A ratio of net debt to RCV is limited to 75%
- since 1 April 2010, the Company and the Securitisation Group has the option to issue Subordinated Debt ("Class B"). At the same time, there is an increase in the combined Class A and Class B (together "Senior") net Debt/RCV ratio to a maximum of 85%
- each Obligor (the companies within the Securitisation Group) had entered into the Security Trust and Inter-creditor Deed ("STID") with the Security Trustee pursuant to which Thames Water Utilities Holdings Limited guarantees the obligations of each other Obligor under the finance documents and the Company and its wholly owned subsidiaries guarantee the obligations of each other under the finance documents, in each case to the Security Trustee.

## Thames Water Utilities Limited

### Governance (continued)

- as part of the WBS Thames Water Utilities Holdings Limited has granted share security over its shares in TWUL
- TWUL is subject to certain restrictions in paying dividends as part of its covenant-based ring-fencing. Due to the WBS and creation of the "ring-fenced" group, TWUL is only entitled to pay dividends or make any other payments if certain conditions are satisfied and is restricted on the amount of any such payments
- following an event of default, the documents provide for an automatic 18 month standstill of the claims of the creditors that have entered into the STID

# Thames Water Utilities Limited

## Governance (continued)

### Committees of the Board

The Board has formally delegated specific responsibilities to certain committees. Each committee has written terms of reference (which have been approved by the Board) and the collective function of the Committees is to exercise oversight on behalf of the Board and to provide advice to the Board. All of our Board Committees are provided with sufficient resources to undertake their duties and are supported by our secretariat team. In addition, directors have the authority to seek independent advice if they feel it is appropriate. Each Committee reviews its terms of reference and effectiveness on an annual basis, and makes appropriate recommendations back to the Board. Other Committees are formed as and when required to deal with specific matters. Due to its significance, a Board committee ("Tideway Committee") was created in October 2007 to oversee the Tideway project. Additionally, the Board created the AMP 6 Capital Works

Committee to oversee the development of the Company's procurement plans for the next regulatory period.

The five standing committees of the Board are as follows:

- Audit and Risk Review ("ARRC")
- Regulatory
- Health, Safety and Environment
- Compensation and HR
- Customer Service

### Committees of the Board

- Membership of the Committees in operation during the year ended 31 March 2013 is set out below.

Audit and Risk Review Committee	M Pavia (Chairman) G I W Parsons R Blomfield-Smith (appointed 07/03/13) R Verrion (resigned 29/10/12)
Regulatory Committee	G I W Parsons (Chairman) E Beckley E C Richards D Shah
Health, Safety and Environment Committee	G I W Parsons (Chairman) Dame D M Hutton D Shah
Compensation and HR Committee	Sir P J Mason (Chairman) M Stanley (resigned 07/09/12) C Deacon M Pavia
Customer Service Committee	Dame D M Hutton (Chairman) G I W Parsons E C Richards R Verrion (resigned 29/10/12) D Rees (appointed 07/03/13, resigned 24/05/13)
Tideway Tunnel Committee	Sir P J Mason (Chairman) E Beckley G I W Parsons D Shah M Pavia R Blomfield-Smith (appointed 07/03/13)
AMP 6 Capital Works Committee	Sir P J Mason (Chairman) C Deacon P Dyer

# Thames Water Utilities Limited

## Governance (continued)

### The Audit and Risk Review Committee

The ARRC comprises two NEDs and one independent NED, 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 Chairman of the Committee also met with both the Head of Internal Audit and the external audit lead partner outside of Committee meetings as required throughout the year.

The Committee met four times during the financial year ended 31 March 2013. Two Committee meetings were inquorate following the resignation of Robert Verron in October 2012. However, this situation did not materially impact on the workings of the Committee and was rectified by the appointment of Rosamund Blomfield-Smith to the Committee in March 2013.

The Board reviews risk management arrangements and the effectiveness of the Company's internal control systems through the work of the ARRC. The Committee's primary objectives are:

- (i) Exercising oversight over the accuracy and completeness of the financial statements and the Annual Performance Report to Ofwat,
- (ii) Making informed decisions regarding accounting policies, practices and disclosures,
- (iii) Reviewing the scope and results of internal and external audits,
- (iv) Assessing the adequacy of the Company's internal control framework to ensure compliance with policies approved by the Board,
- (v) Maintaining open lines of communication between the Board, management and the external auditor,
- (vi) 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.

During the year, the Committee discharged its responsibilities in the following manner:

### Financial Reporting

The Committee considered, prior to recommending their approval to the Board, the integrity of the financial statements of the Company and, together with the Regulatory Committee, reviewed the Annual Return to Ofwat. In undertaking this review, the Committee discussed the critical accounting policies and judgments applied with management and the external auditors. It discussed a report from the external auditors identifying the significant accounting and judgmental issues that arose in the course of the audit. The ARRC also considered the management letter for any non-standard issues and monitored action taken by management as a result of any audit recommendations.

In respect of these financial statements, the key issues addressed by the Committee included:

- recoverability of the Company's debtors, provisions for bad debt and the level of bad debt expense,
- the level of accruals for contractor claims and disputes associated with work performed during the current and previous financial years,
- the market value of the Company's land and buildings assets, and,
- the availability of financial resources, borrowing facilities and the assessment of going concern.

The consistency of accounting policies across the Company and the methods used to account for significant or unusual transactions was 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 Audit plc. The Committee further considered whether appropriate disclosure had been made in the financial statements, the business review and the Corporate Governance Statement (insofar as it relates to the audit and risk management). The Committee reviewed all statutory financial reporting and internal control certifications required to be entered into or signed by the directors individually or the Board collectively prior to these being presented to the directors or Board, as appropriate, for formal sign-off.

### Internal Audit

The Committee monitored and reviewed the effectiveness of the Company's internal audit.

# Thames Water Utilities Limited

## Governance (continued)

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, 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 any change or delay 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.

### External Audit

The Committee oversaw the relationship with the external auditors KPMG Audit plc including (but not limited to) whether fees for audit or non-audit services were appropriate. It reviewed KPMG Audit plc'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. The Committee met regularly with the external auditors, which, at least once, was without management being present, to discuss their remit and the findings of the audit and any related issues, errors or audit judgements.

### Auditor's independence and objectivity

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

- self review,
- Make management decisions for the Company,
- have a mutuality of financial interest with the Company,
- act in the role of advocate for the Company

Approval of 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.

Details of the fees paid to the external auditor during the year ended 31 March 2013 for audit and non-audit services are set out in note 3 to the financial statements on page 70 of this Annual

report and financial statements

### Internal Controls and Risk Management Systems

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, and the process is overseen by 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 ensured that the Board received regular and sufficient reports on internal controls from management. It ensured that effective risk management controls were kept in place and embedded into normal management and governance processes including, amongst other things, an organisation-wide risk register and continuous monitoring of the most significant risks. 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 confirmed the existence of policies for compliance with relevant regulatory, legal and code of conduct requirements (including amongst other things the Instrument of Appointment, the UK Corporate Governance Code, Ofwat's Regulatory Accounting Guidelines and other relevant publications), the operational effectiveness of policies and procedures and ensured that appropriate audit work was undertaken on risk management.

### Principal risks and uncertainties

The Committee reviewed the material risks and uncertainties appearing at pages 18 to 21. Following detailed consideration, it also considered the appropriateness of the Company's mitigation plans (including through engagement with responsible Executive members).

### Compliance, whistleblowing and fraud

The Committee reviewed the Company's

# Thames Water Utilities Limited

## Governance (continued)

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 on non-compliance.

### Reporting Responsibilities

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 shareholders 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 Company's System of Internal control

The Board has overall responsibility for the Company's system of internal control. This is 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 system 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 confirm that the system of internal control is operating effectively
- an internal audit function providing independent scrutiny of internal control systems and risk management procedures
- a review of reports produced by internal and external audit

The directors routinely review the effectiveness of the system of internal control and risk management, principally by means of

- regular presentations to the ARRC and the executive 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

### Regulatory Committee

Given the Company's status as a regulated utility, the Board has created a standing Committee (the "Regulatory Committee") to provide oversight and guidance in respect of regulatory issues.

The main objectives of the Regulatory Committee are to assist the Board in reviewing any matters of significance affecting the regulation of the Company including

- (i) reviewing the governance, policy and strategy of decisions with regulatory implications,
- (ii) providing guidance on current, emerging and future regulatory and competition matters and advise the Board on regulatory and competition strategy,
- (iii) reviewing progress in relation to delivering regulatory outputs,
- (iv) overseeing the preparation, and approving submission, of
  - the principal statement required by Ofwat,
  - the Annual return required by Ofwat,
  - information relating to performance against the AMP Monitoring Plans,
  - action plans (as required by Ofwat) and performance monitoring against these plans,
  - responses to regulators' consultations,
  - price determinations, and
  - other material regulatory commitments

# Thames Water Utilities Limited

## Governance (continued)

During the year in addition to the performance of its activities set out above, the following subjects were specifically considered by the Committee on the agenda

- Annual Return 2013 and the development of the 2013 Annual Return
- preparations for PR14 including the development of the Company's Business Plans
- Strategic Direction Statement
- the Company's response to various Ofwat consultations including Future Price Limits – Statement of Principles
- joint meeting with the Audit & Risk Review Committee to approve the Annual Return
- Water Resource Management Plan preparations
- review of 2013-14 charges
- response to Information Provision Consultations
- Counters Creek (Sewer Flooding Programme)

### Health, Safety and Environment Committee

As stated elsewhere in this report, the Company is committed to the highest standards of health and safety and environmental compliance in the performance of its activities

To ensure that health and safety and environmental issues receive appropriate Board oversight, the Health, Safety & Environment Committee assist's the Board as necessary in relation to health, safety, environmental and corporate responsibility matters affecting the Company

Its terms of reference include

- (i) environmental protection,
- (ii) social and ethical policy and performance,
- (iii) incident and accident prevention,
- (iv) the promotion of a health and safety culture,
- (v) the evaluation of health and safety procedures and performance,
- (vi) implementation and compliance with respect to applicable standards,
- (vii) contractor management, and
- (viii) workplace planning, control and reporting issues

During the year Health, Safety & Environment Committee meetings specifically considered the following items

- health, safety and environmental performance
- the Company's Health, Safety & Wellbeing Business Plan
- cyclist Safety
- Process Health & Safety Management
- confined Spaces working
- pollution incidents
- the management of catastrophic risk

### Tideway Tunnel Committee

In light of the significance of the Tideway project to the Company, the Tideway Committee was constituted to progress matters in respect of the structuring and financing of the proposed Tideway Tunnel

The scope of its activities include

- (i) to progress the structuring and financing of the Project and to make recommendations to the Board in respect of the same,
- (ii) to enter into discussions in respect of and make any appointments on behalf of TWUL that are in the opinion of the Committee necessary or desirable for the purposes of the Project, including without limitation the appointment of Advisors and the negotiation of and entry into the Project Advisory Agreement,
- (iii) to authorise the making of submissions to and filings with any legal or regulatory authority (including Ofwat) and to enter into agreements with, and/or give undertakings to, any such authority, in each case on terms that the Committee may consider necessary or desirable, and
- (iv) to pay or authorise the payment of all fees, expenses or charges (including any VAT payable thereon) incurred by or on behalf of TWUL or its subsidiaries in connection with the Project, including (but without limitation) the fees and expenses of financial and professional advisors

During the year, and in addition to performing the activities set out above, the Committee specifically considered the following

- progress against key activities such as planning and property acquisition,
- the ongoing development of a Project delivery model,
- stakeholder engagement and impact,
- preparations for the procurement of the project and underlying works contracts,
- project timetable and milestones



# Thames Water Utilities Limited

## Governance (continued)

### Customer Service Committee

The Board recognises the importance of the Company providing a good service to its customers and to drive improved customer service and experience, has set up a Customer Service Committee

The Committee focuses on Customer Service, Engagement and Communications and its activities include

- (i) Performance – review of current company position and performance against industry comparators and external best practice companies
- (ii) Strategy – reviewing the development of the customer service strategy reflecting the challenges faced by the company over the next five years
  - understanding the future ambitions of the Company and the drivers for change including market reform
  - review and analysis of the potential options to achieve the Company goals
  - advising the Board on key issues and decisions
- (iii) Customer Consultation and Engagement
  - review and advise on the various communications routes with consumers and customers including
    - future plans for formal representation via the Consumer Council for Water
    - communication channels and contacts routes
    - nature and content of subject areas and messaging
    - consultation processes on strategic projects and initiatives

In addition to performing the core activities set out above, the following items were specifically discussed at Customer Service Committee meetings

- customer Engagement & Customer Engagement Strategy,
- customer Service Improvement initiatives,
- customer reaction to the Drought
- retail Strategy / PR14
- Customer Challenge Group feedback on Company performance
- review of the Company's Customer Service performance metrics, Customer Equity and Social Tariffs proposals

### AMP 6 Capital Works Committee

The Committee was formed on 13 September 2012. Its terms of reference are to assist in the development and progression of the Company's AMP 6 Capital Works procurement plans in the lead up to the next regulatory period

Specifically, the Committee considered

- the development of the Company's alliancing model for AMP 6
- the procurement strategy for the AMP 6 Capital Works programme

# Thames Water Utilities Limited

## Governance (continued)

### Compensation & Human Resources Committee

The Company operates a Compensation & Human Resources Committee ("the Committee") which broadly functions as both a remuneration and a nomination committee

The Committee's responsibilities include, but are not limited to, 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 director of Human Resources (both of whom are invited to attend meetings from time to time). No individuals are involved in the determination of their own remuneration.

### Key activities

The Committee's activities during 2012/13 were as follows -

Meeting	Activities
February 2012	<ul style="list-style-type: none"><li>Setting bonus plan for 2012/13</li></ul>
May 2012	<ul style="list-style-type: none"><li>Reviewing performance against targets 2011/12</li><li>Reviewing salaries for Senior Executives 2012</li></ul>
June 2012	<ul style="list-style-type: none"><li>Board meeting to approve bonus payments 2011/12, payments made July 2012</li><li>Board meeting to approve salary reviews for Senior Executives, increases effective July 2012</li></ul>
February 2013	<ul style="list-style-type: none"><li>Setting bonus plans for 2013/14</li><li>Reviewing salaries for Senior Executives 2013, agreed no increases to be applied</li></ul>
May 2013	<ul style="list-style-type: none"><li>Reviewing performance against 2012/13 bonus and 2010-2013 LTIP targets. Resulting payments to be made July 2013</li></ul>
June 2013	<ul style="list-style-type: none"><li>Board to approve bonus and LTIP payouts</li></ul>

To ensure that the Company's remuneration practices are competitive, the Committee has access to detailed external research on market data and trends from PricewaterhouseCoopers LLP.

### Succession of Senior Management

As part of its role, the Compensation and HR Committee is responsible for ensuring that there are plans in place for the orderly succession of executive directors and the Company's senior management (including the executive team). During the year there has been further focus on succession planning.

# Thames Water Utilities Limited

## Directors' remuneration report

The directors' remuneration report is unaudited as it is not a statutory requirement to do so. However, the Company provides this information in accordance with its regulatory Licence.

In this section of the Annual report, the Company describes how the Chairman, executive directors and non-executive directors are remunerated. The total remuneration awarded for services to the Group, the element of this awarded for services to the Company and the element that relates to regulatory performance is disclosed.

### Remuneration policy

The Committee bases its decision-making with respect to remuneration policy on a number of underlying principles, which can be summarised as follows,

- arrangements should attract, retain, motivate and reward high calibre directors and executives,
- packages should be aligned with the interests of the Group's stakeholders, in particular its shareholders and its customers,
- packages 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,
- packages should include a mix of basic salary plus performance related incentives. Further detail is included within the bonus section on pages 49 to 52 which indicates how Directors' pay is linked to standards of performance.

The Committee considers carefully the blend of remuneration linked to regulatory performance and remuneration linked to other performance measures in order to produce well balanced short-term and long-term incentive plans. These arrangements are designed to incentivise value creation and a high quality service to customers and are aligned with both the internal remuneration policy and external corporate governance requirements.

The committee is also mindful of pay and conditions for the wider employee population when determining executive remuneration.

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.

### Summary of remuneration and overview for the year to 31 March 2013

The remuneration of the Executive Directors is linked to the performance of the Company and the Group and their own personal performance.

A summary of remuneration for 2012/13 is as follows,

- Martin Baggs, Chief Executive Officer (CEO) received an increase in salary of 5.9% and Stuart Siddall, Chief Financial Officer (CFO) received an increase in salary of 3.3%,
- annual bonus payments for the year 2012/13 reflected the Company's challenging financial performance as well as its strong performance against some of its key strategic initiatives. This resulted in total payouts relating to services to the Group of 60.8% of salary for Martin Baggs, Chief Executive Officer (CEO) and Stuart Siddall, Chief Financial Officer (CFO),
- payment of the 2009 Long Term Incentive Plan (LTIP) in July 2012 as a result of the Group's performance against key financial, regulatory and sustainability targets during the performance period with payment levels of 67.5% of salary for Stephen Shine, Former Chief Operating Officer (FCOO), and Mark Braithwaite, Former Chief Financial Officer (FCFO). Mark Braithwaite's payment was prorated to reflect service during the scheme period. A Long Term Incentive Plan is offered to ensure that Executive Directors are incentivised to deliver long term, sustainable performance over a period of several years and is separate from a bonus which rewards in-year performance. Payouts are made based on performance against agreed targets and are dependent on the Directors remaining employed by the Group at the end of the performance period, unless the Committee exercises their discretion to make a payment in other circumstances.

# Thames Water Utilities Limited

## Directors' remuneration report (continued)

There have been no significant changes to remuneration policy for 2013/14. Points to note are as follows,

- toughening and reweighting of performance conditions in the annual bonus with greater focus on financial performance,
- the first payment will be made under the 2010 LTIP in July 2013 as a result of performance against key financial, regulatory and sustainability targets during the performance period which has run for the last three years. The payout level is expected to be 81.3% of current base salary for Martin Baggs, CEO. Steve Shine, FCOO also is expected to receive a payment of 83.3% of basic salary at date of leaving, under this scheme.

### Remuneration of Executive Directors

The remuneration arrangements for Executive Directors are summarised below

Element	Description	Level 2012/13	Level 2013/14
Base salary	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.	Salary increases for 2012/13 range from 3.3% to 5.9% for Executive Directors.	No salary increases will be awarded to Executive Directors in 2013/14.
Annual bonus	The performance conditions are selected to motivate Executive Directors to achieve the Company's key financial, operational and strategic objectives through a combination of financial, corporate and personal performance targets. The bonus is structured to reward significant improvement in the Group's financial and operational performance.	<ul style="list-style-type: none"> <li>Target award of 56.25% of base salary for 2012/13 awards</li> <li>Maximum award of 112.5% of base salary</li> </ul>	<ul style="list-style-type: none"> <li>Target award of 56.25% of base salary for 2013/14 awards</li> <li>Maximum award of 112.5% of base salary</li> </ul>
Long term incentive plan (LTIP)	Plan rewards performance over 2010-15 (AMP5), with deferred payouts over 2013-17. Vesting is conditional on the following performance conditions - <ul style="list-style-type: none"> <li>Financial performance (40%),</li> <li>Sustainability (40%), and</li> <li>Regulatory and customer (20%)</li> </ul>	<ul style="list-style-type: none"> <li>Annual target award of 75% of base salary</li> <li>Annual maximum award of 150% of base salary</li> </ul>	<ul style="list-style-type: none"> <li>Annual target award of 75% of base salary</li> <li>Annual maximum award of 150% of base salary</li> </ul>
Pensions	Provide competitive cost effective saving benefits for employees.	Contribution of 25% of base salary for Executive Directors.	Contribution of 25% of base salary for Executive Directors.
Benefits	The Executive Directors received a car allowance, private medical insurance, life assurance, Group Income Protection and 25 days holiday. The Chief Executive Officer also received a housing allowance.		

# Thames Water Utilities Limited

## Directors' remuneration report (continued)

The following table summarises the total cash elements of the package of the Executive Directors and their value as a percentage of salary. The table also shows the proportion of these payments related to variable and long term performance.

Components of Executive Director remuneration	2012/13		2013/14	
	Value (% salary)		Value (% salary)	
	Target performance	Maximum performance	Target performance	Maximum performance
Salary	100%		100%	
Pension	25%		25%	
Bonus	56.25%	112.5%	56.25%	112.5%
LTIP	75%	150%	75%	150%
<b>Total</b>	<b>256.25%</b>	<b>387.5%</b>	<b>256.25%</b>	<b>387.5%</b>
Variable pay – Bonus and LTIP (% total)	51%	68%	51%	68%
Long-term pay - LTIP and Pension (% total)	39%	45%	39%	45%

### Base salaries and benefits

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. Martin Baggs, CEO, received a 5.9% pay

increase on 1 April 2012. This was the first review of his annual salary since his appointment in 2010. Stuart Siddall received a 3.3% increase on 1 July 2012. The average pay increase for employees across the Company was 3% for this period.

Executive director	Salary at 31 March 2013
Martin Baggs, CEO	£450,000
Stuart Siddall, CFO	£310,000

### Bonuses

Executive Directors are eligible to participate in an annual bonus scheme, which is designed to motivate them to achieve the Company's key financial, operational and strategic objectives through a combination of financial, corporate and personal performance targets.

The amount of any annual incentive award is determined by performance against set targets and is at the discretion of the Committee. The Committee reserves the right to reduce bonus payments if overall Group performance does not warrant payment. The Board believes that this is the most appropriate means of aligning directors' remuneration to performance.

# Thames Water Utilities Limited

## Directors' remuneration report (continued)

### Executive Directors' annual bonus plan measures 2012/13

The 2012/13 annual bonus plan aimed to reward significant improvement in the Group's financial performance and corporate performance whilst recognising individual performance. The maximum level of award for the 2012/13 scheme for Executive Directors was 112.5% of salary based on three equally weighted performance areas, financial, corporate challenge and

personal

The financial targets and corporate challenges were selected as being the most critical for the organisation during 2012/13. 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 Groups overall key operational and strategic objectives.

### Executive Directors' annual bonus plan measures 2012/13 (continued)

Performance measure		Weight for 2012/13 (as % of maximum)	2012/13 achievement (% of maximum bonus)	
			Martin Baggs CEO	Stuart Siddall CFO
Financial measures	Regulated net capital expenditure	11.11%	3.37%	
	Group cash flow before funding	11.11%	5.67%	
	Group Earnings Before Interest Tax Depreciation & Amortisation (EBITDA)	11.11%	0%	
Corporate Challenges	Tideway Tunnel delivery model and funding arrangements	33.33%	25%	
	Customer Service stabilisation			
	Management of impact of the Olympics			
	Management of the impact of the drought including achievement of leakage target			
	Implementation of new working patterns			
Reduction in central overhead costs				
Personal performance		33.34%	20%	20%
Overall (% maximum)		100%	52.04%	54.04%
<b>Payout for 2012/13</b>			<b>£273,555</b>	<b>£188,449</b>

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 opex 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 2012/13 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 attained

The payments under this scheme will be made in July 2013

# Thames Water Utilities Limited

## Directors' remuneration report (continued)

### Executive Directors' annual bonus plan measures 2013/14

The 2013/14 annual bonus plan will follow the overall structure of the 2012/13 plan however two thirds of the personal performance element have been allocated to performance against the Group EBITDA target

As a result of this change, the structure of the bonus plan for 2013/14 for the Executive Directors will be as follows -

Performance measure		Weight for 2013/14 (as % of maximum)
Financial measures	Regulated net capital expenditure efficiency	11 11%
	Cashflow before funding	11 11%
	EBITDA	11 11%
Corporate challenges		33 34%
Personal performance – based on performance against objectives		11 11%
Personal performance – based on EBITDA performance		22 22%
<b>Overall (% maximum)</b>		<b>100 00%</b>

As in the 2012/13 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 pays out. The financial underpin on the personal element of the bonus will continue to be a Group cash flow before funding target.

### Long Term Incentive Plans ("LTIP")

In order to focus executives on long term, sustained performance and to aid retention, the Company's Executive Directors and Senior Management are from time to time invited to participate in an LTIP.

The LTIP 2009 was a three year plan with a performance related payout at the end of the vesting period. The LTIP 2009 vested in July 2012, following Board approval of the audited accounts.

The current plan, the LTIP 2010, is a multiple year plan, with the performance period running from July 2010 to July 2015 and payouts being made in each year from July 2013 to July 2017.

Payouts are only made in full if the performance targets are met and the Directors remain employed by the Group at the end of the performance period, unless the Committee exercises their discretion to make a payment in other circumstances.

The performance measures selected for the LTIP are considered to be aligned to the creation of value for the Company, meeting and exceeding regulatory performance requirements and managing key strategic initiatives to deliver improved future performance. As a privately held Company, total shareholder return ("TSR") is not relevant or meaningful measure for the Company, therefore, a benchmark TSR performance graph has not been included in this report.

### LTIP 2009

A LTIP was offered covering the period 1 April 2009 to 31 March 2012 in which Steve Shine, FCOO, and Mark Braithwaite, FCFO, participated. Following Board approval of the audited accounts, payments were made in July 2012, pro-rata to the length of service during the performance period. The plan is based on the Company's performance against the following measures between 1 April 2010 and 31 March 2012 -

## Thames Water Utilities Limited

### Directors' remuneration report (continued)

Measurement area	Description	Overall weighting
Financial performance	Delivering on core financial targets over AMP 5 These measures are based on regulated net capital expenditure, operating expenditure, cash flow and EBITDA	40%
Sustainability	Delivering on measures that ensure a sustainable future and success beyond AMP 5 This includes <ul style="list-style-type: none"> <li>• strategic initiatives around improving operating efficiency, for example WAMI and SCADA,</li> <li>• developing a successful business plan for AMP 6, including an assessment of the quality of stakeholder engagement, business planning and efficiency bandings,</li> <li>• significantly improving employee engagement as measured by our annual employee engagement survey plus an overall review of the levels of employee engagement, and</li> <li>• improving health &amp; safety standards, taking into account the nature and seriousness of accidents as well as the Company's accident injury rate</li> </ul>	40%
Regulatory and customer	Improving the Company's scores under Operational Performance Assessment ("OPA") and Ofwat's core measure, SIM	20%

The performance measures are reviewed annually taking relevant economic factors in to account. For the payments to be made in 2014 onwards, OPA is being replaced with the Company's KPI dashboard which includes

Ofwat's core performance measures. The value of the awards that have vested are shown in the LTIP award tables on page 53.



# Thames Water Utilities Limited

## Directors' remuneration report (continued)

### LTIP 2010

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 for the next regulatory period which are critical to the Company's business plan as follows:

Measurement area	Description	Overall weighting
Financial performance	Delivering on core financials over AMP 5. These measures are based on regulated net capital expenditure, operating expenditure, cashflow and EBITDA.	40%
Sustainability	Delivering on measures that ensure a sustainable future and success beyond AMP 5. This includes: <ul style="list-style-type: none"> <li>strategic initiatives around improving operating efficiency, for example WAMI and SCADA,</li> <li>developing a successful business plan for AMP 6, including an assessment of the quality of stakeholder engagement, business planning and efficiency bandings,</li> <li>significantly improving employee engagement as measured by our annual employee engagement survey plus an overall review of the levels of employee engagement, and</li> <li>improving health &amp; safety standards, taking into account the nature and seriousness of accidents as well as the Company's accident injury rate.</li> </ul>	40%
Regulatory and customer	Improving the Company's scores under OPA and Ofwat's core measure, SIM.	20%

The performance measures are reviewed annually taking relevant economic factors into account.

The plan 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 released each year from July 2013 to July 2017 based on performance achieved as follows:

- 20% of the award will be 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.

# Thames Water Utilities Limited

## Directors' remuneration report (continued)

New joiners after 1 April 2010 are eligible to participate in the LTIP 2010 at the discretion of the Committee. For new joiners, the first payment from the LTIP will be made on the next vesting date following completion of two years' service. This payment will be pro-rated based on the part year service. 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 3 years of the performance period.

Pro-rating also applies to good leavers and is subject to the Committee's discretion and was applied to Steve Shine (FCOO).

The value of the awards that have vested and that will be paid in July 2013 are shown in the LTIP award tables on page 53.

### Pensions

Each Executive Director is eligible to receive payments into pension worth 25% of base salary. The Committee has agreed that where Executives' accumulated pension rights are already in excess of the Lifetime Allowance or where the value of their contributions would exceed the Annual Allowance, a cash payment in lieu of this payment to pension may be made. No element of bonus or LTIP is pensionable.

- Martin Baggs, CEO, participates in the Company Defined Contribution pension scheme and receives contributions of 25% of base salary capped at the value of the Annual Allowance with the balance being paid as a taxable monthly allowance directly to the Executive. Company contributions to the pension scheme for the year were £50,000 (2011/12 £106,250) and the value of the allowance paid was £62,500 (2011/12 £nil).

Stuart Suddall, CFO, receives a salary supplement of 25% of base salary in lieu of a pension contribution. Cash payments for the year were £76,875 (2012 £40,057).

### Non-Executive Directors' fees

The Chairman and Non-Executive Directors 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.

The Chairman receives an annual fee of £300,000 and Non-Executive Directors receive an annual fee of £45,000. Michael Pavia receives an additional annual fee of £10,000 for his role as Chairman, Audit & Risk Review Committee. Fees are reviewed regularly by the Committee and no individuals are involved in the determination of their own remuneration.

Further details of the Chairman and Non-Executive Directors' remuneration are set out in the emoluments table on page 56.

For 2013/14, the fees payable to all NEDs, with the exception of Gordon Parsons and Edward Beckley (who are nominated by Macquarie), will increase by £4,000 per annum.

### Service contracts

Reflecting current market practice, the Executive Directors do not hold service contracts that provide for a notice period longer than one year. It is not the Committee's intention to recommend the appointment of any new Executive Directors with contracts that provide for a longer notice period.

The Committee endorses the principle of mitigation of loss on early termination of a service contract and generally seeks to achieve that objective where possible and appropriate. 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. For Non-Executive Directors, no compensation is payable on the event of early termination.

# Thames Water Utilities Limited

## Directors' remuneration report (continued)

### Service Contracts

Executive Directors	Contract start date as Executive Director	Service period	Notice period
Martin Baggs, CEO	5 March 2010	n/a	6 months by employee, 12 months by company
Stuart Siddall, CFO	20 September 2011	n/a	6 months by employee, 12 months by company

	Initial Contract start date	Length of Each Period of Appointment	Expiry Date of Current Contract
<b>Chairman</b>			
Sir Peter Mason	01 December 2006	3 years	9 June 2014
<b>Independent Non-Executive Directors</b>			
Dame Deirdre Hutton	22 July 2010	3 years	21 July 2015
Michael Pavia	01 December 2006	3 years	21 July 2015
Edward Richards	22 July 2010	3 years	21 July 2015
<b>Non-Executive Directors</b>			
Edward Beckley	26 March 2008	n/a	n/a
Rosamund Blomfield-Smith	29 November 2012	n/a	n/a
Christopher Deacon	01 December 2006	n/a	n/a
Simon Eaves	20 January 2012	n/a	n/a
Gordon Parsons	10 June 2010	n/a	n/a
David Rees <sup>1</sup>	29 October 2012	n/a	n/a
Kevin Roseke <sup>2</sup>	02 January 2013	n/a	n/a
Dipesh Shah	15 October 2007	n/a	n/a
Yaping Shi <sup>3</sup>	19 January 2012	n/a	n/a
Martin Stanley <sup>4</sup>	01 December 2006	n/a	n/a
Robert Verron <sup>5</sup>	01 January 2011	n/a	n/a
Lincoln Webb	21 November 2011	n/a	n/a
Dapeng Xu	29 October 2012	n/a	n/a

<sup>1</sup>David Rees resigned with effect from 2 January 2013

<sup>2</sup>Kevin Roseke resigned with effect from 24 May 2013

<sup>3</sup>Yaping Shi resigned with effect from 28 September 2012

<sup>4</sup>Martin Stanley resigned with effect from 7 September 2012

<sup>5</sup>Robert Vernon resigned with effect from 29 October 2012

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

# Thames Water Utilities Limited

## Directors' remuneration report (continued)

### Emoluments table (Excluding LTIPs)

	Directors' salaries / fees £'000	Benefits in kind £'000	Allowances £'000	Pension Allowance £'000	Annual cash bonus £'000	Group Total year to 31 March 2013 £'000	Group Total year to 31 March 2012 £'000	Company Total Year to 31 March 2013 £'000	Company Total Year to 31 March 2012 £'000
<b>Executive Directors</b>									
M Baggs <sup>1</sup>	450	2	51	63	274	840	896	588	627
S Siddall <sup>2</sup>	308	2	13	77	188	588	369	412	258
<b>Chairman</b>									
Sir P Mason	300	-	-	-	-	300	300	180	180
<b>Independent Non-Executive Directors</b>									
Dame D Hutton	45	-	-	-	-	45	45	45	45
M Pavia	55	-	-	-	-	55	55	55	55
E Richards*	45	-	-	-	-	45	45	45	45
<b>Non-Executive Directors</b>									
E Beckley*	45	-	-	-	-	45	45	-	-
R Blomfield-Smith <sup>3</sup>	51	-	-	-	-	51	46	36	30
C Deacon <sup>4</sup>	105	-	-	-	-	105	107	50	-
S Eaves*	45	-	-	-	-	45	11	-	-
G Parsons*	45	-	-	-	-	45	45	-	-
D Rees <sup>5</sup>	8	-	-	-	-	8	-	-	-
K Roseke <sup>6</sup>	11	-	-	-	-	11	-	-	-
D Shah*	45	-	-	-	-	45	45	-	-
Y Shi <sup>7</sup>	23	-	-	-	-	23	11	-	-
M Stanley <sup>8</sup>	19	-	-	-	-	19	45	-	-
R Vernon <sup>9</sup>	26	-	-	-	-	26	45	-	-
L Webb*	45	-	-	-	-	45	22	-	-
D Xu <sup>10</sup>	19	-	-	-	-	19	-	-	-
<b>Total</b>	<b>1,690</b>	<b>4</b>	<b>64</b>	<b>140</b>	<b>462</b>	<b>2,360</b>	<b>2,132</b>	<b>1,411</b>	<b>1,240</b>

The Group is Kemble Water Holdings Limited and the Company refers to TWUL

\*Director's fees are paid to the shareholder's nominated company and not to the individual director

<sup>1</sup> Allowances for Martin Baggs comprise £15,000 car allowance and £36,000 housing allowance

<sup>2</sup> Allowances for Stuart Siddall comprise £12,500 car allowance

<sup>3</sup> Rosamund Blomfield-Smith was re-appointed on 29 November 2012. Fees shown include a consultancy fee of £36,000 for work on the Tideway Improvements project prior to her re-appointment to the Board

<sup>4</sup> Fees shown include a consultancy fee of £60,000 (2011 £61,666) for work on the Tideway Improvements project

<sup>5</sup> David Rees was appointed on 29 October 2012 and resigned with effect from 2 January 2013

<sup>6</sup> Kevin Roseke was appointed on 2 January 2013 and resigned with effect from 24 May 2013

<sup>7</sup> Yaping Shi resigned with effect from 28 September 2012

<sup>8</sup> Martin Stanley resigned with effect from 7 September 2012

<sup>9</sup> Robert Vernon resigned with effect from 29 October 2012

<sup>10</sup> Dapeng Xu was appointed on 29 October 2012

# Thames Water Utilities Limited

## Directors' remuneration report (continued)

The following table sets out the proportion of the bonus which is attributable to regulatory performance for 2013 -

Executive Directors	Proportion determined by regulatory performance
Martin Baggs, CEO	£232,522
Stuart Siddall, CFO	£160,182

### Long term incentive awards

The following table sets out the awards under the LTIP 2009 and vested and unvested awards under the LTIP 2010. The potential values shown are the maximum cash levels attainable subject to the performance conditions set out on pages 49 to 52. The expected value shows the level of vesting anticipated based on estimates of current performance, and in the case of the LTIP 2010 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. The actual payments to be made in July 2013 under the LTIP 2010, represent a payout of 57.4% of the maximum, which can be broken down as follows:

Measure	Weighting %	Actual payout %
Regulated net operating expenses	10.0	8.3
EBITDA	10.0	8.3
Regulated capital efficiency	10.0	10.0
Cash flow before funding	10.0	10.0
OPA	10.0	3.3
SIM	10.0	-
AMP 6 planning	10.0	5.0
Employee engagement	10.0	5.0
Health & Safety	10.0	5.0
Strategic initiatives	10.0	2.5
<b>Total</b>	<b>100.0</b>	<b>57.4</b>

# Thames Water Utilities Limited

## Directors' remuneration report (continued)

Performance period	Date of potential payment	Individual	Potential value of awards held at 31 March 2012 £'000	Potential value of awards granted during the year £'000	Value of awards vesting during or related to the year £'000	Value of awards lapsed during the year £'000	Potential value of awards held at 31 March 2013 £'000	Group Expected value of awards held at 31 March 2013 <sup>1</sup> £'000	Company-related Expected value of awards held at 31 March 2013 £'000
<b>LTIP 2010</b>									
1 April 2010 – 31 March 2013	July 2013	M Baggs	638	-	366 <sup>2</sup>	272	-	366	256
		S Shine <sup>3</sup>	450	-	258 <sup>2</sup>	192	-	258	181
		S Siddall	-	-	-	-	-	-	-
1 April 2010 – 31 March 2014	July 2014	M Baggs	638	-	-	-	638	447	313
		S Siddall	225	-	-	-	225	158	111
1 April 2010 – 31 March 2015	July 2015	M Baggs	638	-	-	-	638	447	313
		S Siddall	450	-	-	-	450	315	221
	July 2016	M Baggs	638	-	-	-	638	447	313
		S Siddall	450	-	-	-	450	315	221
	July 2017	M Baggs	638	-	-	-	638	447	313
		S Siddall	450	-	-	-	450	315	221
<b>LTIP 2009</b>									
1 April 2010 – 31 March 2012	July 2012	S Shine <sup>3</sup>	300	-	203	97	-	-	-
		M Braithwaite	300	-	146	154	-	-	-

<sup>1</sup>Based on performance to date

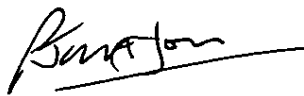
<sup>2</sup>Will be paid in July 2013

<sup>3</sup>Steve Shine resigned as a Director on 31 March 2012

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 amount accrued in the year are shown in note 5, page 72 of the financial statements

Approved by the Board of Directors on 6 June 2013 and signed on its behalf by



**Sir Peter Mason, KBE**  
Chairman, Compensation and HR Committee

## Independent Auditor's Report to the Members of Thames Water Utilities Limited

We have audited the financial statements of Thames Water Utilities Limited for the year ended 31 March 2013 set out on pages 60 to 98. 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 27, 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](http://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 2013 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 matter prescribed by the Companies Act 2006

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

### Matters on which we are required to report by exception

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

- adequate accounting records have not been kept, 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 (Senior Statutory Auditor)**  
for and on behalf of **KPMG Audit Plc**,  
Statutory Auditor  
Chartered Accountants  
15 Canada Square  
London  
E14 5GL  
6 June 2013

## Thames Water Utilities Limited

<b>Statutory financial statements</b>	<b>Pages</b>
Profit and loss account	61
Statement of total recognised gains and losses	61
Balance sheet	62
Cash flow statement	63
Notes to the financial statements for the year ended 31 March	64



# Thames Water Utilities Limited

## Profit and loss account

	Note	Year ended 31 March 2013 £m	Year ended 31 March 2012 £m
<b>Turnover</b>		<b>1,791 9</b>	1,694 9
Operating costs before exceptional item		(1,242 6)	(1,091 0)
Exceptional item pension curtailment gain	3	-	40 0
Operating costs	3	(1,242 6)	(1,051 0)
<b>Operating profit</b>		<b>549 3</b>	643 9
Profit on sale of fixed assets	4	10 8	3 9
Interest payable and similar charges	6	(491 8)	(504 7)
Interest receivable	7	86.5	81 5
		(405 3)	(423 2)
Other finance expense	26	(9 9)	(2 4)
<b>Profit on ordinary activities before taxation</b>		<b>144 9</b>	222 2
Taxation credit on profit on ordinary activities	8	5 1	25 0
<b>Profit for the financial year</b>	21	<b>150 0</b>	247 2

There are no differences between the profit on ordinary activities before taxation for the periods as stated above and their historical cost equivalents

All amounts above relate to continuing operations

## Statement of total recognised gains and losses

	Note	Year ended 31 March 2013 £m	Year ended 31 March 2012 £m
Profit for the financial year		150 0	247 2
Actuarial loss on pension scheme	26	(106 8)	(94 4)
Deferred tax relief relating to actuarial loss		21 3	21 4
<b>Total recognised gains in the year</b>		<b>64 5</b>	174 2

# Thames Water Utilities Limited

## Balance sheet

	Note	As at 31 March 2013 £m	As at 31 March 2012 £m
<b>Fixed assets</b>			
Tangible assets	10	9,297.9	8,788.3
Investments	11	0.1	0.1
		<b>9,298.0</b>	<b>8,788.4</b>
<b>Current assets</b>			
Stocks	12	8.4	9.6
Debtors amounts falling due within one year	13	572.8	647.9
Debtors amounts falling due after more than one year	14	2,015.0	2,015.0
Total debtors		2,587.8	2,662.9
Investments	17	748.7	619.4
Cash at bank and in hand	17	-	2.7
		<b>3,344.9</b>	<b>3,294.6</b>
<b>Creditors amounts falling due within one year</b>	15	<b>(957.3)</b>	<b>(1,460.4)</b>
<b>Net current assets</b>		<b>2,387.6</b>	<b>1,834.2</b>
<b>Total assets less current liabilities</b>		<b>11,685.6</b>	<b>10,622.6</b>
<b>Creditors' amounts falling due after more than one year</b>	16	<b>(9,216.0)</b>	<b>(8,050.2)</b>
<b>Provisions for liabilities and charges</b>	18	<b>(1,044.4)</b>	<b>(1,052.6)</b>
<b>Net assets excluding net pension liabilities</b>		<b>1,425.2</b>	<b>1,519.8</b>
Net pension liabilities			
Total of defined benefit schemes			
With net liabilities		(214.5)	(144.4)
With net assets		23.0	25.2
	26	<b>(191.5)</b>	<b>(119.2)</b>
<b>Net assets including net pension liabilities</b>		<b>1,233.7</b>	<b>1,400.6</b>
<b>Capital and reserves</b>			
Called-up share capital	19	29.0	1,029.0
Share premium account	20	100.0	100.0
Profit and loss account	21	1,104.7	271.6
<b>Total shareholder's funds</b>	22	<b>1,233.7</b>	<b>1,400.6</b>

The notes on pages 64 to 98 form an integral part of these financial statements

The financial statements were approved by the Board of directors on 6 June 2013 and signed on its behalf by



**Stuart Siddall**  
Chief Financial Officer

Company registered number 02366661

# Thames Water Utilities Limited

## Cash flow statement

	Note	Year ended 31 March 2013 £m	Year ended 31 March 2012 £m
Net cash inflow from operating activities	27(a)	1,057 0	924 7
<b>Returns on investments and servicing of finance</b>			
Interest received		122 7	106 1
Interest paid		(375.4)	(354 1)
Interest element in finance lease payments		(8 4)	(6 9)
<b>Net cash outflow from returns on investments and servicing of finance</b>		<b>(261 1)</b>	<b>(254 9)</b>
<b>Taxation</b>		<b>-</b>	<b>79 6</b>
<b>Capital expenditure and financial investment</b>			
Gross cost of purchased fixed assets		(903 5)	(993 6)
Infrastructure renewals expenditure		(185 7)	(176 8)
Receipt of grants and contributions		51 4	44 3
Movement on long term loans to group companies		-	(150 0)
Sale proceeds of fixed assets		12 8	8 8
<b>Net cash outflow for capital expenditure and financial investment</b>		<b>(1,025.0)</b>	<b>(1,267 3)</b>
<b>Equity dividends paid</b>	9	<b>(231 4)</b>	<b>(279 5)</b>
<b>Management of liquid resources</b>		<b>(460 5)</b>	<b>(797 4)</b>
(Increase)/decrease in current asset investments	27(b) & (c)	(129 3)	156 4
<b>Net cash outflow before financing</b>		<b>(589.8)</b>	<b>(641 0)</b>
<b>Financing</b>			
Capital element in finance lease payment		(74 5)	(7 8)
New loans		1,064 6	657 1
Repayment of loans		(470 0)	(9 2)
<b>Net cash inflow from financing</b>	27(b) & (c)	<b>520 1</b>	<b>640 1</b>
<b>Decrease in cash</b>	27(b) (c) & (d)	<b>(69 7)</b>	<b>(0 9)</b>

# Thames Water Utilities Limited

## Notes to the Financial Statements (continued)

### 1 Principal accounting policies

The following accounting policies have been applied consistently in dealing with items, which are considered material to the financial statements, except as noted below

#### Basis of preparation

The financial statements 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 note 1(b) below

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 financial statements

The Company has not prepared consolidated group financial statements, as permitted under section 400 of the Companies Act 2006. The Company and its subsidiaries are included in the consolidated financial statements of its ultimate parent company Kemble Water Holdings Limited, a company registered in the United Kingdom

#### Changes to accounting policies

There have been no changes to the accounting policies from those used for the year ended 31 March 2012

#### Summary of significant accounting policies

##### (a) Revenue recognition

Turnover represents the fair value of the income receivable in the ordinary course of business for goods and services provided and are 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, judgement 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 as a prepayment

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 favourable operating costs when payment is received

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

##### (b) Tangible fixed assets

Tangible fixed assets comprise infrastructure assets (mains, sewers and pumped raw water storage reservoirs and sludge pipelines), plant and equipment, land and buildings, and assets under the course of construction

The Company capitalises the directly attributable costs of procuring and constructing tangible fixed assets. 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

# Thames Water Utilities Limited

## Notes to the Financial Statements (continued)

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 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.

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.

### Land and Buildings

Land and buildings are stated at cost less accumulated depreciation. Freehold land is not depreciated. Buildings are depreciated down to their residual value over 15 to 60 years on a straight-line basis.

### 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

### Assets under 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).

### Infrastructure assets

Infrastructure assets comprise networks of below ground systems (water and sewerage 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") included within the total depreciation charge recognised in the profit and loss account.

The IRC recognised in 2013 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.

### 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 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 financial effect of this departure is disclosed in note 10.

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.

### (c) Impairment of tangible fixed assets

Fixed assets are assessed for impairment whenever there is an indication of impairment to

# Thames Water Utilities Limited

## Notes to the Financial Statements (continued)

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 non-current 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 therefore subjective.

### (d) Stocks

Stocks other than Water Efficiency products, 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.

Stocks of Water Efficiency products, which are to be provided to customers free of charge as part of Thames Water's ongoing water efficiency

measures are recorded at cost and expensed to the profit and loss account when they are given or sent to the customer.

### (e) Taxation

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

#### 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 and it further excludes items that are never taxable or deductible.

#### 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 charged or credited to equity, in which case the deferred tax is also dealt with via the Statement of total recognised gains and losses.

# Thames Water Utilities Limited

## Notes to the Financial Statements (continued)

### (f) 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.

#### 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.

The corresponding liability is shown as a finance lease obligation to the lessor. Leasing repayments comprise both a capital and a finance element. The finance element is written off to the profit and loss account so as to produce an approximately constant periodic rate of charge on the outstanding obligation. Such assets are depreciated over the shorter of their estimated useful lives and the period of the lease to the first break clause.

#### Operating leases

Operating lease rentals are charged to the profit and loss account on a straight-line basis over the period of the lease.

### (g) 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 that 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.

### (h) 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.

### (i) Cash and cash equivalents

Cash and cash equivalents includes cash at bank and in hand, deposits, and short-term highly liquid

# Thames Water Utilities Limited

## Notes to the Financial Statements (continued)

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

### (j) Provision for doubtful debts

At each reporting date, the Company evaluates the collectability 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 accounts and consideration of actual write-off history. The actual level of receivables 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 value 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.

### (k) 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.

### 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.

### 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 GBP denominated.

Foreign currency and interest rate swaps are all in 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 17.

The Company currently does not apply FRS 26 "Financial Instruments Recognition and Measurement", and accordingly the disclosure requirements of FRS 29 "Financial Instruments Disclosures" are not applicable.

Therefore, the presentation requirements of FRS 25 "Financial Instruments Presentation" have been applied.

### (l) 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.

### (m) 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. Insurance provisions are recognised or released by assessing their adequacy using current estimates of future cash flows under insurance contracts. Provisions are recorded in the balance sheet at their full value and are not therefore discounted.



# Thames Water Utilities Limited

## Notes to the Financial Statements (continued)

### (n) Related party disclosures

The Company has taken advantage of the exemption under paragraph 3(c) from the provisions of FRS 8 "Related party disclosures", which requires the disclosure of the details of material transactions with other wholly owned subsidiaries within the Kemble Water Holdings Limited Group, on the grounds that it is a wholly owned subsidiary of Kemble Water Holdings Limited, a company registered in the United Kingdom

### (o) 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

### (p) 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

### (q) 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 in 2013 (2012 see note 3)

## 2 Segmental analysis

The directors consider that the Company has one class of business and this is conducted wholly within the United Kingdom

# Thames Water Utilities Limited

## Notes to the Financial Statements (continued)

### 3 Operating costs

Analysis of operating costs by type of expense

	Note	Year ended 31 March 2013 £m	Year ended 31 March 2012 £m
Staff costs excluding exceptional item	5	198 5	199 4
Exceptional item – pension curtailment gain *	26	-	(40 0)
Materials and consumables		142 9	155 6
Other operating charges		581.7	476 4
Depreciation			
Owned assets (infrastructure renewals charge)	10	135 3	129 5
Owned assets (non-infrastructure)	10	312 6	276 5
Assets held under finance leases (non-infrastructure)	10	9.6	9 6
Rental under operating leases			
Hire of plant and machinery		5 8	10 0
Other		6 3	5 7
Research and development		3 9	3 9
Other operating income		(6 6)	(7 1)
		1,390 0	1,219 5
Own work capitalised (staff and other costs)		(147 4)	(168 5)
		<b>1,242.6</b>	<b>1,051 0</b>

\* Prior year exceptional item was a curtailment gain of £40 0m arising from changes to certain provisions, in respect of the Thames Water Pension Scheme

For performance purposes operating costs, operating profit and profit after tax are analysed as follows

	Year ended 31 March 2013 £m	Year ended 31 March 2012 £m
Underlying operating expenses	785 1	675 4
Exceptional item – pension curtailment gain	-	(40 0)
Total operating expenses	785 1	635 4
Total depreciation	457 5	415 6
<b>Total operating costs</b>	<b>1,242 6</b>	<b>1,051 0</b>
Underlying operating profit	549.3	603 9
Exceptional item – pension curtailment gain	-	40 0
<b>Operating profit</b>	<b>549 3</b>	<b>643 9</b>
Underlying profit after tax	150 0	216 8
After tax impact of exceptional item*	-	30 4
<b>Profit after tax</b>	<b>150.0</b>	<b>247 2</b>

\*The tax charge on the exceptional item in 2011/12 is £9 6m and it had no cash flow impact

# Thames Water Utilities Limited

## Notes to the Financial Statements (continued)

Amounts receivable by the Company's auditor are shown below in respect of the following services to the Company

	Year ended 31 March 2013 £'000	Year ended 31 March 2012 £'000
<b>Fees payable to the auditor</b>		
Fees payable to the Company's auditor for the audit of the Company's Annual report and financial statements	235	229
Fees payable to the Company's auditor and its associates for other services		
Audit related assurance services	87	122
All other assurance services	49	6
Taxation compliance services	9	22
Taxation advisory services	105	3
Corporate finance services	1,384	1,881
All other non-audit services	97	264
<b>Total aggregate remuneration</b>	<b>1,966</b>	<b>2,527</b>

Fees for corporate finance services above include £1.4m (2012 £1.9m) 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 following a competitive tendering process in line with the Company's procurement processes.

No other fees were payable to KPMG Audit Plc in respect of this Company in this year or the prior year.

#### 4 Profit on sale of fixed assets

	Year ended 31 March 2013 £m	Year ended 31 March 2012 £m
Net profit on disposal of fixed assets	3.8	3.9
Income from insurance claim	7.0	-
<b>Profit on sale of fixed assets</b>	<b>10.8</b>	<b>3.9</b>
Taxation charge attributable, included in the tax charge for the year	2.6	1.6

Income from insurance claim relates to the damage caused to the Company's assets resulting from a fire at Beddington Sewage Treatment Works. The insurance claim has not been settled and is subject to further negotiation.

# Thames Water Utilities Limited

## Notes to the Financial Statements (continued)

### 5 Information regarding directors and employees

#### Aggregate directors' emoluments

	Year ended 31 March 2013 £'000	Year ended 31 March 2012 £'000
Salary	941	1,083
Pension	98	184
Bonus	324	681
LTIPs	593	667
Other benefits	48	66
<b>Total aggregate emoluments</b>	<b>2,004</b>	<b>2,681</b>

Included in the table above, is £1,593,000 (2011/12 £2,365,000) for the executive directors for their services to the Company. In addition, the executive directors received total remuneration of £683,000 (2011/12 £776,000) for their services to other companies within the Group.

At 31 March 2013 no benefits were accruing to any directors (31 March 2012 £2,000 for 2 directors) under the Group's defined benefit scheme in respect of services to the Company. In addition, the Company contributed cash of £140,000 (2011/12 £132,000) as a pension supplement for 2 directors (2011/12 3 directors).

The Company contributed £50,000 into the Company's defined contribution pension scheme for 1 director (2011/12 £74,000 for 1 director).

#### 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 £993,000 (2011/12 £1,021,837). 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 2012/13 (2011/12 £74,000) in relation to the director's work for the Company. In addition, emoluments of £426,000 (2012 £438,000) were paid to the highest paid director for services to other companies within the Group.

Details of Long Term Incentive Plans ("LTIP") can be found within the Directors' remuneration report on pages 51 to 54.

# Thames Water Utilities Limited

## Notes to the Financial Statements (continued)

### Employee information

The average number of persons employed by the Company, including executive directors, during the year, analysed by category, was as follows

	Year ended 31 March 2013 Number	Year ended 31 March 2012 Number
Support	402	323
Operations	4,279	4,228
<b>Total employee numbers</b>	<b>4,681</b>	<b>4,551</b>

Employment costs excluding exceptional item (see note 3, page 70) but including executive directors' remuneration were

	Year ended 31 March 2013 £m	Year ended 31 March 2012 £m
Salaries and wages	157.9	166.3
Social security costs	16.6	15.8
Pension costs – defined benefit scheme	26	16.4
Pension costs – defined contribution scheme	26	1.4
Severance costs	4.9	1.3
<b>Total</b>	<b>200.4</b>	<b>201.2</b>
Employment costs included within research and development expense	(1.9)	(1.8)
<b>Net employment costs</b>	<b>3</b>	<b>199.4</b>

In addition, £17.9m (2012 £9.3m) of employment costs were charged directly to capital projects

### 6 Interest payable and similar charges

	Year ended 31 March 2013 £m	Year ended 31 March 2012 £m
Bank loans, overdrafts and other loans		
Intercompany interest		
Interest expense	(328.2)	(288.3)
RPI accretion on loans	(80.8)	(123.8)
Amortisation of debt issue costs	(3.2)	(4.8)
Bank and other loans		
External interest expense	(20.9)	(21.1)
RPI accretion on loans	(50.9)	(58.5)
Amortisation of debt issue costs	(1.9)	(1.4)
Finance charges in respect of finance leases	(5.9)	(6.8)
<b>Interest payable and similar charges</b>	<b>(491.8)</b>	<b>(504.7)</b>

# Thames Water Utilities Limited

## Notes to the Financial Statements (continued)

### 7 Interest receivable

	Year ended 31 March 2013 £m	Year ended 31 March 2012 £m
Interest receivable		
Intercompany loans	44.7	39.4
Other loans	4.2	7.8
Net swaps receivable	37.6	34.3
<b>Interest receivable</b>	<b>86.5</b>	<b>81.5</b>

Amounts receivable on swaps relate to interest rates taken out to hedge rates on borrowings. See note 17, page 82.

The net interest receivable on swaps is the aggregate effect of all swaps held in the Company.

Interest receivable cash inflow of £122.7m includes £39.4m received from Thames Water Utilities Holdings Limited, which is not included in the adjusted interest cover ratio calculations as defined in the Business review on page 22.

### 8 Taxation

#### (a) Analysis of charge in the year

	Note	Year ended 31 March 2013 £m	Year ended 31 March 2012 £m
<b>Current tax</b>			
Amounts payable in respect of corporation tax for the year		1.1	-
Adjustment in respect of prior years		-	(38.3)
<b>Total current tax charge/(credit)</b>	<b>8(b)</b>	<b>1.1</b>	<b>(38.3)</b>
<b>Deferred tax</b>			
Origination and reversal of timing differences		33.9	43.8
Adjustments in respect of prior years		-	33.1
Impact on deferred tax of tax rate change to 23% (2012: 24%)		(41.8)	(80.7)
Deferred tax credit before pension timing differences	18	(7.9)	(3.8)
Timing difference on pension cost charge		1.7	17.1
<b>Total deferred tax (credit)/charge</b>		<b>(6.2)</b>	<b>13.3</b>
<b>Taxation credit on profit on ordinary activities</b>		<b>(5.1)</b>	<b>(25.0)</b>

The tax charge includes a deferred tax credit of £41.8m to reflect the impact of the reduction of the corporation tax rate from 24% to 23% from 1 April 2013. This change was substantively enacted on 3 July 2012. An additional charge of £4.3m has been taken to reserves. The tax charge in 2012 reflected a deferred tax credit of £80.7m resulting from the reduction in the corporation tax rate from 26% to 24%.

The March 2013 Budget announced that the corporation tax rate will further reduce to 20% from 1 April 2015.

# Thames Water Utilities Limited

## Notes to the Financial Statements (continued)

The overall effect of the planned reductions from 23% to 20% would be to reduce the deferred tax liability by approximately £125m. These planned reductions in corporation tax rates have not been substantially enacted by 6 June 2013 and so are not recognised in these financial statements.

### (b) Factors affecting the current tax charge for the year

The current tax (credit)/charge is based upon UK corporation tax at 24% (2012 26%). The tax charge for the year is lower (2012 lower) than the standard rate of corporation tax in the UK (24%), (2012 26%). The differences are explained below.

	Year ended 31 March 2013 £m	Year ended 31 March 2012 £m
Profit on ordinary activities before tax	144.9	222.2
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 24% (2012 26%)	34.8	57.8
Effects of		
Disallowable expenditure less non taxable income	3.8	3.1
Capital allowances for the year in excess of depreciation and other timing differences	(33.9)	(43.8)
Pension tax relief higher than pension cost in accounts	(3.6)	(17.1)
Adjustments to tax charge in respect of prior years	-	(38.3)
<b>Current tax charge/(credit) for the year</b>	<b>1.1</b>	<b>(38.3)</b>

## 9 Dividends

The application of the interim dividends are analysed as follows:

	Year ended 31 March 2013 £m	Year ended 31 March 2012 £m
External dividend distributions *	74.5	165.1
External interest on Kemble Water Eurobond plc debt	17.5	34.9
Distribution to ultimate shareholders	92.0	200.0
External interest on Kemble Water Finance Limited debt	60.0	50.0
Inter-group group relief settlement payments	40.0	-
Inter-group distribution to parent undertaking **	39.4	24.4
Inter-group dividend to Kemble Water Limited	-	5.1
	<b>231.4</b>	<b>279.5</b>

\* External dividend distribution represents the payment made by Kemble Water Holdings Limited, the ultimate parent company from the dividend it receives indirectly from the Company.

\*\* The immediate parent undertaking, Thames Water Utilities Holdings Limited ("TWUHL") received £39.4m (2012 £24.4m) from the Company, which was used by TWUHL to settle its inter-company interest balance with the Company.

# Thames Water Utilities Limited

## Notes to the Financial Statements (continued)

Dividends paid by date are analysed below

	Note	Year ended 31 March 2013 £m	Year ended 31 March 2012 £m
<i>Dividends paid in respect of prior year but not recognised as liabilities in that year</i>			
11 April 2011 (2012 2 4p) per ordinary share		-	24 4
7 June 2012 19 6p per ordinary share		201.4	-
<i>Interim dividends paid in respect of the current year</i>			
23 June 2011 (2012 10 2p) per ordinary share		-	105 1
30 September 2011 (2012 4 9p) per ordinary share		-	50 0
29 November 2011 (2012 9 7p) per ordinary share		-	100 0
27 March 2013 £1 03p per ordinary share		30 0	-
	21 & 22	231.4	279 5

### 10 Tangible fixed assets

	Land and buildings £m	Plant and equipment £m	Infrastructure assets £m	Assets in course of construction £m	Total £m
<b>Cost</b>					
At 1 April 2012	2,591 2	4,768 1	4,968 0	1,514 7	13,842 0
Additions	-	-	-	1,008 2	1,008 2
Transfers between items	175 1	456 5	199 1	(830 7)	-
Disposals	(0 3)	(2 2)	-	-	(2 5)
<b>At 31 March 2013</b>	<b>2,766.0</b>	<b>5,222.4</b>	<b>5,167.1</b>	<b>1,692.2</b>	<b>14,847.7</b>
<b>Capital contributions</b>					
At 1 April 2012	-	-	663 3	-	663 3
Additions	-	-	39 0	-	39 0
<b>At 31 March 2013</b>	<b>-</b>	<b>-</b>	<b>702.3</b>	<b>-</b>	<b>702.3</b>
<b>Depreciation</b>					
At 1 April 2012	679 2	2,508 6	1,202 6	-	4,390 4
Provided during the year	42 7	279 5	135 3	-	457 5
Disposals	(0 3)	(0 1)	-	-	(0 4)
<b>At 31 March 2013</b>	<b>721.6</b>	<b>2,788.0</b>	<b>1,337.9</b>	<b>-</b>	<b>4,847.5</b>
<b>Net book value</b>					
<b>At 31 March 2013</b>	<b>2,044.4</b>	<b>2,434.4</b>	<b>3,126 9</b>	<b>1,692.2</b>	<b>9,297.9</b>
At 31 March 2012	1,912 0	2,259 5	3,102 1	1,514 7	8,788 3



## Thames Water Utilities Limited

### Notes to the Financial Statements (continued)

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

	As at 31 March 2013 £m	As at 31 March 2012 £m
Freehold land and buildings	2,034.5	1,901.7
Leasehold – over 50 years	7.3	7.6
Leasehold – under 50 years	2.6	2.7
	<b>2,044.4</b>	<b>1,912.0</b>

Depreciation has not been charged on freehold land stated in the financial statements at cost of £155.7m (2012 £120.3m)

Details of the Company's tangible fixed assets, which are held under finance leases, are

	Total £m
<b>Cost</b>	
At 1 April 2012 and 31 March 2013	<b>263.2</b>
<b>Depreciation</b>	
At 1 April 2012	146.4
Provided during the year	9.6
<b>At 31 March 2013</b>	<b>156.0</b>
<b>Net book value</b>	
At 31 March 2013	<b>107.2</b>
At 31 March 2012	<b>116.8</b>

# Thames Water Utilities Limited

## Notes to the Financial Statements (continued)

### 11 Fixed asset investments

	As at 31 March 2013 £m	As at 31 March 2012 £m
<b>Cost of shares in subsidiaries</b>	<b>0 1</b>	<b>0 1</b>

At 31 March 2013 the Company held the allotted share capital of the following undertakings

Name of undertaking	Nominal value and class of shares held	Proportion of nominal value of issued shares held	Activity
Thames Water Utilities Finance Limited	£1 Ordinary	100%	Finance Company
Thames Water Utilities Cayman Finance Holdings Limited	\$1 Ordinary	100%	Finance Company

Thames Water Utilities Finance Limited was incorporated and registered in the United Kingdom. Thames Water Utilities Cayman Finance Holdings Limited was incorporated and registered in the Cayman Islands and is resident in the United Kingdom for tax.

At 31 March 2013 Thames Water Utilities Finance Limited had net liabilities of £110.5m (2012 liabilities £70.7m) and incurred a loss for the year ended 31 March 2013 of £39.7m (2012 loss £27.5m).

At 31 March 2013 Thames Water Utilities Cayman Finance Holdings Limited had net assets of £1 (2012 £1). No profit or loss had been made in the year (2012 £nil).

### 12 Stocks

	As at 31 March 2013 £m	As at 31 March 2012 £m
<b>Raw materials and consumables</b>	<b>8 4</b>	<b>9 6</b>

# Thames Water Utilities Limited

## Notes to the Financial Statements (continued)

### 13 Debtors, amounts falling due within one year

	As at 31 March 2013 £m	As at 31 March 2012 £m
Trade debtors	200 0	254 8
Amounts owed by group undertakings		
- Interest	44 5	39 4
- Non interest	0 7	40 4
Other debtors	67 7	70 5
Insurance claims receivable	62 0	56 8
Prepayments and accrued income	197 9	186 0
	<b>572 8</b>	<b>647 9</b>

Prepayments and accrued income as at 31 March 2013 includes water and wastewater income not yet billed of £161.1m (2012: £146.7m)

Amounts owed by group undertakings are comprised of

- Interest receivable of £44.5m (2012: £39.4m) owed by Thames Water Utilities Holdings Limited, the immediate parent undertaking, which is included within debtors' amounts falling due within one year
- All other amounts are unsecured, interest free and payable on demand

### 14 Debtors' amounts falling due after more than one year

	As at 31 March 2013 £m	As at 31 March 2012 £m
Amounts owed by group undertakings	2,015 0	2,015 0

Amounts owed by group undertakings are comprised of

- An unsecured loan of £2,015.0m (2012: £2,015.0m) owed by Thames Water Utilities Holdings Limited, the immediate parent undertaking. The directors do not anticipate any repayment of principal within the next twelve months.

Interest is charged at the London Inter-bank Offered rate ("LIBOR") + 0.35%

## Thames Water Utilities Limited

### Notes to the Financial Statements (continued)

#### 15 Creditors amounts falling due within one year

	As at 31 March 2013 £m	As at 31 March 2012 £m
Overdraft	67 0	-
Obligations under finance leases	10.5	56 5
Derivative collateral liability	1.3	-
Trade creditors		
- Operating	287 3	280 7
- Capital	160 4	243 0
Amounts owed to group undertakings		
- Secured loan amounts (see below)	-	417 1
- Interest	142.8	126 8
- Non interest	14.1	8 9
Other loans and financial instruments	-	52 9
Amounts payable in respect of group relief	2.1	0 9
Other taxation and social security payable	5.1	4 6
Accruals and deferred income	266 7	269 0
	<b>957.3</b>	<b>1,460 4</b>

Accruals and deferred income includes £77 8m (2012 £82 0m) 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 2013/14

The overdraft of £67 0m at 31 March relates to payments processed but not cleared. The Company does not typically utilise overdraft facilities in its banking arrangements.

## Thames Water Utilities Limited

### Notes to the Financial Statements (continued)

#### 16 Creditors: amounts falling due after more than one year

	As at 31 March 2013 £m	As at 31 March 2012 £m
Secured bank loans	1,198 7	666 9
Obligations under finance leases	102.3	130 8
Amounts owed to group undertakings secured loan amounts (see below)	7,634 7	6,939 8
Other loans and financial instruments	106 9	133 6
Accruals and deferred income	173 4	179 1
	<b>9,216 0</b>	<b>8,050 2</b>

Amounts owed to group undertakings for secured loans in the table below for the year ended 31 March 2013 are shown excluding external cross currency and index linked swaps

	As at 31 March 2013 £m	As at 31 March 2012 £m
<b>Amounts owed to group undertakings are</b>		
Inter-company secured loans		
- Within one year	-	417 1
- After more than one year	7,634 7	6,939 8
	<b>7,634 7</b>	<b>7,356 9</b>
Non-loan amounts due within one year		
- Interest	142 8	126 8
- Non interest	14.1	8 9
	<b>7,791 6</b>	<b>7,492 6</b>

Inter-company secured loans for the year ended 31 March 2013 as shown in the above table represent the liability of the Company owed to group undertakings as detailed below and do not include the effect of derivatives held within the Company

#### Secured bank loans

Each Obligor (the companies within the Securitisation Group) has entered into the Security Trust and Inter-creditor Deed ("STID") with the Security Trustee pursuant to which Thames Water Utilities Holdings Limited will guarantee the obligations of each other Obligor under the finance documents and the Company and its wholly-owned subsidiaries will guarantee the obligations of each other under the finance documents, in each case to the Security Trustee

# Thames Water Utilities Limited

## Notes to the Financial Statements (continued)

Amounts due to group undertakings in respect of non-interest amounts are unsecured, interest free and payable on demand. Loan amounts owed to group undertakings include

£2,790.3m (2012: £2,747.2m) owed to Thames Water Utilities Finance Limited, a subsidiary undertaking, within creditors due after more than one year

£4,844.5m (2012: £4,623.0m) owed to Thames Water Utilities Cayman Finance Limited, a subsidiary undertaking, of which £nil (2012: £417.1m) is included within creditors due within one year and £4,844.5m (2012: £4,205.9m) within creditors due after more than one year

Details of maturity of loans falling due after more than one year are detailed in note 17

### 17 Financial instruments

FRS 25 requires the disclosure of the funding and treasury policy together with further details on financial assets and liabilities. Funding and treasury policies are described in the Governance section on pages 37 to 38

The financial instruments disclosures presented cover loans, overdrafts, other liabilities considered borrowings cash and cash equivalents

#### Interest rate risk profile of financial liabilities and assets

After taking into account the Company's interest rate and currency swaps, the interest rate risk profile of the Company's financial liabilities and assets is as follows

#### Financial liabilities

	Total at floating rates		Total at fixed rates		Total at RPI linked rates		Total book value	
	2013 £m	2012 £m	2013 £m	2012 £m	2013 £m	2012 £m	2013 £m	2012 £m
Bank loans and overdraft								
- £ Sterling	300.2	132.3	15.0	17.7	950.5	516.8	1,265.7	666.8
Other loans and finance leases *								
- £ Sterling	73.3	316.0	3,969.5	3,680.2	3,812.9	3,734.6	7,855.7	7,730.8
	<b>373.5</b>	<b>448.3</b>	<b>3,984.5</b>	<b>3,697.9</b>	<b>4,763.4</b>	<b>4,251.4</b>	<b>9,121.4</b>	<b>8,397.6</b>

	Weighted average interest rate at fixed rate and RPI linked debt		Weighted average period until maturity for which rate is fixed at fixed rate and RPI linked debt	
	2013 %	2012 %	2013 Years	2012 Years
Bank loans and overdraft				
- £ Sterling	1.2	2.0	10.0	12.9
Other loans and finance leases *				
- £ Sterling	3.5	3.6	22.5	22.1
	<b>3.4</b>	<b>3.6</b>	<b>21.9</b>	<b>22.1</b>

\* Includes inter-company debt

# Thames Water Utilities Limited

## Notes to the Financial Statements (continued)

The Company's interest rate and cross currency swaps convert £nil (2012 £nil) of floating rate borrowing to fixed rate and £nil (2012 £235 0m) of fixed rate borrowing to floating rate. Cross currency swaps hedge currency risk on £1,256 6m (2012 £1,646 0m) of foreign currency borrowing through conversion to Sterling Index linked swaps of £1,394 1m (2012 £894 1m) swapped inter-company fixed rate debt to index linked debt. All swaps are included at their notional amount. Total accretion on the RPI linked swaps is £129 2m (2012 £132 0m).

Short-term floating rate loans bear interest at rates linked to LIBOR. Base rate is the benchmark rate for all cash at bank.

	Total at floating rates		Total at book value	
	31 March 2013 £m	31 March 2012 £m	31 March 2013 £m	31 March 2012 £m
Short term deposits	748.7	619.4	748.7	619.4
Cash in bank and in hand	-	2.7	-	2.7
	<b>748.7</b>	<b>622.1</b>	<b>748.7</b>	<b>622.1</b>

The totals in the table above are treated as available cash for covenant calculation purposes.

### Currency risk

The Company is not exposed to any significant currency risk after taking the effects of its cross currency swaps into consideration.

### Fair values

Fair value is the amount at which a financial instrument could be exchanged in an arm's length transaction between informed and willing parties, other than in a forced or liquidation sale. The table below sets out a comparison of the book and fair values of the Company's financial instruments.

	Book value		Fair value	
	31 March 2013 £m	31 March 2012 £m	31 March 2013 £m	31 March 2012 £m
<b>Primary financial instruments</b>				
<b>Financial assets</b>				
- Short term deposits	748.7	619.4	748.7	619.4
- (Overdraft)/Cash at bank and in hand	-	2.7	-	2.7
<b>Financial liabilities</b>				
- Overdraft	(67.0)	-	(67.0)	-
- Bank loans	(1,198.7)	(666.9)	(1,198.7)	(666.9)
- Other loans and finance leases *	(7,712.9)	(7,544.2)	(8,935.7)	(8,162.0)
<b>Derivative financial instruments</b>				
- Interest rate swaps	-	-	(89.6)	(93.0)
- Cross currency swaps	(13.6)	(54.5)	(59.5)	(90.3)
- Index linked swaps	(129.2)	(132.0)	(384.1)	(279.9)
<b>Total</b>	<b>(8,372.7)</b>	<b>(7,775.5)</b>	<b>(9,985.9)</b>	<b>(8,670.0)</b>

\* Includes inter-company debt

# Thames Water Utilities Limited

## Notes to the Financial Statements (continued)

Thames Water Utilities Limited does issue bonds

Other loans include bonds issued by group undertakings and external providers, which are publicly traded and loaned to Thames Water Utilities Limited. Fair values for these have been calculated using the 31 March 2013 quoted prices

Mark-to-market techniques (discounting expected cash flows at prevailing interest and exchange rates) are employed in computing fair values for the remaining fixed rate borrowings and all derivative financial instruments

Maturities	31 March 2013 £m	31 March 2012 £m
Bank loans and overdrafts		
- Within one year	67 0	-
- Between one and two years	99 5	-
- Between two and five years	349 0	-
- After more than five years	750.2	666 9
	<b>1,265 7</b>	<b>666 9</b>
Other loans including inter-company		
- Within one year	1 3	470 0
- Between one and two years	100 0	-
- Between two and five years	634 2	734 3
- After more than five years	7,007 4	6,339 1
	<b>7,742.9</b>	<b>7,543 4</b>
Finance leases		
- Within one year	10 5	56 5
- Between one and two years	45 7	28 1
- Between two and five years	56 6	80 2
- After more than five years	-	22 5
	<b>112.8</b>	<b>187 3</b>
<b>Total borrowing</b>	<b>9,121.4</b>	<b>8,397 6</b>

Loans are repayable between 2013 and 2062

Loans wholly repayable after more than five years, excluding finance leases are

	31 March 2013 £m	31 March 2012 £m
Bank loans	750 2	666 9
Other loans including inter-company	7,007.4	6,399 1
	<b>7,757 6</b>	<b>7,066 0</b>



# Thames Water Utilities Limited

## Notes to the Financial Statements (continued)

Other listed secured loans repayable to Group undertakings in order of maturity include

£200m 4 90% Fixed rate bond due 2015	£50m 3 85% Index linked bond due 2040
€500m 3 25% Fixed rate bond due 2016	£500m 5 5% Fixed rate bond due 2041
£400m 7 241% Fixed rate bond due 2058 (note 1)	£50m 1 98% Index linked bond due 2042
£200m 5 05% Fixed rate bond due 2020	£55m 2 09% Index linked bond due 2042
£225m 6 59% Fixed rate bond due 2021	£40m 1 97% Index linked bond due 2045
£175m 3 38% Index linked bond due 2021	£300m 4 625% Fixed rate bond due 2046
£550m 5 38% Fixed rate bond due 2025 (note 2)	£100m 1 85% Index linked bond due 2047
£330m 6 75% Fixed rate bond due 2028	£200m 1 82% Index linked bond due 2049
£300m 5 75% Fixed rate bond due 2030 (note 3)	£300m 1 68% Index linked bond due 2053
£200m 6 50% Fixed rate bond due 2032	£300m 1 68% Index linked bond due 2055
£300m 4 37% fixed rate bond due 2034	£200m 1 77% Index linked bond due 2057
£600m 5 13% Fixed rate bond due 2037	£350m 1 76% Index linked bond due 2062
20bn Yen 3 28% Fixed rate bond due 2038	

Note 1 £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 PCR rate (4 572%) plus the prevailing credit spread or the Company will settle related derivative contracts with bank counterparties and redeem the bond at par. If the Company were to account for derivative financial instruments under IFRS a net fair value loss of £84 4 million would be recognised as at 31 March 2013. This reflects the potential future value of cash flows relating to the remarketing of the bond.

Note 2 £550m Class B bond issued on a fixed coupon basis until 21 July 2017, when the bond resets to floating rate interest at LIBOR plus margin.

Note 3 £300m Class B bond issued on a fixed coupon basis until 13 September 2022, when the bond resets to floating rate interest at LIBOR plus margin.

See notes 15 and 16, pages 80 and 81 for details of secured bank loans.

Loans repayable by instalments after more than five years hence are

	31 March 2013 £m	31 March 2012 £m
Finance leases	-	22 5

The ranges of interest rates charged on outstanding loans are 0 21% to 8 35% (2012 0 21% to 8 35%).

These interest rates are those contracted on the underlying borrowing before taking account of interest rate protection. There are no interest free loans.

### Borrowing facilities

At 31 March 2013 the Company had access to committed facilities of £2,816 4m (2012 £1,867 0m) of which £1,201 4m (2012 £nil) had been drawn at the balance sheet date.

# Thames Water Utilities Limited

## Notes to the Financial Statements (continued)

### 18 Provisions for liabilities

	Deferred tax £m	Insurance liabilities £m	Restructuring £m	Other £m	Total £m
At beginning of the year	969.1	56.8	0.5	26.2	1,052.6
Utilised during the year	-	-	(0.5)	(6.9)	(7.4)
(Credit)/charge to profit and loss for the year	(7.9)	5.2	4.6	(2.7)	(0.8)
<b>At end of the year</b>	<b>961.2</b>	<b>62.0</b>	<b>4.6</b>	<b>16.6</b>	<b>1,044.4</b>

The deferred tax liability at 31 March 2013 has been calculated based on the rate of 23% (31 March 2012 24%) substantively enacted at the balance sheet date. The effect of this change in tax rates has been reflected in the financial statements for the year, with a credit of £41.8m taken to the profit and loss account and a charge of £4.3m taken to reserves.

The March 2013 Budget announced that the rate will further reduce to 20% by 2015 in addition to the planned reduction to 21% by 2014 previously announced in the December 2012 Autumn Statement. The overall effect of the further reductions from 23% to 20%, if these were applied to the deferred tax liability at 31 March 2013, would be to further reduce the deferred tax liability by approximately £125.4m.

The insurance provision is in respect of insurance claims notified. A debtor in respect of these obligations is included in note 13 (see page 79) 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. This provision is expected to be utilised over the next year.

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.

#### The elements of deferred tax are as follows

	31 March 2013 £m	31 March 2012 £m
Accelerated capital allowances	967.3	978.4
Tax losses carried forward	-	(2.6)
Other timing differences	(6.1)	(6.7)
	<b>961.2</b>	<b>969.1</b>
<b>Total deferred tax provision:</b>		
Included above	961.2	969.1
Net deferred tax asset recognised on net pension deficit	26	(37.2)
	<b>904.0</b>	<b>931.9</b>

At 31 March 2013 there are no amounts of deferred tax unprovided for (2012: £nil)

## Thames Water Utilities Limited

### Notes to the Financial Statements (continued)

#### 19 Called up share capital

		As at 31 March 2013 £m	As at 31 March 2012 £m
<hr/>			
<b>Allotted, called up and fully paid</b>			
29,050,000 (2012 1,029,050,000) ordinary shares of £1 each	21	29.0	1,029.0

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 (2012 £1,029.0m), all of which is 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. See preparation for conversion to new updated UK GAAP page 18

Total shareholder's funds are unaffected by this transaction

#### 20 Share premium account

		2013 £m	2012 £m
<hr/>			
At 1 April and 31 March		100.0	100.0

Premium of 25p on issue of 400,000,000 £1 ordinary shares

## Thames Water Utilities Limited

### Notes to the Financial Statements (continued)

#### 21 Profit and loss account

		2013 £m	2012 £m
At the beginning of the year		271.6	376.9
Capital reduction	19	1,000.0	-
Profit for the year		150.0	247.2
Actuarial loss on pension scheme	26	(106.8)	(94.4)
Movement on deferred tax relating to pension scheme		21.3	21.4
Dividends paid	9	(231.4)	(279.5)
<b>At the end of the year</b>		<b>1,104.7</b>	<b>271.6</b>

#### 22 Reconciliation of movements in shareholder's funds

		2013 £m	2012 £m
At the beginning of the year		1,400.6	1,505.9
Profit for the year		150.0	247.2
Actuarial loss on pension scheme	26	(106.8)	(94.4)
Movement on deferred tax relating to pension scheme		21.3	21.4
Dividends paid	9	(231.4)	(279.5)
<b>At the end of the year</b>		<b>1,233.7</b>	<b>1,400.6</b>

#### 23 Capital commitments

	As at 31 March 2013 £m	As at 31 March 2012 £m
Contracted for but not provided	842.5	1,035.5

In addition to these commitments, the Company has long-term capital investment plans to provide for future growth

# Thames Water Utilities Limited

## Notes to the Financial Statements (continued)

### 24 Contingencies

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 18

#### Contingent liabilities - AMP4 sewer flooding programme

The Company has responded to an information request 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. The information requested relates to the level of evidence required to support a judgment that a property is likely to have flooded in the past.

Ofwat first indicated its concerns in June 2010 and passed the investigation to its casework team in June 2012. Since this time, Ofwat has been considering whether to take regulatory enforcement action in relation to this case. The principal question will be whether the Company has met its legal obligations by complying with the relevant guidance. Ofwat has indicated that it is unlikely to conclude its investigations until the end of 2013.

If Ofwat concludes the Company has mis-reported its sewer flooding outputs, it may seek to impose sanctions including financial penalties of up to 10% of Company turnover attributable to regulated sewerage services. Any such potential financial impact cannot yet be quantified and, as such, no provision has been made within these accounts.

#### Contingent liabilities – £400m 7 24% Fixed rate bond due 2058

As described in Note 17, if the Company were to account for derivative financial instruments associated with the bond under IFRS a net fair value loss of £84.4 million would be recognised as at 31 March 2013, reflecting the potential future value of cash flows relating to the remarketing of the bond in April 2018. The Company expects that it will be able to successfully remarket the bond 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).

### 25 Operating leases

At 31 March 2013 the Company was committed to making the following annual payments in respect of non-cancellable operating leases:

	As at 31 March 2013		As at 31 March 2012	
	Land and buildings £m	Other £m	Land and buildings £m	Other £m
<b>Leases which expire</b>				
- Within one year	0.2	1.1	0.1	-
- In the second to fifth year inclusive	0.4	0.9	0.6	0.2
- Over five years	6.1	-	5.9	1.2
	<b>6.7</b>	<b>2.0</b>	<b>6.6</b>	<b>1.4</b>

See note 17 "Financial instruments" on page 82 for further information regarding obligations under finance leases.

# Thames Water Utilities Limited

## Notes to the Financial Statements (continued)

### 26 Pension schemes

Pension arrangements for the majority of the Company's employees are of the defined benefit type, funded through two Group pension schemes, TWPS and TWMIPS (see table below for details of each schemes' respective deficit or surplus), covering employees within the Thames Water Group, whose assets are held separately from those of the Group in independently administered funds

The defined benefit arrangements were closed to new employees from 1 April 2011. From this date, new employees have been offered membership of a defined contribution scheme managed through Standard Life. Contributions to the scheme are charged to the profit and loss account in the period to which they relate.

Contributions to the defined contribution pension scheme in the year were £2.2m (2012: £1.4m)

The Company's defined benefit pension arrangements are of the group multi-employer scheme nature, such that the Company's pension schemes' assets and liabilities are included with those of other companies in the Group. The Company contributes the vast majority of the contributions into the schemes and any consequence of there being a surplus or a deficit in the schemes is felt by the Company. 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.

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 2013, payments amounted to £0.2m (2012: £1.5m).

# Thames Water Utilities Limited

## Notes to the Financial Statements (continued)

The latest full actuarial valuation was undertaken as at 31 December 2010 on behalf of the pension Trustees by AON Hewitt Limited ("Hewitt") (the independent and professionally qualified consulting actuaries to the schemes) This valuation has been updated at 31 March 2013 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 liability by pension schemes after deferred tax

	As at 31 March 2013 £m	As at 31 March 2012 £m
<b>Thames Water Pension Scheme</b>		
Deficit in scheme	(278 6)	(190 0)
Deferred tax asset on deficit	64 1	45 6
<b>Net liability of the scheme</b>	<b>(214 5)</b>	<b>(144 4)</b>
<b>Thames Water Mirror Image Pension Scheme:</b>		
Surplus in scheme	55 7	73 5
Impact of irrecoverable surplus	(25 8)	(39 9)
<b>Net surplus after impact of irrecoverable surplus</b>	<b>29.9</b>	<b>33 6</b>
Deferred tax liability on surplus	(6 9)	(8 4)
<b>Net asset of the scheme</b>	<b>23 0</b>	<b>25 2</b>
<b>Net pension liability</b>	<b>(191 5)</b>	<b>(119 2)</b>

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 2013

# Thames Water Utilities Limited

## Notes to the Financial Statements (continued)

### Reconciliation of funded status to balance sheet

	31 March 2013 £m	31 March 2012 £m
Fair value of scheme assets	1,693.3	1,540.0
Present value of scheme liabilities	(1,916.2)	(1,656.5)
Deficit in scheme	(222.9)	(116.5)
Impact of irrecoverable surplus	(25.8)	(39.9)
Liability recognised on the balance sheet	(248.7)	(156.4)
Deferred tax asset	57.2	37.2
<b>Net pension liability</b>	<b>(191.5)</b>	<b>(119.2)</b>

The assumptions used in the valuation of assets and liabilities of the schemes are the same for both schemes, see page 95, therefore the following tables are for the combined values for both schemes

### Movement in the present value of scheme liabilities

	31 March 2013 £m	31 March 2012 £m
Opening present value of scheme liabilities	1,656.5	1,510.0
Current service cost Thames Water Utilities Limited	18.8	16.4
Current service cost Other Thames Water Group participating companies	0.1	0.1
Interest cost	75.9	79.7
Contribution by scheme participants	0.2	0.2
Curtailment gain on changes to scheme benefits	-	(40.0)
Actuarial losses on scheme liabilities	229.6	153.7
Net benefit paid out	(65.1)	(65.1)
Termination pension cost	0.2	1.5
<b>Closing present value of scheme liabilities</b>	<b>1,916.2</b>	<b>1,656.5</b>



# Thames Water Utilities Limited

## Notes to the Financial Statements (continued)

Movement in fair value of scheme assets	31 March 2013 £m	31 March 2012 £m
Opening fair value of scheme assets	1,540 0	1,403 8
Expected return on scheme assets	66 0	77 3
Actuarial gains on scheme assets	108 7	77 6
Contributions by the employer	43 2	44 6
Contributions by Other Thames Water Group participating companies	0 1	0 1
Contributions by scheme participants	0 2	0 2
Termination pension costs	0 2	1 5
Net benefits paid out	(65 1)	(65 1)
<b>Closing fair value of scheme assets</b>	<b>1,693.3</b>	<b>1,540 0</b>

Expense/(Income) recognised in the profit and loss account	31 March 2013 £m	31 March 2012 £m
Current service cost	18 8	16 4
Exceptional item – pension curtailment gain	-	(40 0)
Interest cost	75 9	79 7
Expected return on scheme assets	(66.0)	(77 3)
<b>Total expense/(income) recognised in the profit and loss account</b>	<b>28 7</b>	<b>(21 2)</b>

The expense/(income) is recognised in the following line items in the profit and loss account

	31 March 2013 £m	31 March 2012 £m
Operating costs staff costs/(income)	18.8	(23 6)
Other finance expense	9 9	2 4
<b>Total expense/(income) recognised in the profit and loss account</b>	<b>28 7</b>	<b>(21 2)</b>

# Thames Water Utilities Limited

## Notes to the Financial Statements (continued)

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

	Year ended 31 March 2013 £m	Year ended 31 March 2012 £m
Actual return less expected return on pension scheme assets	108.7	77.6
Changes in assumptions underlying the present value of scheme liabilities	(229.6)	(153.7)
Adjustment relating to irrecoverable surplus	14.1	(18.3)
<b>Actuarial loss recognised in the Statement of total recognised gains and losses</b>	<b>(106.8)</b>	<b>(94.4)</b>
<b>Cumulative amount of losses recognised in the Statement of total recognised gains and losses</b>	<b>(436.1)</b>	<b>(329.3)</b>

### Fair value of scheme assets and 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 table

	2013 Long-term expected rate of return	Value £m	2012 Long-term expected rate of return	Value £m
Equities	7.15%	575.5	7.11%	533.0
Bonds	4.30%	121.1	4.63%	32.9
Gilts	2.90%-3.15%	854.6	1.86-3.11%	774.3
Property	6.15%	99.8	6.11%	103.3
Other assets	3.15%	42.3	3.11%	96.5
<b>Weighted average expected long-term rate of return/total fair value of assets</b>	<b>4.6%</b>	<b>1,693.3</b>	<b>4.6%</b>	<b>1,540.0</b>

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.

# Thames Water Utilities Limited

## Notes to the Financial Statements (continued)

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

	2013	2012
Price inflation – RPI	3.5%	3.1%
Price inflation – CPI	2.8%	2.4%
CARE revaluation (CPI max 2.5%)	2.5%	2.4%
Salary increases - TWPS	n/a	n/a
Salary increases - TWMIPS	4.0%	3.6%
Pension increases – RPI	3.5%	3.1%
Pension increases – CPI	2.8%	2.4%
Discount rate for scheme liabilities	4.3%	4.65%

In valuing the liabilities of the pension schemes at 31 March 2013, mortality assumptions have been made as indicated below. These mortality assumptions are based on the recent actual mortality experience of members within the schemes and the assumptions also allow for future improvements to mortality rates

	2013	2012
<b>TWPS members who joined before/after 1 January 1995</b>		
Life expectancy for a male pensioner from age 60	27	27
Life expectancy for a female pensioner from age 60	29	29
Life expectancy from age 60 for a male pensioner currently aged 40	29	29
Life expectancy from age 60 for a female pensioner currently aged 40	31	31
<b>TWMIPS</b>		
Life expectancy for a male pensioner from age 60	26	26
Life expectancy for a female pensioner from age 60	28	28
Life expectancy from age 60 for a male pensioner currently aged 40	28	28
Life expectancy from age 60 for a female pensioner currently aged 40	30	30

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

	Year ended 31 March 2013 £m	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m	Year ended 31 March 2010 £m	Year ended 31 March 2009 £m
Fair value of scheme assets	1,693.3	1,540.0	1,403.8	1,317.4	1,040.3
Present value of scheme liabilities	(1,916.2)	(1,656.5)	(1,510.0)	(1,466.6)	(1,105.4)
<b>Deficit in scheme</b>	<b>(222.9)</b>	<b>(116.5)</b>	<b>(106.2)</b>	<b>(149.2)</b>	<b>(65.1)</b>

# Thames Water Utilities Limited

## Notes to the Financial Statements (continued)

### Experience adjustments

	Year ended 31 March 2013 £m	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m	Year ended 31 March 2010 £m	Year ended 31 March 2009 £m
<b>Experience gains/(losses) on scheme assets</b>					
Amounts	108.7	77.6	14.1	220.6	(250.4)
Percentage of scheme assets	6.4%	5.0%	1.0%	16.7%	24.1%
<b>Experience losses on scheme liabilities</b>					
Amounts	-	(11.0)	-	-	(44.3)
Percentage of scheme liabilities	-	1%	-	-	4.0%
<b>Total amount recognised in the Statement of total gains and losses</b>					
Amounts	(106.8)	(94.4)	(2.0)	(105.4)	(133.0)
Percentage of present value of scheme liabilities	5.6%	5.7%	0.1%	7.2%	12.0%

TWUL expects to contribute approximately £44.0m to the defined benefit schemes in the next financial year

### 27 Cash flow statement

#### (a) Reconciliation of operating profit to net cash inflow from operating activities

	Note	Year ended 31 March 2013 £m	Year ended 31 March 2012 £m
Operating profit		549.3	643.9
Depreciation (infrastructure renewals charge)	3	135.3	129.5
Depreciation (non-infrastructure)	3	322.2	286.1
Difference between pension charge and cash contributions		(24.8)	(68.1)
Decrease/(increase) in stocks		1.1	(1.3)
Decrease/(increase) in debtors and prepaid expenses		80.1	(36.3)
Decrease in creditors and accrued expenses		12.9	(14.4)
Decrease in provisions		(5.5)	(0.9)
Release of deferred income		(13.6)	(13.8)
<b>Net cash inflow from operating activities</b>		<b>1,057.0</b>	<b>924.7</b>

# Thames Water Utilities Limited

## Notes to the Financial Statements (continued)

### (b) Reconciliation of net cash flow to movement in net debt

	Note	Year ended 31 March 2013 £m	Year ended 31 March 2012 £m
Decrease in cash in the year	(e)	(2 7)	(0 9)
Cash inflow/(outflow) from increase in liquid resources		129 3	(156 4)
Cash inflow from movement in net debt and financing		(587 1)	(640 1)
<b>Increase in net debt resulting from cash flows</b>		<b>(460.5)</b>	<b>(797 4)</b>
Non-cash increase in net debt		(136 7)	(182 3)
<b>Total increase in net debt</b>		<b>(597 2)</b>	<b>(979 7)</b>
Opening net debt		(7,775 5)	(6,795 8)
<b>Closing net debt</b>	(c)	<b>(8,372 7)</b>	<b>(7,775 5)</b>

The non-cash increase in net debt comprises amortisation of bond fees and the carrying value accretion by RPI, 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"

### (c) Analysis of movement in net debt

	As at 1 April 2012 £m	Cash flow £m	Other non- cash movements £m	As at 31 March 2013 £m
Cash at bank and in hand	2 7	(2 7)	-	-
Current asset investments	619 4	129 3	-	748 7
	622 1	126 6	-	748 7
Overdraft	-	(67 0)	-	(67.0)
Debt due within one year	(470 0)	468 7	-	(1 3)
Debt due after more than one year	(7,740 3)	(1,063 3)	(136 7)	(8,940 3)
Finance leases	(187 3)	74 5	-	(112 8)
	(8,397 6)	(587 1)	(136 7)	(9,121.4)
<b>Total</b>	<b>(7,775 5)</b>	<b>(460 5)</b>	<b>(136 7)</b>	<b>(8,372 7)</b>

# Thames Water Utilities Limited

## Notes to the Financial Statements (continued)

### (d) Decrease in cash

	Year ended 31 March 2013 £m	Year ended 31 March 2012 £m
Unrestricted cash movement	(71 0)	(0 9)
Restricted cash movement *	1 3	-
	<b>(69 7)</b>	<b>(0 9)</b>

\*Included in the overdraft in note 15, page 80 and shown within the decrease in cash in the cash flow statement, page 63, is a restricted cash receipt of £1.3m (2012: £nil). This receipt is currently 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 cash receipt relates to collateral posted by derivative counter parties that have failed to meet minimum credit rating criteria assigned by Moody's.

### 28 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:

- Operating leases (see note 25, page 89)
- Outsourcing contracts

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 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.

### 29 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 or from the Company's website ([www.thameswater.co.uk](http://www.thameswater.co.uk)).

# Thames Water Utilities Limited

## Regulatory accounts and required regulatory information

	<b>Pages</b>
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# Thames Water Utilities Limited

## Regulatory accounts and required regulatory information

### Explanatory note

The regulatory accounts and required regulatory information on pages 100 to 109 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

The regulatory accounts are prepared in accordance with the Regulatory Accounting Guidelines ("RAG") issued by Ofwat. These guidelines were revised in February 2013 being operative from the financial year ended 31 March 2013. These revised RAGs have been adopted in the preparation and presentation of these regulatory accounts.

There are differences between UK Generally Accepted Accounting Practice and the RAG. Where different treatments are specified under each, the RAG takes precedence.

A glossary of regulatory terms is shown on pages 137 to 138.

The regulatory financial statements should be read in conjunction with the statutory Annual Report and financial statements ("AR&A"). The AR&A include a Business review (pages 6 to 22). In addition, the Directors' report (pages 23 to 26) includes a statement as to the disclosure of information to the auditor (page 26), the dividend policy of the Company which also applies to the appointed business (page 23) and information in respect of the Company's charitable donations (page 25). In addition, the Directors' remuneration report (pages 47 to 58) includes information linking their remuneration with standards of regulatory performance.

#### Accounting Separation - methodology

The Company has also produced a separately published Accounting Separation methodology statement in respect of the operating costs and associated fixed asset book values in notes on pages 116 to 121. This methodology statement details the assumptions used in the allocation of costs into the relevant Accounting Separation value streams and also includes the Company's capitalisation policy.

#### Basis of allocation

Finance data within the Company's finance

system (SAP) is recorded by expenditure type within a cost centre.

Where possible, costs are recorded at the lowest level within the cost centre hierarchy i.e. the relevant process level appropriate to the type of cost and business value stream. 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. These costs are therefore allocated to the process level by using pre-determined rules as defined by management, the appropriate rules are recorded within SAP.

The costs to be allocated are assessed by management with regard to the nature and type of cost and an appropriate rule is created, this allocates costs from a sender cost centre to a receiver cost centre. The receiver cost centres are structured into the Accounting Separation table value streams.

The rules and assessment cycles are reviewed at least annually to ensure that they are appropriate and valid, taking into account any business unit reorganisation and any operational process changes.

The results of the allocations are reviewed by management and revised where necessary. There is a clear audit trail in place of any adjustments that are made.

#### Changes to methodology used in 2013

Management has reviewed the basis of allocation of general and support services costs and allocation of power costs. The change in allocation of general and support costs was to remove a smoothing adjustment made in previous years. Management considered that this adjustment was no longer appropriate as the underlying financial system (SAP) holds information at a more granular level.

In addition, management has reviewed its power cost allocation based on a large sample of Water Treatment Works. This review has indicated that costs associated with high lift pumping, previously reflected in treated Water Distribution, should be reported within Water Treatment.



# Thames Water Utilities Limited

## Regulatory accounts and required regulatory information

### 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,
- 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

### Ring fencing

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 This relates to the availability of rights and assets in the event of a special administration order

### Definitions of appointed and non-appointed business

The appointed business comprises the regulated activities of the Company as defined in Condition A of its licence These are activities necessary in order for a company to fulfill 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, which are conducted on an arms lengths basis These activities include third-party discharges to STWs, property searches, gravel sales, activities the company performed for the Olympic and Paralympic games and certain other commercial activities The non-appointed business also includes charitable donations made on behalf of the shareholder which the customer does not fund

# Thames Water Utilities Limited

## Regulatory historic profit and loss account

	Year ended 31 March 2013			Year ended 31 March 2012		
	Appointed business £m	Non-Appointed business £m	Total £m	Appointed business £m	Non-Appointed business £m	Total £m
<b>Turnover</b>	<b>1,758.9</b>	<b>33.0</b>	<b>1,791.9</b>	1,670.9	24.0	1,694.9
Operating costs*	(770.5)	(14.6)	(785.1)	(665.8)	(9.6)	(675.4)
Infrastructure renewals charge	(135.3)	-	(135.3)	(129.5)	-	(129.5)
Historical cost depreciation	(321.2)	(1.0)	(322.2)	(285.1)	(1.0)	(286.1)
Operating income	10.8	-	10.8	43.9	-	43.9
<b>Operating profit</b>	<b>542.7</b>	<b>17.4</b>	<b>560.1</b>	634.4	13.4	647.8
Other expenses	(9.9)	-	(9.9)	(2.4)	-	(2.4)
Net interest payable	(405.1)	(0.2)	(405.3)	(423.0)	(0.2)	(423.2)
<b>Profit on ordinary activities before taxation</b>	<b>127.7</b>	<b>17.2</b>	<b>144.9</b>	209.0	13.2	222.2
Taxation - current	2.9	(4.0)	(1.1)	41.3	(3.0)	38.3
- deferred	6.4	(0.2)	6.2	(12.9)	(0.4)	(13.3)
<b>Profit for the year</b>	<b>137.0</b>	<b>13.0</b>	<b>150.0</b>	237.4	9.8	247.2
Dividends	(218.4)	(13.0)	(231.4)	(269.7)	(9.8)	(279.5)
<b>Retained loss for the year</b>	<b>(81.4)</b>	<b>-</b>	<b>(81.4)</b>	(32.3)	-	(32.3)

\*operating costs include exceptional items 2012/13 £nil (2011/12 £40m pension curtailment gain)

## Statement of total recognised gains and losses (historical cost accounting) for the appointed business

	Year ended 31 March 2013	Year ended 31 March 2012
	£m	£m
Profit for the year	137.0	237.4
Actuarial loss on post-employment plans	(106.8)	(94.4)
Deferred tax relating to actuarial loss	21.3	21.4
<b>Total recognised gains for the year</b>	<b>51.5</b>	<b>164.4</b>

# Thames Water Utilities Limited

## Regulatory historical cost balance sheet

	As at 31 March 2013			As at 31 March 2012		
	Appointed business £m	Non- Appointed business £m	Total £m	Appointed business £m	Non- Appointed business £m	Total £m
<b>Fixed assets</b>						
Tangible assets	9,221 3	6 8	9,228 1	8,747 7	7 7	8,755 4
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
<b>Total fixed assets</b>	<b>11,236 4</b>	<b>6 8</b>	<b>11,243 2</b>	<b>10,762 8</b>	<b>7 7</b>	<b>10,770 5</b>
Infrastructure renewals prepayment	69 8	-	69 8	32 9	-	32 9
Other current assets	1,329 9	-	1,329 9	1,279 6	-	1,279 6
<b>Creditors amounts falling due within one year</b>						
Borrowings	(78 8)	-	(78 8)	(526 5)	-	(526 5)
Other creditors	(865 1)	(6 2)	(871 3)	(919 4)	(7 3)	(926 7)
<b>Total creditors amounts falling due within one year</b>	<b>(943 9)</b>	<b>(6 2)</b>	<b>(950 1)</b>	<b>(1,445 9)</b>	<b>(7 3)</b>	<b>(1,453 2)</b>
<b>Net current asset / (liabilities)</b>	<b>455 8</b>	<b>(6 2)</b>	<b>449 6</b>	<b>(133 4)</b>	<b>(7 3)</b>	<b>(140 7)</b>
<b>Total assets less current liabilities</b>	<b>11,692 2</b>	<b>0 6</b>	<b>11,692 8</b>	<b>10,629 4</b>	<b>0 4</b>	<b>10,629 8</b>
<b>Creditors amounts falling due after more than one year</b>						
Borrowings	(9,042 6)	-	(9,042 6)	(7,871 1)	-	(7,871 1)
Other creditors	(44 6)	-	(44 6)	(49 3)	-	(49 3)
<b>Total creditors amounts falling due after more than one year</b>	<b>(9,087 2)</b>	<b>-</b>	<b>(9,087 2)</b>	<b>(7,920 4)</b>	<b>-</b>	<b>(7,920 4)</b>
Provisions for liabilities and charges	(1,371 3)	(0 6)	(1,371 9)	(1,308 4)	(0 4)	(1,308 8)
<b>Net assets employed</b>	<b>1,233 7</b>	<b>-</b>	<b>1,233 7</b>	<b>1,400 6</b>	<b>-</b>	<b>1 400 6</b>
<b>Capital and reserves</b>	<b>1,233 7</b>	<b>-</b>	<b>1,233 7</b>	<b>1,400 6</b>	<b>-</b>	<b>1,400 6</b>

## Thames Water Utilities Limited

### Historical cost reconciliation between statutory and regulatory accounts

	2013 Statutory UK GAAP £m	Regulatory RAG 3 £m	Explanation
<b>Profit and loss account</b>			
Operating costs	(1,242 6)	(785 1)	The difference of £457 5m is due to the reporting of historic cost depreciation (£322 2m cost) and Infrastructure renewals charge (£135 3m) as separate categories in the regulatory accounts
Operating income	-	10 8	Profit on sale of fixed assets of £10 8m as reported above are disclosed within operating income in the regulatory accounts
Operating profit	549 3	560 1	The difference of £10 8m is due to the statutory accounts profit on sale of assets is shown below operating result. Ofwat accounting guidelines state that this should be classified within operating costs as "operating income" for regulatory accounts
Profit on sale of fixed assets	10.8	-	The difference of £10 8m is due to the statutory accounts profit on sale of assets is shown below operating result. Ofwat accounting guidelines state that this should be classified within operating costs as "operating income" for regulatory accounts
Profit before taxation	144 9	144 9	Profit before taxation is unaffected by this re-classification

## Thames Water Utilities Limited

### Historical cost reconciliation between statutory and regulatory accounts

	2013 Statutory UK GAAP £m	Regulatory RAG 3 £m	Explanation
<b>Balance sheet</b>			
<u>Fixed assets</u>			
Tangible fixed assets (net book value)	9,297.9	9,228.1	The difference of £69.8m is due to the infrastructure renewals prepayment as this is excluded from the fixed assets net book value in the regulatory accounts. This is in line with RAG 3.07 as FRS 15 is not applied for infrastructure renewals accounting for regulatory accounting purposes. For more detail see page 106.
Investments – loan to group company	-	2,015.0	A loan to the immediate parent company, Thames Water Utilities Holdings Limited is classified within this category within the regulatory accounts but disclosed as a debtor amount falling due after more than one year in the statutory accounts.
Debtors amount falling due after more than one year	2,015.0	-	As above
<u>Current Assets</u>			
Infrastructure renewals prepayment	-	69.8	The difference of £69.8m reflects the reclassification of infrastructure renewals prepayment described above.
<u>Short-term and long-term creditors</u>			
Deferred income – grants and contributions	(136.0)	-	Deferred grants and contributions of £136.0m within the statutory accounts are analysed between creditors amounts falling due within one year (£7.2m) and creditors amounts falling due after more than one year (£128.8m). This is in contrast to the regulatory accounts, which shows total deferred grants and contributions within provisions for liabilities and charges.
Provision for liabilities and charges	-	(136.0)	As above

# Thames Water Utilities Limited

## 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 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 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. The departures from applicable UK Accounting Standards are necessary to comply with regulatory reporting requirements laid down by Ofwat

### Accounting policies

The same accounting policies as those used for the year ended 31 March 2012 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. This represents a departure from FRS 3 as adopted in the Company's 31 March 2013 statutory financial statements in which profit and loss on sale of fixed assets are shown after operating profit

#### (b) Infrastructure renewals expenditure

Infrastructure renewals expenditure ("IRE") has been accounted for in accordance with RAG 3.07. Accordingly, IRE net of Infrastructure Renewals Charge ("IRC") has been included within debtors

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. Within these regulatory historic cost financial statements, the Company in accordance with RAG 3.067 reports IRE net of IRC within debtors in the

regulatory historic cost financial statements for the year ended 31 March 2013

The reconciliation from the tangible fixed assets shown in the statutory financial statements to the regulatory historical cost financial statements is shown on page 109

#### (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 would not be recognised in the profit and loss account

#### (d) Allocation of costs

All direct costs are allocated immediately to the activity to which they relate. Indirect costs and overheads are apportioned on an appropriate basis to reflect the incidence of such costs. Indirect costs include administrative expenses and the provision of common services

Direct costs attributable to the provision of services other than the Appointed Business are separately allocated and identified as "non-Appointed". Indirect costs, relating to non-appointed activities, are recovered as a fixed percentage of direct costs based upon the analysis of operating costs

#### (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 is 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

## Thames Water Utilities Limited

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, judgement 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 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,
- 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

## Thames Water Utilities Limited

disconnected are not chargeable for water and sewerage therefore no billing is raised and no turnover recognised in respect of these properties

### Unoccupied properties policy

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 has 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.

### Provision for bad debt

Information regarding the Company's policy for providing for bad and doubtful debts can be found within Note 1, Principal accounting policies on page 68 of the statutory financial statements.



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### 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
<b>Cost</b>			
At 31 March 2013 as per statutory accounts (FRS 15)	9,680 6	5,167 1	14,847 7
Infrastructure renewals expenditure capitalised in previous years	-	(1,236 4)	(1,236 4)
Infrastructure renewals expenditure capitalised in the year	-	(172 2)	(172 2)
Disposals in prior years	-	0 9	0 9
<b>Cost at 31 March 2013 per regulatory accounts (RAG 3)</b>	<b>9,680 6</b>	<b>3,759 4</b>	<b>13,440 0</b>
<b>Capital contributions</b>			
Contributions at 31 March 2013 as per statutory accounts (FRS 15)	-	702 3	702 3
Contributions at 31 March 2013 as per regulatory accounts (RAG 3)	-	<b>702 3</b>	<b>702 3</b>
<b>Depreciation</b>			
At 31 March 2013 as per statutory accounts (FRS 15)	3,509 6	1,337 9	4,847 5
Infrastructure renewals charge in previous years	-	(1,203 5)	(1,203 5)
Infrastructure renewals charge in the year	-	(135 3)	(135 3)
Disposals in prior years	-	0 9	0 9
<b>Depreciation at 31 March 2013 per regulatory accounts (RAG 3)</b>	<b>3,509 6</b>	<b>-</b>	<b>3,509 6</b>
<b>Net book value</b>			
At 31 March 2013 as per statutory accounts (FRS 15)	6,171 0	3,126 9	9,297 9
Adjustment for infrastructure renewals accounting (see below)	-	(69 8)	(69 8)
<b>At 31 March 2013 per regulatory accounts (RAG 3)</b>	<b>6,171 0</b>	<b>3,057 1</b>	<b>9,228 1</b>
<b>Adjustment for infrastructure renewals accounting</b>			
		<b>Infrastructure assets £m</b>	
<b>RAG 3 net infrastructure renewals reclassification</b>			
Infrastructure renewals prepayment at 31 March 2012			32 9
Infrastructure renewals expenditure capitalised in the year			172 2
Infrastructure renewals charge in the year			(135 3)
<b>Infrastructure renewals prepayment at 31 March 2013</b>			<b>69 8</b>

# Thames Water Utilities Limited

## Regulatory current costs financial statements

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# Thames Water Utilities Limited

## Regulatory current cost financial statements

### Introductory note

The Current cost information within pages 112 to 123 is provided in accordance with RAG 3 07 (issued February 2013), which replaces RAG 3 06. There are certain departures from the information previously required under RAG 3 06 and these are listed below.

The following financial statements are no longer required:

- current cost balance sheet
- turnover analysis
- movement in current cost reserve
- net debt analysis
- net cash flow from operating activities
- reconciliation of net cash flow to movement in net debt for the appointed business

The format of the following financial statements has changed:

- format of the current cost profit and loss account has been amended to include detailed turnover analysis previously provided as a separate note to the accounts
- format of the current cost statement of cash flows has been amended to include analysis of net cash flow from operating activities previously provided as a separate note
- the format of the Operating costs and associated fixed asset book values and the Current cost analysis of fixed assets by asset type have been amended. The Current cost analysis of fixed assets by asset type statements are now stand alone statements and are not linked to any primary statement.

There are two new requirements to be published:

- an analysis of capital expenditure, grants and land
- a non-financial Properties analysis

## Thames Water Utilities Limited

### Regulatory current cost profit and loss account for the appointed business

	Note	Year ended 31 March 2013			Year ended 31 March 2012		
		Water	Sewerage	Total	Water	Sewerage	Total
		£m			£m		
<b>Turnover</b>							
Unmeasured		480 1	477 8	957 9	468 7	448 4	917 1
	- household						
	- non-household	7 2	6 5	13 7	6 6	5 0	11 6
Measured		183 0	231 1	414 1	174 1	205 1	379 2
	- household						
	- non-household	156 6	127 4	284 0	157 5	117 5	275 0
Trade effluent		-	6 8	6 8	-	6 6	6 6
Bulk supplies / inter company payments		3 0	-	3 0	3 0	-	3 0
Other third party services (incl non-potable water)		2 2	1 0	3 2	2 7	5 7	8 4
Other sources		39 2	37 0	76 2	38 8	31 2	70 0
<b>Total turnover</b>		<b>871 3</b>	<b>887 6</b>	<b>1,758 9</b>	<b>851 4</b>	<b>819 5</b>	<b>1,670 9</b>
Current cost operating costs - retail	2	(106 2)	(111 2)	(217 4)	(95 6)	(74 7)	(170 3)
Current cost operating costs - wholesale	2	(527 4)	(587 3)	(1,114 7)	(490 9)	(516 3)	(1,007 2)
<b>Operating income*</b>		<b>4 7</b>	<b>4 8</b>	<b>9 5</b>	<b>22 5</b>	<b>21 8</b>	<b>44 3</b>
Working capital adjustment		5 2	5 3	10 5	10 2	9 9	20 1
<b>Current cost operating profit</b>		<b>247 6</b>	<b>199 2</b>	<b>446 8</b>	<b>297 6</b>	<b>260 2</b>	<b>557 8</b>
Net interest				(415 0)			(425 4)
Financing adjustment				50 8			41 0
<b>Current cost profit before taxation</b>				<b>82 6</b>			<b>173 4</b>
Net revenue movement out of tariff basket		0 6	-	0 6	(1 6)	(0 4)	(2 0)

\* Operating income includes exceptional items 2012/13 £nil (2011/12 £40m pension curtailment gain)

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### Regulatory current cost cash flow statement – Appointed business only

	Year ended 31 March 2013	Year ended 31 March 2012
	£m	£m
<b>Current cost operating profit</b>	<b>446.8</b>	<b>557.8</b>
Working capital adjustment	(10.5)	(20.1)
Movement in working capital	50.1	10.1
Current cost depreciation	429.0	375.5
Current cost profit on sale of fixed assets	(9.5)	(4.3)
Current cost exceptional item	-	(40.0)
Infrastructure renewals charge	135.3	129.5
Difference between pension charge and cash contribution	(24.8)	(68.1)
Other non-cash items (Including movement in provisions)	9.8	(27.1)
<b>Net cash inflow from operating activities</b>	<b>1,026.2</b>	<b>913.3</b>
Returns on investments and servicing of finance	(260.9)	(254.7)
Taxation received	4.0	83.0
<b>Capital expenditure and financial investment</b>		
Gross cost of purchased fixed assets	(903.4)	(993.0)
Receipt of grants and contributions	51.4	44.3
Infrastructure renewals expenditure	(172.2)	(179.4)
Disposal of fixed assets	12.8	8.8
Movement on long term group loans to group companies	-	(150.0)
<b>Net cash outflow from investing activities</b>	<b>(1,011.4)</b>	<b>(1,269.3)</b>
Equity dividends paid	(218.4)	(269.7)
Net cash (inflow)/outflow from management of liquid resources	(129.3)	156.4
<b>Net cash outflow before financing</b>	<b>(589.8)</b>	<b>(641.0)</b>
Net cash inflow from financing	520.1	640.1
<b>Decrease in cash</b>	<b>(69.7)</b>	<b>(0.9)</b>

# Thames Water Utilities Limited

## Notes to the regulatory current cost financial statements

### 1 Current cost accounting policies

These financial statements have been prepared in accordance with guidance issued by the Water Services Regulation Authority 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 used for the year ended 31 March 2012 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 an 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 £6,732m (2012 £6,480m) based upon a pipe length of 19,000km (2012 19,000km). Adjustments may be required to those estimates in future years as more accurate information becomes available.

##### • 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.

##### (iii) 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.

# Thames Water Utilities Limited

## Notes to the regulatory current cost financial statements

(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 is calculated by applying the change in the RPI over the year to the opening balance of net finance, which comprises all monetary assets and liabilities in the balance sheet apart from those included in working capital, but excluding index rate linked debt and the deferred tax provision

(c) **Operating costs**

In note 2, direct costs incurred with associated companies are less than 20% of the total operating costs of the business before interest and tax. Therefore the costs have been allocated across the appropriate headings in accordance with RAG 3.07



# Thames Water Utilities Limited

## Notes to the regulatory current cost financial statements

2 Operating costs and associated fixed asset book values for year ended 31 March 2013

2a Water Services

	Resources £m	Raw water distribution £m	Treatment £m	Treated distribution £m	Total £m
<b>Operating expenditure</b>					
Power	8.5	3.1	28.0	6.8	46.4
Service charges	18.5	-	-	-	18.5
Other operating expenditure	10.9	6.1	40.3	124.6	181.9
Local authority rates	1.7	2.0	3.1	27.9	34.7
<b>Total operating expenditure excluding third party services</b>	<b>39.6</b>	<b>11.2</b>	<b>71.4</b>	<b>159.3</b>	<b>281.5</b>
<b>Capital maintenance</b>					
Infrastructure renewals charge	8.5	-	-	69.3	77.8
Current cost depreciation	15.6	3.4	98.5	50.5	168.0
Amortisation of deferred credits	(0.1)	(0.1)	(0.3)	(1.2)	(1.7)
<b>Total capital maintenance excluding third party services</b>	<b>24.0</b>	<b>3.3</b>	<b>98.2</b>	<b>118.6</b>	<b>244.1</b>
<b>Third party services</b>					
Operating expenditure	0.3	-	1.0	0.5	1.8
<b>Total operating costs</b>	<b>63.9</b>	<b>14.5</b>	<b>170.6</b>	<b>278.4</b>	<b>527.4</b>

# Thames Water Utilities Limited

## Notes to the regulatory current cost financial statements

### 2b Sewerage Services

£m	Sewerage collection	Sewerage treatment	Sludge treatment, disposal	Sludge disposal	Total
<b>Operating expenditure</b>					
Power	10.1	35.0	6.0	-	51.1
Income treated as negative expenditure	-	(3.8)	(3.3)	-	(7.1)
Service charges	2.4	3.2	-	-	5.6
Other operating expenditure	90.3	74.8	25.3	22.7	213.1
Local authority rates	-	28.8	10.0	1.4	40.2
<b>Total operating expenditure excluding third party services</b>	<b>102.8</b>	<b>138.0</b>	<b>38.0</b>	<b>24.1</b>	<b>302.9</b>
<b>Capital maintenance</b>					
Infrastructure renewals charge	57.5	-	-	-	57.5
Current cost depreciation	48.5	142.5	38.2	2.2	231.4
Amortisation of deferred credits	(7.5)	(0.6)	(0.1)	-	(8.2)
<b>Total capital maintenance excluding third party services</b>	<b>98.5</b>	<b>141.9</b>	<b>38.1</b>	<b>2.2</b>	<b>280.7</b>
<b>Third party services</b>					
Operating expenditure	1.0	1.7	0.3	0.7	3.7
<b>Total operating costs</b>	<b>202.3</b>	<b>281.6</b>	<b>76.4</b>	<b>27.0</b>	<b>587.3</b>

# Thames Water Utilities Limited

## Notes to the regulatory current cost financial statements

### 2c Retail Services

	Household £m	Non- household £m	Total £m
<b>Operating expenditure - direct costs</b>			
Customer services	35.8	4.8	40.6
Debt management	18.6	1.9	20.5
Doubtful debts	82.3	11.4	93.7
Meter reading	5.0	1.9	6.9
Support for trade effluent compliance	-	1.0	1.0
Services to developers	-	1.8	1.8
Other operating expenditure	17.5	5.4	22.9
Local authority rates	0.3	0.1	0.4
<b>Total operating expenditure</b>	<b>159.5</b>	<b>28.3</b>	<b>187.8</b>
<b>Capital maintenance</b>			
Current cost depreciation	25.1	4.5	29.6
<b>Total capital maintenance</b>	<b>25.1</b>	<b>4.5</b>	<b>29.6</b>
<b>Total operating costs</b>	<b>184.6</b>	<b>32.8</b>	<b>217.4</b>
Debt written off	71.3	5.6	76.9

# Thames Water Utilities Limited

## Notes to the regulatory current cost financial statements

### Current cost analysis of fixed assets by asset type

#### Water Services current cost fixed assets

	Resources	Raw Water Distribution	Treatment	Treated Water Distribution	Total
	£m	£m	£m	£m	£m
<b>Non-Infrastructure assets</b>					
<b>Gross replacement cost</b>					
At 1 April 2012	393.8	58.4	2,768.7	1,617.5	4,838.4
AMP Adjustment	2.6	0.2	16.7	9.8	29.3
RPI adjustment	13.1	1.9	91.4	53.4	159.8
Disposals	(3.0)	-	(61.7)	(58.2)	(122.9)
Additions	5.3	1.2	84.2	49.6	140.3
<b>At 31 March 2013</b>	<b>411.8</b>	<b>61.7</b>	<b>2,899.3</b>	<b>1,672.1</b>	<b>5,044.9</b>
<b>Depreciation</b>					
At 1 April 2012	215.8	34.0	1,488.9	714.1	2,452.8
AMP Adjustment	1.4	0.2	10.4	5.2	17.2
RPI adjustment	7.1	1.1	49.2	23.6	81.0
Disposals	(3.0)	-	(61.7)	(58.1)	(122.8)
Charge for year	15.6	3.4	98.5	50.5	168.0
<b>At 31 March 2013</b>	<b>236.9</b>	<b>38.7</b>	<b>1,585.3</b>	<b>735.3</b>	<b>2,596.2</b>
<b>Net book amount at 31 March 2013</b>	<b>174.9</b>	<b>23.0</b>	<b>1,314.0</b>	<b>936.8</b>	<b>2,448.7</b>
Net book amount at 1 April 2012	178.0	24.4	1,279.8	903.4	2,385.6
<b>Infrastructure assets</b>					
<b>Gross replacement cost</b>					
At 1 April 2012	534.3	1,216.6	0.2	10,517.7	12,268.8
AMP Adjustment	3.7	5.5	-	69.3	78.5
RPI adjustment	17.6	40.1	-	347.3	405.0
Disposals	-	-	-	(43.4)	(43.4)
Additions	1.3	-	-	28.0	29.3
<b>At 31 March 2013</b>	<b>556.9</b>	<b>1,262.2</b>	<b>0.2</b>	<b>10,918.9</b>	<b>12,738.2</b>

Note The disposal of £43.4m (2012 £48.6m) 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

# Thames Water Utilities Limited

## Notes to the regulatory current cost financial statements

### Sewerage Services current cost fixed assets

	Sewage collection £m	Sewage treatment £m	Sludge treatment £m	Sludge disposal £m	Total £m
<b>Non-Infrastructure assets</b>					
<b>Gross replacement cost</b>					
At 1 April 2012	2,194.9	5,617.3	971.8	102.3	8,886.3
AMP adjustment	13.6	31.0	8.9	0.8	54.3
Reclassification adjustment	(17.6)	-	-	-	(17.6)
RPI adjustment	71.9	185.3	32.2	3.4	292.8
Disposals	(21.7)	(89.0)	(25.7)	(0.2)	(136.6)
Additions	77.6	258.9	92.5	3.2	432.2
<b>At 31 March 2013</b>	<b>2,318.7</b>	<b>6,003.5</b>	<b>1,079.7</b>	<b>109.5</b>	<b>9,511.4</b>
<b>Depreciation</b>					
At 1 April 2012	1,259.1	3,144.4	444.4	23.1	4,871.0
AMP Adjustment	8.6	20.8	4.8	0.4	34.6
RPI adjustment	41.6	103.8	14.7	0.8	160.9
Disposals	(21.7)	(85.7)	(25.7)	(0.2)	(133.3)
Charge for year	48.5	142.5	38.2	2.2	231.4
<b>At 31 March 2013</b>	<b>1,336.1</b>	<b>3,325.8</b>	<b>476.4</b>	<b>26.3</b>	<b>5,164.6</b>
<b>Net book amount at 31 March 2013</b>	<b>982.6</b>	<b>2,677.7</b>	<b>603.3</b>	<b>83.2</b>	<b>4,346.8</b>
Net book amount at 1 April 2012	935.8	2,472.9	527.4	79.2	4,015.3
<b>Infrastructure assets</b>					
<b>Gross replacement cost</b>					
At 1 April 2012	75,510.1	22.1	2.9	-	75,535.1
AMP adjustment	378.4	-	0.1	-	378.5
Reclassification adjustment	17.6	-	-	-	17.6
RPI adjustment	2,490.3	0.7	0.1	-	2,491.1
Additions	196.0	-	-	-	196.0
<b>At 31 March 2013</b>	<b>78,592.4</b>	<b>22.8</b>	<b>3.1</b>	<b>-</b>	<b>78,618.3</b>

# Thames Water Utilities Limited

## Notes to the regulatory current cost financial statements

### Retail current cost fixed assets

	Household £m	Non- household £m	Total £m
<b>Non-Infrastructure assets</b>			
<b>Gross replacement cost</b>			
At 1 April 2012	309.6	63.4	373.0
AMP Adjustment	55.3	5.0	60.3
RPI adjustment	12.0	2.2	14.2
Disposals	(6.0)	(1.2)	(7.2)
Additions	31.6	6.5	38.1
<b>At 31 March 2013</b>	<b>402.5</b>	<b>75.9</b>	<b>478.4</b>
<b>Depreciation</b>			
At 1 April 2012	209.1	42.8	251.9
AMP Adjustment	33.5	3.1	36.6
RPI adjustment	8.0	1.5	9.5
Disposals	(6.0)	(1.2)	(7.2)
Charge for year	25.1	4.5	29.6
<b>At 31 March 2013</b>	<b>269.7</b>	<b>50.7</b>	<b>320.4</b>
<b>Net book amount at 31 March 2013</b>	<b>132.8</b>	<b>25.2</b>	<b>158.0</b>
Net book amount at 31 March 2012	100.5	20.6	121.1

# Thames Water Utilities Limited

## Notes to the regulatory current cost financial statements

### Analysis of capital expenditure, grants and land

	Year ended 31 March 2013			Year ended 31 March 2012		
	Gross	Grants & contributions	Net	Gross	Grants & contributions	Net
<b>Capital expenditure - water</b>						
<b>Base</b>						
Infrastructure Renewals Expenditure	113 7	14 7	99 0	149 9	15 3	134 6
Maintenance non-infrastructure (MNI)	138 3	2 3	136 0	152 5	2 7	149 8
<b>Enhancements</b>						
Infrastructure enhancements	29 4	19 4	10 0	24 9	12 0	12 9
Non-infrastructure enhancements	40 0	-	40 0	43 9	-	43 9
<b>Total capital expenditure - water</b>	<b>321 4</b>	<b>36 4</b>	<b>285 0</b>	<b>371 2</b>	<b>30 0</b>	<b>341 2</b>
<b>Grants and contributions - water</b>						
Infrastructure charge receipts - new connections		9 3			8 5	
<b>Total grants and contributions - water</b>		<b>9 3</b>			<b>8 5</b>	
<b>Capital expenditure - sewerage</b>						
<b>Base</b>						
Infrastructure Renewals Expenditure	91 9	18 6	73 3	67 7	23 0	44 7
Maintenance non-infrastructure (MNI)	151 4	3 7	147 7	165 7	4 4	161 3
<b>Enhancements</b>						
Infrastructure enhancements	86 7	-	86 7	72 6	-	72 6
Non-infrastructure enhancements	280 9	-	280 9	399 4	-	399 4
<b>Large projects capex</b>						
Infrastructure enhancements	109 2	-	109 2	57 4	-	57 4
<b>Total capital expenditure - sewerage</b>	<b>720 1</b>	<b>22 3</b>	<b>697 8</b>	<b>762 8</b>	<b>27 4</b>	<b>735 4</b>
<b>Grants and contributions - sewerage</b>						
Infrastructure charge receipts - new connections		10 3			11 6	
<b>Total grants and contributions - sewerage</b>		<b>10 3</b>			<b>11 6</b>	
<b>Total capital expenditure</b>	<b>1,041 5</b>	<b>78 3</b>	<b>963 2</b>	<b>1 134 0</b>	<b>77 5</b>	<b>1,056 5</b>
Land sales - Proceeds from disposals of protected land		6 4			6 7	

# Thames Water Utilities Limited

## Notes to the regulatory current cost financial statements

### Current cost working capital

	As at 31 March 2013 £m	As at 31 March 2012 £m
Stocks	8.4	9.6
Trade debtors		
- Measured household	65.1	77.0
- Unmeasured household	88.4	115.2
- Measured non-household	33.3	39.9
- Unmeasured non-household	1.4	1.7
- Other	11.8	21.0
Measured income accrual	161.1	146.7
Prepayments and other debtors	36.7	39.3
Trade creditors	(287.3)	(280.7)
Deferred income – customer advance receipts	(77.8)	(87.8)
Capital creditors	(160.4)	(243.0)
Accruals and other creditors	(187.9)	(178.6)
<b>Total working capital</b>	<b>(307.2)</b>	<b>(339.7)</b>
<b>Total revenue outstanding</b>		
- household	298.5	303.2
- non-household	67.5	65.5

### Analysis of net debt, gearing and interest costs

	Fixed rate £m	Floating rate £m	Index linked £m	Total £m
Borrowings	(3,984.5)	(306.5)	(4,763.4)	(9,054.4)
Overdraft				(67.0)
Short term deposits				748.7
<b>Net debt</b>				<b>(8,372.7)</b>
Regulatory capital value				10,897.0
Gearing				76.8%
Full year equivalent nominal interest cost	(205.4)	(18.8)	(72.6)	(296.8)
Full year equivalent cash interest payment	(208.3)	(19.5)	(72.7)	(300.5)
<b>Indicative interest rates</b>				
Indicative weighted average nominal interest rate			1.5%	3.3%
Indicative weighted average cash interest rate			1.5%	3.3%
Weighted average years to maturity	18.7	7.4	27.5	22.9



# Thames Water Utilities Limited

## Property analysis

	Year ended 31 March 2013		Year ended 31 March 2012	
	Water	Sewerage	Water	Sewerage
<b>Number of properties ('000s)</b>				
Households billed	3,363.9	5,184.1	3,347.1	5,166.0
Non-households billed	214.1	297.6	214.9	290.3
Household voids	65.9	113.5	60.0	108.5
Non-household voids	22.9	33.1	23.6	33.6
Properties served by new appointee in supply area as at 1 April 2009	-	-	-	-
<b>Per capita consumption (excluding supply pipe leakage) l/h/d*</b>				
Unmeasured household	164.1	-	169.1	-
Measured household	131.9	-	138.6	-
<b>Volume (Ml/d)**</b>				
Bulk supply export	95.2	-	95.4	-
Bulk supply input	0.4	1.0	0.4	0.6
Distribution input	2,526.1	-	2,551.0	-

\*litres per household per day ("l/h/d")

\*\* Megalitres per day ("Ml/d")

**Thames Water Utilities Limited**  
**Supplemental regulatory information**

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## Thames Water Utilities Limited

### RAG 5 Intra-group trade

During the year there were no contracts in excess of 0.5% (£8.8m) of the Company's turnover with any subsidiary of the Thames Water group of companies

The Company voluntarily discloses all transactions with associated companies of Kemble Water Holdings Limited and transactions with companies whereby certain directors of the company have interests in the companies listed

#### Associated company

Service	Company	Turnover of associate in the year (£'000)	Terms of supply	Value of turnover received (£'000)
Property management	Thames Water Property Services Limited	1,113	Third party	745
Site sales and rents	Kennet Properties Limited	10,378	Third party	2,580
				3,325

#### Directors' interest

Service	Company	Terms of supply	Value of cost incurred (£'000)
Advisory fees	Macquarie capital funds (Europe) Limited	Agreed cost	3,160
Subscription fees	Water UK	Agreed cost	545
Rent of parking spaces	National Car Parks	At cost	176
Maps	Cranfield university	Third party	179
			4,060

#### Dividends paid to associated undertakings

During the year, the Company paid interim dividends totalling £231.4m (2012: £279.5m) to Thames Water Utilities Holdings Limited. Full disclosure of these dividends are provided in note 9 on pages 75 to 76 of the statutory section of these financial statements

#### 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 (2012: £nil)

# Thames Water Utilities Limited

## Borrowings

All borrowings from the Company's wholly owned subsidiaries are as follows for the year ended 31 March 2013

Instrument	Amount borrowed	Total book value *
<b>Thames Water Utilities Cayman Limited</b>		
\$156m 3 month US\$ LIBOR + 0.95% floating rate bond due 2015	103.1	103.1
€500m 3.25% Fixed rate bond due 2016	422.4	422.4
£400m 7.24% Fixed rate bond due 2058	400.0	398.8
\$150m USPP Fixed rate bond due 2019	99.1	97.3
€113m 2.30% CPI index linked bond due 2022	95.5	98.5
\$150m USPP Fixed rate bond due 2022	99.1	99.1
\$200m USPP Fixed rate bond due 2024	132.2	132.2
£550m 5.38% Fixed rate bond due 2025	550.0	546.7
\$250m USPP Fixed rate bond due 2027	165.2	165.2
£300m 5.75% Fixed rate bond due 2030	300.0	296.9
20bn Yen 3.28% Fixed rate bond due 2038	139.9	139.9
£50m 3.85% Index linked bond due 2040	50.0	56.7
£500m 5.5% Fixed rate bond due 2041	500.0	489.2
£50m 1.98% Index linked bond due 2042	50.0	59.4
£55m 2.09% Index linked bond due 2042	55.0	63.2
£40m 1.97% Index linked bond due 2045	40.0	43.9
£100m 1.85% Index linked bond due 2047	100.0	118.8
£200m 1.82% Index linked bond due 2049	200.0	237.2
£200m 1.77% Index linked bond due 2057	200.0	237.2
£350m 1.76% Index linked bond due 2062	350.0	415.0
£300m 4.375% Fixed rate bond due 2034	300.0	294.8
£300m 4.625% fixed rate bond due 2046	300.0	292.8
<b>Total</b>	<b>4,651.5</b>	<b>4,808.3</b>
<b>Thames Water Finance Limited</b>		
£200m 4.90% Fixed rate bond due 2015	200.0	200.0
£200m 5.05% Fixed rate bond due 2020	200.0	200.0
£175m 3.38% Index linked bond due 2021	175.0	243.4
£225m 6.59% Fixed rate bond due 2021	225.0	225.0
£330m 6.75% Fixed rate bond due 2028	330.0	327.9
£200m 6.50% Fixed rate bond due 2032	200.0	198.1
£600m 5.13% Fixed rate bond due 2037	600.0	596.6
£300m 1.68% Index linked bond due 2053	300.0	376.0
£300m 1.68% Index linked bond due 2055	300.0	376.0
<b>Total</b>	<b>2,530.0</b>	<b>2,743.0</b>
<b>Grand total</b>	<b>7,181.5</b>	<b>7,551.3</b>

\* Total book value includes interest accretion of index linked bonds and unamortized bond fees

See page 84 for analysis of the above amounts owed to group undertakings within one year and after more than one year

To the best of the directors' knowledge, all appropriate transactions with associated companies have been disclosed

TWUCL and TWUFL lend the proceeds of external borrowings on to the Company, net of derivatives of £64.3m. Under these arrangements the Company owes TWUCL £4,808.3m and TWUFL £2,743.0m

# Thames Water Utilities Limited

## RAG 5 Directors' interests information

Listed below are details of directorships held by Thames Water Utilities Limited directors at 31 March 2013 in associated companies that have traded with the regulated business during the year

### Directorships held in Associated Companies

The following directors held directorships in Thames Water Limited and Thames Water Utilities Holdings Limited

Director	Appointment	Resignation
Sir Peter Mason KBE – Chairman		
E Beckley		
R Blomfield-Smith	29 November 2012	
C R Deacon		
S R Eaves		
G I W Parsons		
D Rees	29 October 2012	2 January 2013
K Roseke	2 January 2013	24 May 2013
D J Shah OBE		
Y Shi		28 September 2012
M S W Stanley		7 September 2012
R Verrion		29 October 2012
L Webb		
D Xu	29 October 2012	

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 I W Parsons		
R Blomfield-Smith	29 November 2012		P Noble	29 November 2012	
C R Deacon			R Evenden		
S R Eaves			M C Hill		
G I W Parsons			E Beckley		
D Rees	29 October 2012	2 January 2013	S Kolenc	29 October 2012	2 January 2013
K Roseke	2 January 2013	24 May 2013	D Rees	2 January 2013	24 May 2013
D J Shah OBE			K Roseke		2 January 2013
			C Van Heijningen	2 January 2013	
Y Shi		28 September 2012	F Sheng		28 September 2012
R Vernon		29 October 2012	S Kolenc		29 October 2012
L Webb			C Pham		
D Xu	29 October 2012		F Sheng	29 October 2012	

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

# Thames Water Utilities Limited

## Directors' Certificate under Condition F6A of the Company's Appointment

### Directors' Certificate under Condition F6A of the Company's Appointment

This is to certify that at their meeting on 6 June 2012 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(s)),
- 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 subparagraph 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 Appointee operated as if it were substantially the Appointee's sole business and that the Appointee were a separate public limited Company
- that financial resources and facilities are adequate to enable the Appointee to meet its regulatory obligations
- the net worth of the Company and the strength of the Company's key performance indicators as shown on page 6 of the Chief Executive Officer's Business review
- the strong investment grade ratings as shown on page 14 of the Chief Executive Officer's Business review
- borrowing facilities, which include significant, undrawn bank facilities
- the outcome of the 2009 regulatory price review for the five year period to 31 March 2015 and its impact on the appointee's business plans



**S Siddall**  
Chief Financial Officer  
6 June 2013

# Thames Water Utilities Limited

## Risk and compliance statement

### Background and explanation

#### Purpose of this document

Ofwat expects every water company to produce a yearly risk and compliance statement which should set 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, the Water Services Regulation Authority (Ofwat), the Environment Agency, the Drinking Water Inspectorate, the Office of Fair Trading and the Consumer Council for Water.

This is the second 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.

#### 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<sup>1</sup> ("Obligations").

Last year our Risk and Compliance Statement covered compliance with the following:

- Our Instrument of Appointment,

- 7 pieces of European legislation, and
- 12 key pieces of national legislation for which Ofwat is the relevant enforcement authority<sup>2</sup>.

This year we extended the scope of the legislation covered by our Risk and Compliance Statement by an additional 69 pieces of environmental and corporate national legislation in addition to Ofwat's 12 key pieces.

We refer to these collectively as our Obligations. The Statement applies to the period 1 April 2012 to 31 March 2013, unless otherwise stated.

#### Requirements of the Statement

In the guidance<sup>1</sup> 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.
- 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).

<sup>1</sup> 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.

<sup>2</sup> Ofwat states on 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.

# Thames Water Utilities Limited

## Risk and compliance statement

### 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 2012-13, the Company has assessed its compliance with key Obligations

The Company's Internal Audit function reviewed the activities that led to this assessment as part of its assurance of the Annual Return 2013

Additionally, the Company has employed the services of its former Reporter to Ofwat to audit the information contained in its Annual Return 2013 and confirm compliance with its reporting obligations to Ofwat

Based on the results of these exercises, 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'

Where the assurance activities have identified the need for further control improvements, we will monitor progress to completion

#### 2 The Company has taken steps to understand and meet customer expectations

For the reporting year 2012-13, the Company has taken steps 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 2012-13, the Company has ensured that our communications adhere with Ofwat's information principles. The Company has

- regularly used its 2,000-strong customer panel to review topics such as
  - service levels,
  - drought perceptions, and
  - drought campaign communications
- met regularly with the Customer Challenge Group to help shape its plans for the 2014

Price Review Meetings are held monthly and actions discussed

- held consultations and focus groups on its Water Resources Management Plan, Drought Plan and two current major projects, the Thames Tideway Tunnel and Phase 1 of the upgrade to Deephams Sewage Treatment Works
- developed websites [www.deephamsconsultation.co.uk](http://www.deephamsconsultation.co.uk) and [www.thamestidewaytunnel.co.uk](http://www.thamestidewaytunnel.co.uk) to share significant projects with customers and stakeholders
- engaged with numerous groups on local issues and a customer engagement portal, for internal use, is under construction to share all engagement and consultation activity
- held deliberative workshops and focus groups on topics including our
  - future plans,
  - drought,
  - water efficiency,
  - bill design, and
  - service improvements
- 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

More broadly, the Company's current business plan is based on extensive customer research undertaken as part of the 2009 Price Review

We have continued to build on our customer service strategy. This was achieved using feedback we have received from customers and through understanding the causes of customer contacts

#### 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 to meet its obligations

In addition to ensuring that it has a full understanding of, and is meeting the Obligations, the Company has assessed the controls that assure its achievement of these Obligations



# Thames Water Utilities Limited

## Risk and compliance statement

These controls include the Company's Internal Audit function, and its self-certification and risk management processes. We have improved our knowledge of our obligations, within the business, but recognise that further work is still required to fully embed these processes into our 'business as usual' practice

#### 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, regulatory and statutory obligations, performance targets and specified outputs

When identifying and assessing risks, the company is mindful of Ofwat's broad outcomes for customers it accepted in the 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, promote the efficient use of water by our customers and ensuring that leakage is kept 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, which looks both at performance and risk

- oversight by the Thames Water Regulatory Committee
- the corporate risk management process, which considers risks and response plans to all company issues. The summarised risk register is reviewed by the 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 accounts which set out the material risks the company is currently facing, together with mitigation steps it is taking. These can be located in the business review on pages 18 to 21

#### 5 Delivery of outputs

For 2012-13, 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 2012-13 is presented, and
- a comprehensive Outputs Report showing delivery against its 2009 Final Determination outputs for 2012-13

These reports have been audited by the Company's former Reporter, who has 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. Thames Water'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 exceptions to delivery of the final determination outputs in 2012-13. These are as follows

#### Delivery of 'stable serviceability'

Last year our performance assessment for our underground wastewater assets moved from 'stable' to 'marginal'. This means that the performance of these assets has worsened and is outside of the performance targets set by Ofwat

This assessment of performance is driven by the significant increase in sewer flooding and pollution incidents. The year was particularly challenging due to the record rainfall which caused large

## Independent Auditors' 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 2013 on pages 99 to 128 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 balance sheet, the current cost cash flow statement and the related notes to the current cost financial statements, including the statement of accounting policies

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

This report is made, on terms that have been agreed, solely to the Company and the 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 and the WSRA, for our audit work, for this report or for the opinions we have formed.

### Respective responsibilities of the directors and auditors

As explained more fully in the Statement of Directors' Responsibilities set out on page 27, the directors are responsible for the preparation of the Regulatory Accounts and for their fair presentation in accordance with the basis of preparation and accounting policies. Our responsibility is to audit and express an opinion on the Regulatory Accounts in accordance with International

Standards on Auditing (UK and Ireland), except as stated in the "Scope of the audit of the Regulatory Accounts" below, and having regard to the guidance contained in Audit 05/03 "Reporting to Regulators of Regulated Entities" issued by the Institute of Chartered Accountants in England and Wales. Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

### Scope of the audit of the Regulatory Accounts

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

We have not assessed whether the accounting policies are appropriate to the circumstances of the Company where these are laid down by Condition F. Where Condition F does not give specific guidance on the accounting policies to be followed, our audit includes an assessment of whether the accounting policies adopted in respect of the transactions and balances required to be included in the Regulatory Accounts are consistent with those used in the preparation of the statutory financial statements of the Company. Furthermore, as the nature, form and content of Regulatory Accounts are determined by the WSRA, we did not evaluate the overall adequacy of the presentation of the information, which would have been required if we were to express an audit opinion under International Standards on Auditing (UK & Ireland).

# Thames Water Utilities Limited

## Risk and compliance statement

quantities of groundwater and river water to enter our sewers and those owned privately and by local authorities. Despite these exceptional circumstances, we have not always provided the best service to our customers, for example the speed at which we responded to blockages, could have been better. We are continuing to implement our recovery plans to return to 'stable' serviceability.

### Customer service performance

Our customer service performance is not as good as we would like it to be. Although there is no set regulatory target for customer satisfaction, this causes us concern as our customer service aspiration is to deliver the basics excellently.

Last year was particularly challenging due to the introduction of a new IT system, which together with the heavy rainfall we experienced, put a strain on our resources and the service we were able to provide. We implemented a number of changes to our processes to stabilise our service performance and to provide a strong platform upon which to deliver improvement in the current year and beyond.

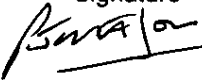
With respect to the Company's five year obligations, the Company has identified that it will be able to deliver the required net reduction to its high risk flooding register at a significantly reduced cost. This saving will be passed back to customers at the next price review.

### 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.

06 June 2013

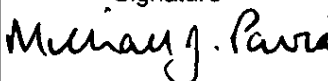
Sir Peter Mason KBE  
Chairman

Signature  


Martin Baggs  
Chief Executive Officer

Signature  


Michael Pavia  
Independent Non-Executive Director

Signature  


For and on behalf of the Board of Thames Water Utilities Limited

# Independent Auditors' 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 2013 on pages 99 to 128 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 balance sheet, the current cost cash flow statement and the related notes to the current cost financial statements, including the statement of accounting policies

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

This report is made, on terms that have been agreed, solely to the Company and the 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 and the WSRA, for our audit work, for this report or for the opinions we have formed.

## Respective responsibilities of the directors and auditors

As explained more fully in the Statement of Directors' Responsibilities set out on page 27, the directors are responsible for the preparation of the Regulatory Accounts and for their fair presentation in accordance with the basis of preparation and accounting policies. Our responsibility is to audit and express an opinion on the Regulatory Accounts in accordance with International

Standards on Auditing (UK and Ireland), except as stated in the "Scope of the audit of the Regulatory Accounts" below, and having regard to the guidance contained in Audit 05/03 "Reporting to Regulators of Regulated Entities" issued by the Institute of Chartered Accountants in England and Wales. Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

## Scope of the audit of the Regulatory Accounts

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

We have not assessed whether the accounting policies are appropriate to the circumstances of the Company where these are laid down by Condition F. Where Condition F does not give specific guidance on the accounting policies to be followed, our audit includes an assessment of whether the accounting policies adopted in respect of the transactions and balances required to be included in the Regulatory Accounts are consistent with those used in the preparation of the statutory financial statements of the Company. Furthermore, as the nature, form and content of Regulatory Accounts are determined by the WSRA, we did not evaluate the overall adequacy of the presentation of the information, which would have been required if we were to express an audit opinion under International Standards on Auditing (UK & Ireland).

# Independent Auditors' report to the Water Services Regulation Authority and the Directors of Thames Water Utilities Limited

## 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 106 to 108 and 114 to 115, the state of the Company's affairs at 31 March 2013 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") Financial information other than that prepared on the basis of UK GAAP does not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in statutory financial statements prepared in accordance with the Companies Act 2006 Furthermore, the regulatory historical cost accounting statements on pages 102 and 103 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 Generally Accepted Accounting Practice and a reconciliation of the balance sheet drawn up on this basis to the balance sheet drawn up under the Companies Act 2006 is given on page 104

## 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 2012 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

*KPMG Audit Plc*

KPMG Audit Plc  
Chartered Accountants  
London  
6 June 2013

## **Independent Auditors' report to the Water Services Regulation Authority and the Directors of Thames Water Utilities Limited**

### **Notes**

1 The maintenance and integrity of the Company's web site is the responsibility of the directors and the maintenance and integrity of the Regulator's web site is the responsibility of the Regulator, the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have

occurred to the Regulatory Accounts since they were initially presented on the web sites

2 Legislation in the United Kingdom governing the preparation and dissemination of financial statements and Regulatory Accounts may differ from legislation in other jurisdictions

# Thames Water Utilities Limited

## 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. AMP4 covers the investment period April 2005 to March 2010. 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

# Thames Water Utilities Limited

## Glossary of regulatory terms

**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